

**UNITED STATES  
SECURITIES AND EXCHANGE COMMISSION**

Washington, D.C. 20549

**FORM 10-Q**

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

**OR**

- 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**  
(State of Incorporation)

**36-3871531**  
(I.R.S. Employer Identification No.)

**2775 Sanders Road**  
**Northbrook, Illinois**  
(Address of principal executive offices)

**60062**  
(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  No

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

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

Yes  No

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

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September 30, 2006**

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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<br>September 30, |               | Nine Months Ended<br>September 30, |               |
|--|-------------------------------------|---------------|------------------------------------|---------------|
|  | 2006                                | 2005          | 2006                               | 2005          |
|  | (Unaudited)                         |               | (Unaudited)                        |               |
| <b>Revenues</b>  |                                     |               |                                    |               |
| Property-liability insurance premiums earned                             | \$ 6,801                            | \$ 6,781      | \$ 20,537                          | \$ 20,201     |
| Life and annuity premiums and contract charges                           | 444                                 | 505           | 1,454                              | 1,525         |
| Net investment income  | 1,554                               | 1,457         | 4,613                              | 4,264         |
| Realized capital gains and losses  | (61)                                | 199           | 90                                 | 448           |
|  | <u>8,738</u>                        | <u>8,942</u>  | <u>26,694</u>                      | <u>26,438</u> |
| <b>Costs and expenses</b>  |                                     |               |                                    |               |
| Property-liability insurance claims and claims expense                   | 4,012                               | 8,529         | 11,879                             | 16,706        |
| Life and annuity contract benefits                                       | 388                                 | 395           | 1,135                              | 1,209         |
| Interest credited to contractholder funds                                | 667                                 | 608           | 1,939                              | 1,784         |
| Amortization of deferred policy acquisition costs                        | 1,160                               | 1,160         | 3,522                              | 3,557         |
| Operating costs and expenses   | 726                                 | 713           | 2,252                              | 2,266         |
| Restructuring and related charges  | 52                                  | 10            | 171                                | 36            |
| Interest expense   | 90                                  | 85            | 261                                | 251           |
|  | <u>7,095</u>                        | <u>11,500</u> | <u>21,159</u>                      | <u>25,809</u> |
| Loss on disposition of operations  | (1)                                 | (4)           | (89)                               | (12)          |
| <b>Income (loss) from operations before income tax expense (benefit)</b> | 1,642                               | (2,562)       | 5,446                              | 617           |

|  |                 |                   |                 |                |
|--|-----------------|-------------------|-----------------|----------------|
| Income tax expense (benefit)                 | 484             | (1,014)           | 1,666           | (107)          |
| <b>Net income (loss)</b>                     | <u>\$ 1,158</u> | <u>\$ (1,548)</u> | <u>\$ 3,780</u> | <u>\$ 724</u>  |
| <b>Earnings per share:</b>                   |                 |                   |                 |                |
| <b>Net income (loss) per share - Basic</b>   | <u>\$ 1.84</u>  | <u>\$ (2.36)</u>  | <u>\$ 5.95</u>  | <u>\$ 1.09</u> |
| <b>Weighted average shares - Basic</b>       | <u>629.0</u>    | <u>654.8</u>      | <u>635.4</u>    | <u>666.3</u>   |
| <b>Net income (loss) per share - Diluted</b> | <u>\$ 1.83</u>  | <u>\$ (2.36)</u>  | <u>\$ 5.91</u>  | <u>\$ 1.08</u> |
| <b>Weighted average shares - Diluted</b>     | <u>633.9</u>    | <u>654.8</u>      | <u>639.9</u>    | <u>671.9</u>   |
| Cash dividends declared per share            | <u>\$ 0.35</u>  | <u>\$ 0.32</u>    | <u>\$ 1.05</u>  | <u>\$ 0.96</u> |

See notes to condensed consolidated financial statements.

**THE ALLSTATE CORPORATION AND SUBSIDIARIES**  
**CONDENSED CONSOLIDATED STATEMENTS OF FINANCIAL POSITION**

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

Treasury stock, at cost (273 million and 254 million shares)

(10,674)

(9,575)

Accumulated other comprehensive income:

Unrealized net capital gains and losses

1,961

2,090

Unrealized foreign currency translation adjustments

38

22

Minimum pension liability adjustment

(30)

(30)

Total accumulated other comprehensive income

1,969

2,082

**Total shareholders' equity**

22,200

20,186

**Total liabilities and shareholders' equity**

\$ 160,324

\$ 156,072

See notes to condensed consolidated financial statements.

**THE ALLSTATE CORPORATION AND SUBSIDIARIES**  
**CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS**

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

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

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

**Adopted accounting standards**

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

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

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

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

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

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

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

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

subsequent to the effective date of SFAS No. 123, less the tax on the cumulative incremental compensation costs the Company included in its pro forma net income disclosures as if the Company had applied the fair-value method to all awards, less the share-based compensation costs included in net income as reported.

#### **Pending accounting standards**

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

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

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

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

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

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

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##### *SFAS No. 157, Fair Value Measurements (“SFAS No. 157”)*

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

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

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

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

## 2. Earnings per share

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

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

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

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

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

## 3. Supplemental Cash Flow Information

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

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

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

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

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

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

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

#### 5. Reinsurance

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

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

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

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

#### Property-liability

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



\$214 million and \$406 million in the three-month and nine-month periods ended September 30, 2006, compared to \$60 million and \$136 million in the three-month and nine-month periods ended September 30, 2005.

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

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## Life and annuity

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

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

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

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

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

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In the five-months of 2006, prior to the disposition of substantially all of the variable annuity business, ALIC’s and ALNY’s variable annuity business generated approximately \$127 million in contract charges. In the three-month and nine-month periods ended September 30, 2006, life and annuity premiums and contract charges of \$72 million and \$94 million, contract benefits of \$15 million and \$20 million, interest credited to contractholder funds of \$17 million

and \$22 million, and operating costs and expenses of \$29 million and \$39 million, respectively, were ceded to Prudential pursuant to the Reinsurance Agreements.

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

## 6. Company Restructuring

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

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

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

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

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

## 7. Guarantees and Contingent Liabilities

### State facility assessments

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

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

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

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

### **Shared markets**

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

### **Guarantees**

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

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

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

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

### **Regulation**

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

### **Legal and regulatory proceedings and inquiries**

#### **Background**

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

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

In the lawsuits, plaintiffs seek a variety of remedies including equitable relief in the form of injunctive and other remedies and monetary relief in the form of contractual and extra-contractual damages. In some cases, the monetary damages sought include punitive or treble damages. Often specific information about the relief sought, such as the amount of damages, is not available because plaintiffs have not requested specific relief in their pleadings. When specific monetary demands are made, they are often set just below a state court jurisdictional limit in order to seek the maximum amount available in state court, regardless of

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

- In connection with regulatory examinations and proceedings, government authorities may seek various forms of relief, including penalties, restitution and changes in business practices. The Company may not be advised of the nature and extent of relief sought until the final stages of the examination or proceeding.
- For the reasons specified above, it is often not possible to make meaningful estimates of the amount or range of loss that could result from the matters described below in the “Proceedings” subsection. The Company reviews these matters on an on-going basis and follows the provisions of SFAS No. 5, “Accounting for Contingencies”, when making accrual and disclosure decisions. When assessing reasonably possible and probable outcomes, the Company bases its decisions on its assessment of the ultimate outcome following all appeals.
- Due to the complexity and scope of the matters disclosed in the “Proceedings” subsection below and the many uncertainties that exist, the ultimate outcome of these matters cannot be reasonably predicted. In the event of an unfavorable outcome in one or more of these matters, the ultimate liability may be in excess of amounts currently reserved and may be material to the Company’s operating results or cash flows for a particular quarter or annual period. However, based on information currently known to it, management believes that the ultimate outcome of all matters described below as they are resolved over time is not likely to have a material adverse effect on the financial position of the Company.

### **Proceedings**

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

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

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

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

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

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

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

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

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

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

#### **Other Matters**

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

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

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

## Asbestos and environmental

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

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

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

## 8. Components of Net Periodic Pension and Postretirement Benefit Costs

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

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

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

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

## 9. Equity Incentive Plans

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

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

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

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

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

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

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

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

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

respectively. The total fair value of options vested was \$0.5 million and \$2.4 million during the three-month periods ended September 30, 2006 and 2005, respectively, and was \$60.4 million and \$79.2 million during the nine-month periods ended September 30, 2006 and 2005, respectively.

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

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

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

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

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

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

## 10. Business Segments

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

| (in millions)                                | Three months ended<br>September 30, |          | Nine months ended<br>September 30, |           |
|--|-------------------------------------|----------|------------------------------------|-----------|
|  | 2006                                | 2005     | 2006                               | 2005      |
| <b>Revenues</b>                              |                                     |          |                                    |           |
| <i>Property-Liability</i>                    |                                     |          |                                    |           |
| Property-liability insurance premiums earned |                                     |          |                                    |           |
| Standard auto                                | \$ 4,199                            | \$ 4,086 | \$ 12,498                          | \$ 12,118 |
| Non-standard auto                            | 377                                 | 438      | 1,177                              | 1,345     |



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

(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.

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

| (in millions)  | Three months ended<br>September 30, |            | Nine months ended<br>September 30, |            |
|--|-------------------------------------|------------|------------------------------------|------------|
|  | 2006                                | 2005       | 2006                               | 2005       |
| <b>Net income</b>  |                                     |            |                                    |            |
| <i>Property-Liability</i>  |                                     |            |                                    |            |
| Underwriting income (loss)   |                                     |            |                                    |            |
| Allstate Protection  | \$ 1,196                            | \$ (3,227) | \$ 3,652                           | \$ (1,218) |
| Discontinued Lines and Coverages   | (118)                               | (136)      | (133)                              | (170)      |
| Total underwriting income (loss)   | 1,078                               | (3,363)    | 3,519                              | (1,388)    |
| Net investment income  | 455                                 | 454        | 1,382                              | 1,333      |
| Income tax (expense) benefit on operations   | (466)                               | 1,124      | (1,523)                            | 291        |
| Realized capital gains and losses, after-tax                                       | (22)                                | 99         | 153                                | 248        |
| Loss on disposition of operations, after-tax                                       | —                                   | —          | (1)                                | —          |
| Property-Liability net income (loss)   | 1,045                               | (1,686)    | 3,530                              | 484        |
| <i>Allstate Financial</i>  |                                     |            |                                    |            |
| Life and annuity premiums and contract charges                                     | 444                                 | 505        | 1,454                              | 1,525      |
| Net investment income  | 1,063                               | 974        | 3,115                              | 2,838      |
| Periodic settlements and accruals on non-hedge derivative financial instruments    | 14                                  | 14         | 44                                 | 49         |
| Contract benefits and interest credited to contractholder funds                    | (1,059)                             | (1,003)    | (3,080)                            | (2,961)    |
| Operating costs and expenses and amortization of deferred policy acquisition costs | (244)                               | (270)      | (840)                              | (819)      |
| Restructuring and related charges  | (5)                                 | (1)        | (24)                               | (1)        |
| Income tax expense on operations   | (65)                                | (63)       | (217)                              | (189)      |
| Operating income   | 148                                 | 156        | 452                                | 442        |
| Realized capital gains and losses, after-tax                                       | (19)                                | 17         | (89)                               | 33         |

|  |            |            |            |            |
|--|------------|------------|------------|------------|
| Deferred policy acquisition costs and deferred sales inducements amortization relating to realized capital gains and losses, after-tax | 16         | (2)        | 40         | (106)      |
| Non-recurring increase in liability for future benefits, after-tax (1)   | —          | —          | —          | (22)       |
| Reclassification of periodic settlements and accruals on non-hedge financial instruments, after-tax                                    | (9)        | (10)       | (28)       | (32)       |
| Loss on disposition of operations, after-tax   | (1)        | (7)        | (59)       | (11)       |
| Allstate Financial net income  | <u>135</u> | <u>154</u> | <u>316</u> | <u>304</u> |

#### Corporate and Other

|  |                 |                   |                 |               |
|--|-----------------|-------------------|-----------------|---------------|
| Service fees(2)                              | 2               | 3                 | 7               | 7             |
| Net investment income                        | 36              | 29                | 116             | 93            |
| Operating costs and expenses                 | (91)            | (82)              | (266)           | (255)         |
| Restructuring and related charges            | —               | —                 | (1)             | —             |
| Income tax benefit on operations             | 29              | 29                | 81              | 84            |
| Operating loss                               | <u>(24)</u>     | <u>(21)</u>       | <u>(63)</u>     | <u>(71)</u>   |
| Realized capital gains and losses, after-tax | 2               | 5                 | (3)             | 7             |
| Corporate and Other net loss                 | <u>(22)</u>     | <u>(16)</u>       | <u>(66)</u>     | <u>(64)</u>   |
| Consolidated net income (loss)               | <u>\$ 1,158</u> | <u>\$ (1,548)</u> | <u>\$ 3,780</u> | <u>\$ 724</u> |

- (1) The non-recurring increase in liability for future benefits is for a discontinued plan (see Note 8 for impact to pension and postretirement benefits).
- (2) For presentation in the Condensed Consolidated Statements of Operations, service fees of the Corporate and Other segment are reclassified to operating costs and expenses.

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

## 11. Other Comprehensive Income

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

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

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

## 12. Capital Structure

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

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

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

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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 September 30, 2006, and the related condensed consolidated statements of operations for the three-month and nine-month periods ended September 30, 2006 and 2005, and the condensed consolidated statements of cash flows for the nine-month periods ended September 30, 2006 and 2005. These interim financial statements are the responsibility of the Company’s management.

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

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

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

/s/ Deloitte & Touche LLP

Chicago, Illinois  
November 1, 2006

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

### OVERVIEW

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

### HIGHLIGHTS

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

- Total revenues decreased 2.3% to \$8.74 billion in the third quarter of 2006 from \$8.94 billion in the third quarter of last year, and increased 1.0% to \$26.69 billion in the first nine months of 2006 from \$26.44 billion in the first nine months of last year.
- Book value per share increased 18.3% to \$35.08 as of September 30, 2006 compared to \$29.66 as of September 30, 2005 and increased 13.1% compared to \$31.01 as of December 31, 2005.
- For the twelve months ended September 30, 2006, return on the average of beginning and ending period shareholders' equity increased 14.0 points to 23.2% from 9.2% for the twelve months ended September 30, 2005.
- Property-Liability premiums earned increased 0.3% to \$6.80 billion in the third quarter of 2006 from \$6.78 billion in the third quarter of 2005 and increased 1.7% to \$20.54 billion for the first nine months of 2006 from \$20.20 billion for the first nine months of 2005.
- The Property-Liability combined ratio was 84.1 in the third quarter of 2006 compared to 149.6 in the third quarter of 2005 and 82.9 in the first nine months of 2006 compared to 106.9 in the first nine months of 2005. The effect of catastrophe losses on the combined ratio was 2.5 points and 69.4 points in the third quarter of 2006 and 2005, respectively, and 2.6 points and 24.8 points in the first nine months of 2006 and 2005, respectively.
- Allstate Financial net income declined 12.3% to \$135 million in the third quarter of 2006 and increased 3.9% to \$316 million in the first nine months of 2006 compared to the same periods in 2005.

