ALLSTATE CORP
Form 10-Q
November 01, 2006

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

FORM 10-Q

x **QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934 FOR THE QUARTERLY PERIOD ENDED SEPTEMBER 30, 2006**

OR

o **TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**

Commission file number 1-11840

THE ALLSTATE CORPORATION
(Exact name of registrant as specified in its charter)

Delaware	**36-3871531**
(State of Incorporation)	(I.R.S. Employer Identification No.)
2775 Sanders Road Northbrook, Illinois	**60062**
(Address of principal executive offices)	(Zip Code)

Registrant s telephone number, including area code: 847/402-5000

Indicate by check mark whether the registrant: (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days.

Yes x No o

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, or a non-accelerated filer. See definition of accelerated filer and large accelerated filer in Rule 12b-2 of the Exchange Act.

Large accelerated filer	Accelerated filer	Non-accelerated filer
x	o	o

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act).

Yes o No x

As of October 27, 2006, the registrant had 624,941,736 common shares, $.01 par value, outstanding.

THE ALLSTATE CORPORATION
INDEX TO QUARTERLY REPORT ON FORM 10-Q
September 30, 2006

PART I. FINANCIAL INFORMATION

ITEM 1. FINANCIAL STATEMENTS

THE ALLSTATE CORPORATION AND SUBSIDIARIES

CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS

(in millions, except per share data)	Three Months Ended September 30, 2006 (Unaudited)	2005	Nine Months Ended September 30, 2006 (Unaudited)	2005
Revenues				
Property-liability insurance premiums earned	$ 6,801	$ 6,781	$ 20,537	$ 20,201
Life and annuity premiums and contract charges	444	505	1,454	1,525
Net investment income	1,554	1,457	4,613	4,264
Realized capital gains and losses	(61)	199	90	448
	8,738	8,942	26,694	26,438
Costs and expenses				
Property-liability insurance claims and claims expense	4,012	8,529	11,879	16,706
Life and annuity contract benefits	388	395	1,135	1,209
Interest credited to contractholder funds	667	608	1,939	1,784
Amortization of deferred policy acquisition costs	1,160	1,160	3,522	3,557
Operating costs and expenses	726	713	2,252	2,266
Restructuring and related charges	52	10	171	36
Interest expense	90	85	261	251
	7,095	11,500	21,159	25,809
Loss on disposition of operations	(1)	(4)	(89)	(12)
Income (loss) from operations before income tax expense (benefit)	1,642	(2,562)	5,446	617
Income tax expense (benefit)	484	(1,014)	1,666	(107)
Net income (loss)	$ 1,158	$ (1,548)	$ 3,780	$ 724
Earnings per share:				
Net income (loss) per share - Basic	$ 1.84	$ (2.36)	$ 5.95	$ 1.09
Weighted average shares - Basic	629.0	654.8	635.4	666.3
Net income (loss) per share - Diluted	$ 1.83	$ (2.36)	$ 5.91	$ 1.08
Weighted average shares - Diluted	633.9	654.8	639.9	671.9
Cash dividends declared per share	$ 0.35	$ 0.32	$ 1.05	$ 0.96

See notes to condensed consolidated financial statements.

THE ALLSTATE CORPORATION AND SUBSIDIARIES

CONDENSED CONSOLIDATED STATEMENTS OF FINANCIAL POSITION

(in millions, except par value data)	September 30, 2006 (Unaudited)	December 31, 2005
Assets		
Investments		
Fixed income securities, at fair value (amortized cost $97,188 and $94,777)	$ 99,919	$ 98,065
Equity securities, at fair value (cost $5,922 and $4,873)	7,377	6,164
Mortgage loans	9,116	8,748
Short-term	3,845	3,470
Other	1,924	1,850
Total investments	122,181	118,297
Cash	327	313
Premium installment receivables, net	4,943	4,739
Deferred policy acquisition costs	5,391	5,802
Reinsurance recoverables, net	5,979	5,180
Accrued investment income	1,072	1,074
Property and equipment, net	1,004	1,040
Goodwill	825	825
Other assets	3,007	3,567
Separate Accounts	15,595	15,235
Total assets	$ 160,324	$ 156,072
Liabilities		
Reserve for property-liability insurance claims and claims expense	$ 19,131	$ 22,117
Reserve for life-contingent contract benefits	12,672	12,482
Contractholder funds	62,395	60,040
Unearned premiums	10,680	10,294
Claim payments outstanding	753	1,263
Other liabilities and accrued expenses	11,049	8,804
Deferred income taxes	320	351
Short-term debt		413
Long-term debt	5,529	4,887
Separate Accounts	15,595	15,235
Total liabilities	138,124	135,886
Commitments and Contingent Liabilities (Note 7)		
Shareholders Equity		
Preferred stock, $1 par value, 25 million shares authorized, none issued		
Common stock, $.01 par value, 2.0 billion shares authorized and 900 million issued, 627 million and 646 million shares outstanding	9	9
Additional capital paid-in	2,905	2,798
Retained income	28,075	24,962
Deferred ESOP expense	(84)	(90)
Treasury stock, at cost (273 million and 254 million shares)	(10,674)	(9,575)
Accumulated other comprehensive income:		
Unrealized net capital gains and losses	1,961	2,090
Unrealized foreign currency translation adjustments	38	22
Minimum pension liability adjustment	(30)	(30)

Total accumulated other comprehensive income	1,969	2,082
Total shareholders equity	22,200	20,186
Total liabilities and shareholders equity	$ 160,324	$ 156,072

See notes to condensed consolidated financial statements.

2

THE ALLSTATE CORPORATION AND SUBSIDIARIES

CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS

(in millions)	Nine Months Ended September 30, 2006 (Unaudited)	2005
Cash flows from operating activities		
Net income	$ 3,780	$ 724
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation, amortization and other non-cash items	(156)	(37)
Realized capital gains and losses	(90)	(448)
Loss on disposition of operations	89	12
Interest credited to contractholder funds	1,939	1,784
Changes in:		
Policy benefits and other insurance reserves	(3,061)	4,193
Unearned premiums	373	548
Deferred policy acquisition costs	(251)	(188)
Premium installment receivables, net	(199)	(234)
Reinsurance recoverables, net	796	(228)
Income taxes payable	455	(1,151)
Other operating assets and liabilities	(30)	294
Net cash provided by operating activities	3,645	5,269
Cash flows from investing activities		
Proceeds from sales		
Fixed income securities	18,654	15,711
Equity securities	3,375	3,152
Investment collections		
Fixed income securities	3,598	4,545
Mortgage loans	1,390	971
Investment purchases		
Fixed income securities	(23,868)	(23,964)
Equity securities	(4,042)	(3,206)
Mortgage loans	(1,722)	(1,604)
Change in short-term investments, net	658	446
Change in other investments, net	(90)	(57)
Disposition of operations	(812)	(2)
Purchases of property and equipment, net	(108)	(186)
Net cash used in investing activities	(2,967)	(4,194)
Cash flows from financing activities		
Change in short-term debt, net	(413)	(43)
Proceeds from issuance of long-term debt	644	789
Repayment of long-term debt	(19)	(1,198)
Contractholder fund deposits	8,137	8,614
Contractholder fund withdrawals	(7,402)	(6,647)
Dividends paid	(653)	(621)
Treasury stock purchases	(1,259)	(2,247)
Other	301	272
Net cash used in financing activities	(664)	(1,081)
Net increase (decrease) in cash	14	(6)
Cash at beginning of period	313	414
Cash at end of period	$ 327	$ 408

See notes to condensed consolidated financial statements.

3

THE ALLSTATE CORPORATION AND SUBSIDIARIES
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
(Unaudited)

1. General

Basis of presentation

The accompanying condensed consolidated financial statements include the accounts of The Allstate Corporation and its wholly owned subsidiaries, primarily Allstate Insurance Company (AIC), a property-liability insurance company with various property-liability and life and investment subsidiaries, including Allstate Life Insurance Company (ALIC) (collectively referred to as the Company or Allstate).

The condensed consolidated financial statements and notes as of September 30, 2006, and for the three-month and nine-month periods ended September 30, 2006 and 2005 are unaudited. The condensed consolidated financial statements reflect all adjustments (consisting only of normal recurring accruals), which are, in the opinion of management, necessary for the fair presentation of the financial position, results of operations and cash flows for the interim periods. These condensed consolidated financial statements and notes should be read in conjunction with the consolidated financial statements and notes thereto included in the Company s Annual Report on Form 10-K for the year ended December 31, 2005. The results of operations for the interim periods should not be considered indicative of results to be expected for the full year.

To conform to the 2006 presentation, certain amounts in the prior year condensed consolidated financial statements and notes have been reclassified.

Adopted accounting standards

Financial Accounting Standards Board Staff Position No. FAS 115-1, The Meaning of Other-Than-Temporary Impairment and Its Application to Certain Investments (FSP FAS 115-1)

The Company adopted Financial Accounting Standards Board (FASB) FSP FAS 115-1 as of January 1, 2006. FSP FAS 115-1 nullifies the guidance in paragraphs 10-18 of EITF Issue 03-1, The Meaning of Other-Than-Temporary Impairment and Its Application to Certain Investments and references existing other-than-temporary impairment guidance. FSP FAS 115-1 clarifies that an investor should recognize an impairment loss no later than when the impairment is deemed other-than-temporary, even if a decision to sell the security has not been made, and also provides guidance on the subsequent accounting for income recognition on an impaired debt security. The adoption of FSP FAS 115-1 was required on a prospective basis and did not have a material effect on the results of operations or financial position of the Company.

Statement of Financial Accounting Standards No. 154, Accounting Changes and Error Corrections (SFAS No. 154)

The Company adopted SFAS No. 154 on January 1, 2006. SFAS No. 154 replaces Accounting Principles Board (APB) Opinion No. 20, Accounting Changes , and SFAS No. 3, Reporting Accounting Changes in Interim Financial Statements . SFAS No. 154 requires retrospective application to prior periods financial statements for changes in accounting principle, unless determination of either the period specific effects or the cumulative effect of the change is impracticable or otherwise promulgated. The Company had no accounting changes or error corrections affected by the new standard.

