ALLSTATE CORP
Form 10-Q
May 01, 2007

# 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 MARCH 31, 2007**

**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<br>Northbrook, Illinois<br>(Address of principal executive offices)** | **60062<br>(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 April 30, 2007, the registrant had 607,408,065 common shares, $.01 par value, outstanding.**

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**THE ALLSTATE CORPORATION**
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**March 31, 2007**


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**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 March 31, 2007 (Unaudited) | 2006 |
|---|---|---|
| **Revenues** | | |
| Property-liability insurance premiums earned | $ 6,806 | $ 6,876 |
| Life and annuity premiums and contract charges | 483 | 495 |
| Net investment income | 1,571 | 1,511 |
| Realized capital gains and losses | 471 | 199 |
| | 9,331 | 9,081 |
| **Costs and expenses** | | |
| Property-liability insurance claims and claims expense | 4,117 | 3,873 |
| Life and annuity contract benefits | 428 | 373 |
| Interest credited to contractholder funds | 649 | 620 |
| Amortization of deferred policy acquisition costs | 1,153 | 1,139 |
| Operating costs and expenses | 727 | 779 |
| Restructuring and related charges | (1) | 107 |
| Interest expense | 72 | 81 |
| | 7,145 | 6,972 |
| Loss on disposition of operations | | (53) |
| **Income from operations before income tax expense** | 2,186 | 2,056 |
| Income tax expense | 691 | 641 |
| **Net income** | $ 1,495 | $ 1,415 |
| **Earnings per share:** | | |
| **Net income per share - Basic** | $ 2.42 | $ 2.20 |
| **Weighted average shares - Basic** | 616.8 | 643.2 |
| **Net income per share - Diluted** | $ 2.41 | $ 2.19 |
| **Weighted average shares - Diluted** | 621.6 | 647.4 |
| Cash dividends declared per share | $ 0.38 | $ 0.35 |

See notes to condensed consolidated financial statements.

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**THE ALLSTATE CORPORATION AND SUBSIDIARIES**

**CONDENSED CONSOLIDATED STATEMENTS OF FINANCIAL POSITION**

| (in millions, except par value data) | March 31, 2007 (Unaudited) | December 31, 2006 |
|---|---|---|
| **Assets** | | |
| Investments | | |
| Fixed income securities, at fair value (amortized cost $97,424 and $95,780) | $ 100,033 | $ 98,320 |
| Equity securities, at fair value (cost $6,263 and $6,026) | 7,924 | 7,777 |
| Mortgage loans | 9,544 | 9,467 |
| Short-term | 3,197 | 2,430 |
| Other | 1,684 | 1,763 |
| Total investments | 122,382 | 119,757 |
| | | |
| Cash | 471 | 443 |
| Premium installment receivables, net | 4,796 | 4,789 |
| Deferred policy acquisition costs | 5,191 | 5,332 |
| Reinsurance recoverables, net | 5,826 | 5,827 |
| Accrued investment income | 1,125 | 1,062 |
| Deferred income taxes | 268 | 224 |
| Property and equipment, net | 1,033 | 1,010 |
| Goodwill | 825 | 825 |
| Other assets | 2,142 | 2,111 |
| Separate Accounts | 16,030 | 16,174 |
| **Total assets** | $ 160,089 | $ 157,554 |
| | | |
| **Liabilities** | | |
| Reserve for property-liability insurance claims and claims expense | $ 18,667 | $ 18,866 |
| Reserve for life-contingent contract benefits | 12,806 | 12,786 |
| Contractholder funds | 62,472 | 62,031 |
| Unearned premiums | 10,221 | 10,427 |
| Claim payments outstanding | 741 | 717 |
| Other liabilities and accrued expenses | 12,021 | 10,045 |
| Short-term debt | | 12 |
| Long-term debt | 4,640 | 4,650 |
| Separate Accounts | 16,030 | 16,174 |
| **Total liabilities** | 137,598 | 135,708 |
| | | |
| **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, 611 million and 622 million shares outstanding | 9 | 9 |
| Additional capital paid-in | 2,985 | 2,939 |
| Retained income | 30,322 | 29,070 |
| Deferred ESOP expense | (68 ) | (72 ) |
| Treasury stock, at cost (289 million and 278 million shares) | (11,775 ) | (11,091 ) |
| | | |
| Accumulated other comprehensive income: | | |
| Unrealized net capital gains and losses | 2,058 | 2,074 |
| Unrealized foreign currency translation adjustments | 28 | 26 |
| Net funded status of pension and other postretirement benefit obligation | (1,068 ) | (1,109 ) |
| Total accumulated other comprehensive income | 1,018 | 991 |
| **Total shareholders  equity** | 22,491 | 21,846 |
| **Total liabilities and shareholders  equity** | $ 160,089 | $ 157,554 |

See notes to condensed consolidated financial statements.

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**THE ALLSTATE CORPORATION AND SUBSIDIARIES**

**CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS**

| (in millions) | Three Months Ended March 31, 2007 (Unaudited) | 2006 |
|---|---|---|
| **Cash flows from operating activities** | | |
| Net income | $ 1,495 | $ 1,415 |
| Adjustments to reconcile net income to net cash provided by operating activities: | | |
| Depreciation, amortization and other non-cash items | (48) | (36) |
| Realized capital gains and losses | (471) | (199) |
| Loss on disposition of operations | | 53 |
| Interest credited to contractholder funds | 649 | 620 |
| Changes in: | | |
| Policy benefits and other insurance reserves | (195) | (1,840) |
| Unearned premiums | (208) | (209) |
| Deferred policy acquisition costs | 32 | (58) |
| Premium installment receivables, net | (6) | (64) |
| Reinsurance recoverables, net | (80) | 493 |
| Income taxes payable | 561 | 1,010 |
| Other operating assets and liabilities | (201) | (334) |
| Net cash provided by operating activities | 1,528 | 851 |
| **Cash flows from investing activities** | | |
| Proceeds from sales | | |
| Fixed income securities | 4,377 | 6,589 |
| Equity securities | 1,958 | 1,796 |
| Investment collections | | |
| Fixed income securities | 1,359 | 1,133 |
| Mortgage loans | 517 | 492 |
| Investment purchases | | |
| Fixed income securities | (6,144) | (7,503) |
| Equity securities | (1,823) | (1,706) |
| Mortgage loans | (579) | (880) |
| Change in short-term investments, net | (237) | (62) |
| Change in other investments, net | 66 | (3) |
| Purchases of property and equipment, net | (78) | (67) |
| Net cash used in investing activities | (584) | (211) |
| **Cash flows from financing activities** | | |
| Change in short-term debt, net | (12) | (379) |
| Proceeds from issuance of long-term debt | | 644 |
| Repayment of long-term debt | (9) | (6) |
| Contractholder fund deposits | 2,363 | 2,084 |
| Contractholder fund withdrawals | (2,363) | (2,391) |
| Dividends paid | (218) | (207) |
| Treasury stock purchases | (720) | (454) |
| Shares reissued under equity incentive plans, net | 33 | 20 |
| Excess tax benefits from share-based payment arrangements | 15 | 2 |
| Other | (5) | 77 |
| Net cash used in financing activities | (916) | (610) |
| **Net increase in cash** | 28 | 30 |
| **Cash at beginning of period** | 443 | 313 |
| **Cash at end of period** | $ 471 | $ 343 |

See notes to condensed consolidated financial statements.



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**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 March 31, 2007, and for the three-month periods ended March 31, 2007 and 2006 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, 2006. 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 2007 presentation, certain amounts in the prior year condensed consolidated financial statements and notes have been reclassified.

**Adopted 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 through the exchange of an existing contract for a new contract, or by amendment, endorsement or rider to an existing contract, or by the election of a feature or coverage within an existing contract. In February 2007, the AICPA issued Technical Practice Aids ( TPAs ) that provide interpretive guidance to be used in applying the SOP. The Company adopted the provisions of SOP 05-1 on January 1, 2007, for internal replacements occurring in fiscal years beginning after December 15, 2006. The adoption resulted in a $9 million after-tax adjustment to unamortized DAC and DSI related to the impact on future estimated gross profits from the changes in accounting for certain costs associated with contract continuations, that no longer qualify for deferral under SOP 05-1. The adjustment was recorded as a reduction of retained income at January 1, 2007, and a reduction of DAC and DSI balances of $13 million pre-tax. The ongoing effects of SOP 05-1 are not expected to have a material impact on the Company s results of operations or financial position.

*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 at the date of adoption of any hybrid financial instrument containing an embedded derivative that otherwise would require bifurcation under paragraph 12 or 13 of 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 embedded derivatives requiring bifurcation; and clarifies that concentrations of credit risk in the form of subordination are not embedded derivatives. The Company adopted the provisions of SFAS No. 155 on January 1, 2007, which are effective for all financial instruments acquired, issued or subject to a remeasurement event occurring after the beginning of the first fiscal year that begins after September 15, 2006. The Company elected not to remeasure existing hybrid financial instruments at the date of adoption that contained embedded derivatives requiring bifurcation pursuant to paragraph 12 or 13 of SFAS No.

133. The adoption of SFAS No. 155 did not have a material effect on the results of operations or financial position of the Company.

*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. The Company adopted the provisions of FIN 48, which are effective for fiscal years beginning after December 15, 2006, on January 1, 2007. No cumulative effect of a change in accounting principle or adjustment to the liability for unrecognized tax benefits was recognized as a result of the adoption of FIN 48. Accordingly, the adoption of FIN 48 did not have an effect on the results of operations or financial position of the Company.