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## CONSOLIDATED NET INCOME

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

## PROPERTY-LIABILITY HIGHLIGHTS

- Premiums written decreased 0.5% in the third quarter of 2006 from the third quarter of 2005 and increased 0.9% in the first nine months of 2006 over the first nine months of 2005. Allstate brand standard auto premiums written increased 2.2% and 3.3% in the third quarter and first nine months of 2006, respectively, over the same periods of 2005. Allstate brand homeowners premiums written decreased 2.6% and 0.1% in the third quarter and first nine months of 2006, respectively, from the same periods of 2005. Premiums written is an operating measure that is defined and reconciled to premiums earned on page 30.
- The impact of the cost of the catastrophe reinsurance program on premiums written and premiums earned totaled \$214 million in the third quarter of 2006 compared to \$60 million in the same period of 2005. The impact of the cost of the catastrophe reinsurance program on premiums written and premiums earned totaled \$406 million in the first nine months of 2006 compared to \$136 million in the same period of 2005. Excluding this cost, premiums written grew 1.6% and 2.2% in the third quarter and first nine months of 2006, respectively, when compared to the same periods of 2005.
- Allstate brand standard auto new issued applications decreased 1.4% in the third quarter of 2006 from the same period of 2005 and increased 1.2% in the first nine months of 2006 over the first nine months of 2005. Allstate brand homeowners new issued applications decreased 19.8% in the third quarter of 2006 from the same period of 2005 and 16.6% in the first nine months of 2006 from the first nine months of 2005.

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- Policies in force (“PIF”) as of the third quarter of 2006 when compared to the third quarter of 2005 for Allstate brand standard auto and homeowners increased 2.6% and 0.6%, respectively.
- The Allstate brand standard auto renewal ratio was 90.1 in the third quarter of 2006 compared to 90.5 in the third quarter of 2005 and 90.1 in the first nine months of 2006 compared to 90.7 in the first nine months of 2005. The Allstate brand homeowners renewal ratio was 87.4 in the third quarter of 2006 compared to 88.5 in the third quarter of 2005 and 87.2 in the first nine months of 2006 compared to 88.4 in the first nine months of 2005.
- Claim frequencies (rate of claim occurrence), excluding catastrophes, in the auto and homeowners insurance lines continue to decline, while current year claim severity (average cost per claim) was higher, when compared to the third quarter and first nine months of 2005.
- Underwriting income for Property-Liability was \$1.08 billion in the third quarter of 2006 compared to an underwriting loss of \$3.36 billion in the third quarter of 2005. Underwriting income for Property-Liability was \$3.52 billion in the first nine months of 2006 compared to an underwriting loss of \$1.39 billion in the first nine months of 2005. Underwriting income, a measure that is not based on generally accepted accounting principles (“GAAP”), is defined below.
- Catastrophe losses in the third quarter of 2006 totaled \$169 million compared to \$4.71 billion in the same period of 2005. Catastrophe losses in the first nine months of 2006 totaled \$531 million compared to \$5.02 billion in the same period of 2005.
- Prior year favorable net reserve reestimates in the third quarter of 2006 totaled \$221 million compared to \$150 million in the third quarter of 2005 and \$787 million in the first nine months of 2006 compared to \$322 million in the first nine months of 2005.

## PROPERTY-LIABILITY OPERATIONS

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

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

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

- Claims and claims expense (“loss”) ratio — the ratio of claims and claims expense to premiums earned. Loss ratios include the impact of catastrophe losses.
- Expense ratio — the ratio of amortization of DAC, operating costs and expenses and restructuring and related charges to premiums earned.
- Combined ratio — the ratio of claims and claims expense, amortization of DAC, operating costs and expenses and restructuring and related charges to premiums earned. The combined ratio is the sum of the loss ratio and the expense ratio. The difference between 100% and the combined ratio represents underwriting income as a percentage of premiums earned.

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

- Effect of catastrophe losses on combined ratio — the percentage of catastrophe losses included in claims and claims expense to premiums earned.
- Effect of pretax reserve reestimates on combined ratio — the percentage of pretax reserve reestimates included in claims and claims expense to premiums earned.
- Effect of restructuring and related charges on combined ratio — the percentage of restructuring and related charges to premiums earned.
- Effect of Discontinued Lines and Coverages on combined ratio — the ratio of claims and claims expense and other costs and expenses in the Discontinued Lines and Coverages segment to Property-Liability premiums earned. The sum of the effect of Discontinued Lines and Coverages on the combined ratio and the Allstate Protection combined ratio is equal to the Property-Liability combined ratio.

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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<br>September 30, |          | Nine Months Ended<br>September 30, |           |
|-----------------------------------|-------------------------------------|----------|------------------------------------|-----------|
|                                   | 2006                                | 2005     | 2006                               | 2005      |
| Premiums written                  | \$ 7,123                            | \$ 7,158 | \$ 20,922                          | \$ 20,733 |
| <b>Revenues</b>                   |                                     |          |                                    |           |
| Premiums earned                   | \$ 6,801                            | \$ 6,781 | \$ 20,537                          | \$ 20,201 |
| Net investment income             | 455                                 | 454      | 1,382                              | 1,333     |
| Realized capital gains and losses | (34)                                | 163      | 233                                | 385       |

|   |                 |                   |                 |                 |
|---|-----------------|-------------------|-----------------|-----------------|
| Total revenues  | 7,222           | 7,398             | 22,152          | 21,919          |
| <b>Costs and expenses</b>                                     |                 |                   |                 |                 |
| Claims and claims expense                                     | (4,012)         | (8,529)           | (11,879)        | (16,706)        |
| Amortization of DAC   | (1,039)         | (1,029)           | (3,088)         | (3,061)         |
| Operating costs and expenses                                  | (625)           | (577)             | (1,905)         | (1,787)         |
| Restructuring and related charges                             | (47)            | (9)               | (146)           | (35)            |
| Total costs and expenses                                      | (5,723)         | (10,144)          | (17,018)        | (21,589)        |
| Loss on disposition of operations                             | —               | —                 | (1)             | —               |
| Income tax (expense) benefit                                  | (454)           | 1,060             | (1,603)         | 154             |
| <b>Net income (loss)</b>                                      | <u>\$ 1,045</u> | <u>\$ (1,686)</u> | <u>\$ 3,530</u> | <u>\$ 484</u>   |
| <b>Underwriting income (loss)</b>                             | \$ 1,078        | \$ (3,363)        | \$ 3,519        | \$ (1,388)      |
| Net investment income   | 455             | 454               | 1,382           | 1,333           |
| Income tax (expense) benefit on operations                    | (466)           | 1,124             | (1,523)         | 291             |
| Realized capital gains and losses, after-tax                  | (22)            | 99                | 153             | 248             |
| Loss on disposition of operations, after-tax                  | —               | —                 | (1)             | —               |
| <b>Net income (loss)</b>                                      | <u>\$ 1,045</u> | <u>\$ (1,686)</u> | <u>\$ 3,530</u> | <u>\$ 484</u>   |
| Catastrophe losses  | <u>\$ 169</u>   | <u>\$ 4,707</u>   | <u>\$ 531</u>   | <u>\$ 5,017</u> |
| <b>GAAP operating ratios</b>                                  |                 |                   |                 |                 |
| Claims and claims expense (“loss”) ratio                      | 59.0            | 125.8             | 57.9            | 82.7            |
| Expense ratio   | 25.1            | 23.8              | 25.0            | 24.2            |
| Combined ratio  | 84.1            | 149.6             | 82.9            | 106.9           |
| Effect of catastrophe losses on combined ratio                | 2.5             | 69.4              | 2.6             | 24.8            |
| Effect of pretax reserve reestimates on combined ratio        | (3.2)           | (2.2)             | (3.8)           | (1.6)           |
| Effect of restructuring and related charges on combined ratio | 0.7             | 0.1               | 0.7             | 0.2             |
| Effect of Discontinued Lines and Coverages on combined ratio  | 1.7             | 2.0               | 0.7             | 0.9             |

**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.

|                                     | Three Months Ended<br>September 30, |                 | Nine Months Ended<br>September 30, |                  |
|-------------------------------------|-------------------------------------|-----------------|------------------------------------|------------------|
|                                     | 2006                                | 2005            | 2006                               | 2005             |
| <b>Premiums written:</b>            |                                     |                 |                                    |                  |
| Allstate Protection                 | \$ 7,123                            | \$ 7,158        | \$ 20,921                          | \$ 20,732        |
| Discontinued Lines and Coverages    | —                                   | —               | 1                                  | 1                |
| Property-Liability premiums written | 7,123                               | 7,158           | 20,922                             | 20,733           |
| Increase in unearned premiums(1)    | (352)                               | (393)           | (609)                              | (548)            |
| Other (1)                           | 30                                  | 16              | 224                                | 16               |
| Property-Liability premiums earned  | <u>\$ 6,801</u>                     | <u>\$ 6,781</u> | <u>\$ 20,537</u>                   | <u>\$ 20,201</u> |
| <b>Premiums earned:</b>             |                                     |                 |                                    |                  |
| Allstate Protection                 | \$ 6,801                            | \$ 6,780        | \$ 20,535                          | \$ 20,201        |
| Discontinued Lines and Coverages    | —                                   | 1               | 2                                  | —                |
| Property-Liability                  | <u>\$ 6,801</u>                     | <u>\$ 6,781</u> | <u>\$ 20,537</u>                   | <u>\$ 20,201</u> |

(1) Nine months ended September 30, 2006 includes the transfer of \$152 million to Property-Liability unearned premiums related to the loan protection business previously managed by Allstate Financial. Prior periods have not been reclassified.

## ALLSTATE PROTECTION SEGMENT

Throughout 2006 we have been implementing 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. Although in many areas of the country we are currently achieving returns within acceptable risk tolerances, we continue to seek solutions to improve returns in areas that have known exposure to hurricanes, earthquakes and other catastrophes. We will continue to reduce our catastrophe exposure over time while working to mitigate the impact of our actions on customers. We are also working for changes in the regulatory environment, including fewer restrictions on underwriting,

recognizing the need for and improving appropriate risk based pricing and promoting the creation of government sponsored, privately funded solutions. Our property business includes personal homeowners, commercial property and other property lines.

Actions we have taken or are considering to attain an acceptable catastrophe exposure level in our property business include:

- removing wind coverage from certain policies and allowing our agencies to help customers apply for wind coverage through state facilities such as wind pools;
- changing rates, deductibles and coverage;
- placing limitations on new business writings;
- changing underwriting requirements, including limitations in coastal and adjacent counties;
- not offering continuing coverage to some existing policyholders;
- purchasing reinsurance or other forms of risk transfer arrangements;
- discontinuing coverage for certain types of residences; and/or
- withdrawing from certain markets.

Examples of catastrophe exposure actions taken during 2006, related to our risk of hurricane loss, include purchasing additional reinsurance on a countrywide basis for our personal lines property insurance, and in areas most exposed to hurricanes (for further information on our reinsurance program see the Allstate Protection Reinsurance section of the MD&A); a limitation on personal homeowners new business writings in coastal areas of

Texas, Louisiana, Mississippi, and certain other states; and not offering continuing coverage on select policies in eight coastal counties in the state of New York, which may continue for several years. Additionally, we have entered into a reinsurance agreement to cede losses incurred on 120,000 personal property policies in the state of Florida to Royal Palm Insurance Company ("Royal Palm"). Allstate Floridian plans to no longer offer coverage on these policies after their contract terms expire, at which time Royal Palm may offer coverage to these policyholders.

Actions taken during 2006 related to our risk of earthquake loss include the previous announcement to no longer offer new optional earthquake coverage in most states and to begin removing optional earthquake coverage on approximately 400,000 property policies at December 31, 2005 (now 330,000 policies at September 30, 2006) upon renewal in most states. In California, we have changed homeowners underwriting requirements in an effort to reduce our exposure to fires following earthquakes. We have also purchased reinsurance for fires following earthquakes.

We have entered into arrangements to make earthquake coverage available through other insurers for new and renewal business in 11 states. During the third quarter of 2006, we entered into an arrangement to make earthquake coverage available, through other insurers, for many of the approximately 140,000 renewal homeowners customers in the states of Alabama, Arkansas, Illinois, Indiana, Missouri, Mississippi, Ohio, South Carolina and Tennessee. This arrangement is also applicable for new homeowners customers in these nine states. Previously, Allstate entered into agreements in two states for approximately 58,000 homeowners policies with optional earthquake coverage.

By the end of 2007, we anticipate that we will have eliminated approximately 90% of our optional earthquake coverages countrywide, based on our policies in force at December 31, 2005. Allstate's premiums written attributable to optional earthquake coverage totaled approximately \$60 million in 2005. While this is a countrywide strategy, we will continue to have optional earthquake coverage available in certain states due to regulatory and other reasons. We also will continue to have exposure to earthquake risk on certain policies and coverages that do not specifically exclude coverage for earthquake losses, including our auto policies, and to fires following earthquakes. Allstate policyholders in the state of California are offered coverage through the California Earthquake Authority ("CEA"), a privately-financed, publicly-managed state agency created to provide insurance coverage for earthquake damage. Allstate is subject to assessments from the CEA under certain circumstances.

We continue to aggressively seek recovery of our reinsurance costs. The period over which we will file, obtain approvals where required, and implement the rates related to these costs began in 2006 but is expected to impact earned premiums over several years. Through the end of the third quarter of 2006, we have submitted more than 350 rate filings in 29 states related to the cost of our reinsurance programs. These rate filings are intended to reflect the cost of our reinsurance. Accordingly, changes in the cost of reinsurance due to changes in coverage may lead to additional filings. Including rates approved in Florida and other states related to our reinsurance programs, rates currently effective reflect approximately 35% of the total 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 total cost of these reinsurance programs by the end of 2007, and will be included in premiums written during 2008.

While our actions taken will be primarily focused on reducing the catastrophe exposure in our homeowners and property businesses, we also consider their impact on our ability to market our auto lines.

Premiums written by brand are shown in the following tables.

| (in millions)     | Three Months Ended September 30, |          |                 |        |                           |          |
|-------------------|----------------------------------|----------|-----------------|--------|---------------------------|----------|
|                   | Allstate brand                   |          | Encompass brand |        | Total Allstate Protection |          |
|                   | 2006                             | 2005     | 2006            | 2005   | 2006                      | 2005     |
| Standard auto     | \$ 3,988                         | \$ 3,901 | \$ 296          | \$ 305 | \$ 4,284                  | \$ 4,206 |
| Non-standard auto | 346                              | 398      | 23              | 28     | 369                       | 426      |
| Auto              | 4,334                            | 4,299    | 319             | 333    | 4,653                     | 4,632    |
| Homeowners        | 1,635                            | 1,678    | 156             | 163    | 1,791                     | 1,841    |

|                         |                 |                 |               |               |                 |                 |
|-------------------------|-----------------|-----------------|---------------|---------------|-----------------|-----------------|
| Other personal lines(1) | 643             | 642             | 36            | 43            | 679             | 685             |
| Total                   | <u>\$ 6,612</u> | <u>\$ 6,619</u> | <u>\$ 511</u> | <u>\$ 539</u> | <u>\$ 7,123</u> | <u>\$ 7,158</u> |

**Nine Months Ended September 30,**

| (in millions)           | Allstate brand   |                  | Encompass brand |                 | Total Allstate Protection |                  |
|-------------------------|------------------|------------------|-----------------|-----------------|---------------------------|------------------|
|                         | 2006             | 2005             | 2006            | 2005            | 2006                      | 2005             |
| Standard auto           | \$ 11,813        | \$ 11,435        | \$ 872          | \$ 900          | \$ 12,685                 | \$ 12,335        |
| Non-standard auto       | 1,076            | 1,226            | 72              | 90              | 1,148                     | 1,316            |
| Auto                    | 12,889           | 12,661           | 944             | 990             | 13,833                    | 13,651           |
| Homeowners              | 4,543            | 4,548            | 458             | 463             | 5,001                     | 5,011            |
| Other personal lines(1) | 1,977            | 1,938            | 110             | 132             | 2,087                     | 2,070            |
| Total                   | <u>\$ 19,409</u> | <u>\$ 19,147</u> | <u>\$ 1,512</u> | <u>\$ 1,585</u> | <u>\$ 20,921</u>          | <u>\$ 20,732</u> |

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

Premiums earned by brand are shown in the following tables.