SFAS No. 123 (revised 2004), Share-Based Payment (SFAS No. 123R)

On January 1, 2006, the Company adopted SFAS No. 123R, which revises SFAS No. 123 Accounting for Stock-based Compensation and supersedes APB Opinion No. 25 Accounting for Stock Issued to Employees . SFAS No. 123R requires all share-based payment transactions to be accounted for using a fair value based method to recognize the cost of awards over the period in which the requisite service is rendered. The Company used the modified prospective application method for adoption, and therefore the prior year results have not been restated. As a result, 2006 compensation expense includes amounts related to options granted in 2002, since the Company utilizes a four year vesting schedule and previously adopted the expense provisions of SFAS No. 123 for awards granted or modified subsequent to January 1, 2003. The effect of adoption was not material. See Note 9 for further information.

4

Financial Accounting Standards Board Staff Position No. FAS 123R-3, Transition Election Related to Accounting for the Tax Effects of Share-Based Payment Awards (FSP FAS 123R-3)

In conjunction with its adoption of SFAS No. 123R, the Company elected the transition method described in FSP FAS 123R-3. FSP FAS 123R-3 provided companies an option to elect an alternative calculation method for determining the pool of excess tax benefits available to absorb tax deficiencies recognized subsequent to the adoption of SFAS No. 123R. SFAS No. 123R requires companies to calculate the pool of excess tax benefits as the net excess tax benefits that would have qualified as such had the Company adopted SFAS No. 123 for recognition purposes when first effective in 1995. FSP FAS 123R-3 provided an alternative calculation based on actual increases to additional capital paid-in related to tax benefits from share-based compensation subsequent to the effective date of SFAS No. 123, less the tax on the cumulative incremental compensation costs the Company included in its pro forma net income disclosures as if the Company had applied the fair-value method to all awards, less the share-based compensation costs included in net income as reported.

Pending accounting standards

Statement of Position 05-1, Accounting by Insurance Enterprises for Deferred Acquisition Costs in Connection with Modifications or Exchanges of Insurance Contracts (SOP 05-1)

In October 2005, the AICPA issued SOP 05-1. SOP 05-1 provides accounting guidance for deferred policy acquisition costs associated with internal replacements of insurance and investment contracts other than those already described in SFAS No. 97, Accounting and Reporting by Insurance Enterprises for Certain Long-Duration Contracts and for Realized Gains and Losses from the Sale of Investments . SOP 05-1 defines an internal replacement as a modification in product benefits, features, rights or coverages that occurs by the exchange of a contract for a new contract, or by amendment, endorsement or rider to a contract, or by the election of a feature or coverage within a contract. The provisions of SOP 05-1 are effective for internal replacements occurring in fiscal years beginning after December 15, 2006. The Company is currently assessing the impact of the SOP on its results of operations and financial position. Based on the issued standard, the Company does not expect the impact of the adoption to have a material effect on its results of operations or financial position; however, the standard is currently under review and clarifications or revisions may be issued by the American Institute of Certified Public Accountants and/or the Financial Accounting Standards Board that could affect the Company s impact assessment.

SFAS No. 155, Accounting for Certain Hybrid Financial Instruments an amendment of FASB Statements No. 133 and 140 (SFAS No. 155)

In February 2006, the FASB issued SFAS No. 155, which, permits the fair value remeasurement of any hybrid financial instrument that contains an embedded derivative that otherwise would require bifurcation under SFAS No. 133, Accounting for Derivative Instruments and Hedging Activities ; clarifies which interest-only strips and principal-only strips are not subject to the requirements of SFAS No. 133; establishes a requirement to evaluate interests in securitized financial assets to identify interests that are freestanding derivatives or hybrid financial instruments that contain an embedded derivative requiring bifurcation and clarifies that concentrations of credit risk in the form of subordination are not embedded derivatives. At the date of initial adoption, the Company must decide whether or not to remeasure its then existing hybrid financial instruments in accordance with SFAS No. 155 or retain its current accounting under SFAS No. 133. All securities acquired on or after January 1, 2007 must be accounted for in accordance with the new guidance. The Company will adopt SFAS No. 155 as of January 1, 2007, but has not yet determined if it will utilize the option to fair value hybrid contracts owned at the date of adoption and subject to SFAS No. 133.

Financial Accounting Standards Board Interpretation No. 48, Accounting for Uncertainty in Income Taxes, (FIN 48)

In July 2006, the FASB issued FIN 48, which clarifies the accounting for uncertainty in income taxes recognized in an entity s financial statements in accordance with FASB Statement No. 109, Accounting for Income Taxes . FIN 48 requires an entity to recognize the tax benefit of uncertain tax positions only when it is more likely than not, based on the position s technical merits, that the position would be sustained upon examination by the respective taxing authorities. The tax benefit is measured as the largest benefit that is more than fifty-percent likely of being realized upon final settlement with the respective taxing authorities. FIN 48 is effective for fiscal years beginning after December 15, 2006. FIN 48 is not expected to have a material effect on the results of operations or financial position of the Company.

SFAS No. 157, Fair Value Measurements (SFAS No. 157   )

In September 2006, the FASB issued SFAS No. 157 which defines fair value, establishes a framework for measuring fair value in generally accepted accounting principles (GAAP   ), and expands disclosures about fair value measurements. SFAS No. 157 applies where other accounting pronouncements require or permit fair value measurements; it does not require any new fair value measurements under GAAP. SFAS No. 157 is effective for fiscal years beginning after November 15, 2007. The effects of adoption will be determined by the types of instruments carried at fair value in the Company   s financial statements at the time of adoption as well as the method utilized to determine their fair values prior to adoption. Based on the Company   s current use of fair value measurements, SFAS No. 157 is not expected to have a material effect on the results of operations or financial position of the Company.

SFAS No. 158, Employers   Accounting for Defined Benefit Pension and Other Postretirement Plans, an amendment of FASB Statements No. 87, 88, 106 and 132(R) (SFAS No. 158   )

In September 2006, the FASB issued SFAS No. 158 which requires recognition in the Statements of Financial Position of the over or under funded status of defined pension and other postretirement plans, measured as the difference between the fair value of plan assets and the projected benefit obligation for the pension plans and the accumulated benefit obligation for other postretirement benefit plans. This effectively requires the recognition of all previously unrecognized actuarial gains and losses and prior service costs as a component of accumulated other comprehensive income, net of tax. In addition, SFAS No. 158 requires that on a prospective basis the actuarial gains and losses and the prior service costs and credits that arise during any reporting period but are not recognized as components of net periodic benefit cost be recognized as a component of other comprehensive income, net of tax, the measurement date of the plans to be the same as the Statements of Financial Position, and disclosure in the notes to the financial statements of certain effects on the net periodic benefit cost in the upcoming fiscal year that arise from delayed recognition of the actuarial gains and losses and the prior service costs and credits. Guidance relating to the recognition of the over or under funded status of the plan and additional disclosure requirements is effective for periods ending after December 15, 2006. Guidance relating to the measurement date of the plans is effective for the years ending after December 15, 2008. There is no impact on results of operations or cash flows. Retrospective application of this standard is not permitted. However, based on the Company   s current interpretation and the most recent measurement date of its plans of October 31, 2005, as of December 31, 2005, if the standard had been effective and adopted, the impact of adoption would have resulted in a decrease in shareholders   equity of $1.37 billion. Adoption impacts will be based on the most recent measurement date of the plans as of December 31, 2006, which is October 31, 2006.

Securities and Exchange Commission (SEC   ) Staff Accounting Bulletin No. 108, Considering the Effects of Prior Year Misstatements when Quantifying Misstatements in Current Year Financial Statements (SAB 108   )

In September 2006, the SEC issued SAB 108 in order to eliminate the diversity of practice in the process by which misstatements are quantified for purposes of assessing materiality on the financial statements. SAB 108 establishes a single quantification framework wherein the significance measurement is based on the effects of the misstatements on each of the financial statements as well as the related financial statement disclosures. If a company   s existing methods for assessing the materiality of misstatements are not in compliance with the provisions of SAB 108, the initial application of the provisions may be adopted by restating prior period financial statements under certain circumstances or otherwise by recording the cumulative effect of initially applying the provisions of SAB 108 as adjustments to the carrying values of assets and liabilities as of January 1, 2006 with an offsetting adjustment recorded to the opening balance of retained earnings. The provisions of SAB 108 must be applied no later than the annual financial statements issued for the first fiscal year ending after November 15, 2006. The Company   s adoption of SAB 108 in the fourth quarter of 2006 for the fiscal year then ended is not expected to have a material effect on its results of operations or financial position.

2. Earnings per share

Basic earnings per share is computed based on the weighted average number of common shares outstanding. Diluted earnings per share is computed based on weighted average number of common and dilutive potential common shares outstanding. For Allstate, dilutive potential common shares consist of outstanding stock options and unvested restricted stock units.

The computation of basic and diluted earnings per share are presented in the following table.

(in millions, except per share data)	Three months ended September 30, 2006	Three months ended September 30, 2005	Nine months ended September 30, 2006	Nine months ended September 30, 2005
Numerator:				
Net income (loss)	$ 1,158	$ (1,548)	$ 3,780	$ 724
Denominator:				
Weighted average common shares outstanding	629.0	654.8	635.4	666.3
Effect of potential dilutive securities:				
Stock options	3.5		3.2	5.2
Unvested restricted stock units	1.4		1.3	0.4
Weighted average common and dilutive potential common shares outstanding	633.9	654.8	639.9	671.9
Earnings per share Basic:	$ 1.84	$ (2.36)	$ 5.95	$ 1.09
Earnings per share Diluted:	$ 1.83	$ (2.36)	$ 5.91	$ 1.08

As a result of the third quarter 2005 net loss, weighted average dilutive potential common shares outstanding, resulting from stock options and restricted stock units of 5.1 million and 0.5 million, respectively, were not included in the computation of diluted earnings per share for the three-month period ended September 30, 2005 since inclusion of these securities had an anti-dilutive effect. In the absence of the net loss, weighted average common and dilutive potential common shares outstanding would have totaled 660.4 million.

Options to purchase 5.1 million and 0.3 million Allstate common shares, with exercise prices ranging from $52.23 to $61.90 and $58.47 to $61.90, were outstanding at September 30, 2006 and 2005, respectively, but were not included in the computation of diluted earnings per share for the three-month periods. Options to purchase 5.9 million and 0.5 million Allstate common shares, with exercise prices ranging from $50.79 to $61.90 and $56.25 to $61.90, were outstanding at September 30, 2006 and 2005, respectively, but were not included in the computation of diluted earnings per share for the nine-month periods. These options were excluded either because their exercise prices exceeded the average market price of Allstate common shares during the period or because the unrecognized compensation cost on the options would have an anti-dilutive effect.