The liability for net unrecognized tax benefits at January 1, 2007 was $48 million. This liability represents an accrual relating to uncertain income tax positions the Company has taken or expects to take on its tax returns. The liability is net of a recoverable of $11 million related to the settlement of prior years examinations. The Company believes it is reasonably possible that the liability balance will increase by $11 million within the next 12 months due to the expected collection of this recoverable. Due to the impact of deferred tax accounting, recognition of previously unrecognized tax benefits would not be expected to impact the Company s effective tax rate.

The Company recognizes interest accrued related to unrecognized tax benefits in income tax expense. The balance of interest receivable included in the statement of financial position relating to unrecognized tax benefits at January 1, 2007 was $9 million.

The Internal Revenue Service ( IRS ) completed its review of the Company s federal income tax returns through the 2002 tax year and the statute of limitations has expired on those years. The IRS is currently examining the Company s federal income tax returns for the 2003 and 2004 tax years.

*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 )*

SFAS No. 158 requires recognition in the statements of financial position of the over or underfunded status of defined pension and other postretirement plans, measured as the difference between the fair value of plan assets and the projected benefit obligation ( PBO ) for the pension plans and the accumulated postretirement benefit obligation ( APBO ) for other postretirement benefit plans. This effectively requires the recognition of all previously unrecognized actuarial gains and losses and prior service cost as a component of accumulated other comprehensive income, net of tax. In addition, SFAS No. 158 requires: 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 net of tax as components of net periodic benefit cost be recognized as a component of other comprehensive income; that the measurement date of the plans be the same as the statements of financial position; and that disclosure in the notes to the financial statements include the anticipated impact on the net periodic benefit cost of actuarial gains and losses and the prior service costs and credits previously deferred and recognized net of tax as a component of other comprehensive income. 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. The impact of adoption, including the inter-related impact on the minimum pension liability, resulted in a decrease in shareholders equity of $1.11 billion at December 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 is intended to eliminate the potential for the build up of improper amounts on the balance sheet due to the limitations of certain methods of materiality assessment utilized in current practice. 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 income. 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 did not have any effect on its results of operations or financial position.

*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.

*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. The effect of the transition calculation was not material.

**Pending accounting standards**

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

In September 2006, the FASB issued SFAS No. 157 which redefines 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. 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 methods 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. 159, The Fair Value Option for Financial Assets and Financial Liabilities (  SFAS No. 159  )*

In February 2007, the FASB issued SFAS No. 159 which provides reporting entities an option to report selected financial assets, including investment securities designated as available for sale, and liabilities, including most insurance contracts, at fair value. SFAS No. 159 establishes presentation and disclosure requirements designed to facilitate comparisons between companies that choose different measurement attributes for similar types of assets and liabilities. The standard also requires additional information to aid financial statement users  understanding of a reporting entity s choice to use fair value on its earnings and also requires entities to display on the face of the balance sheet the fair value of those assets and liabilities for which the reporting entity has chosen to measure at fair value. SFAS No. 159 is effective as of the beginning of a reporting entity s first fiscal year beginning after November 15, 2007. Early adoption is permitted as of the beginning of the previous fiscal year provided the entity makes that choice in the first 120 days of that fiscal year and also elects to apply the provisions of SFAS No. 157. Because application of the standard is optional, any impacts are limited to those financial assets and liabilities to which SFAS No. 159 would be applied, which have yet to be determined.

## 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 March 31, 2007 | 2006 |
|---|---|---|
| Numerator: | | |
| Net income | $ 1,495 | $ 1,415 |
| Denominator: | | |
| Weighted average common shares outstanding | 616.8 | 643.2 |
| Effect of potential dilutive securities: | | |
| Stock options | 3.2 | 3.1 |
| Unvested restricted stock units | 1.6 | 1.1 |
| Weighted average common and dilutive potential common shares outstanding | 621.6 | 647.4 |
| Earnings per share Basic: | $ 2.42 | $ 2.20 |
| Earnings per share Diluted: | $ 2.41 | $ 2.19 |

Options to purchase 4.1 million and 4.0 million Allstate common shares, with exercise prices ranging from $52.23 to $65.38 and $50.79 to $61.90, were outstanding at March 31, 2007 and 2006, respectively, but were not included in the computation of diluted earnings per share for the three-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 $60 million and $36 million for the three months ended March 31, 2007 and 2006, respectively.

Liabilities for collateral received in conjunction with the Company s securities lending and other business activities and for funds received from the Company s security repurchase business 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 activities resulting from management of the proceeds, which for the three months ended March 31 are as follows:

| (in millions) | Three months ended March 31, 2007 | 2006 |
|---|---|---|
| **Net change in proceeds managed** | | |
| Net change in fixed income securities | $ (979) | $ (2) |
| Net change in short-term investments | (490) | (1,400) |
| Operating cash flow used | (1,469) | (1,402) |
| Net change in cash | 2 | |
| Net change in proceeds managed | $ (1,467) | $ (1,402) |
| | | |
| **Net change in liabilities** | | |
| Liabilities for collateral and security repurchase, beginning of year | $ (4,144) | $ (4,102) |
| Liabilities for collateral and security repurchase, end of period | (5,611) | (5,504) |
| Operating cash flow provided | $ 1,467 | $ 1,402 |

## 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 the balance sheet 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 March 31, | |
|---|---|---|
| | **2007** | **2006** |
| Property-liability insurance premiums earned | $ 347 | $ 180 |
| Life and annuity premiums and contract charges | 233 | 161 |

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 March 31, | |
|---|---|---|
| | **2007** | **2006** |
| Property-liability insurance claims and claims expense | $ 104 | $ 337 |
| Life and annuity contract benefits | 146 | 115 |
| Interest credited to contractholder funds | 13 | 1 |

*Variable Annuity Business*

On June 1, 2006, in accordance with the terms of the definitive Master Transaction Agreement and related agreements (collectively the Agreement ) the Company and its subsidiaries, Allstate Life Insurance Company ( ALIC ) and Allstate Life Insurance Company of New York ( ALNY ), completed the disposal through reinsurance of substantially all of Allstate Financial s variable annuity business to Prudential Financial, Inc. and its subsidiary, The Prudential Insurance Company of America (collectively Prudential ). For Allstate, this disposal achieved the economic benefit of transferring to Prudential the future rights and obligations associated with this business.

The disposal was effected through reinsurance agreements (the Reinsurance Agreements ) which include both coinsurance and modified coinsurance provisions. Coinsurance and modified coinsurance provisions are commonly used in the reinsurance of variable annuities because variable annuities generally include both separate account and general account liabilities. When contractholders make a variable annuity deposit, they must choose how to allocate their account balances between a selection of variable-return mutual funds that must be held in a separate account and fixed-return funds held in the Company s general account. In addition, variable annuity contracts include various benefit guarantees that are general account obligations of the Company. The Reinsurance Agreements do not extinguish the Company s primary liability under the variable annuity contracts.

Variable annuity balances invested in variable-return mutual funds are held in separate accounts, which are legally segregated assets and available only to settle separate account contract obligations. Because the separate account assets must remain with the Company under insurance regulations, modified coinsurance is typically used when parties wish to transfer future economic benefits of such business. Under the modified coinsurance provisions, the separate account assets remain on the Company s Condensed Consolidated Statements of Financial Position, but the related results of operations are fully reinsured and presented net of reinsurance on the Condensed Consolidated Statements of Operations.

The coinsurance provisions of the Reinsurance Agreements were used to transfer the future rights and obligations related to fixed return fund options and benefit guarantees. $1.37 billion of assets supporting general account liabilities were transferred to Prudential, net of consideration, under the coinsurance provisions as of the transaction closing date. General account liabilities of $1.41 billion at March 31, 2007 and $1.49 billion as of

December 31, 2006, however, remain on the Condensed Consolidated Statements of Financial Position with a corresponding reinsurance recoverable.

For purposes of presentation in the 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 of $744 million (computed as $1.37 billion of general account liabilities transferred to Prudential on the closing date less consideration of $628 million), the cost of hedging the ceding commission received from Prudential of $69 million, pretax, and the costs of executing the transaction of $13 million, pretax, were classified as a disposition of operations in the cash flows from investing activities section of the Consolidated Statements of Cash Flows.

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 Reinsurance Agreements contain no limits or indemnifications with regard to insurance risk transfer, and transferred all of the future risks and responsibilities for performance on the underlying variable annuity contracts to Prudential, including those related to benefit guarantees, in accordance with the provisions of SFAS No. 113 Accounting and Reporting for Reinsurance of Short-Duration and Long-Duration Contracts .

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 from the effective date of the transaction, 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 $77 million pretax for ALIC, which was deferred as a result of the disposition being executed through reinsurance. The deferred gain is included as a component of other liabilities and accrued expenses on the Consolidated Statements of Financial Position, and is amortized to loss on dispositions of operations on the 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 $9 million pretax. 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 Company s Consolidated Statements of Operations and amounted to $61 million, after-tax during 2006. For the three-month and twelve-month periods ended March 31, 2007 and December 31, 2006, loss on disposition of operations on the Consolidated Statements of Operations included $1 million, after-tax of amortization of ALIC s deferred gain. DAC and 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.