**Three Months Ended September 30,**

| (in millions)        | Allstate brand  |                 | Encompass brand |               | Total Allstate Protection |                 |
|----------------------|-----------------|-----------------|-----------------|---------------|---------------------------|-----------------|
|                      | 2006            | 2005            | 2006            | 2005          | 2006                      | 2005            |
| Standard auto        | \$ 3,909        | \$ 3,791        | \$ 290          | \$ 295        | \$ 4,199                  | \$ 4,086        |
| Non-standard auto    | 353             | 407             | 24              | 31            | 377                       | 438             |
| Auto                 | 4,262           | 4,198           | 314             | 326           | 4,576                     | 4,524           |
| Homeowners           | 1,418           | 1,441           | 143             | 148           | 1,561                     | 1,589           |
| Other personal lines | 626             | 626             | 38              | 41            | 664                       | 667             |
| Total                | <u>\$ 6,306</u> | <u>\$ 6,265</u> | <u>\$ 495</u>   | <u>\$ 515</u> | <u>\$ 6,801</u>           | <u>\$ 6,780</u> |

**Nine Months Ended September 30,**

| (in millions)        | Allstate brand   |                  | Encompass brand |                 | Total Allstate Protection |                  |
|----------------------|------------------|------------------|-----------------|-----------------|---------------------------|------------------|
|                      | 2006             | 2005             | 2006            | 2005            | 2006                      | 2005             |
| Standard auto        | \$ 11,627        | \$ 11,225        | \$ 871          | \$ 893          | \$ 12,498                 | \$ 12,118        |
| Non-standard auto    | 1,102            | 1,248            | 75              | 97              | 1,177                     | 1,345            |
| Auto                 | 12,729           | 12,473           | 946             | 990             | 13,675                    | 13,463           |
| Homeowners           | 4,369            | 4,301            | 446             | 431             | 4,815                     | 4,732            |
| Other personal lines | 1,928            | 1,885            | 117             | 121             | 2,045                     | 2,006            |
| Total                | <u>\$ 19,026</u> | <u>\$ 18,659</u> | <u>\$ 1,509</u> | <u>\$ 1,542</u> | <u>\$ 20,535</u>          | <u>\$ 20,201</u> |

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. Encompass brand statistics are subject to some distortion due to the integration of systems and exclude 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, 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.

As we continue to use our sophisticated risk segmentation process ("Tiered Pricing"), there is a diminishing capacity to draw meaningful comparisons to historical presentations, including the distinctions between standard and non-standard auto which have become less relevant in certain states.

Standard auto premiums written increased 1.9% to \$4.28 billion in the three months ended September 30, 2006 from \$4.21 billion in the same period of 2005 and 2.8% to \$12.69 billion during the first nine months of 2006 as compared to \$12.34 billion in the first nine months of 2005.

Our standard auto growth strategy includes actions such as the continued roll out of Allstate<sup>a</sup> Your Choice Auto ("YCA"), increased marketing, the continued roll out and refinement of Tiered Pricing, underwriting actions and agency growth. These strategies are particularly emphasized as applicable in states impacted by our catastrophe management actions such as Florida, New York and Texas.

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



| (in thousands)                      | 2006 | 2005 | % Change | 2006  | 2005  | % Change |
|-------------------------------------|------|------|----------|-------|-------|----------|
| <b>Allstate brand standard auto</b> |      |      |          |       |       |          |
| Hurricane exposure states(1)        | 270  | 270  | —        | 790   | 771   | 2.5      |
| California                          | 76   | 80   | (5.0)    | 238   | 236   | 0.8      |
| All other states                    | 159  | 162  | (1.9)    | 470   | 473   | (0.6)    |
| Total new issued applications       | 505  | 512  | (1.4)    | 1,498 | 1,480 | 1.2      |

(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.

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Allstate brand standard auto new issued applications in the hurricane exposure states were comparable in the three months ended September 30, 2006 and increased 2.5% in the nine months ended September 30, 2006 compared to the same periods of 2005. In Florida, new issued applications increased 11.7% in the three months ended September 30, 2006 and 28.5% in the nine months ended September 30, 2006 compared to the same periods of 2005 due to agency growth, changes in underwriting requirements and marketing. New issued applications in the hurricane exposure states continue to be impacted by catastrophe management actions on cross-sell opportunities and competitive pressures in certain markets.

| Allstate brand standard auto                | Three Months Ended<br>September 30, |        | Nine Months Ended<br>September 30, |        |
|---|-------------------------------------|--------|------------------------------------|--------|
|   | 2006                                | 2005   | 2006                               | 2005   |
| Renewal ratio (%)                           | 90.1                                | 90.5   | 90.1                               | 90.7   |
| PIF (thousands)                             | 17,991                              | 17,532 | 17,991                             | 17,532 |
| Average premium- gross written (six months) | \$ 419                              | \$ 417 | \$ 419                             | \$ 416 |

Allstate brand standard auto premiums written increased 2.2% to \$3.99 billion in the three months ended September 30, 2006 from \$3.90 billion in the same period of 2005 and 3.3% to \$11.81 billion during the first nine months of 2006 as compared to \$11.44 billion in the first nine months of 2005 due to increases in PIF and average premium. The 2.6% increase in Allstate brand standard auto PIF as of September 30, 2006 as compared to September 30, 2005 is the result of growth in policies available for renewal, resulting in increases in 34 of our 49 states and in the District of Columbia. The Allstate brand standard auto average premium increased 0.5% for the three months ended September 30, 2006 and 0.7% in the first nine months of 2006 compared to the same periods of 2005 primarily due to higher average new premiums reflecting a shift by policyholders to newer and more expensive autos and a shift in the mix of business to more YCA policies, partly offset by net rate decreases. The Allstate brand standard auto renewal ratio declined 0.4 points in the third quarter of 2006 and 0.6 points in the first nine months of 2006 compared to the same periods of 2005 due to competitive pressures in certain states.

Encompass brand standard auto premiums written decreased 3.0% to \$296 million in the three months ended September 30, 2006 from \$305 million in the same period of 2005 and decreased 3.1% to \$872 million during the first nine months of 2006 as compared to \$900 million in the first nine months of 2005 due to declines in PIF. PIF declined 0.9% to 1.14 million as of September 30, 2006 compared to September 30, 2005 as a decline in the policies available to renew more than offset new business. The 12-month average premium declined 1.0% to \$979 for the three months ended September 30, 2006 from \$989 in the same period of 2005 and increased 0.4% to \$983 in the first nine months of 2006 from \$979 in the same period of 2005. The decline in the three months ended September 30, 2006 as compared to the same period of 2005 was primarily due to a change in the mix of business to policies with lower average premium and diminishing impacts from rate activity. The increase during the first nine months of 2006 as compared to the same period of 2005 was due to rate actions, the effect of which is declining due to a decrease in rate change activity, and a shift by policyholders to newer and more expensive autos, partially offset by a change in the mix of business to policies with a lower average premium. The renewal ratio was 74.7% in the third quarter of 2006 compared to 76.3% in the same period of 2005 and 76.6% in the first nine months of 2006 compared to 74.6% in the same period of 2005.

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We continue to pursue rate changes for standard auto in all locations when indicated. The following table shows the net rate changes that were approved for standard auto during the three-month and nine-month periods ended September 30, 2006. These rate changes do not reflect initial rates filed for insurance subsidiaries initially writing new business in a state.

|                   | Three Months Ended<br>September 30, 2006 |                        |                           | Nine Months Ended<br>September 30, 2006 |                        |                           |
|-------------------|--|------------------------|---------------------------|---|------------------------|---------------------------|
|                   | # of States                              | Countrywide<br>(%) (1) | State Specific<br>(%) (2) | # of States                             | Countrywide<br>(%) (1) | State Specific<br>(%) (2) |
| Allstate brand(3) | 11                                       | (0.1)                  | (0.9)                     | 21                                      | (0.3)                  | (1.3)                     |
| Encompass brand   | 1  | —                      | 5.0                       | 10                                      | (0.6)                  | (4.8)                     |

(1) Represents the impact in the states where rate changes were approved during the three month or nine month periods ended September 30, 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 the three month or nine month periods ended September 30, 2006 as a percentage of total prior year-end premiums written in those states.

(3) Rate changes in the first nine months of 2006 include rate reductions due to rate bureau changes in the state of North Carolina and a rate reduction implemented in Texas following discussions with the Department of Insurance.

*Non-standard auto premiums written* decreased 13.4% to \$369 million in the three months ended September 30, 2006 from \$426 million in the same period of 2005 and 12.8% to \$1.15 billion during the first nine months of 2006 from \$1.32 billion in the first nine months of 2005.

| <b>Allstate brand non-standard auto</b>    | <b>Three Months Ended<br/>September 30,</b> |             | <b>Nine Months Ended<br/>September 30,</b> |             |
|--|---|-------------|--|-------------|
|  | <b>2006</b>                                 | <b>2005</b> | <b>2006</b>                                | <b>2005</b> |
| Renewal ratio (%)                          | 75.5  | 77.5        | 75.8                                       | 78.0        |
| PIF (thousands)                            | 984   | 1,151       | 984  | 1,151       |
| Average premium-gross written (six months) | \$ 616                                      | \$ 632      | \$ 618                                     | \$ 630      |

Allstate brand non-standard auto premiums written decreased 13.1% to \$346 million in the three months ended September 30, 2006 from \$398 million in the same period of 2005 and 12.2% to \$1.08 billion during the first nine months of 2006 from \$1.23 billion in the first nine months of 2005 due to declines in PIF and average premium. Allstate brand non-standard auto new issued applications decreased 18.4% in the third quarter of 2006 and 11.4% in the first nine months of 2006 compared to the same periods of 2005 due to lower new business production as agencies continued to focus on our standard auto business. PIF decreased 14.5% as of September 30, 2006 compared to September 30, 2005 due to new business production insufficient to offset the inherently low renewal ratio in this business. The decline of 2.5% in average premium for the three months ended September 30, 2006 and 1.9% in the first nine months of 2006 compared to the same periods of 2005 are due to a shift in the geographic mix of business and net rate decreases.

In the fourth quarter of 2006, we expect to launch a new non-standard auto product. We expect to have this product introduced in selective states by year-end 2007. We anticipate that this new product will contribute favorably to the non-standard auto trends after its introduction is complete.

Encompass brand (Deerbrook) non-standard auto premiums written decreased 17.9% to \$23 million in the three months ended September 30, 2006 from \$28 million in the same period of 2005 and 20.0% to \$72 million during the first nine months of 2006 from \$90 million in the first nine months of 2005, primarily due to declines in PIF and average premium. PIF declined 16.0% to 88 thousand as of September 30, 2006 compared to September 30, 2005. Average premium declined 3.8% to \$532 for the three months ended September 30, 2006 from \$553 in the same period of 2005 and 5.0% to \$537 in the first nine months of 2006 from \$565 in the same period of 2005. The renewal ratio was 68.2% in the third quarter of 2006 compared to 64.5% in the same period of 2005 and 67.3% in the first nine months of 2006 compared to 65.0% in the same period of 2005.

We continue to pursue rate changes for non-standard auto in all locations when indicated. The following table shows the net rate changes that were approved for non-standard auto during the three-month and nine-month periods ended September 30, 2006. These rate changes do not reflect initial rates filed for insurance subsidiaries initially writing new business in a state.

|                   | <b>Three Months Ended<br/>September 30, 2006</b> |                                |                                   | <b>Nine Months Ended<br/>September 30, 2006</b> |                                |                                   |
|-------------------|--|--------------------------------|-----------------------------------|---|--------------------------------|-----------------------------------|
|                   | <b># of States</b>                               | <b>Countrywide<br/>(%) (1)</b> | <b>State Specific<br/>(%) (2)</b> | <b># of States</b>                              | <b>Countrywide<br/>(%) (1)</b> | <b>State Specific<br/>(%) (2)</b> |
| Allstate brand(3) | —  | —                              | —                                 | 1   | (1.0)                          | (9.0)                             |
| Encompass brand   | 1  | —                              | (10.7)                            | 3   | —                              | (0.2)                             |

- (1) Represents the impact in the states where rate changes were approved during the three month or nine month periods ended September 30, 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 the three month or nine month periods ended September 30, 2006 as a percentage of total prior year-end premiums written in those states.
- (3) Rate changes in the first nine months of 2006 include a rate reduction implemented in the state of Texas following discussions with the Department of Insurance.

*Auto premiums written* increased 0.5% to \$4.65 billion in the three months ended September 30, 2006 from \$4.63 billion in the same period of 2005 and 1.3% to \$13.83 billion during the first nine months of 2006 as compared to \$13.65 billion in the first nine months of 2005. Auto includes standard auto and non-standard auto business.

| <b>Allstate brand auto</b>     | <b>Three Months Ended<br/>September 30,</b> |             | <b>Nine Months Ended<br/>September 30,</b> |             |
|--------------------------------|---|-------------|--|-------------|
|                                | <b>2006</b>                                 | <b>2005</b> | <b>2006</b>                                | <b>2005</b> |
| Renewal ratio (%)              | 89.2  | 89.6        | 89.2                                       | 89.7        |
| PIF (thousands)                | 18,975                                      | 18,683      | 18,975                                     | 18,683      |
| Average premium- gross written | \$ 430                                      | \$ 431      | \$ 431                                     | \$ 431      |

Allstate brand auto premiums written increased 0.8% to \$4.33 billion in the three months ended September 30, 2006 from \$4.30 billion in the same period of 2005 and 1.8% to \$12.89 billion during the first nine months of 2006 as compared to \$12.66 billion in the first nine months of 2005 due to increases in PIF. The 1.6% increase in Allstate brand auto PIF as of September 30, 2006 as compared to September 30, 2005 is the result of new business and growth in policies available for renewal. Allstate brand auto new issued applications declined 3.6% to 567 thousand in the three months ended September 30, 2006 and declined 0.5% to 1.71 million in the first nine months ended September 30, 2006 when compared to the same periods of 2005 due to the impact of catastrophe management actions on cross-sell opportunities and competitive pressures in certain markets. The Allstate brand auto average premium decreased 0.2% for the three months ended September 30, 2006 and was comparable in the first nine months of 2006 to the same period of 2005. The decline in the three months ended September 30, 2006 as compared to the same period of 2005 was primarily due to declines in non-standard auto and a shift in the mix of business to more YCA policies for standard auto and net rate decreases. The Allstate brand auto renewal ratio declined 0.4 points in the third quarter of

2006 and 0.5 points in the first nine months of 2006 compared to the same periods of 2005 due to competitive pressures in certain states and impacts of catastrophe management actions.