3. Supplemental Cash Flow Information

Non-cash investment exchanges and modifications, which primarily reflect refinancing of fixed income securities and mergers completed with equity securities, totaled $81 million and $36 million for the nine-month periods ended September 30, 2006 and 2005, respectively.

Liabilities for collateral received in conjunction with securities lending and other activities and for funds received from security repurchase activities are reported in other liabilities and accrued expenses in the Condensed Consolidated Statements of Financial Position. The accompanying cash flows are included in cash flows from operating activities in the Condensed Consolidated Statements of Cash Flows along with the related changes in investments, which are as follows:

	Nine months ended September 30,	
(in millions)	**2006**	**2005**
Net change in fixed income securities	$ (492)	$ (1,219)
Net change in short-term investments	(875)	479
Operating cash flow used	$ (1,367)	$ (740)
Liabilities for collateral and security repurchase, beginning of year	$ (4,102)	$ (4,854)
Liabilities for collateral and security repurchase, end of period	(5,469)	(5,594)
Operating cash flow provided	$ 1,367	$ 740

4. Reserve for Property-Liability Insurance Claims and Claims Expense

The Company establishes reserves for claims and claims expense (loss) on reported and unreported claims of insured losses. The Company s reserving process takes into account known facts and interpretations of circumstances and factors including the Company s experience with similar cases, actual claims paid, historical trends involving claim payment patterns and pending levels of unpaid claims, loss management programs, product mix and contractual terms, law changes, court decisions, changes to regulatory requirements and economic conditions. In the normal course of business, the Company may also supplement its claims processes by utilizing third party adjusters, appraisers, engineers, inspectors, other professionals and information sources to assess and settle catastrophe and non-catastrophe related claims. The effects of inflation are implicitly considered in the reserving process.

Because reserves are estimates of unpaid portions of losses that have occurred, including incurred but not reported (IBNR) losses, the establishment of appropriate reserves, including reserves for catastrophes, is an inherently uncertain and complex process. The ultimate cost of losses may vary materially from recorded amounts, which are based on management s best estimates. The highest degree of uncertainty is associated with reserves for losses incurred in the current reporting period as it contains the greatest proportion of losses that have not been reported or settled. The Company regularly updates its reserve estimates as new information becomes available and as events unfold that may affect the resolution of unsettled claims. Changes in prior year reserve estimates, which may be material, are reported in property-liability insurance claims and claims expense in the Condensed Consolidated Statements of Operations in the period such changes are determined.

Management believes that the reserve for property-liability claims and claims expense, net of reinsurance recoverables, is appropriately established in the aggregate and adequate to cover the ultimate net cost of reported and unreported claims arising from losses which had occurred by that date based on available facts, technology, laws and regulations.

5. Reinsurance

Property-liability insurance premiums earned and life and annuity premiums and contract charges have been reduced by the reinsurance premium ceded amounts shown in the following table.

(in millions)	Three months ended September 30, 2006	2005	Nine months ended September 30, 2006	2005
Property-liability insurance premiums earned	$ 336	$ 151	$ 772	$ 429
Life and annuity premiums and contract charges	233	171	572	511

Property-liability insurance claims and claims expense and life and annuity contract benefits have been reduced by the reinsurance recovery amounts shown in the following table.

(in millions)	Three months ended September 30, 2006	2005	Nine months ended September 30, 2006	2005
Property-liability insurance claims and claims expense	$ 118	$ 466	$ 401	$ 833
Life and annuity contract benefits	161	135	424	429

Property-liability

The Company entered into the following reinsurance agreements effective June 1, 2006: aggregate excess of loss agreement that covers storms named or numbered by the National Weather Service, earthquakes, and fires following earthquakes for personal lines auto and property business countrywide except for Florida; New Jersey excess of loss agreement that covers personal property catastrophe losses in excess of the New Jersey multi-year agreement entered into in 2005; South-East agreement that covers personal property excess catastrophe losses for storms named or numbered by the National Weather Service in 10 Atlantic and Gulf states and the District of Columbia; and four reinsurance agreements entered into by Allstate Floridian Insurance Company (AFIC), a subsidiary of the Company, for personal property excess catastrophe losses in Florida. The Company also entered into a California Fire Following agreement, effective February 1, 2006, that covers personal property excess catastrophe losses in California for fires following earthquakes. In addition, the Company has multi-year reinsurance treaties, effective June 1, 2005, that cover excess catastrophe losses in Connecticut, New Jersey, New York, and Texas. The Company also has an excess of loss agreement, effective June 1, 2005, that covers excess catastrophe losses in Florida. On May 31, 2006, the Company terminated the multi-year treaties, effective June 1, 2005, in North Carolina and South Carolina. The Company also renewed its catastrophe reimbursement agreement, effective June 1, 2006, with the Florida Hurricane Catastrophe Fund (FHCF). Under these contracts, the Company ceded premiums earned of $214 million and $406 million in the three-month and nine-month periods ended September 30, 2006, compared to $60 million and $136 million in the three-month and nine-month periods ended September 30, 2005.

AFIC entered into a 100% quota share reinsurance agreement, effective April 1, 2006, with Royal Palm Insurance Company (Royal Palm) on selected personal property policies written in Florida. AFIC plans to no longer offer coverage on these policies after their contract terms expire, at which time Royal Palm may offer coverage to these policyholders. Any qualifying recoveries from the Florida Hurricane Catastrophe Fund (FHCF) and the existing excess of loss agreement will be shared with Royal Palm under this agreement. In the second quarter of 2006, the Company ceded $63 million of unearned premiums on the policies subject to the agreement at April 1, 2006 and recorded the related transfer of cash in cash flows from operating activities in the Company s Condensed Consolidated Statements of Cash Flows. AFIC also ceded $28 million and $57 million, and $3 million and $9 million of premiums earned and claims and claims expense, respectively, in the three-month and nine-month periods ended September 30, 2006.

2. Earnings per share

Life and annuity

On June 1, 2006, the Company and its subsidiaries, ALIC and Allstate Life Insurance Company of New York (ALNY), completed the disposal of substantially all of Allstate Financial s variable annuity business pursuant to a definitive agreement (the Agreement) with Prudential Financial, Inc. and its subsidiary, The Prudential Insurance Company of America (collectively Prudential), which was entered into on March 8, 2006. The disposal was effected through a combination of coinsurance and modified coinsurance reinsurance agreements (the Reinsurance Agreements).

As a result of the modified coinsurance reinsurance, the separate account assets remain on the Company s Condensed Consolidated Statements of Financial Position, but the related results of operations are fully reinsured to Prudential beginning on June 1, 2006 and presented net of reinsurance on the Condensed Consolidated Statements of Operations. In contrast, $1.36 billion of assets supporting general account liabilities have been transferred to Prudential, net of consideration, under the coinsurance reinsurance provisions. The general account liabilities of $1.63 billion, however, remain on the Condensed Consolidated Statements of Financial Position with a corresponding reinsurance recoverable and the results of operations are presented net of reinsurance. For purposes of presentation in the Condensed Consolidated Statements of Cash Flows, the Company treated the reinsurance of substantially all the variable annuity business of ALIC and ALNY to Prudential as a disposition of operations, consistent with the substance of the transaction which was the disposition of a block of business accomplished through reinsurance. Accordingly, the net consideration transferred to Prudential, $731 million (computed as $1.36 billion of general account insurance liabilities transferred to Prudential on the closing date less consideration of $628 million), the cost of hedging the ceding commission received from Prudential, $69 million, pretax, and the costs of executing the transaction, $12 million, pretax, were classified as a disposition of operations in the cash flows from investing activities section of the Condensed Consolidated Statements of Cash Flows. The Reinsurance Agreements do not extinguish the Company s primary liability under the variable annuity contracts.

Under the Agreement, the Company, ALIC and ALNY have indemnified Prudential for certain pre-closing contingent liabilities (including extra-contractual liabilities of ALIC and ALNY and liabilities specifically excluded from the transaction) that ALIC and ALNY have agreed to retain. In addition, the Company, ALIC and ALNY will each indemnify Prudential for certain post-closing liabilities that may arise from the acts of ALIC, ALNY and their agents, including in connection with ALIC s and ALNY s provision of transition services.

The terms of the Agreement give Prudential the right to be the exclusive provider of its variable annuity products through the Allstate proprietary agency force for three years and a non-exclusive preferred provider for the following two years. During a transition period, ALIC and ALNY will continue to issue new variable annuity contracts, accept additional deposits on existing business from existing contractholders on behalf of Prudential and, for a period of twenty-four months or less, service the reinsured business while Prudential prepares for the migration of the business onto its servicing platform.

Pursuant to the Agreement, the final market-adjusted consideration was $628 million. The disposal resulted in a gain of $88 million pretax for ALIC, which was deferred as a result of the disposition being executed through reinsurance. The deferred gain decreased to $78 million as of September 30, 2006, due to closing adjustments and amortization. The deferred gain is included as a component of other liabilities and accrued expenses on the Condensed Consolidated Statements of Financial Position, and is amortized to loss on dispositions of operations on the Condensed Consolidated Statements of Operations over the life of the reinsured business which is estimated to be approximately 18 years. For ALNY, the transaction resulted in a loss of $6 million pretax, which was recognized in the second quarter. ALNY s reinsurance loss and other amounts related to the disposal of the business, including the initial costs and final market value settlements of the derivatives acquired by ALIC to economically hedge substantially all of the exposure related to market adjustments between the effective date of the Agreement and the closing of the transaction, transactional expenses incurred and amortization of ALIC s deferred reinsurance gain, were included as a component of loss on disposition of operations on the Condensed Consolidated Statements of Operations and amounted to $59 million, after-tax, in the nine months ended September 30, 2006. During the third quarter of 2006, loss on disposition of operations on the Condensed Consolidated Statements of Operations included $1 million, after-tax, of amortization of ALIC s deferred gain. Deferred acquisition costs (DAC) and deferred sales inducements (DSI) were reduced by $726 million and $70 million, respectively, as of the effective date of the transaction for balances related to the variable annuity business subject to the Reinsurance Agreements.

In the five-months of 2006, prior to the disposition of substantially all of the variable annuity business, ALIC s and ALNY s variable annuity business generated approximately $127 million in contract charges. In the three-month and nine-month periods ended September 30, 2006, life and annuity premiums and contract charges of $72 million and $94 million, contract benefits of $15 million and $20 million, interest credited to contractholder funds of $17 million and $22 million, and operating costs and expenses of $29 million and $39 million, respectively, were ceded to Prudential pursuant to the Reinsurance Agreements.