The separate account balances related to the modified coinsurance were $14.91 billion as of March 31, 2007 and $15.07 billion as of December 31, 2006. Separate account balances totaling approximately $1.12 billion as of March 31, 2007 and $1.10 billion at December 31, 2006 relate primarily to the variable life business that is being retained by ALIC and ALNY, and the variable annuity business in three affiliated companies that were not included in the Agreement. In the first quarter of 2006 prior to this disposition, ALIC s and ALNY s variable annuity business generated approximately $75 million in contract charges.

## 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 ($1) million and $107 million for the three months ended March 31, 2007 and 2006, respectively.

The following table illustrates the changes in the restructuring liability during the three months ended March 31, 2007:

| (in millions) | **Employee costs** | **Exit costs** | **Total liability** |
|---|---|---|---|
| Balance at the beginning of the year | $ 20 | $ 2 | $ 22 |
| Expense incurred | 1 | 2 | 3 |
| Adjustments to liability | (8 ) | (1 ) | (9 ) |
| Payments applied against liability | (1 ) | | (1 ) |
| Balance at the end of the period | $ 12 | $ 3 | $ 15 |

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**

The Company is required to participate in assigned risk plans, reinsurance facilities and joint underwriting associations in various states that provide insurance coverage to individuals or entities that otherwise are unable to purchase such coverage from private insurers. Because of the Company s participation, it may be exposed to losses that surpass the capitalization of these facilities and/or to assessments from these facilities.

**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 March 31, 2007, the Company s maximum obligation pursuant to these guarantees, assuming the automobiles have no residual value, would be $17 million at March 31, 2007. The remaining term of each residual value guarantee is equal to the term of the underlying lease that ranges 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 $274 million at March 31, 2007. 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 are 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 March 31, 2007.

**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 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,

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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 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 was denied on November 29, 2006. Plaintiffs had until February 27, 2007 to petition the U.S. Supreme Court to review this case, but failed to do so. 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 the uninsured motorist property damage coverage dispute 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.

There is a nationwide putative class action pending against Allstate that challenges Allstate s use of a vendor s automated database in valuing total loss automobiles. To a large degree, this lawsuit mirrors similar lawsuits filed against other carriers in the industry. Plaintiffs allege that flaws in the database result in valuations to the detriment of insureds. The plaintiffs are seeking actual and punitive damages. The lawsuit is in the early stages of discovery and Allstate is vigorously defending it, but the ultimate outcome is currently uncertain.

The Company has received final 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 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 putative 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. In a putative class action in Louisiana, the trial court judge recently ruled that Allstate s and other carriers flood, water and negligent construction exclusions do not apply to man-made floods (i.e., floods caused by human negligence), and therefore do not apply to flooding in the New Orleans area to the extent it was caused by human negligence in the design, construction and/or maintenance of the levees. Allstate and other insurers have filed a petition for interlocutory appeal with the Fifth Circuit Court of Appeals, which was accepted on February 2, 2007. 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.

Allstate is defending various lawsuits involving worker classification issues. These lawsuits include 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 asked the court to clarify and/or reconsider its memorandum and order and on January 16, 2007, the judge denied their request. On March 21, 2007, the judge entered a memorandum and order tentatively indicating that he intends to dismiss most or all of the claims asserted in the consolidated EEOC I and Romero I litigation. 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 s petitions for interlocutory review of the trial court s summary judgment order were granted. The Company s interlocutory appeal is now pending in the Court of Appeals for the Eighth Circuit. 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. On March 21, 2007, the trial judge entered a memorandum and order tentatively indicating that he intends to dismiss most or all of the claims asserted in this case. In all of these various matters, plaintiffs seek compensatory and punitive damages, and equitable relief. Allstate has been



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vigorously defending these lawsuits and other matters related to its agency program reorganization. The outcome of these disputes 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, the Texas 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 filed a petition for judicial review of the Texas Commissioner s rate refund order with the district court, and also filed and implemented a 5% rate decrease occurring in two stages. On March 8, 2007 the district court affirmed in whole the Texas Commissioner s rate refund order. On April 5, 2007 the Company appealed this judgment of the district court to the Texas Third Court of Appeals.

***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. An area of inquiry includes 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 $1.36 billion and $1.38 billion, net of reinsurance recoverables of $812 million and $823 million at March 31, 2007 and December 31, 2006, respectively. Reserves for environmental claims were $189 million and $194 million, net of reinsurance recoverables of $55 million and $55 million at March 31, 2007 and December 31, 2006, respectively. Approximately 63% and 67% of the total net asbestos and environmental reserves at March 31, 2007 and December 31, 2006, 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 for the three months ended March 31 are as follows:

| (in millions) | **Pension benefits** | | **Postretirement benefits** | |
|---|---|---|---|---|
| | **2007** | **2006** | **2007** | **2006** |
| Service cost | $ 40 | $ 46 | $ 6 | $ 6 |
| Interest cost | 78 | 76 | 16 | 17 |
| Expected return on plan assets | (88 ) | (80 ) | | |
| Amortization of: | | | | |
| Prior service costs | (1 ) | (1 ) | | |
| Net actuarial loss | 29 | 36 | | |
| Settlement loss | 11 | 6 | | |
| Special termination benefit | | | | 3 |
| Net periodic cost | $ 69 | $ 83 | $ 22 | $ 26 |

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**9.** Business Segments

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

| (in millions) | Three months ended March 31, 2007 | 2006 |
|---|---|---|
| **Revenues** | | |
| *Property-Liability* | | |
| Property-liability insurance premiums earned | | |
| Standard auto | $ 4,235 | $ 4,129 |
| Non-standard auto | 344 | 405 |
| Auto | 4,579 | 4,534 |
| Homeowners | 1,580 | 1,644 |
| Other | 647 | 697 |
| Allstate Protection | 6,806 | 6,875 |
| Discontinued Lines and Coverages | | 1 |
| Total property-liability insurance premiums earned | 6,806 | 6,876 |
| Net investment income | 491 | 466 |
| Realized capital gains and losses | 444 | 224 |
| Total Property-Liability | 7,741 | 7,566 |
| | | |
| *Allstate Financial* | | |
| Life and annuity premiums and contract charges | | |
| Traditional life | 74 | 64 |
| Immediate annuities with life contingencies | 77 | 49 |
| Accident and health and other | 91 | 82 |
| Total life and annuity premiums | 242 | 195 |
| Interest-sensitive life | 223 | 207 |
| Fixed annuities | 18 | 17 |
| Variable annuities | | 76 |
| Total contract charges | 241 | 300 |
| Total life and annuity premiums and contract charges | 483 | 495 |
| Net investment income | 1,050 | 1,004 |
| Realized capital gains and losses | 23 | (28 ) |
| Total Allstate Financial | 1,556 | 1,471 |
| | | |
| *Corporate and Other* | | |
| Service fees | 3 | 2 |
| Net investment income | 30 | 41 |
| Realized capital gains and losses | 4 | 3 |
| Total Corporate and Other before reclassification of service fees | 37 | 46 |
| Reclassification of service fees(1) | (3 ) | (2 ) |
| Total Corporate and Other | 34 | 44 |
| Consolidated Revenues | $ 9,331 | $ 9,081 |

(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.

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

| (in millions) | Three months ended March 31, 2007 | 2006 |
|---|---|---|
| **Net income** | | |
| *Property-Liability* | | |
| Underwriting income | | |
| Allstate Protection | $ 1,006 | $ 1,249 |
| Discontinued Lines and Coverages | 40 | (7) |
| Total underwriting income | 1,046 | 1,242 |
| Net investment income | 491 | 466 |
| Income tax expense on operations | (475) | (532) |
| Realized capital gains and losses, after-tax | 287 | 145 |
| Property-Liability net income | 1,349 | 1,321 |
| *Allstate Financial* | | |
| Life and annuity premiums and contract charges | 483 | 495 |
| Net investment income | 1,050 | 1,004 |
| Periodic settlements and accruals on non-hedge derivative financial instruments | 12 | 16 |
| Contract benefits and interest credited to contractholder funds | (1,077) | (996) |
| Operating costs and expenses and amortization of deferred policy acquisition costs | (234) | (287) |
| Restructuring and related charges | | (16) |
| Income tax expense on operations | (78) | (72) |
| Operating income | 156 | 144 |
| Realized capital gains and losses, after-tax | 15 | (18) |
| Deferred policy acquisition costs and deferred sales inducements amortization relating to realized capital gains and losses, after-tax | | 27 |
| Reclassification of periodic settlements and accruals on non-hedge financial instruments, after-tax | (8) | (10) |
| Gain (loss) on disposition of operations, after-tax | 1 | (35) |
| Allstate Financial net income | 164 | 108 |
| *Corporate and Other* | | |
| Service fees (1) | 3 | 2 |
| Net investment income | 30 | 41 |
| Operating costs and expenses | (77) | (82) |
| Restructuring and related charges | | (1) |
| Income tax benefit on operations | 23 | 24 |
| Operating loss | (21) | (16) |
| Realized capital gains and losses, after-tax | 3 | 2 |
| Corporate and Other net loss | (18) | (14) |
| Consolidated net income | $ 1,495 | $ 1,415 |

(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.