Encompass brand auto premiums written decreased 4.2% to \$319 million in the three months ended September 30, 2006 from \$333 million in the same period of 2005 and 4.6% to \$944 million during the first nine months of 2006 as compared to \$990 million in the first nine months of 2005 due to declines in PIF and average premium. PIF declined 2.2% to 1.22 million as of September 30, 2006 compared to September 30, 2005 due to a decrease in new business and declining business in force available for renewal. Average premium (12-month for standard auto and six-month for non-standard) declined 0.6% to \$924 for the three months ended September 30, 2006 from \$930 in the same period of 2005 and increased 0.9% to \$926 in the first nine months of 2006 from \$918 in the same period of 2005. The decline in the three months ended September 30, 2006 as compared to the same period of 2005 was primarily due to a change in the mix of business to policies with lower average premium. The increase during the first nine months of 2006 as compared to the same period of 2005 was due to rate actions, the effect of which is declining due to a decrease in rate change

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activity, and a shift by policyholders to newer and more expensive autos, partially offset by a change in the mix of business to policies with a lower average premium. The renewal ratio was 73.9% in the third quarter of 2006 compared to 74.6% in the same period of 2005 and 75.4% in the first nine months of 2006 compared to 73.2% in the same period of 2005.

The following table shows the net rate changes that were approved for auto during the three-month and nine-month periods ended September 30, 2006. These rate changes do not reflect initial rates filed for insurance subsidiaries initially writing new business in a state.

|                   | Three Months Ended<br>September 30, 2006 |                        |                           | Nine Months Ended<br>September 30, 2006 |                        |                           |
|-------------------|--|------------------------|---------------------------|---|------------------------|---------------------------|
|                   | # of States                              | Countrywide<br>(%) (1) | State Specific<br>(%) (2) | # of States                             | Countrywide<br>(%) (1) | State Specific<br>(%) (2) |
| Allstate brand(3) | 11                                       | (0.1)                  | (0.9)                     | 21                                      | (0.4)                  | (1.6)                     |
| Encompass brand   | 2  | —                      | 4.4                       | 12                                      | (0.6)                  | (4.6)                     |

(1) Represents the impact in the states where rate changes were approved during the three month or nine month periods ended September 30, 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 the three month or nine month periods ended September 30, 2006 as a percentage of total prior year-end premiums written in those states.

(3) Rate changes in the first nine months of 2006 include rate reductions due to rate bureau changes in the state of North Carolina and a rate reduction implemented in Texas following discussions with the Department of Insurance.

Homeowners premiums written decreased 2.7% to \$1.79 billion in the three months ended September 30, 2006 from \$1.84 billion in the same period of 2005 and 0.2% to \$5.00 billion during the first nine months of 2006 as compared to \$5.01 billion in the first nine months of 2005 primarily due to increases in ceded reinsurance premiums for our catastrophe reinsurance programs.

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. We expect this trend to continue as we continue to address our catastrophe exposure.

| (in thousands)<br>Allstate brand homeowners | Three Months Ended<br>September 30, |      |          | Nine Months Ended<br>September 30, |      |          |
|---|-------------------------------------|------|----------|------------------------------------|------|----------|
|   | 2006                                | 2005 | % Change | 2006                               | 2005 | % Change |
| Hurricane exposure states(1)                | 126                                 | 158  | (20.3)   | 367                                | 446  | (17.7)   |
| California                                  | 13                                  | 29   | (55.2)   | 43                                 | 87   | (50.6)   |
| All other states                            | 121                                 | 137  | (11.7)   | 353                                | 382  | (7.6)    |
| Total new issued applications               | 260                                 | 324  | (19.8)   | 763                                | 915  | (16.6)   |

(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.

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The Allstate brand homeowners new issued applications decreased in almost all hurricane exposure states as a result of our catastrophe management actions. The decrease in California new issued applications is due to changes in our underwriting requirements. The decrease in all other states reflects generally lower new business in most of the states and includes the impact of earthquake coverage-related actions.

| Allstate brand homeowners                  | Three Months Ended<br>September 30, |        | Nine Months Ended<br>September 30, |        |
|--|-------------------------------------|--------|------------------------------------|--------|
|  | 2006                                | 2005   | 2006                               | 2005   |
| Renewal ratio (%)                          | 87.4                                | 88.5   | 87.2                               | 88.4   |
| PIF (thousands)                            | 7,841                               | 7,792  | 7,841                              | 7,792  |
| Average premium- gross written (12 months) | \$ 833                              | \$ 797 | \$ 831                             | \$ 793 |

Allstate brand homeowners premiums written declined 2.6% to \$1.64 billion in the three months ended September 30, 2006 from \$1.68 billion in the same period of 2005 and 0.1% to \$4.54 billion during the first nine months of 2006 as compared to \$4.55 billion in the first nine months of 2005 due to increases in ceded reinsurance premiums, partially offset by increases in PIF and average premium. The 0.6% increase in Allstate brand homeowners PIF as of September 30, 2006 compared to September 30, 2005 is the result of growth in policies available for renewal.

PIF has been negatively impacted by our catastrophe management actions including our decision to discontinue offering coverage by Allstate Floridian for approximately 95,000 property policies, as part of the arrangement with Universal Insurance Company of North America ("Universal") commencing in the third quarter of 2005, and 120,000 policies, as part of an arrangement with Royal Palm commencing in the fourth quarter of 2006. Allstate Floridian plans to no longer offer coverage on these policies after they expire in accordance with their policy terms. The policies involved in the Universal agreement expired at a rate of 13% in the third quarter of 2005, 21% in the fourth quarter of 2005, 20% in the first quarter of 2006, 25% in the second quarter of 2006, and 13% in the third quarter of 2006, and are expected to expire at a rate of 2% in the fourth quarter of 2006 and the remaining 6% during 2007. The policies involved in the Royal Palm agreement are expected to expire at a rate of 12% in the fourth quarter of 2006, 23% in the first quarter of 2007, 26% in the second quarter of 2007, 24% in the third quarter of 2007 and 15% in the fourth quarter of 2007. Any qualifying recoveries from the Florida Hurricane Catastrophe Fund ("FHCF") and our excess of loss agreement in Florida will be shared with Royal Palm under this agreement.

The Allstate brand homeowners average premium increased 4.5% for the three months ended September 30, 2006 and 4.8% in the first nine months of 2006 compared to the same periods of 2005 primarily due to higher average renewal premiums related to increases in insured value and rate changes approved based on our net cost of reinsurance. The Allstate brand homeowners renewal ratio declined 1.1 points in the third quarter of 2006 and 1.2 points in the first nine months of 2006 compared to the same periods of 2005 primarily due to our catastrophe risk management actions.

Encompass brand homeowners premiums written decreased 4.3% to \$156 million in the three months ended September 30, 2006 from \$163 million in the same period of 2005 and 1.1% to \$458 million during the first nine months of 2006 as compared to \$463 million in the first nine months of 2005 due to increases in ceded reinsurance and declines in PIF, partially offset by increases in average premium. PIF declined 1.7% to 534 thousand as of September 30, 2006 compared to September 30, 2005 due to decreases in new business. The 12 month average premium increased 4.6% to \$1,149 for the three months ended September 30, 2006 from \$1,098 in the same period of 2005 and 5.2% to \$1,135 in the first nine months of 2006 from \$1,079 in the same period of 2005, due to rate actions taken during the current and prior year and increases in insured value. The renewal ratio was 82.3% in the third quarter of 2006 compared to 89.8% in the same period of 2005 and 84.7% in the first nine months of 2006 compared to 88.3% in the same period of 2005. The declines in the renewal ratio in the three months and first nine months of 2006 compared to the same periods of 2005 were primarily due to catastrophe management actions.

The following table shows the net rate changes that were approved for homeowners during the three-month and nine-month periods ended September 30, 2006, including rate changes approved based on our net cost of reinsurance. For a discussion relating to reinsurance costs, see the Allstate Protection Reinsurance section of the MD&A.

|                   | Three Months Ended<br>September 30, 2006 |                        |                           | Nine Months Ended<br>September 30, 2006 |                        |                           |
|-------------------|--|------------------------|---------------------------|---|------------------------|---------------------------|
|                   | # of States                              | Countrywide<br>(%) (1) | State Specific<br>(%) (2) | # of States                             | Countrywide<br>(%) (1) | State Specific<br>(%) (2) |
| Allstate brand(3) | 5(4)                                     | 0.4                    | 4.1                       | 23(4)                                   | 1.6                    | 1.8                       |
| Encompass brand   | 14(4)                                    | 1.2                    | 3.5                       | 20(4)                                   | 1.7                    | 4.2                       |

- (1) Represents the impact in the states where rate changes were approved during the three month or nine month periods ended September 30, 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 the three month or nine month periods ended September 30, 2006 as a percentage of total prior year-end premiums written in those states.
- (3) Rate changes in the first nine months of 2006 include a rate reduction in the state of Texas following an administrative hearing and order issued by the Department of Insurance.
- (4) Includes Washington D.C.

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

| (in millions)                              | Three Months Ended<br>September 30, |            | Nine Months Ended<br>September 30, |            |
|--|-------------------------------------|------------|------------------------------------|------------|
|  | 2006                                | 2005       | 2006                               | 2005       |
| Premiums written                           | \$ 7,123                            | \$ 7,158   | \$ 20,921                          | \$ 20,732  |
| Premiums earned                            | \$ 6,801                            | \$ 6,780   | \$ 20,535                          | \$ 20,201  |
| Claims and claims expense(1)               | (3,897)                             | (8,394)    | (11,752)                           | (16,543)   |
| Amortization of DAC                        | (1,039)                             | (1,029)    | (3,088)                            | (3,061)    |
| Operating costs and expenses(1)            | (622)                               | (575)      | (1,897)                            | (1,780)    |
| Restructuring and related charges(1)       | (47)                                | (9)        | (146)                              | (35)       |
| Underwriting income (loss)                 | \$ 1,196                            | \$ (3,227) | \$ 3,652                           | \$ (1,218) |
| Catastrophe losses                         | \$ 169                              | \$ 4,707   | \$ 531                             | \$ 5,017   |
| <b>Underwriting income (loss) by brand</b> |                                     |            |                                    |            |
| Allstate brand                             | \$ 1,140                            | \$ (3,120) | \$ 3,520                           | \$ (1,187) |
| Encompass brand                            | 56                                  | (107)      | 132                                | (31)       |

(1) During the third quarter and first nine months of 2006, higher lump sum payments to participants of the Company's pension plans resulted in a non-cash settlement charge totaling \$79 million. Allstate Protection also had a favorable \$35 million incentive benefit accrual release in the third quarter of 2005 due to lower than anticipated financial results.

Allstate Protection generated underwriting income of \$1.20 billion during the three months ended September 30, 2006 compared to an underwriting loss of \$3.23 billion in the same period of 2005. For the nine months ended September 30, 2006, Allstate Protection generated underwriting income of \$3.65 billion compared to an underwriting loss of \$1.22 billion for the first nine months of 2005. In both periods, the improvement was due to lower catastrophe losses, increased premiums earned, declines in auto and homeowners claim frequency excluding catastrophes and higher favorable reserve reestimates related to prior years, partially offset by the cost of the catastrophe reinsurance program, a \$79 million pension settlement charge and a \$35 million incentive benefit accrual release in the prior year. For the nine months ended September 30, 2005, claims and claims expense and the claims and claims expense

ratio include the effect of \$120 million or 0.6 points related to an accrual for a pending settlement of a worker classification lawsuit challenging our overtime exemption under California wage and hour laws ("accrual for litigation").

Loss ratios are a measure of profitability. Loss ratios by product, and expense and combined ratios by brand, are shown in the following table. These ratios are defined on page 27.

|   | Three Months Ended<br>September 30, |              |  |             | Nine Months Ended<br>September 30, |              |  |             |
|---|-------------------------------------|--------------|--|-------------|------------------------------------|--------------|--|-------------|
|   | Loss Ratio                          |              | Effect of<br>Catastrophe Losses<br>on the Loss Ratio |             | Loss Ratio                         |              | Effect of<br>Catastrophe Losses<br>on the Loss Ratio |             |
|   | 2006                                | 2005         | 2006   | 2005        | 2006                               | 2005         | 2006   | 2005        |
| <b>Allstate brand loss ratio:</b>           |                                     |              |  |             |                                    |              |  |             |
| Standard auto                               | 59.9                                | 64.8         | 0.1  | 6.5         | 60.3                               | 65.4         | 0.6  | 2.6         |
| Non-standard auto                           | 56.7                                | 59.5         | (0.6)  | 5.9         | 56.8                               | 58.9         | —  | 2.2         |
| Auto  | 59.6                                | 64.3         | —  | 6.4         | 60.0                               | 64.8         | 0.5  | 2.6         |
| Homeowners                                  | 49.8                                | 298.1        | 7.8  | 257.9       | 49.6                               | 131.6        | 9.1  | 90.7        |
| Other                                       | 56.6                                | 148.6        | 2.1  | 91.3        | 51.8                               | 89.9         | (0.9)  | 33.1        |
| <b>Total Allstate brand loss ratio</b>      | <b>57.1</b>                         | <b>126.5</b> | <b>2.0</b>   | <b>72.8</b> | <b>56.8</b>                        | <b>82.7</b>  | <b>2.3</b>   | <b>26.0</b> |
| <b>Allstate brand expense ratio</b>         | <b>24.8</b>                         | <b>23.3</b>  |  |             | <b>24.7</b>                        | <b>23.7</b>  |  |             |
| <b>Allstate brand combined ratio</b>        | <b>81.9</b>                         | <b>149.8</b> |  |             | <b>81.5</b>                        | <b>106.4</b> |  |             |
| <b>Encompass brand loss ratio:</b>          |                                     |              |  |             |                                    |              |  |             |
| Standard auto                               | 51.4                                | 75.3         | 0.3  | 5.8         | 60.0                               | 67.6         | (0.5)  | 1.9         |
| Non-standard auto (Deerbrook)               | 83.3                                | 64.5         | —  | 3.2         | 81.4                               | 73.2         | —  | 1.0         |
| Auto  | 53.8                                | 74.2         | 0.3  | 5.5         | 61.7                               | 68.2         | (0.4)  | 1.8         |
| Homeowners                                  | 65.7                                | 124.3        | 26.6   | 78.4        | 59.6                               | 78.2         | 17.9   | 31.8        |
| Other                                       | 86.9                                | 102.4        | 13.2   | 34.1        | 80.3                               | 81.0         | 8.5  | 14.1        |
| <b>Total Encompass brand loss ratio</b>     | <b>59.8</b>                         | <b>90.9</b>  | <b>8.9</b>   | <b>28.8</b> | <b>62.5</b>                        | <b>72.0</b>  | <b>5.7</b>   | <b>11.2</b> |
| <b>Encompass brand expense ratio</b>        | <b>29.1</b>                         | <b>29.7</b>  |  |             | <b>28.8</b>                        | <b>30.0</b>  |  |             |
| <b>Encompass brand combined ratio</b>       | <b>88.9</b>                         | <b>120.6</b> |  |             | <b>91.3</b>                        | <b>102.0</b> |  |             |
| <b>Total Allstate Protection loss ratio</b> | <b>57.3</b>                         | <b>123.8</b> | <b>2.5</b>   | <b>69.4</b> | <b>57.2</b>                        | <b>81.9</b>  | <b>2.6</b>   | <b>24.8</b> |
| <b>Allstate Protection expense ratio</b>    | <b>25.1</b>                         | <b>23.8</b>  |  |             | <b>25.0</b>                        | <b>24.1</b>  |  |             |
| <b>Allstate Protection combined ratio</b>   | <b>82.4</b>                         | <b>147.6</b> |  |             | <b>82.2</b>                        | <b>106.0</b> |  |             |

*Standard auto loss ratio* for the Allstate brand decreased 4.9 points in the three months ended September 30, 2006 and 5.1 points during the first nine months of 2006 when compared to the same periods of 2005 due to lower catastrophes, higher premiums earned, lower claim frequency excluding catastrophes and favorable reserve reestimates related to prior years, partially offset by higher current year claim severity. The Allstate brand standard auto loss ratio for the first nine months of 2005 also included an accrual for litigation. Standard auto loss ratio for the Encompass brand decreased 23.9 points in the three months ended September 30, 2006 and 7.6 points during the first nine months of 2006 when compared to the same periods of 2005 due to lower catastrophes, lower claim frequency excluding catastrophes and favorable reserve reestimates related to prior years, partially offset by higher current year claim severity and lower premiums earned.