The separate account balances related to the modified coinsurance reinsurance were $14.55 billion as of September 30, 2006. Separate account balances totaling approximately $1.05 billion at September 30, 2006 related to the variable life business, and three affiliated companies that the Company plans to sell continue to be retained by ALIC. In 2005, ALIC s and ALNY s variable annuity business generated approximately $278 million in contract charges. The separate account balances were $14.23 billion and general account balances were $1.81 billion as of December 31, 2005.

6. Company Restructuring

The Company undertakes various programs to reduce expenses. These programs generally involve a reduction in staffing levels, and in certain cases, office closures. Restructuring and related charges include employee termination and relocation benefits, and post-exit rent expenses in connection with these programs, and non-cash charges resulting from pension benefit payments made to agents in connection with the 1999 reorganization of Allstate s multiple agency programs to a single exclusive agency program and the Company s 2006 voluntary termination offer (VTO). The expenses related to these activities are included in the Condensed Consolidated Statements of Operations as restructuring and related charges, and totaled $52 million and $10 million for the three-month periods ended September 30, 2006 and 2005, respectively, and $171 million and $36 million for the nine-month periods ended September 30, 2006 and 2005, respectively.

Restructuring and related charges include $35 million and $141 million for the three-month and nine-month periods ended September 30, 2006 related to the Company s VTO and reduction in force. The VTO included severance, which was recorded as a restructuring liability. The VTO also included one-time termination benefits for accelerated vesting of stock-based incentive compensation, eligibility for postretirement benefits, and a non-cash pension settlement charge recorded during the third quarter, which were expensed as incurred. The VTO was offered to most employees located at the Company s headquarters during the first quarter and was completed during the second quarter of 2006.

The following table illustrates the changes in the restructuring liability during the nine-month period ended September 30, 2006:

(in millions)	**Employee costs**	**Exit costs**	**Total liability**
VTO Program			
Balance at the beginning of the year	$	$	$
Expense incurred	97		97
Net adjustments to liability	(3)		(3)
Payments applied against liability	(94)		(94)
Balance at the end of the period			
Other Programs			
Balance at the beginning of the year	7	3	10
Expense incurred	16		16
Payments applied against liability	(1)	(1)	(2)
Balance at the end of the period	22	2	24
Total	$ 22	$ 2	$ 24

The payments applied against the liability for employee costs primarily reflect severance costs, and the payments for exit costs generally consist of post-exit rent expenses and contract termination penalties.

7. Guarantees and Contingent Liabilities

State facility assessments

AFIC sells and services Allstate s Florida residential property policies. AFIC and its subsidiaries are subject to assessments from Citizens Property Insurance Corporation in the state of Florida (FL Citizens), which was created to provide insurance to property owners unable to obtain coverage in the private insurance market. FL Citizens, at the discretion and direction of its Board of Governors (FL Citizens Board), can levy a regular assessment on participating companies for a deficit in any calendar year up to a maximum of the greater of 10% of the deficit or 10% of Florida property premiums industry-wide for the prior year. An insurer may recoup a regular assessment through a surcharge to policyholders. In order to recoup its FL Citizens regular assessment, an insurer must file for a policy surcharge with the Florida Office of Insurance Regulation (FL OIR) at least fifteen days prior to imposing the surcharge on policies. If a deficit remains after the regular assessment, FL Citizens can also fund any remaining deficit through emergency assessments in the current and subsequent years. Companies are required to collect the emergency assessments directly from residential property policyholders and remit to FL Citizens as collected. In addition, FL Citizens may issue bonds to further fund a deficit. Participating companies are obligated to purchase any unsold bonds issued by FL Citizens.

FL Citizens reported losses from Hurricane Wilma in 2005, which followed a deficit for the 2004 plan year. The FL Citizens Board met at the end of May 2006 and certified the 2005 FL Citizens deficit at $1.73 billion of which $920 million was to be funded through a regular assessment. The remainder of the deficit and the continuing growth of Citizens will be funded by $3.1 billion in bonds that were sold in the third quarter of 2006. Should the actions taken by Citizens not produce adequate cash flow to cover the debt, the Company would be subject to an emergency assessment. In the third quarter of 2006, the Company reduced its accrual for an expected regular assessment from FL Citizens by $12 million to $14 million based on recent communications made by the FL Citizens Board and other government officials. The Company had accrual balances of $83 million as of March 31, 2006 and $26 million as of June 30, 2006 based on communications it had received as of those dates indicating a future regular assessment was both probable and could be reasonably estimated. The Company estimates that the recoupment from policyholders will be approximately $12 million which will be recognized as billed.

AFIC has access to reimbursements on certain qualifying Florida hurricane losses from the FHCF, and has exposure to assessments and pays annual premiums to the FHCF for this reimbursement protection. The FHCF has the authority to issue bonds to pay its obligations to participating insurers in excess of its capital balances, which are funded by emergency assessments on all property and casualty premiums in the state, except workers compensation, medical malpractice, accident and health insurance and polices written under the National Flood Insurance Program. The FHCF emergency assessments are limited to 6% of premiums per year beginning the first year in which reimbursements require bonding, and up to a total of 10% of premiums per year for emergency assessments in the second and subsequent years, if required to fund additional bonding. In June 2006, the FL OIR ordered an emergency assessment of 1% of premiums collected, which will commence on January 1, 2007. Upon the order of the FL OIR, companies are required to collect the FHCF emergency assessments directly from policyholders and remit them to the FHCF as they are collected.

Facilities such as FL Citizens and the FHCF are generally designed so that the ultimate cost is borne by policyholders, however, the exposure to assessments and the availability of recoupments or premium rate increases from these facilities may not offset each other in the Company s financial statements. Moreover, even if they do offset each other, they may not offset each other in financial statements for the same fiscal period due to the ultimate timing of the assessments and recoupments or premium rate increases, as well as the possibility of policies not being renewed in subsequent years.

Shared markets

As a condition of maintaining its licenses to write personal property and casualty insurance in various states, the Company is required to participate in assigned risk plans, reinsurance facilities and joint underwriting associations that provide various types of insurance coverage to individuals or entities that otherwise are unable to purchase such coverage from private insurers. Underwriting results related to these arrangements, which tend to be adverse, have been immaterial to the results of operations.

Guarantees

The Company provides residual value guarantees on Company leased automobiles. If all outstanding leases were terminated effective September 30, 2006, the Company s maximum obligation pursuant to these guarantees, assuming the automobiles have no residual value, would be $19 million at September 30, 2006. The remaining term of each residual value guarantee is equal to the term of the underlying lease that range from less than one year to three years. Historically, the Company has not made any material payments pursuant to these guarantees.

The Company owns certain fixed income securities that obligate the Company to exchange credit risk or to forfeit principal due, depending on the nature or occurrence of specified credit events for the referenced entities. In the event all such specified credit events were to occur, the Company s maximum amount at risk on these fixed income securities, as measured by the amount of the aggregate initial investment, was $240 million at September 30, 2006. The obligations associated with these fixed income securities expire at various times during the next seven years.

In the normal course of business, the Company provides standard indemnifications to counterparties in contracts in connection with numerous transactions, including acquisitions and divestitures. The types of indemnifications typically provided include indemnifications for breaches of representations and warranties, taxes and certain other liabilities, such as third party lawsuits. The indemnification clauses are often standard contractual terms and were entered into in the normal course of business based on an assessment that the risk of loss would be remote. The terms of the indemnifications vary in duration and nature. In many cases, the maximum obligation is not explicitly stated and the contingencies triggering the obligation to indemnify have not occurred and are not expected to occur. Consequently, the maximum amount of the obligation under such indemnifications is not determinable. Historically, the Company has not made any material payments pursuant to these obligations.

The aggregate liability balance related to all guarantees was not material as of September 30, 2006.

Regulation

The Company is subject to changing social, economic and regulatory conditions. From time to time, regulatory authorities or legislative bodies seek to influence and restrict premium rates, require premium refunds to policyholders, restrict the ability of insurers to cancel or non-renew policies, limit insurers ability to change coverage terms or to impose underwriting standards, impose additional regulations regarding agent and broker compensation and otherwise expand overall regulation of insurance products and the insurance industry. The ultimate changes and eventual effects of these initiatives on the Company s business, if any, are uncertain.

Legal and regulatory proceedings and inquiries

Background

The Company and certain subsidiaries are involved in a number of lawsuits, regulatory inquiries, and other legal proceedings arising out of various aspects of its business. As background to the Proceedings sub-section below, please note the following:

- These matters raise difficult and complicated factual and legal issues and are subject to many uncertainties and complexities, including but not limited to, the underlying facts of each matter; novel legal issues; variations between jurisdictions in which matters are being litigated, heard or investigated; differences in applicable laws and judicial interpretations; the length of time before many of these matters might be resolved by settlement, through litigation or otherwise and, in some cases, the timing of their resolutions relative to other similar matters involving other companies; the fact that many of the lawsuits are putative class actions in which a class has not been certified and in which the purported class may not be clearly defined; the fact that many of the lawsuits involve multi-state class actions in which the applicable law(s) for the claims at issue is in dispute and therefore unclear; and the current challenging legal environment faced by large corporations and insurance companies.

- In the lawsuits, plaintiffs seek a variety of remedies including equitable relief in the form of injunctive and other remedies and monetary relief in the form of contractual and extra-contractual damages. In some cases, the monetary damages sought include punitive or treble damages. Often specific information about the relief sought, such as the amount of damages, is not available because plaintiffs have not requested specific relief in their pleadings.

When specific monetary demands are made, they are often set just below a state court jurisdictional limit in order to seek the maximum amount available in state court, regardless of

13

the specifics of the case, while still avoiding the risk of removal to federal court. In our experience, monetary demands in pleadings bear little relation to the ultimate loss, if any, to the Company.

- In connection with regulatory examinations and proceedings, government authorities may seek various forms of relief, including penalties, restitution and changes in business practices. The Company may not be advised of the nature and extent of relief sought until the final stages of the examination or proceeding.

- For the reasons specified above, it is often not possible to make meaningful estimates of the amount or range of loss that could result from the matters described below in the Proceedings subsection. The Company reviews these matters on an on-going basis and follows the provisions of SFAS No. 5, Accounting for Contingencies , when making accrual and disclosure decisions. When assessing reasonably possible and probable outcomes, the Company bases its decisions on its assessment of the ultimate outcome following all appeals.