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**10. Other Comprehensive Income**

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

| (in millions) | **Three months ended March 31,** | | | | | |
|---|---|---|---|---|---|---|
| | **2007** | | | **2006** | | |
| | **Pretax** | **Tax** | **After-tax** | **Pretax** | **Tax** | **After-tax** |
| Unrealized net holding gains (losses) arising during the period, net of related offsets | $ 434 | $ (152) | $ 282 | $ (619) | $ 217 | $ (402) |
| Less: reclassification adjustment of realized capital gains and losses | 458 | (160) | 298 | 83 | (29) | 54 |
| Unrealized net capital gains and losses | (24) | 8 | (16) | (702) | 246 | (456) |
| Unrealized foreign currency translation adjustments | 3 | (1) | 2 | | | |
| Net funded status of pension and other postretirement benefit obligation | 29 | 12 | 41 | | | |
| Other comprehensive income (loss) | $ 8 | $ 19 | 27 | $ (702) | $ 246 | (456) |
| Net income | | | 1,495 | | | 1,415 |
| Comprehensive income | | | $ 1,522 | | | $ 959 |

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**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 March 31, 2007, and the related condensed consolidated statements of operations and cash flows for the three-month periods ended March 31, 2007 and 2006. 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, 2006, 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 21, 2007, which report includes an explanatory paragraph as to changes in the Company s method of accounting for defined pension and other postretirement plans in 2006, and its method of accounting for certain nontraditional long-duration contracts and separate accounts in 2004, 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, 2006 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
May 1, 2007

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**Item 2. MANAGEMENT S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF** OPERATIONS FOR THE THREE-MONTH PERIODS ENDED MARCH 31, 2007 AND 2006

**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 2006. Analysis of our insurance segments is provided in Property-Liability Operations (which includes the Allstate Protection and the Discontinued Lines and Coverages segments) and in 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 5.7% to $1.50 billion in the first quarter of 2007 from $1.42 billion in the first quarter of 2006. Net income per diluted share increased 10.0% to $2.41 in the first quarter of 2007 from $2.19 in the first quarter of 2006.

- Total revenues increased 2.8% to $9.33 billion in the first quarter of 2007 from $9.08 billion in the first quarter of 2006.

- Book value per diluted share increased 14.3% to $36.54 as of March 31, 2007 from $31.98 as of March 31, 2006 and increased 4.9% from $34.84 as of December 31, 2006.

- For the twelve months ended March 31, 2007, return on the average of beginning and ending period shareholders equity increased 13.8 points to 23.6% from 9.8% for the twelve months ended March 31, 2006.

- Property-Liability premiums earned decreased 1.0% to $6.81 billion in the first quarter of 2007 from $6.88 billion in the first quarter of 2006.

- The Property-Liability combined ratio was 84.6 in the first quarter of 2007 compared to 81.9 in the first quarter of 2006.

- Allstate Financial net income increased 51.9% to $164 million in the first quarter of 2007 from $108 million in the first quarter of 2006.

- Stock repurchases totaled $700 million for the three months ended March 31, 2007.

- The Allstate Board of Directors authorized the issuance of up to $1 billion of junior subordinated securities, that we expect to issue during the second quarter of 2007 (favorable market conditions existing), the proceeds of which will be used to repurchase up to $1 billion of our common stock by March 31, 2008 in addition to the current $3 billion share repurchase program.

**CONSOLIDATED NET INCOME**

| (in millions) | Three Months Ended March 31, 2007 | 2006 |
|---|---|---|
| **Revenues** | | |
| Property-liability insurance premiums earned | $ 6,806 | $ 6,876 |
| Life and annuity premiums and contract charges | 483 | 495 |
| Net investment income | 1,571 | 1,511 |
| Realized capital gains and losses | 471 | 199 |
| Total revenues | 9,331 | 9,081 |
| **Costs and expenses** | | |
| Property-liability insurance claims and claims expense | (4,117) | (3,873) |
| Life and annuity contract benefits | (428) | (373) |
| Interest credited to contractholder funds | (649) | (620) |
| Amortization of deferred policy acquisition costs | (1,153) | (1,139) |
| Operating costs and expenses | (727) | (779) |
| Restructuring and related charges | 1 | (107) |
| Interest expense | (72) | (81) |
| Total costs and expenses | (7,145) | (6,972) |
| Loss on disposition of operations | | (53) |
| Income tax expense | (691) | (641) |
| **Net income** | $ 1,495 | $ 1,415 |
| Property-Liability | $ 1,349 | $ 1,321 |
| Allstate Financial | 164 | 108 |
| Corporate and Other | (18) | (14) |
| Net income | $ 1,495 | $ 1,415 |

**PROPERTY-LIABILITY HIGHLIGHTS**

- Premiums written decreased 1.7% to $6.61 billion in the first quarter of 2007 from $6.73 billion in the first quarter of 2006. Allstate brand standard auto premiums written increased 2.5% to $4.05 billion in the first quarter of 2007 from $3.95 billion in the first quarter of 2006. Allstate brand homeowners premiums written decreased 5.8% to $1.21 billion in the first quarter of 2007 from $1.29 billion in the first quarter of 2006. Premiums written is an operating measure that is defined and reconciled to premiums earned on page 26.

- The impact of the cost of the catastrophe reinsurance program on premiums written totaled $216 million in the first quarter of 2007 compared to $73 million in the first quarter of 2006. Excluding this cost, premiums written grew 0.4% in the first quarter of 2007 when compared to the same period in 2006.

- Premium operating measures and statistics contributing to the overall Allstate brand standard auto premiums written growth were the following:

- 2.6% increase in policies in force ( PIF )
- 7.3% increase in new issued applications
- 0.2 point decline in the renewal ratio to 89.7%
- 0.2% increase in six month average premium to $420

- Premium operating measures and statistics contributing to the overall Allstate brand homeowners premiums written decline were the following:

- 0.5% decrease in PIF

- 11.8% decrease in new issued applications

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- 0.6 point decline in the renewal ratio to 86.4%

- 1.9% increase in twelve month average premium to $847

- Standard auto property damage gross claim frequency (rate of claim occurrence) increased 4.8% in the first quarter of 2007 from the same period of 2006, while bodily injury gross claim frequency decreased 1.1% in the first quarter of 2007 from the same period of 2006. Auto property damage and bodily injury paid severities (average cost per claim) increased 1.2% and 1.1%, respectively, in the first quarter of 2007 from the same periods of 2006. The Allstate brand standard auto loss ratio increased 5.6 points to 63.6 in the first quarter of 2007 from 58.0 in the first quarter of 2006.

- Homeowner gross claim frequency excluding catastrophes increased 14.7% in the first quarter of 2007 from the same period of 2006. Homeowners paid severity increased 8.6% in the first quarter of 2007 from the same period of 2006. The Allstate brand homeowners loss ratio increased 3.4 points to 55.2 in the first quarter of 2007 from 51.8 in the first quarter of 2006.

- Prior year favorable reserve reestimates in the first quarter of 2007 totaled $129 million compared to $211 million in the first quarter of 2006.

- Catastrophe losses in the first quarter of 2007 totaled $161 million compared to $107 million in the same period of 2006.

- Underwriting income for Property-Liability was $1.05 billion in the first quarter of 2007 compared to $1.24 billion in the first quarter of 2006. Underwriting income, a measure that is not based on generally accepted accounting principles ( GAAP ), is defined below.

**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 25, 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. Net income is the GAAP measure most directly comparable to underwriting income (loss). Underwriting income (loss) should not be considered as a substitute for net income and does not reflect the overall profitability of the business.

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.

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. This ratio includes prior year reserve reestimates.

- Effect of prior year reserve reestimates on combined ratio the percentage of prior year reserve reestimates included in claims and claims expense to premiums earned. This ratio includes prior year reserve reestimates of catastrophe losses.

• 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 March 31, 2007 | 2006 |
|---|---|---|
| Premiums written | $ 6,609 | $ 6,725 |
| **Revenues** | | |
| Premiums earned | $ 6,806 | $ 6,876 |
| Net investment income | 491 | 466 |
| Realized capital gains and losses | 444 | 224 |
| Total revenues | 7,741 | 7,566 |
| **Costs and expenses** | | |
| Claims and claims expense | (4,117) | (3,873) |
| Amortization of DAC | (1,024) | (1,019) |
| Operating costs and expenses | (620) | (652) |
| Restructuring and related charges | 1 | (90) |
| Total costs and expenses | (5,760) | (5,634) |
| Income tax expense | (632) | (611) |
| **Net income** | $ 1,349 | $ 1,321 |
| **Underwriting income** | $ 1,046 | $ 1,242 |
| Net investment income | 491 | 466 |
| Income tax expense on operations | (475) | (532) |
| Realized capital gains and losses, after-tax | 287 | 145 |
| **Net income** | $ 1,349 | $ 1,321 |
| Catastrophe losses | $ 161 | $ 107 |
| **GAAP operating ratios** | | |
| Claims and claims expense ratio | 60.5 | 56.3 |
| Expense ratio(2) | 24.1 | 25.6 |
| Combined ratio | 84.6 | 81.9 |
| Effect of catastrophe losses on combined ratio(1) | 2.4 | 1.6 |
| Effect of prior year reserve reestimates on combined ratio(1) | (1.9) | (3.1) |
| Effect of restructuring and related charges on combined ratio | | 1.3 |
| Effect of Discontinued Lines and Coverages on combined ratio | (0.6) | 0.1 |

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(1) Favorable reserves reestimates included in catastrophe losses totaled $6 million and $64 million in the three months ended March 31, 2007 and March 31, 2006, respectively.

(2) The effect of premiums ceded for catastrophe reinsurance programs on the expense ratio totaled 0.7 points and 0.3 points, respectively, in the first quarter of 2007 and 2006.

OR

**Premiums written**, an operating measure, is the amount of premiums charged for policies issued during a fiscal period. Premiums earned is a GAAP measure. Premiums are considered earned and are included in the financial results on a pro-rata basis over the policy period. The portion of premiums written applicable to the unexpired terms of the policies is recorded as unearned premiums on our Consolidated Statements of Financial Position.