*Non-standard auto loss ratio* for the Allstate brand decreased 2.8 points in the three months ended September 30, 2006 and 2.1 points during the first nine months of 2006 when compared to the same periods of 2005 due to lower catastrophes, lower claim frequency, partially offset by higher current year claim severity and lower premiums earned. The Allstate brand non-standard auto loss ratio for the first nine months of 2005 also included an accrual for

litigation. Non-standard auto loss ratio for the Encompass brand increased 18.8 points in the three months ended September 30, 2006 and 8.2 points during the first nine months of 2006 when compared to the same periods of 2005 due to higher current year claim severity and lower premiums earned, partially offset by lower catastrophes and lower claim frequency excluding catastrophes.

*Auto loss ratio* for the Allstate brand decreased 4.7 points in the three months ended September 30, 2006 and 4.8 points during the first nine months of 2006 when compared to the same periods of 2005 due to lower catastrophes, higher premiums earned, lower claim frequency excluding catastrophes and favorable reserve reestimates related to prior years, partially offset by higher current year claim severity. The Allstate brand loss ratio for the first nine months of 2005 also included an accrual for litigation. *Auto loss ratio* for the Encompass brand decreased 20.4 points in the three months ended September 30, 2006 and 6.5 points during the first nine months of 2006 when compared to the same periods of 2005 due to lower catastrophes, lower claim frequency excluding catastrophes and favorable reserve reestimates related to prior years, partially offset by higher current year claim severity and lower premiums earned.

*Homeowners loss ratio* for the Allstate brand decreased 248.3 points in the three months ended September 30, 2006 and 82.0 points during the first nine months of 2006 when compared to the same periods of 2005. Homeowners loss ratio for the Encompass brand decreased 58.6 points in the three months ended September 30, 2006 and 18.6 points during the first nine months of 2006 when compared to the same periods of 2005. These decreases were primarily due to lower catastrophes, higher premiums earned during the first nine months of 2006 when compared to the same period of 2005, lower claim frequency, excluding catastrophes, and higher favorable Allstate brand reserve reestimates related to prior years, partially offset by higher current year claim severity and lower premiums earned due to higher ceded earned premium for catastrophe reinsurance. The Allstate brand loss ratio for the first nine months of 2005 also included an accrual for litigation.

*Expense ratio* for Allstate Protection increased 1.3 points in the three months ended September 30, 2006 and 0.9 points during the first nine months of 2006 when compared to the same periods of 2005 due to increased restructuring charges related to the Voluntary Termination Offer (“VTO”) and a non-cash pension settlement charge of \$50 million along with the impact of lower premiums earned due to higher ceded premiums for reinsurance. The non-cash pension settlement charge impacted the expense ratio by 0.7 points and 0.2 points in the three months and nine months ended September 30, 2006, respectively. The three months ended September 30, 2005 included a \$35 million reduction in employee incentives due to lower anticipated financial results for 2005. The incentive benefit accrual release favorably impacted the expense ratio by 0.5 points and 0.2 points for the three months and nine months ended September 30, 2005, respectively. For further information on the VTO, see Note 6 to the Condensed Consolidated Financial Statements.

The impact of specific costs and expenses on the expense ratio are included in the following table.

|                                   | <b>Three Months Ended<br/>September 30,</b> |             |                        |             |                            |             |
|-----------------------------------|---|-------------|------------------------|-------------|----------------------------|-------------|
|                                   | <b>Allstate brand</b>                       |             | <b>Encompass brand</b> |             | <b>Allstate Protection</b> |             |
|                                   | <b>2006</b>                                 | <b>2005</b> | <b>2006</b>            | <b>2005</b> | <b>2006</b>                | <b>2005</b> |
| Amortization of DAC               | 15.0  | 14.8        | 19.8                   | 20.6        | 15.3                       | 15.2        |
| Other costs and expenses          | 9.1   | 8.4         | 9.2                    | 9.1         | 9.2                        | 8.5         |
| Restructuring and related charges | 0.7   | 0.1         | 0.1                    | —           | 0.6                        | 0.1         |
| <b>Total expense ratio</b>        | <b>24.8</b>                                 | <b>23.3</b> | <b>29.1</b>            | <b>29.7</b> | <b>25.1</b>                | <b>23.8</b> |

  

|                                   | <b>Nine Months Ended<br/>September 30,</b> |             |                        |             |                            |             |
|-----------------------------------|--|-------------|------------------------|-------------|----------------------------|-------------|
|                                   | <b>Allstate brand</b>                      |             | <b>Encompass brand</b> |             | <b>Allstate Protection</b> |             |
|                                   | <b>2006</b>                                | <b>2005</b> | <b>2006</b>            | <b>2005</b> | <b>2006</b>                | <b>2005</b> |
| Amortization of DAC               | 14.7                                       | 14.7        | 19.7                   | 20.6        | 15.1                       | 15.1        |
| Other costs and expenses          | 9.3  | 8.8         | 8.8                    | 9.1         | 9.2                        | 8.8         |
| Restructuring and related charges | 0.7  | 0.2         | 0.3                    | 0.3         | 0.7                        | 0.2         |
| <b>Total expense ratio</b>        | <b>24.7</b>                                | <b>23.7</b> | <b>28.8</b>            | <b>30.0</b> | <b>25.0</b>                | <b>24.1</b> |

### Allstate Protection Reinsurance

For Allstate Protection, we utilize reinsurance to reduce exposure to catastrophe risk and manage capital, while lessening earnings volatility and improving shareholder return, and to support the required statutory surplus and the insurance financial strength ratings of certain subsidiaries such as Allstate Floridian Insurance Company (“AFIC”) and Allstate New Jersey Insurance Company. We purchase reinsurance where we believe the greatest benefit may be achieved relative to our aggregate countrywide exposure. The price and terms of reinsurance and the credit quality of the reinsurer are considered in the purchase process, as well as the possibility of recovering reinsurance costs in setting future premium rates charged to policyholders. We also participate in various reinsurance mechanisms, including industry pools and facilities. We retain primary liability as a direct insurer for all risks ceded to reinsurers.

Our Allstate Protection catastrophe reinsurance program coordinates coverage under various agreements. As discussed below, our reinsurance program is comprised of agreements that provide coverage for the occurrence of certain qualifying catastrophes in specific states including New York, New Jersey, Connecticut and Texas (“multi-year agreements”); Florida; other states along the Atlantic and Gulf coasts (“South-East agreement”) principally for hurricanes, and in California for fires following earthquakes. Another reinsurance agreement provides coverage nationwide, excluding Florida, for the aggregate or sum of catastrophe losses in excess of an annual retention associated with storms named or numbered by the National Weather Service, earthquakes and fires following earthquakes (“aggregate excess agreement”). The Florida component of the reinsurance program is designed separately from the other components of the program to address the distinct needs of our separately capitalized legal entities in that state.

We anticipate that the total annualized cost of all reinsurance programs will be approximately \$840 million per year or \$210 million per quarter. This represents an increase of approximately \$600 million per year or \$150 million per quarter over our total annualized cost experienced in 2005. Our ceded

premiums earned were \$214 million in the third quarter of 2006. We currently expect that a similar level of coverage will be purchased or renewed for the comparable 2007 period.

The terms, retentions and limits for all of Allstate's catastrophe management reinsurance agreements in place as of June 30, 2006 are listed in the following tables.

| (in millions)<br>Coordinated coverage | Effective Date | %<br>Placed | Reinstatement  | Retention | Per Occurrence<br>Limit |
|---------------------------------------|----------------|-------------|--|-----------|-------------------------|
| Aggregate excess(1)                   | 6/1/2006       | 95          | None   | \$2,000   | \$2,000                 |
| California fire following(2)          | 2/1/2006       | 95          | 2 limits over 28 month<br>term, prepaid  | 500       | 1,500                   |
| Multi-year(3):                        | 6/1/2005       |             |  |           |                         |
| Connecticut                           |                | 95          | 2 limits over 3-year term,<br>prepaid  | 114       | 200                     |
| New Jersey                            |                | 95          | 1 reinstatement each<br>contract year over 3-year<br>term, premium required                | 120       | 200                     |
| New York(4)                           |                | 90          | 2 limits over 3-year term,<br>prepaid  | 830       | 1,000                   |
| Texas(5)                              |                | 95          | 2 limits for each contract<br>year over 3-year term,<br>prepaid                            | 361       | 650                     |
| New Jersey excess(6)                  | 6/1/2006       | 95          | 1 reinstatement, premium<br>required   | 320       | 200                     |
| South-East(7)                         | 6/1/2006       | 80          | 1 limit of \$220 over 1-<br>year term; 1 reinstatement<br>of \$180 limit, premium required | 500       | 500                     |

Coordinated Coverage

- (1) Aggregate Excess Agreement — This agreement is effective 6/1/2006 for 1 year and covers storms named or numbered by the National Weather Service, earthquakes and fires following earthquakes for Allstate Protection personal lines auto and property business countrywide except for Florida. Losses recoverable, if any, from our California fire following agreement, multi-year agreements and the New Jersey excess agreement are excluded when determining the retention of this agreement.
- (2) California Fire Following Agreement — This agreement is effective 2/1/2006 and expires 5/31/2008. This agreement covers Allstate Protection personal property excess catastrophe losses in California for fires following earthquakes. This agreement provides \$1.5 billion of coverage for all qualifying losses with one reinstatement except when a qualifying loss occurrence exceeds \$2 billion, then for 21 days no additional recovery can occur for any losses within the same seismic geographically affected area. The retention on this agreement is subject to remeasurement.
- (3) Multi-year Agreements — These agreements have been in effect since June 1, 2005 and cover the Allstate brand personal property excess catastrophe losses, expiring 5/31/2008. The retentions on these agreements are subject to annual remeasurements on their anniversary dates.
- (4) Two separate reinsurance agreements provide coverage for catastrophe risks in the state of New York: Allstate Insurance Company ("AIC") has a \$512 retention and a \$550 limit, and Allstate Indemnity Company has a \$318 retention and a \$450 limit.
- (5) The Texas agreement is with Allstate Texas Lloyd's ("ATL"), a syndicate insurance company. ATL also has a 100% reinsurance agreement with AIC covering losses in excess of and/or not reinsured by the Texas agreement.
- (6) New Jersey Excess — This agreement is effective 6/1/2006 for 1 year and covers Allstate Protection personal property catastrophe losses in excess of the New Jersey multi-year agreement.

- (7) South-East — This agreement is effective 6/1/2006 for 1 year and covers Allstate Protection personal property excess catastrophe losses for storms named or numbered by the National Weather Service. This agreement covers personal property business in the states of Louisiana, Mississippi,

Alabama, Georgia, South Carolina, North Carolina, Virginia, Maryland, Delaware and Pennsylvania and the District of Columbia. Qualifying losses under this agreement are also eligible to be ceded under the aggregate excess agreement.

**Allstate Floridian(1)**

| <u>(in millions)</u>          | <u>Effective Date</u> | <u>% Placed</u> | <u>Reinstatement</u>  | <u>Retention</u>   | <u>Per Occurrence Limit</u>  |
|-------------------------------|-----------------------|-----------------|---|--|--|
| FHCF Retention (2)            | 6/1/2006              | 70              | 2 limits over 1-year term, prepaid                                      | 50   | 100  |
| FHCF (3)                      | 6/1/2006              | 90              | Annual remeasurements with a first and second season coverage provision | 150 for the 2 largest storms,<br>50 for all other storms | 476  |
| FHCF sliver (4)               | 6/1/2006              | 100             | None  | 150  | Allstate's 10% co-participation of the FHCF recoveries estimated at \$476, up to a limit of \$48 |
| Excess of loss (5)            | 6/1/2005              | 90              | 2 limits over 2-year term, prepaid                                      | Excess of FHCF Limit                                     | 700  |
| Excess of loss sliver (6)     | 6/1/2006              | 100             | 1 reinstatement over 1-year term, premium required                      | Excess of FHCF limit                                     | 5% of the excess of loss limit or \$45   |
| Additional excess of loss (7) | 6/1/2006              | 95              | None  | In excess of the FHCF and excess of loss agreements      | 200  |

(1) The coverage of these agreements is adjusted to exclude the economic impact of policies reinsured with Universal in 2005 and Royal Palm in 2006. The estimated net economic benefit after sharing recoveries on ceded policies to Universal and Royal Palm is shown above and reflects Universal and Royal Palm losses in proportion to the total losses recoverable subject to the FHCF limit and a \$200 million limit acquired by Royal Palm of the excess of loss program. Also, the excess of loss and additional excess of loss coverages are adjusted to only exclude policies reinsured by Universal.

(2) FHCF Retention - provides coverage beginning 6/1/2006 for 1 year covering personal property excess catastrophe losses on policies written by Allstate Floridian, excluding policies remaining in force by Allstate Floridian and ceded to Universal and Royal Palm.

(3) FHCF — provides 90% reimbursement on qualifying personal property losses up to an estimated maximum per hurricane season. Estimated coverages are calculated for AFIC and each of its subsidiaries independently, and are subject to annual remeasurements at the beginning of the FHCF fiscal year of 6/1. As of 6/1/2006, these limits are an estimated \$595 for AFIC, \$128 for Allstate Floridian Indemnity Company, \$37 for Encompass Floridian Insurance Company, and \$8 for Encompass Floridian Indemnity Company for a total of \$768. Provisional retentions, that is, estimated retentions based on preliminary exposure data, for each of the Floridian companies are an estimated \$188 for AFIC, \$40 for Allstate Floridian Indemnity Company, \$12 for Encompass Floridian Insurance Company, and \$3 for Encompass Floridian Indemnity Company for a total of \$243. "Provisional retentions" are initial estimates subject to adjustment upward or downward to the actual retention which is determined based on the submitted exposures of all FHCF participants.

(4) FHCF sliver - provides coverage beginning 6/1/2006 for 1 year covering primarily excess catastrophe losses not reimbursed by the FHCF. The provisional retention is \$150 and is subject to adjustment upward or downward to an actual retention that will equal the FHCF retention as respects business covered by this contract, excluding policies remaining in force by Allstate Floridian and ceded to Universal and Royal Palm.