- Due to the complexity and scope of the matters disclosed in the Proceedings subsection below and the many uncertainties that exist, the ultimate outcome of these matters cannot be reasonably predicted. In the event of an unfavorable outcome in one or more of these matters, the ultimate liability may be in excess of amounts currently reserved and may be material to the Company s operating results or cash flows for a particular quarter or annual period. However, based on information currently known to it, management believes that the ultimate outcome of all matters described below as they are resolved over time is not likely to have a material adverse effect on the financial position of the Company.

Proceedings

There are two multi-state certified class action lawsuits pending against Allstate in state courts alleging that its failure to pay inherent diminished value to insureds under the collision, comprehensive, or uninsured motorist property damage liability provisions of auto policies constitutes breach of contract and fraud. Plaintiffs define inherent diminished value as the difference between the market value of the insured automobile before an accident and the market value after repair. Plaintiffs allege that they are entitled to the payment of inherent diminished value under the terms of the policy. To a large degree, these lawsuits mirror similar lawsuits filed against other carriers in the industry. A trial in the case involving collision and comprehensive coverage concluded on April 29, 2004, with a jury verdict in favor of the Company. The plaintiffs filed an appeal from the judgment, and on June 1, 2006, the judgment for Allstate was affirmed by the appellate court. The plaintiffs requested a reconsideration of this ruling, which was denied by the court. The plaintiffs then filed a petition for leave to appeal to the Illinois Supreme Court, and that petition is currently pending. In the other case, which involves uninsured motorist property damage coverage, the trial court certified a 19 state class action. The appellate court granted the Company s petition for review of the order of certification, and has affirmed the certification. The Company filed a petition to appeal to the Washington Supreme Court, which was denied. The case has been remanded to the trial court for further proceedings. The Company has been vigorously defending these lawsuits and, since 1998, has been implementing policy language in more than 40 states reaffirming that its collision and comprehensive coverages do not include diminished value claims. The outcome of these disputes remains uncertain.

There are a number of state and nationwide class action lawsuits pending in various state courts challenging the legal propriety of Allstate s medical bill review processes on a number of grounds, including, among other things, the manner in which Allstate determines reasonableness and necessity. One nationwide class action and one statewide class action have been certified. These lawsuits, which to a large degree mirror similar lawsuits filed against other carriers in the industry, allege these processes result in a breach of the insurance policy as well as fraud. Plaintiffs seek monetary damages in the form of contractual and extra-contractual damages. The Company denies these allegations and has been vigorously defending these lawsuits. The outcome of these disputes is currently uncertain.

Nationwide and statewide putative class actions are pending against Allstate that challenge Allstate s use of certain automated database vendors in valuing total loss automobiles. To a large degree, these lawsuits mirror similar lawsuits filed against other carriers in the industry. Plaintiffs allege that flaws in these databases result in valuations to the detriment of insureds. The plaintiffs are seeking actual and punitive damages. The lawsuits are in various stages of development and Allstate has been vigorously defending them, but the outcome of these disputes is currently uncertain.

The Company has received preliminary approval of a settlement in a putative nationwide class action that alleged that the Company discriminates against non-Caucasian policyholders through underwriting and rate-making practices, including the use of credit information. The Company is also defending a putative statewide class action in federal court challenging its use of credit information under certain state insurance statutes. These plaintiffs seek monetary and

14

equitable relief, including actual and punitive damages and injunctive relief. The Company denies these allegations and has been vigorously defending this lawsuit. The outcome of this dispute is currently uncertain.

The Company is defending a number of matters filed in the aftermath of Hurricanes Katrina and Rita, including several statewide putative class action lawsuits pending in Mississippi, Louisiana and Texas. In one matter, the Mississippi Attorney General filed a suit asserting that the flood exclusion found in Allstate s and other insurance companies policies is either ambiguous, unenforceable as unconscionable or contrary to public policy, or inapplicable to the damage suffered in the wake of Hurricane Katrina. In a purported class action in Mississippi, some members of the Mississippi Windstorm Underwriters Association (MWUA) have filed suit against the MWUA board members and the companies they represent, including an Allstate subsidiary, alleging that the Board purchased insufficient reinsurance to protect the MWUA members. These suits seek primarily declaratory relief, and in some cases, actual and punitive damages in unspecified amounts. These matters are in various stages of development and Allstate intends to vigorously defend them. The outcome of these disputes is currently uncertain. Additionally, the Louisiana Attorney General had filed a lawsuit seeking a declaration that two recently enacted state laws are constitutionally valid and enforceable. These state laws extend the contractual period to file claims or file suit for losses arising out of the hurricanes by one additional year to a total of two years. The Louisiana Supreme Court recently ruled that the state legislature could constitutionally extend the prescriptive period under the present circumstances and, therefore, these laws are valid and enforceable.

Allstate is defending various lawsuits involving worker classification issues. These lawsuits include a putative class action and several certified class actions challenging the overtime exemption claimed by the Company under the Fair Labor Standards Act or state wage and hour laws. In these cases, plaintiffs seek monetary relief, such as penalties and liquidated damages, and non-monetary relief, such as injunctive relief and an accounting. These class actions mirror similar lawsuits filed against other carriers in the industry and other employers. Allstate is continuing to vigorously defend its worker classification lawsuits. The outcome of these disputes is currently uncertain.

The Company is defending certain matters relating to the Company s agency program reorganization announced in 1999. These matters include a lawsuit filed in December 2001 by the U.S. Equal Employment Opportunity Commission (EEOC) alleging retaliation under federal civil rights laws (the EEOC I suit) and a class action filed in August 2001 by former employee agents alleging retaliation and age discrimination under the Age Discrimination in Employment Act (ADEA), breach of contract and ERISA violations (the Romero I suit). In March 2004, in the consolidated EEOC I and Romero I litigation, the trial court issued a memorandum and order that, among other things, certified classes of agents, including a mandatory class of agents who had signed a release, for purposes of effecting the court s declaratory judgment that the release is voidable at the option of the release signer. The court also ordered that an agent who voids the release must return to Allstate any and all benefits received by the [agent] in exchange for signing the release. The court also stated that, on the undisputed facts of record, there is no basis for claims of age discrimination. The EEOC and plaintiffs have asked the court to clarify and/or reconsider its memorandum and order. The case otherwise remains pending. The EEOC also filed another lawsuit in October 2004 alleging age discrimination with respect to a policy limiting the rehire of agents affected by the agency program reorganization (the EEOC II suit). In EEOC II, in October 2006, the court granted partial summary judgment to the EEOC. Although the court did not determine that the Company was liable for age discrimination under the ADEA, it determined that the rehire policy resulted in a disparate impact, reserving for trial the determination on whether the Company had reasonable factors other than age to support the rehire policy. The Company is also defending a certified class action filed by former employee agents who terminated their employment prior to the agency program reorganization. These plaintiffs have asserted breach of contract and ERISA claims. A putative nationwide class action has also been filed by former employee agents alleging various violations of ERISA, including a worker classification issue. These plaintiffs are challenging certain amendments to the Agents Pension Plan and are seeking to have exclusive agent independent contractors treated as employees for benefit purposes. This matter was dismissed with prejudice by the trial court, was the subject of further proceedings on appeal, and was reversed and remanded to the trial court in April 2005. In all of these various matters, plaintiffs seek compensatory and punitive damages, and equitable relief. Allstate has been vigorously defending these lawsuits and other matters related to its agency program reorganization. The outcome of these disputes is currently uncertain.

The Company has resolved through mediation and settlement all but two of its lawsuits brought by plaintiffs challenging trading restrictions the Company adopted in an effort to limit market-timing activity in its variable annuity sub-accounts. In the remaining lawsuits, the plaintiffs seek a variety of remedies including monetary and equitable relief. The Company has been vigorously defending these matters, but their outcome is currently uncertain.

The Company is defending its homeowners insurance rates and discount programs in administrative actions filed by the Texas Department of Insurance. The Department is focusing, as they have with other insurers, on the reasonableness of the Company s rates for the risks to which they apply. On July 13, 2005, the Administrative Law Judge granted partial summary disposition in the Company s favor on almost all of the Department s claims regarding the Company s discount program. In the rate proceeding, on May 22, 2006, following an administrative hearing, the Commissioner of Insurance ordered the Company to reduce its homeowners rates by 5% and to pay refunds on the difference plus interest back to December 30, 2004, for which the Company has been accruing. The Company has filed a petition for judicial review of the Commissioner s rate refund order with the district court, and has also filed and implemented a 5% rate decrease occurring in two stages.

Other Matters

The Company and some of its subsidiaries have received interrogatories and demands for information from regulatory and enforcement authorities relating to various insurance products and practices. The areas of inquiry include variable annuity market timing, late trading and the issuance of funding agreements backing medium-term notes. The Company and some of its subsidiaries have also received interrogatories and demands for information from authorities seeking information relevant to on-going investigations into the possible violation of antitrust or insurance laws by unnamed parties and, in particular, seeking information as to whether any person engaged in activities for the purpose of price fixing, market allocation, or bid rigging. The Company believes that these inquiries are similar to those made to many financial services companies as part of industry-wide investigations by various authorities into the practices, policies and procedures relating to insurance and financial services products. The Company and its subsidiaries have responded and will continue to respond to these inquiries.

Various other legal and regulatory actions, including state market conduct exams, are currently pending that involve the Company and specific aspects of its conduct of business. Like other members of the insurance industry, the Company is the target of a number of class action lawsuits and other types of proceedings, some of which involve claims for substantial or indeterminate amounts. These actions are based on a variety of issues and target a range of the Company s practices. The outcome of these disputes is currently unpredictable.

One or more of these matters could have an adverse effect on the Company s operating results or cash flows for a particular quarter or annual period. However, based on information currently known to it, management believes that the ultimate outcome of all matters described in this Other Matters subsection, in excess of amounts currently reserved, as they are resolved over time is not likely to have a material effect on the operating results, cash flows or financial position of the Company.

Asbestos and environmental

Allstate s reserves for asbestos claims were $1.40 billion and $1.37 billion, net of reinsurance recoverables of $832 million and $831 million, at September 30, 2006 and December 31, 2005, respectively. Reserves for environmental claims were $201 million and $205 million, net of reinsurance recoverables of $57 million and $47 million, at September 30, 2006 and December 31, 2005, respectively. Approximately 67% and 68% of the total net asbestos and environmental reserves at September 30, 2006 and December 31, 2005, respectively, were for incurred but not reported estimated losses.