A reconciliation of premiums written to premiums earned is presented in the following table.

| (in millions) | Three Months Ended March 31, 2007 | 2006 |
|---|---|---|
| **Premiums written:** | | |
| Allstate Protection | $ 6,609 | $ 6,725 |
| Discontinued Lines and Coverages | | |
| Property-Liability premiums written | 6,609 | 6,725 |
| Decrease (Increase) in unearned premiums | 203 | (13 ) |
| Other (1) | (6 ) | 164 |
| Property-Liability premiums earned | $ 6,806 | $ 6,876 |
| | | |
| **Premiums earned:** | | |
| Allstate Protection | $ 6,806 | $ 6,875 |
| Discontinued Lines and Coverages | | 1 |
| Property-Liability | $ 6,806 | $ 6,876 |

(1) Three months ended March 31, 2006, includes the transfer at January 1, 2006 of $152 million to Property-Liability unearned premiums related to the loan protection business previously managed by Allstate Financial.

**ALLSTATE PROTECTION SEGMENT**

Premiums written by brand for the three months ended March 31, are shown in the following table.

| | Allstate brand | | Encompass brand | | Total Allstate Protection | |
|---|---|---|---|---|---|---|
| **(in millions)** | **2007** | **2006** | **2007** | **2006** | **2007** | **2006** |
| Standard auto | $ 4,051 | $ 3,952 | $ 266 | $ 273 | $ 4,317 | $ 4,225 |
| Non-standard auto | 321 | 375 | 21 | 25 | 342 | 400 |
| Auto | 4,372 | 4,327 | 287 | 298 | 4,659 | 4,625 |
| Homeowners | 1,213 | 1,288 | 123 | 139 | 1,336 | 1,427 |
| Other personal lines(1) | 581 | 637 | 33 | 36 | 614 | 673 |
| Total | $ 6,166 | $ 6,252 | $ 443 | $ 473 | $ 6,609 | $ 6,725 |

(1) Other personal lines include involuntary auto, commercial lines, condominium, renters and other personal lines.

Premiums earned by brand for the three months ended March 31, are shown in the following table.

| | Allstate brand | | Encompass brand | | Total Allstate Protection | |
|---|---|---|---|---|---|---|
| **(in millions)** | **2007** | **2006** | **2007** | **2006** | **2007** | **2006** |
| Standard auto | $ 3,951 | $ 3,838 | $ 284 | $ 291 | $ 4,235 | $ 4,129 |
| Non-standard auto | 322 | 378 | 22 | 27 | 344 | 405 |
| Auto | 4,273 | 4,216 | 306 | 318 | 4,579 | 4,534 |
| Homeowners | 1,438 | 1,491 | 142 | 153 | 1,580 | 1,644 |
| Other personal lines | 611 | 656 | 36 | 41 | 647 | 697 |
| Total | $ 6,322 | $ 6,363 | $ 484 | $ 512 | $ 6,806 | $ 6,875 |

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Premium operating measures and statistics that are used to analyze the business are calculated and described below. Measures and statistics presented for Allstate brand exclude Allstate Canada and specialty auto.

- New issued applications: Item counts of automobiles or homeowners insurance applications for insurance policies that were issued during the period. Does not include automobiles that are added by existing customers.

- Renewal ratio: Renewal policies issued during the period, based on contract effective dates, divided by the total policies issued 6 months prior for auto (12 months prior for Encompass brand standard auto) or 12 months prior for homeowners.

- PIF: Policy counts are based on items rather than customers. A multi-car customer would generate multiple item (policy) counts, even if all cars were insured under one legal policy.

- Average premium - gross written: Gross premiums written divided by issued item count. Gross premiums written do not include the impacts from mid-term premium adjustments, ceded reinsurance premiums, or premium refund accruals. Allstate brand average premiums represent the appropriate policy term for each line, which is 6 months for auto and 12 months for homeowners. Encompass brand average premiums represent the appropriate policy term for each line, which is 12 months for standard auto and homeowners and 6 months for non-standard auto.

Allstate Protection continues to pursue our strategy to manage our property catastrophe exposure to provide our shareholders an acceptable return on the risks assumed in our property business and to reduce the variability of our earnings, while providing protection to our customers. Our strategy includes purchasing reinsurance in areas that have known exposure to hurricanes, earthquakes, fires following earthquakes and other catastrophes.

We continue to aggressively seek to cover our reinsurance cost in premium rates. Rates currently effective related to our reinsurance programs reflect approximately 45% of the ceded cost of our reinsurance programs, and will be included in premiums written during 2007. We expect rates will be in effect which will reflect over 50% of the ceded cost of our reinsurance programs by the end of 2007, and be included in premiums written during 2008.

*Standard auto premiums written* increased 2.2% to $4.32 billion in the first quarter of 2007 from $4.23 billion in the same period of 2006.

| Standard Auto | **Allstate brand** | | **Encompass brand** | |
|---|---|---|---|---|
| **Three Months Ended March 31,** | **2007** | **2006** | **2007** | **2006** |
| PIF (thousands) | 18,190 | 17,731 | 1,114 | 1,145 |
| Average premium- gross written (1) | $ 420 | $ 419 | $ 975 | $ 983 |
| Renewal ratio (%)(1) | 89.7 | 89.9 | 75.4 | 77.5 |

(1) Policy term is six months for Allstate brand and twelve months for Encompass brand.

Allstate brand standard auto premiums written increased 2.5% to $4.05 billion in the first quarter of 2007 from $3.95 billion in the first quarter of 2006 due to increases in PIF. The 2.6% increase in Allstate brand standard auto PIF as of March 31, 2007 as compared to March 31, 2006 was primarily the result of growth in policies available for renewal and new issued applications.

Allstate brand standard auto new issued applications are shown in the table below.

| (in thousands) | Three Months Ended March 31 | | % |
|---|---|---|---|
| | **2007** | **2006** | **Change** |
| **Allstate brand standard auto** | | | |
| Hurricane exposure states(1) | 269 | 255 | 5.5 |
| California | 86 | 81 | 6.2 |
| All other states | 171 | 154 | 11.0 |
| Total new issued applications | 526 | 490 | 7.3 |

(1) Hurricane exposure states are Alabama, Connecticut, Delaware, Florida, Georgia, Louisiana, Maine, Maryland, Mississippi, New Hampshire, New Jersey, New York, North Carolina, Pennsylvania, Rhode Island, South Carolina, Texas and Virginia and Washington, D.C.

Allstate brand standard auto average premium increased 0.2% in the first quarter of 2007 compared to the same period of 2006. Standard auto average premium is impacted by rate changes, geographic and product shifts in the mix of business and changes in customer preferences. The Allstate brand standard auto renewal ratio declined 0.2 points in the first quarter of 2007 compared to the same period of 2006 due to competitive pressures.

Encompass brand standard auto premiums written decreased 2.6% to $266 million in the first quarter of 2007 from $273 million in the same period of 2006 due to declines in PIF and average premium. The 2.7% decline in Encompass brand standard auto PIF as of March 31, 2007 as compared to March 31, 2006 was due to a decline in the policies available to renew more than offsetting new business production. The 12 month average premium decreased 0.8% in the first quarter of 2007 compared to the same period of 2006 due to a change in the mix of business to policies with basic coverages and less features resulting in lower average premium.

Rate increases that are indicated based on loss trend analysis to achieve a targeted return will continue to be pursued in all locations. The following table shows the net rate changes that were approved for standard auto during the three months ended March 31, 2007 and 2006. These rate changes do not reflect initial rates filed for insurance subsidiaries initially writing new business in a state.

| | **# of States** | | **Countrywide(%)(1)** | | **State Specific(%)(2)** | |
|---|---|---|---|---|---|---|
| | **2007** | **2006** | **2007** | **2006** | **2007** | **2006** |
| Allstate brand | 9 | 4 | 0.4 | 0.1 | 2.8 | 2.3 |
| Encompass brand | 2 | 2 | 0.2 | | 5.9 | 5.3 |

(1) Represents the impact in the states where rate changes were approved during 2007 and 2006 as a percentage of total countrywide prior year-end premiums written.

(2) Represents the impact in the states where rate changes were approved during 2007 and 2006 as a percentage of total prior year-end premiums written in those states.

*Non-s*tandard auto premiums written decreased 14.5% to $342 million in the first quarter of 2007 from $400 million in the same period of 2006.

| Non-Standard Auto | **Allstate brand** | | **Encompass brand** | |
|---|---|---|---|---|
| **Three Months Ended March 31,** | **2007** | **2006** | **2007** | **2006** |
| PIF (thousands) | 921 | 1,086 | 82 | 95 |
| Average premium- gross written (six months) | $ 613 | $ 620 | $ 522 | $ 540 |
| Renewal ratio (%) | 76.7 | 75.9 | 65.8 | 66.0 |

Allstate brand non-standard auto premiums written decreased 14.4% to $321 million in the first quarter of 2007 from $375 million in the same period of 2006 due to declines in PIF and average premium. Our Allstate brand non-standard growth strategy includes our new Allstate BlueSM product which is targeted toward consumers who prefer a

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recognized brand of insurance and generally have a long term relationship with their insurer. Allstate Blue has been launched in three states as of March 31, 2007 and one state in April 2007.