(5) Excess of loss - covers excess catastrophe losses, effective June 1, 2005, and expires May 31, 2007. This agreement is designed to attach above and contiguous to the FHCF payout and as the FHCF capacity is paid out, the retention on this agreement automatically adjusts to mirror the amount of the payout. The limit is \$900 and is 90% placed. The noted \$700 limit reflects the \$200 limit acquired by Royal Palm and described in footnote 1 above. The retention is subject to annual remeasurements on the anniversary date.

(6) Excess of loss sliver - provides coverage beginning 6/1/2006 for 1 year covering primarily excess catastrophe losses within the 10% co-participation of the excess of loss agreement. The provisional estimated retention on this agreement is \$626 and is subject to adjustment upward or downward to an actual retention that will equal the FHCF retention, plus losses paid by the FHCF divided by .90 as respects business covered by this contract, excluding policies remaining in force by Allstate Floridian and ceded to Universal and Royal Palm.

(7) Additional excess of loss - provides coverage beginning 6/1/2006 for 1 year covering excess catastrophe losses. The retention on this agreement is designed to attach to the excess of loss limit and will adjust automatically as the FHCF and the excess of loss capacity are needed and paid. The contract is triggered once \$100 has been paid by the FHCF for prior events.



Highlights of certain other contract terms and conditions for all of Allstate's catastrophe management reinsurance agreements are listed in the following table.

|   | <u>South-East</u>  | <u>Allstate<br/>Floridian(1)</u>  | <u>Aggregate Excess</u>   | <u>Multi-year, New Jersey excess<br/>and California fire following</u>  |
|---|--|---|---|---|
| Business Reinsured  | Personal Lines Property business   | Personal Lines Property business  | Personal Lines Property and Auto business   | Personal Lines Property business  |
| Location (s)  | 10 states and Washington, DC   | Florida   | Nationwide except Florida   | Each specific state   |
| Covered Losses  | 1 specific peril — storms named or numbered by the National Weather Service                              | Multi-peril — includes hurricanes and earthquakes   | 3 specific perils — storms named or numbered by the National Weather Service, earthquakes, and fires following earthquakes  | Multi-year and New Jersey excess: multi-perils - includes hurricanes and earthquakes<br>California fire following: 1 specific peril — fires following earthquakes   |
| Brands Reinsured  | Allstate Brand Encompass Brand   | Allstate Brand Encompass Brand  | Allstate Brand Encompass Brand  | Multi-year: Allstate Brand New Jersey excess and California fire following: Allstate Brand and Encompass Brand  |
| Exclusions, other than typical market negotiated exclusions | Automobile<br>Terrorism<br>Commercial  | Automobile<br>Terrorism<br>Commercial   | Assessment exposure to<br>CEA<br>Terrorism<br>Commercial  | Automobile<br>Terrorism<br>Commercial   |
| Loss Occurrence   | Sum of all qualifying losses from named or numbered storms by the National Weather Service over 96 hours | Sum of all qualifying losses for specific occurrences over 168 hours<br><br>As regards windstorm related occurrences over 96 hours<br><br>As regards riot related occurrences over 72 hours | Sum of all qualifying losses and sum of all qualifying occurrences (Aggregate)<br><br>Losses over 96 hours from a named or numbered storm<br><br>Losses over 168 hours for an earthquake<br><br>Losses over 168 hours within a 336 hour period for fire following an earthquake | Sum of all qualifying losses for a specific occurrence over 168 hours<br><br>As regards windstorm related occurrences over 96 hours<br><br>As regards riot related occurrences over 72 hours<br><br>As regards California fire following occurrences over 168 hours. No additional recovery can occur for any losses within the same seismic geographically affected area for an additional 336 hours when a qualifying loss exceeds \$2 billion. |

(1) Allstate Floridian information relates to the FHCF retention, FHCF, FHCF sliver, excess of loss, excess of loss sliver and additional excess of loss agreements.

### Reserve reestimates

The tables below show net reserves representing the estimated cost of outstanding claims as they were recorded at the beginning of years 2006 and 2005, and the effect of reestimates in each year.

| <u>(in millions)</u>      | <u>January 1<br/>Reserves</u> |                  |
|---------------------------|-------------------------------|------------------|
|                           | <u>2006</u>                   | <u>2005</u>      |
| Auto                      | \$ 10,460                     | \$ 10,228        |
| Homeowners                | 3,675                         | 1,917            |
| Other personal lines      | 2,619                         | 2,289            |
| Total Allstate Protection | <u>\$ 16,754</u>              | <u>\$ 14,434</u> |
| Allstate brand            | \$ 15,423                     | \$ 13,204        |
| Encompass brand           | 1,331                         | 1,230            |
| Total Allstate Protection | <u>\$ 16,754</u>              | <u>\$ 14,434</u> |

| (in millions, except ratios) | Three Months Ended<br>September 30, |                 |                             |              | Nine Months Ended<br>September 30, |                 |                             |              |
|------------------------------|-------------------------------------|-----------------|-----------------------------|--------------|------------------------------------|-----------------|-----------------------------|--------------|
|                              | Reserve<br>Reestimate               |                 | Effect on<br>Combined Ratio |              | Reserve<br>Reestimate              |                 | Effect on<br>Combined Ratio |              |
|                              | 2006                                | 2005            | 2006                        | 2005         | 2006                               | 2005            | 2006                        | 2005         |
| Auto                         | \$ (220)                            | \$ (276)        | (3.2)                       | (4.1)        | \$ (579)                           | \$ (501)        | (2.8)                       | (2.5)        |
| Homeowners                   | (134)                               | (12)            | (2.0)                       | (0.2)        | (264)                              | (4)             | (1.3)                       | —            |
| Other personal lines         | 18                                  | 4               | 0.3                         | 0.1          | (71)                               | 21              | (0.4)                       | 0.1          |
| Total Allstate Protection    | <u>\$ (336)</u>                     | <u>\$ (284)</u> | <u>(4.9)</u>                | <u>(4.2)</u> | <u>\$ (914)</u>                    | <u>\$ (484)</u> | <u>(4.5)</u>                | <u>(2.4)</u> |
| Allstate brand               | \$ (321)                            | \$ (275)        | (4.7)                       | (4.1)        | \$ (901)                           | \$ (485)        | (4.4)                       | (2.4)        |
| Encompass brand              | (15)                                | (9)             | (0.2)                       | (0.1)        | (13)                               | 1               | (0.1)                       | —            |
| Total Allstate Protection    | <u>\$ (336)</u>                     | <u>\$ (284)</u> | <u>(4.9)</u>                | <u>(4.2)</u> | <u>\$ (914)</u>                    | <u>\$ (484)</u> | <u>(4.5)</u>                | <u>(2.4)</u> |

Allstate Protection prior year favorable reserve reestimates in the three months ended September 30, 2006 and first nine months of 2006 totaled \$336 million and \$914 million, respectively, compared to \$284 million and \$484 million, respectively, in the same periods of the prior year, resulting primarily from claim severity and late reported loss development that were better than anticipated in previous estimates in Allstate Protection. Reserve reestimates in the three months and nine months ended September 30, 2006 also include favorable catastrophe loss reserve reestimates of \$9 million and \$135 million after reinsurance, respectively, for the 2004 and 2005 hurricanes primarily related to lower than expected claim severity for Hurricane Katrina and \$12 million and \$69 million, respectively, related to a reduction in our expected assessment from Citizens Property Insurance Corporation in Florida ("FL Citizens") based on recent communications made by the FL Citizens Board and other government officials as discussed in Note 7 to the Condensed Consolidated Financial Statements. We have also recouped \$16 million and \$45 million in the three months and nine months ended September 30, 2006 of the assessments paid in 2005.

#### 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.

| (in millions)             | Three Months Ended<br>September 30, |                 | Nine Months Ended<br>September 30, |                 |
|---------------------------|-------------------------------------|-----------------|------------------------------------|-----------------|
|                           | 2006                                | 2005            | 2006                               | 2005            |
| Premiums written          | \$ —                                | \$ —            | \$ 1                               | \$ 1            |
| Premiums earned           | \$ —                                | \$ 1            | \$ 2                               | \$ —            |
| Claims and claims expense | (115)                               | (135)           | (127)                              | (163)           |
| Other costs and expenses  | (3)                                 | (2)             | (8)                                | (7)             |
| Underwriting loss         | <u>\$ (118)</u>                     | <u>\$ (136)</u> | <u>\$ (133)</u>                    | <u>\$ (170)</u> |

Underwriting losses of \$118 million in the third quarter of 2006 and \$133 million in the first nine months of 2006 were primarily related to an \$86 million reestimate of asbestos reserves compared to a \$139 million reestimate in the same periods of 2005. Also contributing to the 2006 underwriting losses during these periods were a \$10 million reestimate of environmental reserves and a \$26 million increase in the allowance for future uncollectible reinsurance recoverables.

During the quarter, we completed our annual review to evaluate and establish asbestos, environmental and other discontinued lines reserves. Reserves are recorded in the reporting period in which they are determined. Using established industry and actuarial best practices and assuming no change in the regulatory or economic environment, this detailed and comprehensive "ground up" methodology determines reserves based on assessments of the characteristics of exposure (e.g. claim activity, potential liability, jurisdiction, products versus non-products exposure) presented to policyholders.

Our net asbestos reserves by type of exposure and total reserve additions are shown in the following table.

| (\$ in millions)                          | September 30, 2006      |                 |                  | December 31, 2005       |                 |                  |
|---|-------------------------|-----------------|------------------|-------------------------|-----------------|------------------|
|   | Active<br>Policyholders | Net<br>Reserves | % of<br>Reserves | Active<br>Policyholders | Net<br>Reserves | % of<br>Reserves |
| <b>Direct policyholders(1)</b>            |                         |                 |                  |                         |                 |                  |
| -Primary                                  | 45                      | \$ 16           | 1%               | 46                      | \$ 18           | 1%               |
| -Excess                                   | 338                     | 214             | 15               | 333                     | 180             | 13               |
| Total                                     | <u>383</u>              | <u>230</u>      | <u>16%</u>       | <u>379</u>              | <u>198</u>      | <u>14%</u>       |
| Assumed reinsurance                       |                         | 203             | 15               |                         | 215             | 16               |
| Incurred but not reported ("IBNR") claims |                         | 963             | 69               |                         | 960             | 70               |
| Total net reserves                        |                         | <u>\$ 1,396</u> | <u>100%</u>      |                         | <u>\$ 1,373</u> | <u>100%</u>      |

|  |    |      |    |      |
|--|----|------|----|------|
| Reserve additions  | \$ | 86   | \$ | 139  |
| Net survival ratio(2)  |    |      |    |      |
| -Annual  |    | 7.7  |    | 6.0  |
| -3-Year  |    | 10.6 |    | 10.7 |
| Net survival ratio excluding commutations,<br>policy buy-backs and settlement<br>agreements(2) |    |      |    |      |
| -Annual  |    | 21.1 |    | 24.9 |
| -3-Year  |    | 25.9 |    | 26.8 |

(1) During the first nine months of 2006, 22 direct primary and excess policyholders reported new claims, and claims of 18 policyholders were closed, so the number of direct policyholders with active claims increased by 4.

(2) Our survival ratios are at levels we consider indicative of a strong asbestos reserve position.

Reserve additions for asbestos were primarily for products-related coverage. They were essentially a result of reestimates of liabilities for increased assumed reinsurance cessions, as ceding companies (other insurance carriers) experienced increased claim activity. This increased claim activity over prior estimates has also resulted in an

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increased estimate for future claims reported. These trends are consistent with the trends of other carriers in the industry, which we believe are related to increased publicity and awareness of coverage, ongoing litigation and bankruptcy actions. However, we are somewhat encouraged that the pace of industry asbestos claim activity seems to be slowing, perhaps reflecting various recent state legislative actions and increased legal scrutiny of the legitimacy of claims. IBNR now represents 69% of total net asbestos reserves, one point lower than at December 31, 2005. IBNR provides for estimated probable future unfavorable reserve development of known claims and future reporting of additional unknown claims from current and new policyholders and ceding companies.

Our non-products case reserves represent approximately 5% of total asbestos case reserves. We do not anticipate significant changes in this percentage as insureds' retentions associated with excess insurance programs and assumed reinsurance exposure are seldom exceeded. We did not write direct primary insurance on policyholders with the potential for significant non-products-related loss exposure.

To further limit our asbestos exposure, we have significant reinsurance, primarily to reduce our exposure to loss in our direct excess insurance business. Our net reinsurance recoverables are estimated to be approximately 37% of our gross estimated loss reserves.

For environmental exposures, our "ground up" review resulted in \$10 million of unfavorable reserve reestimates related to existing active claims. There was essentially no change in environmental reserve reestimates as a result of this review in 2005.

As of September 30, 2006, the allowance for uncollectible reinsurance was \$235 million, or approximately 20% of total recoverables from reinsurers in the Discontinued Lines and Coverages segment.

We believe that our reserves are appropriately established based on assessments of pertinent factors and characteristics of exposure (e.g. claim activity, potential liability, jurisdiction, products versus non-products exposure) presented by individual policyholders, assuming no change in the legal, legislative or economic environment.

## PROPERTY-LIABILITY INVESTMENT RESULTS

**Net investment income** increased 0.2% in the third quarter of 2006 and 3.7% in the first nine months of 2006 when compared to the same periods of 2005. These increases were principally due to higher fixed income portfolio yields in both the third quarter and first nine months of 2006 compared to the same periods of 2005 and higher income from partnerships in the first nine months of 2006 compared to the same period of 2005.