Management believes its net loss reserves for environmental, asbestos and other discontinued lines exposures are appropriately established based on available facts, technology, laws and regulations. However, establishing net loss reserves for asbestos, environmental and other discontinued lines claims is subject to uncertainties that are greater than those presented by other types of claims. The ultimate cost of losses may vary materially from recorded amounts, which are based on management s best estimate. Among the complications are lack of historical data, long reporting delays, uncertainty as to the number and identity of insureds with potential exposure and unresolved legal issues regarding policy coverage; unresolved legal issues regarding the determination, availability and timing of exhaustion of policy limits; plaintiffs evolving and expanding theories of liability, availability and collectibility of recoveries from reinsurance, retrospectively determined premiums and other contractual agreements; and estimating the extent and timing of any contractual liability, and other uncertainties. There are also complex legal issues concerning the interpretation of various insurance policy provisions and whether those losses are covered, or were ever intended to be covered, and could be recoverable through retrospectively determined premium, reinsurance or other contractual agreements. Courts have reached different and sometimes inconsistent conclusions as to when losses are deemed to have occurred and which policies provide coverage; what types of losses are covered; whether there is an insurer obligation to defend; how policy limits are determined; how policy exclusions

and conditions are applied and interpreted; and whether clean-up costs represent insured property damage. Management believes these issues are not likely to be resolved in the near future, and the ultimate cost may vary materially from the amounts currently recorded resulting in an increase in loss reserves. In addition, while the Company believes that improved actuarial techniques and databases have assisted in its ability to estimate asbestos, environmental, and other discontinued lines net loss reserves, these refinements may subsequently prove to be inadequate indicators of the extent of probable losses. Due to the uncertainties and factors described above, management believes it is not practicable to develop a meaningful range for any such additional net loss reserves that may be required.

8. Components of Net Periodic Pension and Postretirement Benefit Costs

The components of net periodic cost for the Company s pension and postretirement benefit plans are as follows:

(in millions)	Three months ended September 30, 2006	2005	Nine months ended September 30, 2006	2005
Pension benefits				
Service cost (1)	$ 46	$ 46	$ 139	$ 156
Interest cost	76	71	228	212
Expected return on plan assets	(80)	(79)	(241)	(235)
Amortization of:				
Prior service costs	(1)	(1)	(2)	(2)
Net loss	36	34	107	100
Settlement loss (2)	95	9	108	27
Net periodic pension cost	$ 172	$ 80	$ 339	$ 258
Postretirement benefits				
Service cost (1)	$ 6	$ 6	$ 19	$ 25
Interest cost	17	17	51	50
Amortization of:				
Prior service costs			(1)	(1)
Net loss		1	1	5
Special termination benefit			3	
Net periodic postretirement cost	$ 23	$ 24	$ 73	$ 79

(1) In the nine-months ended September 30, 2005, the Company recognized $19 million and $4 million pretax for pension and postretirement benefits, respectively, related to a non-recurring increase in liability for future benefits of a discontinued benefit plan.

(2) In the three-months ended September 30, 2006, the Company recognized an $89 million pretax non-cash settlement charge as a result of higher lump sum payments to participants of the Company s pension plans.

17

9. Equity Incentive Plans

The Company currently has two equity incentive plans that permit it to grant nonqualified stock options, incentive stock options, restricted or unrestricted shares of the Company s stock and restricted stock units to certain employees and directors of the Company. The total compensation expense related to these equity awards was $15 million and $19 million with income tax benefits of $6 million for both three-month periods ended September 30, 2006 and 2005, respectively. For the nine-month periods ended September 30, 2006 and 2005, the total compensation expense related to these equity awards was $81 million and $69 million, respectively, with income tax benefits of $28 million and $24 million. Total cash received from the exercise of options was $227 million with a tax benefit realized of $44 million during the nine months ended September 30, 2006.

The Company records compensation expense related to awards under these plans over the vesting period of each grant. The Company records compensation expense for employees eligible for continued vesting upon retirement over the vesting period to the date that the employee is eligible for retirement. As of September 30, 2006, total unrecognized compensation cost related to all nonvested awards was $123 million, which is expected to be recognized over the weighted average vesting period of 2.21 years.

Options are granted under the plans at exercise prices equal to the fair value of the Company s common stock on the applicable grant date. The options granted under the Allstate plans generally vest ratably over a four-year period. The options granted may be exercised once vested and will expire ten years after the date of grant. Restricted stock and restricted stock units generally unrestrict in full on the fourth anniversary of the grant date. The awards are subject to forfeiture upon termination. For terminations due to retirement, shares continue to unrestrict as provided for in the original grant. As disclosed in Note 6, the Company accelerated the vesting of stock-based incentive compensation as a one-time benefit for employees electing its VTO program.

A maximum of 49.6 million shares of common stock will be subject to awards under the plans, subject to adjustment in accordance with the plans terms. At September 30, 2006, 22.8 million shares were reserved and remained available for future issuance under these plans. The Company uses its treasury shares for these issuances.

The fair value of each option grant is estimated on the date of grant using a binomial lattice model for the 2006 and 2005 grants, and the Black-Scholes pricing model for prior years grants. The Company uses historical data to estimate option exercise and employee termination within the valuation model. In addition, separate groups of employees that have similar historical exercise behavior are considered separately for valuation purposes. The expected term of options granted is derived from the output of the binominal lattice model and represents the period of time that options granted are expected to be outstanding. The expected volatility of fair value is implied based on traded options and historical volatility of the Company s common stock. The expected dividends are based on the current dividend yield of the Company s stock as of the date of the grant. The risk-free rate for periods within the contractual life of the option is based on the U.S. Treasury yield curve in effect at the time of grant. The assumptions used are shown in the following table.

	Three months ended September 30,		**Nine months ended September 30,**	
	2006	**2005**	**2006**	**2005**
Weighted average expected term	5.91 years	4.27 years	7.11 years	7.28 years
Expected volatility	17.52-30.00%	14.70-30.00%	17.52-30.00%	12.78-30.00%
Weighted average volatility	28.10%	23.32%	28.08%	27.43%
Expected dividends	2.42%	2.20%	2.60%	2.41%
Risk-free rate	4.77-5.18%	3.04-4.25%	4.33-5.18%	2.26-4.38%

A summary of option activity for the nine months ended September 30, 2006 is shown in the following table.

	Number (in 000s)	Weighted average exercise price	Aggregate intrinsic value (in 000s)	Weighted average remaining contractual term
Outstanding at January 1, 2006	24,508	$ 39.90		
Granted	4,971	53.88		
Exercised	(4,150)	36.29		
Forfeited	(402)	49.45		
Expired	(35)	53.81		
Outstanding at September 30, 2006:	24,892	$ 43.12	$ 485,394	6.3 years
Outstanding, net of expected forfeitures	24,061	$ 43.12	$ 469,190	6.3 years
Outstanding, exercisable (vested)	14,503	$ 37.99	$ 212,179	5.1 years

The weighted average grant date fair value of options granted was $14.95 and $11.83 during the three-month periods ended September 30, 2006 and 2005, respectively, and was $15.25 and $14.54 during the nine-month periods ended September 30, 2006 and 2005, respectively. The intrinsic value, which is the difference between the fair value and the exercise price, of options exercised was $43 million and $48 million for the three-month periods ended September 30, 2006 and 2005, respectively, and was $84 million and $167 million for the nine-month periods ended September 30, 2006 and 2005, respectively. The total fair value of options vested was $0.5 million and $2.4 million during the three-month periods ended September 30, 2006 and 2005, respectively, and was $60.4 million and $79.2 million during the nine-month periods ended September 30, 2006 and 2005, respectively.

For the nine months ended September 30, 2006, the changes in restricted stock and restricted stock units are shown in the following table.

	Number (in 000s)	Weighted average grant date fair value
Nonvested at January 1, 2006	2,186	$ 41.02
Granted	884	53.85
Vested	(160)	40.37
Forfeited	(73)	47.46
Nonvested at September 30, 2006	2,837	$ 44.89

The fair value of restricted stock and restricted stock units is based on the market value of the Company s stock as of the date of the grant. The weighted average grant date fair value of restricted stock and restricted stock units granted was $55.74 and $55.11 during the three-month periods ended September 30, 2006 and 2005, respectively, and was $53.85 and $52.92 during the nine-month periods ended September 30, 2006 and 2005, respectively. The total fair value of restricted stock and restricted stock units vested was $1.6 million during the three-month period ended September 30, 2006 and no restricted stock or restricted stock units vested during the three-month period ended September 30, 2005. The total fair value of restricted stock and restricted stock units vested was $8.9 million and $0.3 million during the nine-month periods ended September 30, 2006 and 2005, respectively.

The following table illustrates the effect on net income and earnings per share as if SFAS No. 123 had been applied to all outstanding and unvested options during 2005.

	Three months ended September 30, 2005	Nine months ended September 30, 2005
Net (loss) income, as reported	$ (1,548)	$ 724
Add: Employee stock option expense included in net (loss) income, after-tax (1)	7	24
Deduct: Total employee stock option expense determined under fair value based method for all awards, after-tax	(8)	(32)
Pro forma net (loss) income	$ (1,549)	$ 716
Earnings per share Basic:		
As reported	$ (2.36)	$ 1.09
Pro forma	(2.37)	1.07
Earnings per share Diluted:		
As reported	$ (2.36)	$ 1.08
Pro forma	(2.37)	1.07

(1) In the three-month and nine-month periods ended September 30, 2005, the Company recognized a total of $3 million and $19 million after-tax, respectively, related to the acceleration of deferred compensation expense on unvested stock awards granted to retirement eligible employees, including $2 million and $11 million after-tax, respectively, on unvested stock options (included in the table above) and $1 million and $8 million after-tax, respectively, on restricted stock.