PIF decreased 15.2% as of March 31, 2007 compared to March 31, 2006 due to new business production insufficient to offset the inherently low renewal ratio in this business. The decline of 1.1% in average premium during the first quarter of 2007 compared to the same period of 2006 is due to the impact of prior year rate decreases and a shift in the geographic mix of business.

Encompass brand non-standard auto premiums written decreased 16.0% to $21 million in the first quarter of 2007 from $25 million in the same period of 2006, primarily due to declines in PIF and average premium.

Rate increases that are indicated based on loss trend analysis to achieve a targeted return will continue to be pursued in all locations. The following table shows the net rate changes that were approved for non-standard auto during the three months ended March 31, 2007 and 2006. These rate changes do not reflect initial rates filed for insurance subsidiaries initially writing new business in a state.

| | **# of States** | | **Countrywide(%)(1)** | | **State Specific(%)(2)** | |
|---|---|---|---|---|---|---|
| | **2007** | **2006** | **2007** | **2006** | **2007** | **2006** |
| Allstate brand | 4 | | 1.2 | | 8.0 | |
| Encompass brand | | | | | | |

(1) Represents the impact in the states where rate changes were approved during 2007 and 2006 as a percentage of total countrywide prior year-end premiums written.

(2) Represents the impact in the states where rate changes were approved during 2007 and 2006 as a percentage of total prior year-end premiums written in those states.

*Auto premiums written (standard and non-standard)* increased 0.7% to $4.66 billion in the first quarter of 2007 from $4.63 billion in the same period of 2006.

| Auto | **Allstate brand** | | **Encompass brand** | |
|---|---|---|---|---|
| **Three Months Ended March 31,** | **2007** | **2006** | **2007** | **2006** |
| PIF (thousands) | 19,111 | 18,817 | 1,196 | 1,240 |
| Average premium- gross written | $ 430 | $ 432 | $ 917 | $ 922 |
| Renewal ratio (%) | 89.0 | 89.0 | 74.1 | 75.8 |

Allstate brand auto premiums written increased 1.0% to $4.37 billion in the first quarter of 2007 from $4.33 billion in the same period of 2006 due to increases in PIF, partially offset by a decline in average premium. The 1.6% increase in Allstate brand auto PIF as of March 31, 2007 as compared to March 31, 2006 was the result of growth in policies available for renewal and new issued applications. The decline of 0.5% in Allstate brand auto average premium during the first quarter of 2007 compared to the same period of 2006 was the result of declines in non-standard average premium partly offset by increases in Allstate brand standard auto average premium.

Encompass brand auto premiums written decreased 3.7% to $287 million in the first quarter of 2007 from $298 million in the same period of 2006 due to declines in PIF and average premium. The 3.5% decline in Encompass brand auto PIF as of March 31, 2007 compared to March 31, 2006 was due to a decline in policies available for renewal more than offsetting new business production. Average premium (12 month for standard auto and six-month for non-standard) decreased 0.5% in the first quarter of 2007 compared to the same period of 2006 primarily due to a change in the mix of business to policies with basic coverages and less features resulting in lower average premium.

Rate increases that are indicated based on loss trend analysis to achieve a targeted return will continue to be pursued in all locations. The following table shows the net rate changes that were approved for auto during the three months ended March 31, 2007 and 2006. These rate changes do not reflect initial rates filed for insurance subsidiaries initially writing new business in a state.

| | **# of States** | | **Countrywide(%)(1)** | | **State Specific(%)(2)** | |
|---|---|---|---|---|---|---|
| | **2007** | **2006** | **2007** | **2006** | **2007** | **2006** |
| Allstate brand | 11 | 4 | 0.4 | 0.1 | 3.3 | 2.3 |
| Encompass brand | 2 | 2 | 0.2 | | 5.9 | 5.3 |

(1) Represents the impact in the states where rate changes were approved during 2007 and 2006 as a percentage of total countrywide prior year-end premiums written.

(2) Represents the impact in the states where rate changes were approved during 2007 and 2006 as a percentage of total prior year-end premiums written in those states.

*Homeowners premiums written* decreased 6.4% to $1.34 billion in the first quarter of 2007 from $1.43 billion in the same period of 2006. Excluding the cost of catastrophe reinsurance, premiums written grew 2.0% in the first quarter of 2007 compared to the same period in 2006.

| Homeowners | **Allstate brand** | | **Encompass brand** | |
|---|---|---|---|---|
| **Three Months Ended March 31,** | **2007** | **2006** | **2007** | **2006** |
| PIF (thousands) | 7,801 | 7,843 | 518 | 544 |
| Average premium-gross written (12 months) | $ 847 | $ 831 | $ 1,170 | $ 1,131 |
| Renewal ratio (%) | 86.4 | 87.0 | 80.9 | 86.6 |

Allstate brand homeowners premiums written declined 5.8% to $1.21 billion in the first quarter of 2007 compared to the same period in 2006 due to increases in ceded reinsurance premiums and a 0.5% decline in PIF, partially offset by increases in average premium, reflecting increases to recover the cost of reinsurance. Catastrophe management actions have had an impact on our new business writings for homeowners insurance, as demonstrated by the decline in Allstate brand homeowners new issued applications in the following table.

| (in thousands) | **Three Months Ended March 31** | | **%** |
|---|---|---|---|
| | **2007** | **2006** | **Change** |
| **Allstate brand homeowners** | | | |
| Hurricane exposure states(1) | 97 | 114 | (14.9 ) |
| California | 11 | 16 | (31.3 ) |
| All other states | 101 | 107 | (5.6 ) |
| Total new issued applications | 209 | 237 | (11.8 ) |

(1) Hurricane exposure states are Alabama, Connecticut, Delaware, Florida, Georgia, Louisiana, Maine, Maryland, Mississippi, New Hampshire, New Jersey, New York, North Carolina, Pennsylvania, Rhode Island, South Carolina, Texas, Virginia and Washington D.C.

PIF and renewal ratio will continue to decline due to actions such as our decision to discontinue offering coverage by Allstate Floridian Insurance Company and its subsidiaries ( Allstate Floridian ) on approximately 120,000 property policies, as part of a renewal rights and reinsurance arrangement with Royal Palm Insurance Company ( Royal Palm ) entered into in 2006 ( Royal Palm 1 ), and an additional 106,000 property policies under a renewal rights agreement in anticipation of entering into a reinsurance agreement with Royal Palm ( Royal Palm 2 ). Allstate Floridian plans to no longer offer coverage on the policies involved in Royal Palm 1 and Royal Palm 2, at which time Royal Palm may offer coverage to these policyholders. The policies involved in Royal Palm 1 and Royal Palm 2 expired at the rate of 4% in the fourth quarter of 2006 and 5% in the first quarter of 2007 and are

expected to expire at a rate of 27% in the second quarter of 2007, 27% in the third quarter of 2007, 22% in the fourth quarter of 2007, 14% in the first quarter of 2008 and 1% in the second quarter of 2008.

The Allstate brand homeowners average premium increased 1.9% in the first quarter of 2007 compared to the first quarter of 2006 primarily due to higher average renewal premiums related to increases in insured value and rate changes approved including our net cost of reinsurance. The Allstate brand homeowners renewal ratio declined 0.6 points as of March 31, 2007 compared to March 31, 2006 primarily due to our catastrophe management actions.

Encompass brand homeowners premiums written decreased 11.5% to $123 million in the first quarter of 2007 from $139 million in the same period of 2006 due to increases in ceded reinsurance and declines in PIF, partially offset by increases in average premium. The 4.7% decline in Encompass brand homeowners PIF as of March 31, 2007 compared to March 31, 2006 was partially due to a 5.7 point decline in the renewal ratio primarily due to our catastrophe management actions in certain markets. The 12 month average premium increased 3.4% in the first quarter of 2007 compared to the same period of 2006, due to rate actions taken during the current and prior year and increases in insured value.

We continue to pursue rate changes for homeowners in all locations when indicated. The following table shows the net rate changes that were approved for homeowners during the three months ended March 31, 2007 and 2006, including rate changes approved based on our net cost of reinsurance.

| | **# of States** | | **Countrywide(%)(1)** | | **State Specific(%)(2)** | |
|---|---|---|---|---|---|---|
| | **2007** | **2006** | **2007** | **2006** | **2007** | **2006** |
| Allstate brand | 4 | 4 | 1.6 | 0.3 | 9.0 | 7.7 |
| Encompass brand | 5 | 4 | 2.2 | 0.1 | 7.2 | 4.7 |

(1) Represents the impact in the states where rate changes were approved during 2007 and 2006 as a percentage of total countrywide prior year-end premiums written.

(2) Represents the impact in the states where rate changes were approved during 2007 and 2006 as a percentage of total prior year-end premiums written in those states.

**Underwriting results** are shown in the following table.

| **(in millions)** | **Three Months Ended March 31, 2007** | **2006** |
|---|---|---|
| Premiums written | $ 6,609 | $ 6,725 |
| Premiums earned | $ 6,806 | $ 6,875 |
| Claims and claims expense | (4,159) | (3,868) |
| Amortization of DAC | (1,024) | (1,019) |
| Other costs and expenses | (618) | (649) |
| Restructuring and related charges | 1 | (90) |
| Underwriting income | $ 1,006 | $ 1,249 |
| Catastrophe losses | $ 161 | $ 107 |
| | | |
| **Underwriting income by brand** | | |
| Allstate brand | $ 942 | $ 1,210 |
| Encompass brand | 64 | 39 |
| Underwriting income | $ 1,006 | $ 1,249 |

Allstate Protection s underwriting income was $1.01 billion during the first quarter of 2007 compared to $1.25 billion in the same period of 2006. The decrease was due to the higher cost of the expanded catastrophe reinsurance program, higher catastrophe losses, increases in auto and homeowners claim frequency and severity excluding catastrophes and lower favorable reserve reestimates related to prior years, partially offset by increased premiums earned before the cost of the catastrophe reinsurance program, lower restructuring and related charges and lower operating costs and expenses.