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

| (in millions)                                | Three Months Ended<br>September 30, |        | Nine Months Ended<br>September 30, |         |
|--|-------------------------------------|--------|------------------------------------|---------|
|  | 2006                                | 2005   | 2006                               | 2005    |
| Investment write-downs                       | \$ (8)                              | \$ (6) | \$ (22)                            | \$ (20) |
| Dispositions                                 | 61                                  | 125    | 309                                | 385     |
| Valuation of derivative instruments          | 19                                  | 23     | 22                                 | (4)     |
| Settlements of derivative instruments        | (106)                               | 21     | (76)                               | 24      |
| Realized capital gains and losses, pretax    | (34)                                | 163    | 233                                | 385     |
| Income tax benefit (expense)                 | 12                                  | (64)   | (80)                               | (137)   |
| Realized capital gains and losses, after-tax | \$ (22)                             | \$ 99  | \$ 153                             | \$ 248  |

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

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## ALLSTATE FINANCIAL HIGHLIGHTS

- Net income declined 12.3% to \$135 million in the third quarter of 2006 and increased 3.9% to \$316 million in the first nine months of 2006 compared to the same periods in 2005.
- Allstate Financial gross margin declined 5.2% in the third quarter and increased 5.9% in the first nine months of 2006 compared to the same periods of 2005. Gross margin, a measure that is not based on GAAP, is defined on page 55.
- Contractholder fund deposits totaled \$2.38 billion and \$8.46 billion for the third quarter and first nine months of 2006, respectively, compared to \$1.87 billion and \$8.91 billion for the third quarter and first nine months of 2005, respectively.
- Investments as of September 30, 2006 increased 1.6% from September 30, 2005 and net investment income increased 9.1% and 9.8% in the third quarter and first nine months of 2006, respectively, compared to the same periods in the prior year.
- Dividends of \$300 million and \$125 million in the third quarter and second quarter of 2006, respectively, were paid by Allstate Life Insurance Company ("ALIC") to its parent, AIC. Subject to regulatory approval, ALIC expects to pay additional dividends of approximately \$150 million during the fourth quarter of 2006.
- On June 1, 2006, Allstate Financial completed the disposal of substantially all of its variable annuity business through reinsurance. Additionally, Allstate Financial transferred the loan protection business to the Allstate Protection segment effective January 1, 2006. When comparing the third quarter and first nine months of 2006 to the same period in the prior year, the following impacts to the Condensed Consolidated Statements of Operations and gross margin resulted from the disposal of the variable annuity business and the transfer of the loan protection business:

| (in millions)   | Three months ended<br>September 30, 2006<br>Compared to the<br>Same Period in the<br>Prior Year |       | Nine months ended<br>September 30, 2006<br>Compared to the<br>Same Period in the<br>Prior Year |       |
|---|---|-------|--|-------|
| <b>Favorable/(unfavorable)</b>  |   |       |  |       |
| Life and annuity premiums and contract charges                            | \$  | (110) | \$   | (172) |
| Net investment income   |   | (12)  |  | (21)  |
| Periodic settlements and accruals on non-hedge derivative instruments (1) |   | (1)   |  | (2)   |
| Contract benefits   |   | 42    |  | 100   |
| Interest credited to contractholder funds                                 |   | 17    |  | 19    |
| Amortization of DAC (2)   |   | 34    |  | (46)  |
| Operating costs and expenses  |   | 35    |  | 76    |
| Loss on disposition of operations   |   | 2     |  | (86)  |
| Income from operations before income tax expense                          | \$  | 7     | \$   | (132) |
| Investment margin   | \$  | 1     | \$   | (2)   |
| Benefit margin  |   | 1     |  | 14    |
| Contract charges and fees   |   | (70)  |  | (84)  |
| Gross margin (3)  | \$  | (68)  | \$   | (72)  |

- (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) Amortization deceleration of \$55 million was recognized in the first nine months of 2005 for variable annuities.
- (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 55, 57 and 58, respectively.

## ALLSTATE FINANCIAL SEGMENT

Summarized financial data is presented in the following table.

| (in millions)                                  | Three Months Ended<br>September 30, |         | Nine Months Ended<br>September 30, |          |
|--|-------------------------------------|---------|------------------------------------|----------|
|  | 2006                                | 2005    | 2006                               | 2005     |
| <b>Revenues</b>                                |                                     |         |                                    |          |
| Life and annuity premiums and contract charges | \$ 444                              | \$ 505  | \$ 1,454                           | \$ 1,525 |
| Net investment income                          | 1,063                               | 974     | 3,115                              | 2,838    |
| Realized capital gains and losses              | (30)                                | 27      | (138)                              | 52       |
| Total revenues                                 | 1,477                               | 1,506   | 4,431                              | 4,415    |
| <b>Costs and expenses</b>                      |                                     |         |                                    |          |
| Life and annuity contract benefits             | (388)                               | (395)   | (1,135)                            | (1,209)  |
| Interest credited to contractholder funds      | (667)                               | (608)   | (1,939)                            | (1,784)  |
| Amortization of DAC                            | (121)                               | (131)   | (434)                              | (496)    |
| Operating costs and expenses                   | (102)                               | (142)   | (349)                              | (482)    |
| Restructuring and related charges              | (5)                                 | (1)     | (24)                               | (1)      |
| Total costs and expenses                       | (1,283)                             | (1,277) | (3,881)                            | (3,972)  |

|                                   |                  |                  |                  |                  |
|-----------------------------------|------------------|------------------|------------------|------------------|
| Loss on disposition of operations | (1)              | (4)              | (88)             | (12)             |
| Income tax expense                | (58)             | (71)             | (146)            | (127)            |
| Net income                        | <u>\$ 135</u>    | <u>\$ 154</u>    | <u>\$ 316</u>    | <u>\$ 304</u>    |
| Investments                       | <u>\$ 77,125</u> | <u>\$ 75,881</u> | <u>\$ 77,125</u> | <u>\$ 75,881</u> |

**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, variable annuities, fixed annuities and institutional products 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 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<br>September 30, |               | Nine Months Ended<br>September 30, |                 |
|---|-------------------------------------|---------------|------------------------------------|-----------------|
|   | 2006                                | 2005          | 2006                               | 2005            |
| <b>Premiums</b>                                       |                                     |               |                                    |                 |
| Traditional life                                      | \$ 68                               | \$ 68         | \$ 207                             | \$ 204          |
| Immediate annuities with life contingencies           | 59                                  | 37            | 177                                | 160             |
| Accident and health and other                         | 84                                  | 113           | 247                                | 325             |
| <b>Total premiums</b>                                 | <u>211</u>                          | <u>218</u>    | <u>631</u>                         | <u>689</u>      |
| <b>Contract charges</b>                               |                                     |               |                                    |                 |
| Interest-sensitive life                               | 215                                 | 196           | 632                                | 581             |
| Fixed annuities                                       | 17                                  | 16            | 53                                 | 49              |
| Variable annuities                                    | 1                                   | 75            | 138                                | 206             |
| <b>Total contract charges</b>                         | <u>233</u>                          | <u>287</u>    | <u>823</u>                         | <u>836</u>      |
| <b>Life and annuity premiums and contract charges</b> | <u>\$ 444</u>                       | <u>\$ 505</u> | <u>\$ 1,454</u>                    | <u>\$ 1,525</u> |

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

| (in millions)   | Three Months Ended<br>September 30, |               | Nine Months Ended<br>September 30, |                 |
|---|-------------------------------------|---------------|------------------------------------|-----------------|
|   | 2006                                | 2005          | 2006                               | 2005            |
| <b>Premiums</b>                                       |                                     |               |                                    |                 |
| Allstate agencies                                     | \$ 76                               | \$ 83         | \$ 269                             | \$ 283          |
| Independent agents                                    | 85                                  | 113           | 210                                | 289             |
| Specialized brokers                                   | 49                                  | 22            | 150                                | 115             |
| Other   | 1                                   | —             | 2                                  | 2               |
| <b>Total premiums</b>                                 | <u>211</u>                          | <u>218</u>    | <u>631</u>                         | <u>689</u>      |
| <b>Contract charges</b>                               |                                     |               |                                    |                 |
| Allstate agencies                                     | 138                                 | 129           | 413                                | 388             |
| Independent agents                                    | 77                                  | 78            | 240                                | 224             |
| Financial institutions                                | 13                                  | 73            | 155                                | 202             |
| Specialized brokers                                   | 4                                   | 6             | 13                                 | 20              |
| Other   | 1                                   | 1             | 2                                  | 2               |
| <b>Total contract charges</b>                         | <u>233</u>                          | <u>287</u>    | <u>823</u>                         | <u>836</u>      |
| <b>Life and annuity premiums and contract charges</b> | <u>\$ 444</u>                       | <u>\$ 505</u> | <u>\$ 1,454</u>                    | <u>\$ 1,525</u> |

Total premiums decreased 3.2% to \$211 million in the third quarter of 2006 and declined 8.4% to \$631 million in the first nine months of 2006 compared to the same periods of 2005. Excluding the impact of the transfer of the loan protection business to the Allstate Protection segment effective January 1, 2006, premiums increased 11.6% in the third quarter and 4.3% in the first nine months of 2006 compared to the same periods of 2005. The comparable increase in the third quarter and first nine months of 2006 was attributable primarily to increased premiums on immediate annuities sold with life contingencies. Additionally, for the first nine months of 2006, excluding the impact of the transfer of the loan protection business, accident and health and other premiums increased \$6 million due to increased sales.

Contract charges declined 18.8% to \$233 million in the third quarter of 2006 and 1.6% to \$823 million in the first nine months of 2006 compared to the same periods of 2005. Excluding contract charges on variable annuities, substantially all of which are reinsured to Prudential effective June 1, 2006, contract charges increased 9.4% and

8.7% in the third quarter and first nine months of 2006, respectively, compared to the same periods of 2005. These increases were mostly due to higher contract charges on interest-sensitive life products resulting from growth of business in force. Contract charges on fixed annuities were slightly higher in the third quarter and first nine months of 2006 due to increased surrender charges.

*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<br>September 30, |                  | Nine Months Ended<br>September 30, |                  |
|--|-------------------------------------|------------------|------------------------------------|------------------|
|  | 2006                                | 2005 (1)         | 2006                               | 2005 (1)         |
| <b>Contractholder funds, beginning balance</b>                 | \$ 62,008                           | \$ 59,182        | \$ 60,040                          | \$ 55,709        |
| <b>Deposits</b>  |                                     |                  |                                    |                  |
| Fixed annuities  | 1,838                               | 1,191            | 5,055                              | 4,465            |
| Institutional products (funding agreements)                    | —                                   | —                | 1,600                              | 2,423            |
| Interest-sensitive life  | 352                                 | 363              | 1,052                              | 1,046            |
| Variable annuity and life deposits allocated to fixed accounts | —                                   | 107              | 98                                 | 313              |
| Bank and other deposits  | 194                                 | 211              | 651                                | 659              |
| Total deposits   | 2,384                               | 1,872            | 8,456                              | 8,906            |
| <b>Interest credited</b>                                       | 686                                 | 617              | 1,987                              | 1,774            |
| <b>Maturities, benefits, withdrawals and other adjustments</b> |                                     |                  |                                    |                  |
| Maturities of institutional products                           | (776)                               | (909)            | (2,039)                            | (2,202)          |
| Benefits   | (382)                               | (336)            | (1,145)                            | (1,007)          |
| Surrenders and partial withdrawals                             | (1,368)                             | (1,164)          | (4,175)                            | (3,239)          |
| Contract charges   | (187)                               | (175)            | (554)                              | (519)            |
| Net transfers to separate accounts                             | (1)                                 | (94)             | (146)                              | (249)            |
| Fair value hedge adjustments for institutional products        | 16                                  | (64)             | (4)                                | (237)            |
| Other adjustments  | 15                                  | 23               | (25)                               | 16               |
| Total maturities, benefits, withdrawals and other adjustments  | (2,683)                             | (2,719)          | (8,088)                            | (7,437)          |
| <b>Contractholder funds, ending balance</b>                    | <u>\$ 62,395</u>                    | <u>\$ 58,952</u> | <u>\$ 62,395</u>                   | <u>\$ 58,952</u> |

(1) To conform to the current period presentation, certain prior period balances have been reclassified.

Contractholder funds increased 0.6% and 3.9% in the third quarter and first nine months of 2006, respectively. In comparison, contractholder funds declined slightly in the third quarter of 2005 and increased 5.8% in the first nine months of 2005. Average contractholder funds increased 5.3% and 6.8% in the third quarter and first nine months of 2006, respectively, compared to the same periods in 2005.

Contractholder deposits increased 27.4% in the third quarter and decreased 5.1% in the first nine months of 2006, compared to the same periods of 2005. The increase in the third quarter was the result of higher deposits on fixed annuities, mostly driven by increased deposits on traditional deferred annuities. The magnitude of this increase reflects relatively low deposits in the third quarter of 2005. Additionally, deposits on our innovative Allstate® Treasury-Linked Annuity contracts were \$283 million in the third quarter of 2006, an increase of \$226 million over the prior period. The crediting rate on this patented product is indexed to the 5-year treasury rate, which increases the crediting rate to the customer in a rising interest rate environment. The increase in fixed annuity deposits in the third quarter was partially offset by the absence of variable annuity deposits allocated to the fixed accounts in the third quarter of 2006 due to the disposal of substantially all of our variable annuity business on June

1, 2006. The decline in contractholder fund deposits in the first nine months of 2006 was attributable to decreased deposits on funding agreements and, to a lesser extent, lower variable annuity and life deposits allocated to fixed accounts, partially offset by higher fixed annuity deposits. Higher fixed annuity deposits in the first nine months of 2006 were mostly the result of a \$584 million increase in deposits on Allstate® Treasury-Linked Annuity contracts. Allstate Financial prioritizes the allocation of fixed income investments to support sales of retail products having the best opportunity for sustainable growth and return while maintaining a retail market presence. Partially as a result of this strategy, there were no sales of institutional products in the third quarter. The opportunistic manner in which we manage this business results in fluctuations in funding agreement deposits between periods.

Surrenders and partial withdrawals on deferred fixed annuities, interest-sensitive life products and Allstate Bank products increased 17.5% and 28.9% in the third quarter and first nine months of 2006, respectively, compared to the same periods of 2005. The annualized withdrawal rate on these products was 12.6% for the third quarter of 2006 and 13.0% for the first nine months of 2006 based on the beginning of period contractholder funds balance. This compares to an annualized withdrawal rate of 10.9% for the third quarter of 2005 and 10.7% for the first nine months of 2005. The relatively low interest rate environment of the prior three years contributed to favorable withdrawal rates through 2005, and also resulted in an increased level of policies with little or no surrender charge protection. The increases in the withdrawal rate in the third quarter and first nine months of 2006 are consistent with management's expectation that in an increasing interest rate environment contractholders whose contracts have relatively low or no surrender charges may

choose to move their funds to competing investment alternatives. The aging of our in-force business may cause this trend to continue. In addition, we have implemented crediting rate strategies for renewal business to improve investment spreads on selected contracts that may also have contributed to the increased withdrawal rate.

**Net investment income** increased 9.1% in the third quarter and 9.8% in the first nine months of 2006 compared to the same periods of 2005 due to increased investment yields and higher average portfolio balances. The higher portfolio yields were primarily due to increased yields on floating rate instruments resulting from higher market interest rates. 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.

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

| <u>(in millions)</u>   | <b>Three Months Ended<br/>September 30,</b> |               | <b>Nine Months Ended<br/>September 30,</b> |               |
|--|---|---------------|--|---------------|
|  | <b>2006</b>                                 | <b>2005</b>   | <b>2006</b>                                | <b>2005</b>   |
| Life and annuity premiums and contract charges   | \$ 444                                      | \$ 505        | \$ 1,454                                   | \$ 1,525      |
| Net investment income  | 1,063                                       | 974           | 3,115                                      | 2,838         |
| Periodic settlements and accruals on non-hedge derivative instruments (1)                            | 14  | 14            | 44   | 49            |
| Contract benefits  | (388)                                       | (395)         | (1,135)                                    | (1,209)       |
| Interest credited to contractholder funds (2)  | (658)                                       | (597)         | (1,907)                                    | (1,719)       |
| Gross margin   | <u>475</u>                                  | <u>501</u>    | <u>1,571</u>                               | <u>1,484</u>  |
| Amortization of DAC and DSI (3)  | (155)                                       | (139)         | (529)                                      | (398)         |
| Operating costs and expenses   | (102)                                       | (142)         | (349)                                      | (482)         |
| Restructuring and related charges  | (5)   | (1)           | (24)                                       | (1)           |
| Income tax expense   | (65)  | (63)          | (217)                                      | (183)         |
| Realized capital gains and losses, after-tax   | (19)  | 17            | (89)                                       | 33            |
| DAC and DSI amortization relating to realized capital gains and losses, after-tax (3)                | 16  | (2)           | 40   | (106)         |
| Reclassification of periodic settlements and accruals on non-hedge derivative instruments, after-tax | (9)   | (10)          | (28)                                       | (32)          |
| Loss on disposition of operations, after-tax   | (1)   | (7)           | (59)                                       | (11)          |
| <b>Net income</b>  | <u>\$ 135</u>                               | <u>\$ 154</u> | <u>\$ 316</u>                              | <u>\$ 304</u> |

(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 totaled \$9 million and \$11 million in the three months ended September 30, 2006 and 2005, respectively, and \$32 million and \$65 million in the first nine months of 2006 and 2005, respectively.