10. Business Segments

Summarized revenue data for each of the Company s business segments are as follows:

	Three months ended September 30,		**Nine months ended September 30,**	
(in millions)	**2006**	**2005**	**2006**	**2005**
Revenues				
Property-Liability				
Property-liability insurance premiums earned				
Standard auto	$ 4,199	$ 4,086	$ 12,498	$ 12,118
Non-standard auto	377	438	1,177	1,345
Auto	4,576	4,524	13,675	13,463
Homeowners	1,561	1,589	4,815	4,732
Other	664	667	2,045	2,006
Allstate Protection	6,801	6,780	20,535	20,201
Discontinued Lines and Coverages		1	2	
Total property-liability insurance premiums earned	6,801	6,781	20,537	20,201
Net investment income	455	454	1,382	1,333
Realized capital gains and losses	(34)	163	233	385
Total Property-Liability	7,222	7,398	22,152	21,919
Allstate Financial				
Life and annuity premiums and contract charges				
Traditional life	68	68	207	204
Immediate annuities with life contingencies	59	37	177	160
Accident and health and other	84	113	247	325
Total life and annuity premiums	211	218	631	689
Interest-sensitive life	215	196	632	581
Fixed annuities	17	16	53	49
Variable annuities	1	75	138	206
Total contract charges	233	287	823	836
Total life and annuity premiums and contract charges	444	505	1,454	1,525
Net investment income	1,063	974	3,115	2,838
Realized capital gains and losses	(30)	27	(138)	52
Total Allstate Financial	1,477	1,506	4,431	4,415
Corporate and Other				
Service fees	2	3	7	7
Net investment income	36	29	116	93
Realized capital gains and losses	3	9	(5)	11
Total Corporate and Other before reclassification of service fees	41	41	118	111
Reclassification of service fees (1)	(2)	(3)	(7)	(7)
Total Corporate and Other	39	38	111	104
Consolidated Revenues	$ 8,738	$ 8,942	$ 26,694	$ 26,438

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(1) For presentation in the Condensed Consolidated Statements of Operations, service fees of the Corporate and Other segment are reclassified to operating costs and expenses.

21

Summarized financial performance data for each of the Company s reportable segments are as follows:

(in millions)	Three months ended September 30, 2006	Three months ended September 30, 2005	Nine months ended September 30, 2006	Nine months ended September 30, 2005
Net income				
Property-Liability				
Underwriting income (loss)				
Allstate Protection	$ 1,196	$ (3,227)	$ 3,652	$ (1,218)
Discontinued Lines and Coverages	(118)	(136)	(133)	(170)
Total underwriting income (loss)	1,078	(3,363)	3,519	(1,388)
Net investment income	455	454	1,382	1,333
Income tax (expense) benefit on operations	(466)	1,124	(1,523)	291
Realized capital gains and losses, after-tax	(22)	99	153	248
Loss on disposition of operations, after-tax			(1)	
Property-Liability net income (loss)	1,045	(1,686)	3,530	484
Allstate Financial				
Life and annuity premiums and contract charges	444	505	1,454	1,525
Net investment income	1,063	974	3,115	2,838
Periodic settlements and accruals on non-hedge derivative financial instruments	14	14	44	49
Contract benefits and interest credited to contractholder funds	(1,059)	(1,003)	(3,080)	(2,961)
Operating costs and expenses and amortization of deferred policy acquisition costs	(244)	(270)	(840)	(819)
Restructuring and related charges	(5)	(1)	(24)	(1)
Income tax expense on operations	(65)	(63)	(217)	(189)
Operating income	148	156	452	442
Realized capital gains and losses, after-tax	(19)	17	(89)	33
Deferred policy acquisition costs and deferred sales inducements amortization relating to realized capital gains and losses, after-tax	16	(2)	40	(106)
Non-recurring increase in liability for future benefits, after-tax (1)				(22)
Reclassification of periodic settlements and accruals on non-hedge financial instruments, after-tax	(9)	(10)	(28)	(32)
Loss on disposition of operations, after-tax	(1)	(7)	(59)	(11)
Allstate Financial net income	135	154	316	304
Corporate and Other				
Service fees(2)	2	3	7	7
Net investment income	36	29	116	93
Operating costs and expenses	(91)	(82)	(266)	(255)
Restructuring and related charges			(1)	
Income tax benefit on operations	29	29	81	84
Operating loss	(24)	(21)	(63)	(71)
Realized capital gains and losses, after-tax	2	5	(3)	7
Corporate and Other net loss	(22)	(16)	(66)	(64)
Consolidated net income (loss)	$ 1,158	$ (1,548)	$ 3,780	$ 724

(1) The non-recurring increase in liability for future benefits is for a discontinued plan (see Note 8 for impact to pension and postretirement benefits).

(2) For presentation in the Condensed Consolidated Statements of Operations, service fees of the Corporate and Other segment are reclassified to operating costs and expenses.

The composition of the segments was revised in 2006. The loan protection business previously managed by Allstate Financial is now being managed by Allstate Protection. The revenue results of this business are included in other property-liability insurance premiums earned in 2006 and in accident and health and other in life and annuity premiums and contract charges in 2005. The amounts are not material and therefore the segment results for prior periods have not been reclassified.

11. Other Comprehensive Income

The components of other comprehensive income (loss) on a pretax and after-tax basis are as follows:

	Three months ended September 30, 2006			2005		
(in millions)	Pretax	Tax	After-tax	Pretax	Tax	After-tax
Unrealized net holding gains (losses) arising during the period, net of related offsets	$ 1,570	$ (549)	$ 1,021	$ (734)	$ 257	$ (477)
Less: reclassification adjustment of realized capital gains and losses	235	(82)	153	89	(31)	58
Unrealized net capital gains (losses)	1,335	(467)	868	(823)	288	(535)
Unrealized foreign currency translation adjustments				23	(8)	15
Other comprehensive income (loss)	$ 1,335	$ (467)	868	$ (800)	$ 280	(520)
Net income (loss)			1,158			(1,548)
Comprehensive income (loss)			$ 2,026			$ (2,068)

	Nine months ended September 30, 2006			2005		
(in millions)	Pretax	Tax	After-tax	Pretax	Tax	After-tax
Unrealized net holding (losses) gains arising during the period, net of related offsets	$ (11)	$ 4	$ (7)	$ (761)	$ 266	$ (495)
Less: reclassification adjustment of realized capital gains and losses	188	(66)	122	296	(104)	192
Unrealized net capital (losses) gains	(199)	70	(129)	(1,057)	370	(687)
Unrealized foreign currency translation adjustments	25	(9)	16	12	(4)	8
Other comprehensive (loss) income	$ (174)	$ 61	(113)	$ (1,045)	$ 366	(679)
Net income			3,780			724
Comprehensive income			$ 3,667			$ 45

12. Capital Structure

In March 2006, the Company issued $650 million of 5.95% Senior Notes due 2036. The net proceeds are to be used for general corporate purposes, including to facilitate the repayment of the $550 million of 5.375% Senior Notes at their scheduled maturity on December 1, 2006.

In May 2006, the Company filed a universal shelf registration statement with the Securities and Exchange Commission (SEC). In accordance with rules adopted by the SEC in 2005, this registration statement covers an unspecified amount of securities. The Company may issue debt securities, common stock, preferred stock, depositary shares, warrants, stock purchase contracts, stock purchase units and securities of subsidiaries. This registration statement, under which the Company has not yet issued any securities, replaced the Company s 2003 universal shelf registration statement.

In July 2006, the Company established an investment management variable interest entity (VIE) that holds assets under the management of Allstate Investment Management Company, a subsidiary of the Company, on behalf of unrelated third party investors. The VIE had assets consisting primarily of investment securities and cash totaling $400 million and liabilities, primarily long-term debt, totaling $410 million at September 30, 2006. The Company does not consolidate the VIE because it is not the primary beneficiary. The Company s maximum loss exposure related to its investment in the VIE is the current carrying value of its investment, which was $15 million at September 30, 2006.

23

REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

To the Board of Directors and Shareholders of
The Allstate Corporation:

We have reviewed the accompanying condensed consolidated statement of financial position of The Allstate Corporation and subsidiaries (the Company) as of September 30, 2006, and the related condensed consolidated statements of operations for the three-month and nine-month periods ended September 30, 2006 and 2005, and the condensed consolidated statements of cash flows for the nine-month periods ended September 30, 2006 and 2005. These interim financial statements are the responsibility of the Company s management.

We conducted our reviews in accordance with standards of the Public Company Accounting Oversight Board (United States). A review of interim financial information consists principally of applying analytical procedures and making inquiries of persons responsible for financial and accounting matters. It is substantially less in scope than an audit conducted in accordance with the standards of the Public Company Accounting Oversight Board (United States), the objective of which is the expression of an opinion regarding the financial statements taken as a whole. Accordingly, we do not express such an opinion.

Based on our reviews, we are not aware of any material modifications that should be made to such condensed consolidated interim financial statements for them to be in conformity with accounting principles generally accepted in the United States of America.

We have previously audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), the consolidated statement of financial position of The Allstate Corporation and subsidiaries as of December 31, 2005, and the related consolidated statements of operations, comprehensive income, shareholders equity, and cash flows for the year then ended, not presented herein. In our report dated February 22, 2006, which report includes an explanatory paragraph as to changes in the Company s method of accounting for certain nontraditional long-duration contracts and separate accounts in 2004 and method of accounting for stock-based compensation, embedded derivatives in modified coinsurance agreements, and variable interest entities in 2003, we expressed an unqualified opinion on those consolidated financial statements. In our opinion, the information set forth in the accompanying condensed consolidated statement of financial position as of December 31, 2005 is fairly stated, in all material respects, in relation to the consolidated statement of financial position from which it has been derived.

/s/ Deloitte & Touche LLP

Chicago, Illinois
November 1, 2006

Item 2. MANAGEMENT S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS FOR THE THREE-MONTH AND NINE-MONTH PERIODS ENDED SEPTEMBER 30, 2006 AND 2005

OVERVIEW

The following discussion highlights significant factors influencing the consolidated financial position and results of operations of The Allstate Corporation (referred to in this document as we , our , us , the Company or Allstate). It should be read in conjunction with the condensed consolidated financial statements and notes thereto found under Part I. Item 1. contained herein, and with the discussion, analysis, consolidated financial statements and notes thereto in Part I. Item 1. and Part II. Item 7. and Item 8. of The Allstate Corporation Annual Report on Form 10-K for 2005. Analysis of our insurance segments is provided in the Property-Liability Operations (which includes the Allstate Protection and the Discontinued Lines and Coverages segments) and in the Allstate Financial Segment sections of Management s Discussion and Analysis (MD&A). The segments are consistent with the way in which we use financial information to evaluate business performance and to determine the allocation of resources.

HIGHLIGHTS

- Net income increased to $1.16 billion in the third quarter of 2006 from a net loss of $1.55 billion in the third quarter of last year, and to $3.78 billion in the first nine months of 2006 from $724 million in the first nine months of last year. Net income per diluted share increased to $1.83 in the third quarter of 2006 from a net loss per diluted share of $2.36 in the third quarter of last year, and to $5.91 in the first nine months of 2006 from $1.08 in the first nine months of last year.