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Higher claim frequencies were the result of increases in property damage frequencies, partially due to weather-related events across the central and northeastern sections of the country.

Loss ratios are a measure of profitability. Loss ratios by product, and expense and combined ratios by brand, are shown in the following table for the three months ended March 31. These ratios are defined on page 24.

| | | | Effect of Catastrophe Losses on the Loss Ratio | |
|---|---|---|---|---|
| | 2007 | 2006 | 2007 | 2006 |
| **Allstate brand loss ratio:** | | | | |
| Standard auto | 63.6 | 58.0 | 0.3 | |
| Non-standard auto | 60.3 | 58.7 | | (0.3 ) |
| Auto | 63.4 | 58.1 | 0.3 | |
| Homeowners | 55.2 | 51.8 | 8.3 | 7.2 |
| Other | 60.1 | 48.6 | 3.6 | (2.3 ) |
| **Total Allstate brand loss ratio** | 61.2 | 55.7 | 2.4 | 1.4 |
| **Allstate brand expense ratio** | 23.9 | 25.3 | | |
| **Allstate brand combined ratio** | 85.1 | 81.0 | | |
| **Encompass brand loss ratio:** | | | | |
| Standard auto | 64.8 | 65.3 | 0.4 | 0.3 |
| Non-standard auto | 77.3 | 74.1 | | |
| Auto | 65.7 | 66.0 | 0.3 | 0.3 |
| Homeowners | 49.3 | 56.2 | 4.9 | 9.2 |
| Other | 52.8 | 75.6 | 2.8 | 4.9 |
| **Total Encompass brand loss ratio** | 59.9 | 63.9 | 1.9 | 3.3 |
| **Encompass brand expense ratio** | 26.9 | 28.7 | | |
| **Encompass brand combined ratio** | 86.8 | 92.6 | | |
| **Total Allstate Protection loss ratio** | 61.1 | 56.2 | 2.4 | 1.6 |
| **Allstate Protection expense ratio** | 24.1 | 25.6 | | |
| **Allstate Protection combined ratio** | 85.2 | 81.8 | | |

*Standard auto loss ratio* increased 5.6 points for the Allstate brand in the first quarter of 2007 when compared to the same period of 2006 due to lower favorable reserve reestimates related to prior years, higher claim frequency and claim severity excluding catastrophes, and increased catastrophes, partially offset by higher premiums earned in the Allstate brand. The Encompass brand standard auto loss ratio decreased 0.5 points in the first quarter of 2007 when compared to the same period of 2006.

*Non-standard auto loss ratio* increased 1.6 points for the Allstate brand and 3.2 points for the Encompass brand in the first quarter of 2007 when compared to the same period of 2006 due to higher claim frequency and claim severity excluding catastrophes and lower premiums earned.

*Auto loss ratio* increased 5.3 points for the Allstate brand in the first quarter of 2007 when compared to the same period of 2006 due to lower favorable reserve reestimates related to prior years, higher claim frequency and claim severity excluding catastrophes, and increased catastrophes, partially offset by higher premiums earned. The Encompass brand auto loss ratio decreased 0.3 points in the first quarter of 2007 when compared to the same period of 2006.

*Homeowners loss ratio* increased 3.4 points for the Allstate brand in the first quarter of 2007 when compared to the same period of 2006 due to lower favorable reserve reestimates related to prior years, lower premiums earned, higher claim frequency and claim severity excluding catastrophes, and increased catastrophes. The Encompass brand homeowners

loss ratio decreased 6.9 points in the first quarter of 2007 when compared to the same period of 2006 due to lower catastrophes partially offset by higher claim frequency excluding catastrophes and lower premiums earned.

*Expense ratio* for Allstate Protection decreased 1.5 points in the first quarter of 2007 when compared to the same period of 2006 primarily due to lower restructuring charges.

The impact of specific costs and expenses on the expense ratio for the three months ended March 31, is included in the following table.

| | Allstate brand | | Encompass brand | | Allstate Protection | |
|---|---|---|---|---|---|---|
| | 2007 | 2006 | 2007 | 2006 | 2007 | 2006 |
| Amortization of DAC | 14.7 | 14.4 | 19.8 | 19.6 | 15.0 | 14.8 |
| Other costs and expenses | 9.2 | 9.5 | 7.1 | 8.7 | 9.1 | 9.5 |
| Restructuring and related charges | | 1.4 | | 0.4 | | 1.3 |
| Total expense ratio | 23.9 | 25.3 | 26.9 | 28.7 | 24.1 | 25.6 |

**Reserve reestimates**

The table below shows net reserves representing the estimated cost of outstanding claims as they were recorded at the beginning of years 2007 and 2006, and the effect of reestimates in each year.

| (in millions) | 2007 | | | 2006 | | |
|---|---|---|---|---|---|---|
| | Jan 1 Reserves | Reserve Reestimate | Effect on Combined Ratio | Jan 1 Reserves | Reserve Reestimate | Effect on Combined Ratio |
| Auto | $ 9,995 | $ (66) | (1.0) | $ 10,460 | $ (163) | (2.4) |
| Homeowners | 2,226 | (3) | | 3,675 | (30) | (0.4) |
| Other lines | 2,235 | (18) | (0.3) | 2,619 | (24) | (0.4) |
| Total Allstate Protection | $ 14,456 | $ (87) | (1.3) | $ 16,754 | $ (217) | (3.2) |
| | | | | | | |
| Allstate brand | $ 13,220 | $ (79) | (1.2) | $ 15,423 | $ (220) | (3.2) |
| Encompass brand | 1,236 | (8) | (0.1) | 1,331 | 3 | |
| Total Allstate Protection | $ 14,456 | $ (87) | (1.3) | $ 16,754 | $ (217) | (3.2) |

Favorable prior year reserve reestimates for the first quarter of 2007 resulted primarily from auto claim severity development that was better than anticipated in previous estimates.

**DISCONTINUED LINES AND COVERAGES SEGMENT**

The Discontinued Lines and Coverages segment includes results from insurance coverage that we no longer write and results for certain commercial and other businesses in run-off. Our exposure to asbestos, environmental and other discontinued lines claims is reported in this segment. We have assigned management of this segment to a designated group of professionals with expertise in claims handling, policy coverage interpretation and exposure identification. As part of its responsibilities, this group is also regularly engaged in policy buybacks, settlements and reinsurance assumed and ceded commutations.

Summarized underwriting results are presented in the following table.

| | Three Months Ended March 31, | |
|---|---|---|
| (in millions) | 2007 | 2006 |
| Premiums written | $ | $ |
| | | |
| Premiums earned | $ | $ 1 |
| Claims and claims expense | 42 | (5) |
| Other costs and expenses | (2) | (3) |
| Underwriting income (loss) | $ 40 | $ (7) |

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Three months ended March 31, 2007 includes a $46 million reduction in the reinsurance recoverable valuation allowance related to Equitas Limited s improved financial position as a result of its reinsurance coverage with National Indemnity Company. The allowance for uncollectible reinsurance was $189 million and $235 million at March 31, 2007 and December 31, 2006, respectively. These amounts represent 16.8% and 20.5%, respectively, of the related reinsurance recoverable balances. Reserve reestimates are recorded in the reporting period in which they are determined. We conduct an annual ground-up review in the third quarter of each year to evaluate and establish asbestos, environmental and other discontinued lines reserves.

**PROPERTY-LIABILITY INVESTMENT RESULTS**

**Net investment income** increased 5.4% in the first quarter of 2007 when compared to the same period of 2006. The increase was due to a higher fixed income portfolio balance and fixed income portfolio yield.

**Net realized capital gains and losses, after-tax** are presented in the following table.

| | **Three Months Ended March 31,** | |
|---|---|---|
| **(in millions)** | **2007** | **2006** |
| Investment write-downs | $ (4) | $ (4) |
| Dispositions | 411 | 194 |
| Valuation of derivative instruments | 8 | 32 |
| Settlements of derivative instruments | 29 | 2 |
| Realized capital gains and losses, pretax | 444 | 224 |
| Income tax expense | (157) | (79) |
| Realized capital gains and losses, after-tax | $ 287 | $ 145 |

For a further discussion of net realized capital gains and losses, see the Investments section of the MD&A.

**ALLSTATE FINANCIAL HIGHLIGHTS**

- Net income increased 51.9% to $164 million in the first quarter of 2007 from $108 million in the same period in 2006.
- Allstate Financial gross margin declined 9.6% to $478 million in the first quarter of 2007 from $529 million in the same period in 2006.
- Contractholder fund deposits totaled $2.45 billion for the first quarter of 2007 compared to $2.20 billion for the first quarter of 2006.
- Investments as of March 31, 2007 increased 3.2% from March 31, 2006 and net investment income increased 4.6% in the first quarter of 2007 compared to the same period in the prior year.

• Effective June 1, 2006, Allstate Financial disposed of substantially all of its variable annuity business through reinsurance. The following table presents the results of operations attributable to our variable annuity business for the period of 2006 prior to the disposition.

| (in millions) | Three Months Ended March 31, 2006 | Three Months Ended June 30, 2006 | Six Months Ended June 30, 2006 |
|---|---|---|---|
| **Favorable/(unfavorable)** | | | |
| Life and annuity premiums and contract charges | $ 75 | $ 61 | $ 136 |
| Net investment income | 10 | 6 | 16 |
| Periodic settlements and accruals on non- hedge derivative instruments (1) | 1 | - | 1 |
| Contract benefits | (11) | (1) | (12) |
| Interest credited to contractholder funds (2) | (13) | (8) | (21) |
| Gross margin (3) | 62 | 58 | 120 |
| Realized capital gains and losses | (8) | (1) | (9) |
| Amortization of DAC and DSI (2) | (3) | (44) | (47) |
| Operating costs and expenses | (25) | (18) | (43) |
| Loss on disposition of operations | (53) | (35) | (88) |
| Income from operations before income tax expense | $ (27) | $ (40) | $ (67) |
| | | | |
| Investment margin | $ (2) | $ (2) | $ (4) |
| Benefit margin | (1) | 16 | 15 |
| Contract charges and fees | 65 | 44 | 109 |
| Gross margin (3) | $ 62 | $ 58 | $ 120 |

(1) Periodic settlements and accruals on non-hedge derivative instruments are reflected as a component of realized capital gains and losses on the Condensed Consolidated Statements of Operations.

(2) For purposes of calculating gross margin, amortization of deferred sales inducements ( DSI ) is excluded from interest credited to contractholder funds and aggregated with amortization of DAC due to the similarity in the substance of the two items. Amortization of DSI for variable annuities totaled less than $1 million in the first quarter of 2006 and $3 million in the second quarter of 2006.

(3) Gross margin and its components are measures that are not based on GAAP. Gross margin, investment margin and benefit margin are defined on pages 39, 40 and 41, respectively.

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**ALLSTATE FINANCIAL SEGMENT**

Summarized financial data is presented in the following table.

| (in millions) | Three Months Ended March 31, 2007 | 2006 |
|---|---|---|
| **Revenues** | | |
| Life and annuity premiums and contract charges | $ 483 | $ 495 |
| Net investment income | 1,050 | 1,004 |
| Realized capital gains and losses | 23 | (28) |
| Total revenues | 1,556 | 1,471 |
| | | |
| **Costs and expenses** | | |
| Life and annuity contract benefits | (428) | (373) |
| Interest credited to contractholder funds | (649) | (620) |
| Amortization of DAC | (129) | (120) |
| Operating costs and expenses | (105) | (128) |
| Restructuring and related charges | | (16) |
| Total costs and expenses | (1,311) | (1,257) |
| | | |
| Loss on disposition of operations | | (53) |
| | | |
| Income tax expense | (81) | (53) |
| Net income | $ 164 | $ 108 |
| | | |
| Investments | $ 77,727 | $ 75,342 |

**Life and annuity premiums and contract charges** Premiums represent revenues generated from traditional life, immediate annuities with life contingencies, accident and health and other insurance products that have significant mortality or morbidity risk. Contract charges are revenues generated from interest-sensitive life, fixed annuities, institutional products and variable annuities for which deposits are classified as contractholder funds or separate accounts liabilities. Contract charges are assessed against the contractholder account values for maintenance, administration, cost of insurance and surrender prior to contractually specified dates. As a result, changes in contractholder funds are considered in the evaluation of growth and as indicators of future levels of revenues. Subsequent to the close of our reinsurance transaction with Prudential Financial Inc. ( Prudential ) on June 1, 2006, variable annuity contract charges on the business subject to the transaction are fully reinsured to Prudential and presented net of reinsurance on the Condensed Consolidated Statements of Operations (see Note 5 to the Condensed Consolidated Financial Statements).

The following table summarizes life and annuity premiums and contract charges by product.

| (in millions) | Three Months Ended March 31, 2007 | 2006 |
|---|---|---|
| **Premiums** | | |
| Traditional life | $ 74 | $ 64 |
| Immediate annuities with life contingencies | 77 | 49 |
| Accident and health and other | 91 | 82 |
| **Total premiums** | 242 | 195 |
| **Contract charges** | | |
| Interest-sensitive life | 223 | 207 |
| Fixed annuities | 18 | 17 |
| Variable annuities | | 76 |
| **Total contract charges** | 241 | 300 |
| **Life and annuity premiums and contract charges** | $ 483 | $ 495 |

Total premiums increased 24.1% to $242 million in the first quarter of 2007 compared to the same period of 2006. This increase was due to higher sales of immediate annuities with life contingencies, traditional life products and accident and health products.

Contract charges decreased 19.7% to $241 million in the first quarter of 2007 compared to the same period of 2006. Excluding contract charges on variable annuities, substantially all of which are reinsured to Prudential effective June 1, 2006, contract charges increased 7.6% in the first quarter of 2007 compared to the same period of 2006. The increase was due to higher contract charges on interest-sensitive life products resulting from growth of business in force.

*Contractholder funds* represent interest-bearing liabilities arising from the sale of individual and institutional products, such as interest-sensitive life, fixed annuities, bank deposits and funding agreements. The balance of contractholder funds is equal to the cumulative deposits received and interest credited to the contractholder less cumulative contract maturities, benefits, surrenders, withdrawals and contract charges for mortality or administrative expenses.

The following table shows the changes in contractholder funds.

| (in millions) | Three Months Ended March 31, 2007 | 2006 |
|---|---|---|
| **Contractholder funds, beginning balance** | $ 62,031 | $ 60,040 |
| | | |
| **Deposits** | | |
| Fixed annuities | 696 | 1,201 |
| Institutional products (funding agreements) | 1,200 | 350 |
| Interest-sensitive life | 353 | 342 |
| Variable annuity and life deposits allocated to fixed accounts | | 63 |
| Bank and other deposits | 203 | 239 |
| Total deposits | 2,452 | 2,195 |
| | | |
| **Interest credited** | 658 | 637 |
| | | |
| **Maturities, benefits, withdrawals and other adjustments** | | |
| Maturities of institutional products | (752) | (704) |
| Benefits | (417) | (372) |
| Surrenders and partial withdrawals | (1,221) | (1,265) |
| Contract charges | (194) | (181) |
| Net transfers from (to) separate accounts | 3 | (83) |
| Fair value hedge adjustments | (17) | (18) |
| Other adjustments | (71) | 4 |
| Total maturities, benefits, withdrawals and other adjustments | (2,669) | (2,619) |
| **Contractholder funds, ending balance** | $ 62,472 | $ 60,253 |

Contractholder funds increased 0.7% and 0.4% in the first quarter of 2007 and 2006, respectively. Average contractholder funds increased 3.5% and 6.3% in the first quarters of 2007 and 2006, respectively, compared to the same periods in the prior years.

Contractholder deposits increased 11.7% in the first quarter of 2007 compared to the same period of 2006 due primarily to higher deposits on funding agreements partially offset by lower deposits on fixed annuities and the absence in the first quarter of 2007 of variable annuity deposits allocated to fixed accounts due to the reinsurance of substantially all of the business effective June 1, 2006. Subsequent to the effective date of the transaction, the net change in contractholder funds due to the reinsured variable annuity business is reflected as a component of other adjustments in the table above. Deferred fixed annuity deposits in the first quarter of 2007 were $621 million (including indexed annuities) a decrease of 43.2% compared to the same period in the prior year. This decrease is indicative of lower industry-wide fixed annuity sales and reflects reduced consumer demand as competing short-term and equity-based investment alternatives continued to be relatively attractive during the quarter. Our strategy to raise returns on the capital that supports these products also contributed to the decline. Allstate Financial generally prioritizes the allocation of fixed income investments to support sales of those retail products with the best sustainable growth and contribution margins, and to maintain our retail market presence. As a result, sales of our institutional products vary from period to period.

Surrenders and partial withdrawals on deferred fixed annuities, interest-sensitive life products and Allstate Bank products decreased 3.5% in the first quarter of 2007 compared to the same period of 2006 and the annualized withdrawal rate, based on the beginning of period contractholder funds, decreased to 11.1% for the first quarter 2007 compared to 11.6% for the first quarter of 2006.

**Net investment income** increased 4.6% in the first quarter of 2007 compared to the same period of 2006 due mostly to increased investment yields and higher average portfolio balances in the first quarter of 2007 compared to the same period in the prior year. The higher portfolio yields were primarily due to increased yields on floating rate instruments and, to a lesser extent, improved yields on fixed rate assets supporting deferred fixed annuities. For certain products, the yield changes on our floating rate instruments pass to our floating rate contractholders through changes in crediting rates with minimal impact on our gross margin. Higher average portfolio balances resulted

**from the investment of cash flows from operating and financing activities related primarily to deposits from fixed annuities, funding agreements and interest-sensitive life policies, as well as the proceeds from the $500 million intercompany note from Allstate Life Insurance Company s (** ALIC ) parent, Allstate Insurance Company ( AIC ), which was issued in December 2006 and repaid in the first quarter of 2007.

**Net income** analysis is presented in the following table.

| **(in millions)** | **Three Months Ended March 31, 2007** | **2006** |
|---|---|---|
| Life and annuity premiums and contract charges | $ 483 | $ 495 |
| Net investment income | 1,050 | 1,004 |
| Periodic settlements and accruals on non-hedge derivative instruments(1) | 12 | 16 |
| Contract benefits | (428 ) | (373 ) |
| Interest credited to contractholder funds(2) | (639 ) | (613 ) |
| Gross margin | 478 | 529 |
| | | &n |