- Total revenues decreased 2.3% to $8.74 billion in the third quarter of 2006 from $8.94 billion in the third quarter of last year, and increased 1.0% to $26.69 billion in the first nine months of 2006 from $26.44 billion in the first nine months of last year.

- Book value per share increased 18.3% to $35.08 as of September 30, 2006 compared to $29.66 as of September 30, 2005 and increased 13.1% compared to $31.01 as of December 31, 2005.

- For the twelve months ended September 30, 2006, return on the average of beginning and ending period shareholders equity increased 14.0 points to 23.2% from 9.2% for the twelve months ended September 30, 2005.

- Property-Liability premiums earned increased 0.3% to $6.80 billion in the third quarter of 2006 from $6.78 billion in the third quarter of 2005 and increased 1.7% to $20.54 billion for the first nine months of 2006 from $20.20 billion for the first nine months of 2005.

- The Property-Liability combined ratio was 84.1 in the third quarter of 2006 compared to 149.6 in the third quarter of 2005 and 82.9 in the first nine months of 2006 compared to 106.9 in the first nine months of 2005. The effect of catastrophe losses on the combined ratio was 2.5 points and 69.4 points in the third quarter of 2006 and 2005, respectively, and 2.6 points and 24.8 points in the first nine months of 2006 and 2005, respectively.

- Allstate Financial net income declined 12.3% to $135 million in the third quarter of 2006 and increased 3.9% to $316 million in the first nine months of 2006 compared to the same periods in 2005.

CONSOLIDATED NET INCOME

(in millions)	Three Months Ended September 30, 2006	2005	Nine Months Ended September 30, 2006	2005
Revenues				
Property-liability insurance premiums earned	$ 6,801	$ 6,781	$ 20,537	$ 20,201
Life and annuity premiums and contract charges	444	505	1,454	1,525
Net investment income	1,554	1,457	4,613	4,264
Realized capital gains and losses	(61)	199	90	448
Total revenues	8,738	8,942	26,694	26,438
Costs and expenses				
Property-liability insurance claims and claims expense	(4,012)	(8,529)	(11,879)	(16,706)
Life and annuity contract benefits	(388)	(395)	(1,135)	(1,209)
Interest credited to contractholder funds	(667)	(608)	(1,939)	(1,784)
Amortization of deferred policy acquisition costs	(1,160)	(1,160)	(3,522)	(3,557)
Operating costs and expenses	(726)	(713)	(2,252)	(2,266)
Restructuring and related charges	(52)	(10)	(171)	(36)
Interest expense	(90)	(85)	(261)	(251)
Total costs and expenses	(7,095)	(11,500)	(21,159)	(25,809)
Loss on disposition of operations	(1)	(4)	(89)	(12)
Income tax (expense) benefit	(484)	1,014	(1,666)	107
Net income (loss)	$ 1,158	$ (1,548)	$ 3,780	$ 724
Property-Liability	$ 1,045	$ (1,686)	$ 3,530	$ 484
Allstate Financial	135	154	316	304
Corporate and Other	(22)	(16)	(66)	(64)
Net income (loss)	$ 1,158	$ (1,548)	$ 3,780	$ 724

PROPERTY-LIABILITY HIGHLIGHTS

- Premiums written decreased 0.5% in the third quarter of 2006 from the third quarter of 2005 and increased 0.9% in the first nine months of 2006 over the first nine months of 2005. Allstate brand standard auto premiums written increased 2.2% and 3.3% in the third quarter and first nine months of 2006, respectively, over the same periods of 2005. Allstate brand homeowners premiums written decreased 2.6% and 0.1% in the third quarter and first nine months of 2006, respectively, from the same periods of 2005. Premiums written is an operating measure that is defined and reconciled to premiums earned on page 30.

- The impact of the cost of the catastrophe reinsurance program on premiums written and premiums earned totaled $214 million in the third quarter of 2006 compared to $60 million in the same period of 2005. The impact of the cost of the catastrophe reinsurance program on premiums written and premiums earned totaled $406 million in the first nine months of 2006 compared to $136 million in the same period of 2005. Excluding this cost, premiums written grew 1.6% and 2.2% in the third quarter and first nine months of 2006, respectively, when compared to the same periods of 2005.

- Allstate brand standard auto new issued applications decreased 1.4% in the third quarter of 2006 from the same period of 2005 and increased 1.2% in the first nine months of 2006 over the first nine months of 2005. Allstate brand homeowners new issued applications decreased 19.8% in the third quarter of 2006 from the same period of 2005 and 16.6% in the first nine months of 2006 from the first nine months of 2005.

2. Earnings per share

- Policies in force (PIF) as of the third quarter of 2006 when compared to the third quarter of 2005 for Allstate brand standard auto and homeowners increased 2.6% and 0.6%, respectively.

- The Allstate brand standard auto renewal ratio was 90.1 in the third quarter of 2006 compared to 90.5 in the third quarter of 2005 and 90.1 in the first nine months of 2006 compared to 90.7 in the first nine months of 2005. The Allstate brand homeowners renewal ratio was 87.4 in the third quarter of 2006 compared to 88.5 in the third quarter of 2005 and 87.2 in the first nine months of 2006 compared to 88.4 in the first nine months of 2005.

- Claim frequencies (rate of claim occurrence), excluding catastrophes, in the auto and homeowners insurance lines continue to decline, while current year claim severity (average cost per claim) was higher, when compared to the third quarter and first nine months of 2005.

- Underwriting income for Property-Liability was $1.08 billion in the third quarter of 2006 compared to an underwriting loss of $3.36 billion in the third quarter of 2005. Underwriting income for Property-Liability was $3.52 billion in the first nine months of 2006 compared to an underwriting loss of $1.39 billion in the first nine months of 2005. Underwriting income, a measure that is not based on generally accepted accounting principles (GAAP), is defined below.

- Catastrophe losses in the third quarter of 2006 totaled $169 million compared to $4.71 billion in the same period of 2005. Catastrophe losses in the first nine months of 2006 totaled $531 million compared to $5.02 billion in the same period of 2005.

- Prior year favorable net reserve reestimates in the third quarter of 2006 totaled $221 million compared to $150 million in the third quarter of 2005 and $787 million in the first nine months of 2006 compared to $322 million in the first nine months of 2005.

PROPERTY-LIABILITY OPERATIONS

Our Property-Liability operations consist of two business segments: Allstate Protection and Discontinued Lines and Coverages. Allstate Protection is comprised of two brands, the Allstate brand and Encompass brand. Allstate Protection is principally engaged in the sale of personal property and casualty insurance, primarily private passenger auto and homeowners insurance, to individuals in the United States and Canada. Discontinued Lines and Coverages includes results from insurance coverage that we no longer write and results for certain commercial and other businesses in run-off. These segments are consistent with the groupings of financial information that management uses to evaluate performance and to determine the allocation of resources.

Underwriting income (loss), a measure that is not based on GAAP and is reconciled to net income on page 29, is calculated as premiums earned, less claims and claims expense (losses), amortization of deferred policy acquisition costs (DAC), operating costs and expenses and restructuring and related charges, as determined using GAAP. We use this measure in our evaluation of results of operations to analyze the profitability of the Property-Liability insurance operations separately from investment results. It is also an integral component of incentive compensation. It is useful for investors to evaluate the components of income separately and in the aggregate when reviewing performance. Underwriting income (loss) should not be considered as a substitute for net income and does not reflect the overall profitability of the business. Net income is the GAAP measure most directly comparable to underwriting income (loss).

The table below includes GAAP operating ratios we use to measure our profitability. We believe that they enhance an investor s understanding of our profitability. They are calculated as follows:

- Claims and claims expense (loss) ratio the ratio of claims and claims expense to premiums earned. Loss ratios include the impact of catastrophe losses.

- Expense ratio   the ratio of amortization of DAC, operating costs and expenses and restructuring and related charges to premiums earned.

- Combined ratio   the ratio of claims and claims expense, amortization of DAC, operating costs and expenses and restructuring and related charges to premiums earned. The combined ratio is the sum of the loss ratio and the expense ratio. The difference between 100% and the combined ratio represents underwriting income as a percentage of premiums earned.

27

We have also calculated the following impacts of specific items on the GAAP operating ratios because of the volatility of these items between fiscal periods.

- Effect of catastrophe losses on combined ratio the percentage of catastrophe losses included in claims and claims expense to premiums earned.

- Effect of pretax reserve reestimates on combined ratio the percentage of pretax reserve reestimates included in claims and claims expense to premiums earned.

- Effect of restructuring and related charges on combined ratio the percentage of restructuring and related charges to premiums earned.

- Effect of Discontinued Lines and Coverages on combined ratio the ratio of claims and claims expense and other costs and expenses in the Discontinued Lines and Coverages segment to Property-Liability premiums earned. The sum of the effect of Discontinued Lines and Coverages on the combined ratio and the Allstate Protection combined ratio is equal to the Property-Liability combined ratio.

Summarized financial data, a reconciliation of underwriting income to net income and GAAP operating ratios for our Property-Liability operations are presented in the following table.

(in millions, except ratios)	**Three Months Ended September 30, 2006**	**2005**	**Nine Months Ended September 30, 2006**	**2005**
Premiums written	$ 7,123	$ 7,158	$ 20,922	$ 20,733
Revenues				
Premiums earned	$ 6,801	$ 6,781	$ 20,537	$ 20,201
Net investment income	455	454	1,382	1,333
Realized capital gains and losses	(34)	163	233	385
Total revenues	7,222	7,398	22,152	21,919
Costs and expenses				
Claims and claims expense	(4,012)	(8,529)	(11,879)	(16,706)
Amortization of DAC	(1,039)	(1,029)	(3,088)	(3,061)
Operating costs and expenses	(625)	(577)	(1,905)	(1,787)
Restructuring and related charges	(47)	(9)	(146)	(35)
Total costs and expenses	(5,723)	(10,144)	(17,018)	(21,589)
Loss on disposition of operations			(1)	
Income tax (expense) benefit	(454)	1,060	(1,603)	154
Net income (loss)	$ 1,045	$ (1,686)	$ 3,530	$ 484
Underwriting income (loss)	$ 1,078	$ (3,363)	$ 3,519	$ (1,388)
Net investment income	455	454	1,382	1,333
Income tax (expense) benefit on operations	(466)	1,124	(1,523)	291
Realized capital gains and losses, after-tax	(22)	99	153	248
Loss on disposition of operations, after-tax			(1)	
Net income (loss)	$ 1,045	$		