(3) Amortization of DAC and DSI relating to realized capital gains and losses is analyzed separately because realized capital gains and losses may vary significantly between periods and obscure trends in our business. Amortization of DAC and DSI relating to realized capital gains and losses were \$25 million and \$(3) million in the third quarter of 2006 and 2005, respectively, and were \$63 million and \$(163) million in the first nine months of 2006 and 2005, respectively.

*Gross margin*, a non-GAAP measure, represents life and annuity premiums and contract charges, net investment income and periodic settlements and accruals on non-hedge derivative instruments, less contract benefits and interest credited to contractholder funds excluding amortization of DSI. We reclassify periodic settlements and accruals on non-hedge derivative instruments into gross margin to report them in a manner consistent with the economically hedged investments, replicated assets or product attributes (e.g. net investment income or interest credited to contractholder funds) and, by doing so, appropriately reflect trends in product performance. We use gross margin as a component of our evaluation of the profitability of Allstate Financial’s life insurance and financial product portfolio. Additionally, for many of our products, including fixed annuities, variable life and annuities, and interest-sensitive life insurance, the amortization of DAC and DSI is determined based on actual and expected gross margin. Gross margin is comprised of three components that are utilized to further analyze the business: investment margin, benefit margin, and contract charges and fees. We believe gross margin and its components are useful to investors because they allow for the evaluation of income components separately and in the aggregate when reviewing performance. Gross margin, investment margin and benefit margin should not be considered as a substitute for net income and do not reflect the overall profitability of the business. Net income is the GAAP

measure that is most directly comparable to these margins. Gross margin is reconciled to Allstate Financial’s GAAP net income in the table above.

The components of gross margin are reconciled to the corresponding financial statement line items in the following table.

| (in millions)  | Investment Margin |               | Benefit Margin(3) |               | Contract Charges and Fees |               | Gross Margin  |               |
|--|-------------------|---------------|-------------------|---------------|---------------------------|---------------|---------------|---------------|
|  | 2006              | 2005          | 2006              | 2005          | 2006                      | 2005          | 2006          | 2005          |
| Life and annuity premiums  | \$ —              | \$ —          | \$ 211            | \$ 218        | \$ —                      | \$ —          | \$ 211        | \$ 218        |
| Contract charges   | —                 | —             | 154               | 158           | 79                        | 129           | 233           | 287           |
| Net investment income  | 1,063             | 974           | —                 | —             | —                         | —             | 1,063         | 974           |
| Periodic settlements and accruals on non-hedge derivative instruments(1) | 14                | 14            | —                 | —             | —                         | —             | 14            | 14            |
| Contract benefits  | (139)             | (135)         | (249)             | (260)         | —                         | —             | (388)         | (395)         |
| Interest credited to contractholder funds(2)                             | (658)             | (597)         | —                 | —             | —                         | —             | (658)         | (597)         |
|  | <u>\$ 280</u>     | <u>\$ 256</u> | <u>\$ 116</u>     | <u>\$ 116</u> | <u>\$ 79</u>              | <u>\$ 129</u> | <u>\$ 475</u> | <u>\$ 501</u> |

| (in millions)  | Investment Margin |               | Benefit Margin(3) |               | Contract Charges and Fees |               | Gross Margin    |                 |
|--|-------------------|---------------|-------------------|---------------|---------------------------|---------------|-----------------|-----------------|
|  | 2006              | 2005          | 2006              | 2005          | 2006                      | 2005          | 2006            | 2005            |
| Life and annuity premiums  | \$ —              | \$ —          | \$ 631            | \$ 689        | \$ —                      | \$ —          | \$ 631          | \$ 689          |
| Contract charges   | —                 | —             | 482               | 465           | 341                       | 371           | 823             | 836             |
| Net investment income  | 3,115             | 2,838         | —                 | —             | —                         | —             | 3,115           | 2,838           |
| Periodic settlements and accruals on non-hedge derivative instruments(1) | 44                | 49            | —                 | —             | —                         | —             | 44              | 49              |
| Contract benefits  | (405)             | (398)         | (730)             | (811)         | —                         | —             | (1,135)         | (1,209)         |
| Interest credited to contractholder funds(2)                             | (1,907)           | (1,719)       | —                 | —             | —                         | —             | (1,907)         | (1,719)         |
|  | <u>\$ 847</u>     | <u>\$ 770</u> | <u>\$ 383</u>     | <u>\$ 343</u> | <u>\$ 341</u>             | <u>\$ 371</u> | <u>\$ 1,571</u> | <u>\$ 1,484</u> |

(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 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 totaled \$9 million and \$11 million in the three months ended September 30, 2006 and 2005, respectively, and \$32 million and \$65 million in the first nine months of 2006 and 2005, respectively.

Gross margin declined 5.2% in the third quarter of 2006 and increased 5.9% in the first nine months of 2006 compared to the same periods of 2005. In the third quarter of 2006, higher investment margin was more than offset by lower contract charges and fees resulting from the absence of variable annuity contract charges in the current period due to the disposal of substantially all of Allstate Financial's variable annuity business. Benefit margin and contract charges and fees were reduced by the transfer of the loan protection business to the Allstate Protection segment effective January 1, 2006. In the first nine months of 2006, increased investment and benefit margin more than offset the declines from the disposition of the variable annuity business and the transfer of the loan protection business.

*Investment margin* is a component of gross margin, both of which are non-GAAP measures. Investment margin represents the excess of net investment income and periodic settlements and accruals on certain non-hedge derivative instruments over interest credited to contractholder funds and the implied interest on life-contingent immediate annuities included in the reserve for life-contingent contract benefits. Amortization of DSI is excluded from interest credited to contractholder funds for purposes of calculating investment margin. We use investment margin to evaluate Allstate Financial's profitability related to the difference between investment returns on assets supporting certain products and amounts credited to customers ("spread") during a fiscal period.

Investment margin by product group is shown in the following table.

| (in millions)           | Three Months Ended September 30, |               | Nine Months Ended September 30, |               |
|-------------------------|----------------------------------|---------------|---------------------------------|---------------|
|                         | 2006                             | 2005          | 2006                            | 2005          |
| Annuities               | \$ 188                           | \$ 171        | \$ 579                          | \$ 504        |
| Life insurance          | 61                               | 51            | 166                             | 168           |
| Institutional products  | 31                               | 32            | 95                              | 89            |
| Bank and other          | —                                | 2             | 7                               | 9             |
| Total investment margin | <u>\$ 280</u>                    | <u>\$ 256</u> | <u>\$ 847</u>                   | <u>\$ 770</u> |

Investment margin increased 9.4% in the third quarter and 10.0% in the first nine months of 2006 compared to the same periods of 2005. The increase in both periods was primarily due to improved yields on assets supporting deferred fixed annuities, crediting rate actions relating to renewal business and growth in contractholder funds.

The following table summarizes the annualized weighted average investment yield, interest crediting rates and investment spreads for the three months ended September 30.

|                          | Weighted Average Investment Yield |      | Weighted Average Interest Crediting Rate |      | Weighted Average Investment Spreads |      |
|--------------------------|-----------------------------------|------|--|------|-------------------------------------|------|
|                          | 2006                              | 2005 | 2006                                     | 2005 | 2006                                | 2005 |
| Interest-sensitive life  | 6.2%                              | 6.2% | 4.7%                                     | 4.8% | 1.5%                                | 1.4% |
| Deferred fixed annuities | 5.8                               | 5.4  | 3.8                                      | 3.8  | 2.0                                 | 1.6  |



|   |     |     |     |     |     |     |
|---|-----|-----|-----|-----|-----|-----|
| Immediate fixed annuities with and without life contingencies       | 7.2 | 7.3 | 6.7 | 6.7 | 0.5 | 0.6 |
| Institutional   | 6.4 | 5.0 | 5.4 | 3.9 | 1.0 | 1.1 |
| Investments supporting capital, traditional life and other products | 6.2 | 5.8 | N/A | N/A | N/A | N/A |

The following table summarizes the annualized weighted average investment yield, interest crediting rates and investment spreads for the nine months ended September 30.

|   | Weighted Average Investment Yield |      | Weighted Average Interest Crediting Rate |      | Weighted Average Investment Spreads |      |
|---|-----------------------------------|------|--|------|-------------------------------------|------|
|   | 2006                              | 2005 | 2006                                     | 2005 | 2006                                | 2005 |
| Interest-sensitive life   | 6.2%                              | 6.3% | 4.7%                                     | 4.8% | 1.5%                                | 1.5% |
| Deferred fixed annuities  | 5.7                               | 5.5  | 3.7                                      | 3.8  | 2.0                                 | 1.7  |
| Immediate fixed annuities with and without life contingencies       | 7.2                               | 7.4  | 6.6                                      | 6.7  | 0.6                                 | 0.7  |
| Institutional   | 6.0                               | 4.4  | 5.0                                      | 3.4  | 1.0                                 | 1.0  |
| Investments supporting capital, traditional life and other products | 6.1                               | 6.0  | N/A                                      | N/A  | N/A                                 | N/A  |

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The following table summarizes the liabilities for these contracts and policies.

| (in millions)  | As of September 30, |                  |
|--|---------------------|------------------|
|  | 2006                | 2005             |
| Immediate fixed annuities with life contingencies                    | \$ 8,051            | \$ 7,853         |
| Other life contingent contracts and other                            | 4,621               | 4,537            |
| Reserve for life-contingent contract benefits                        | <u>\$ 12,672</u>    | <u>\$ 12,390</u> |
| Interest-sensitive life  | \$ 9,237            | \$ 8,930         |
| Deferred fixed annuities   | 35,798              | 33,422           |
| Immediate fixed annuities without life contingencies                 | 3,727               | 3,433            |
| Institutional  | 12,459              | 11,827           |
| Allstate Bank  | 781                 | 894              |
| Market value adjustments related to derivative instruments and other | 393                 | 446              |
| Contractholder funds   | <u>\$ 62,395</u>    | <u>\$ 58,952</u> |

*Benefit margin* is a component of gross margin, both of which are non-GAAP measures. Benefit margin represents life and life-contingent immediate annuity premiums, cost of insurance contract charges and, prior to the disposal of substantially all of our variable annuity business through reinsurance, variable annuity contract charges for contract guarantees less contract benefits. Benefit margin excludes the implied interest on life-contingent immediate annuities, which is included in the calculation of investment margin. We use benefit margin to evaluate Allstate Financial's underwriting performance, as it reflects the profitability of our products with respect to mortality or morbidity risk during a fiscal period.

Benefit margin by product group is shown in the following table.

| (in millions)        | Three Months Ended September 30, |               | Nine Months Ended September 30, |               |
|----------------------|----------------------------------|---------------|---------------------------------|---------------|
|                      | 2006                             | 2005          | 2006                            | 2005          |
| Life insurance       | \$ 129                           | \$ 132        | \$ 414                          | \$ 398        |
| Annuities            | (13)                             | (16)          | (31)                            | (55)          |
| Total benefit margin | <u>\$ 116</u>                    | <u>\$ 116</u> | <u>\$ 383</u>                   | <u>\$ 343</u> |

Benefit margin was consistent in the third quarter of 2006 compared to the third quarter of 2005 and increased 11.7% in the first nine months of 2006 compared to the same period in 2005. Benefit margin for the third quarter and first nine months of 2005 includes \$15 million and \$43 million, respectively, of amounts that were classified as contract charges and fees beginning in 2006. Further, benefit margin for the first nine months of 2005 includes \$15 million related to the loan protection business transferred to Allstate Protection in 2006. Excluding these items, benefit margin increased 14.9% and 34.4% in the third quarter and first nine months of 2006, respectively. The improvement in the third quarter of 2006 was the result of growth in life insurance in force and modest improvements in mortality experience. The increase in the first nine months of 2006 was due primarily to improved life insurance mortality experience, growth in business in force and lower variable annuity benefits.

*Amortization of DAC and DSI*, excluding amortization related to realized capital gains and losses, increased 11.5% in the third quarter of 2006 and 32.9% in the first nine months of 2006 compared to the same periods of 2005. The increase in both periods was primarily due to improved gross profits on investment contracts resulting from increased investment and benefit margin, and lower expenses. Partially offsetting this impact, in both periods, was the absence of amortization on the variable annuity contracts that were reinsured effective June 1, 2006. DAC and DSI amortization related to realized capital gains and losses, after-tax, changed by a favorable \$18 million and \$146 million in the third quarter and first nine months of 2006, respectively, compared to the same periods in 2005. The impact of realized capital gains and losses on amortization of DAC and DSI is dependent upon the relationship

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between the assets that give rise to the gain or loss and the product liability supported by the assets. Fluctuations result from changes in the impact of realized capital gains and losses on actual and expected gross profits.

DAC and DSI were reduced by \$726 million and \$70 million, respectively, in the first nine months of 2006 as a result of the disposition of substantially all of Allstate Financial's variable annuity business.

Operating costs and expenses declined 28.2% and 27.6% in the third quarter and first nine months of 2006, respectively, compared to the same periods of 2005. The following table summarizes operating costs and expenses.

| (in millions)                      | Three Months Ended<br>September 30, |               | Nine Months Ended<br>September 30, |               |
|------------------------------------|-------------------------------------|---------------|------------------------------------|---------------|
|                                    | 2006                                | 2005          | 2006                               | 2005          |
| Non-deferrable acquisition costs   | \$ 38                               | \$ 65         | \$ 137                             | \$ 187        |
| Other operating costs and expenses | 64                                  | 77            | 212                                | 295           |
| Total operating costs and expenses | <u>\$ 102</u>                       | <u>\$ 142</u> | <u>\$ 349</u>                      | <u>\$ 482</u> |
| Restructuring and related charges  | <u>\$ 5</u>                         | <u>\$ 1</u>   | <u>\$ 24</u>                       | <u>\$ 1</u>   |

Non-deferrable acquisition costs declined 41.5% in the third quarter of 2006 and 26.7% in the first nine months of 2006 compared to the same periods of 2005 due primarily to the transfer of the loan protection business to Allstate Protection effective January 1, 2006 and a reduction in non-deferrable commissions due to the disposal of substantially all of Allstate Financial's variable annuity business. Non-deferrable acquisition costs related to the loan protection business amounted to \$10 million and \$29 million in the third quarter and first nine months of 2005, respectively. Other operating costs and expenses declined 16.9% in the third quarter of 2006 and 28.1% in the first nine months of 2006 compared to the same periods in 2005. The decline in other operating costs and expenses in the third quarter was primarily the result of lower variable annuity related expenses and the transfer of the loan protection business, partially offset by higher pension expense. The decline in other operating costs and expenses in the first nine months of 2006 compared to the same period in the prior year was primarily attributable to a \$28 million charge in the prior year for an increase in a liability for future benefits of a previously discontinued benefit plan and, to a lesser extent, the impact of the transfer of the loan protection business and lower variable annuity related expenses. Other operating costs and expenses for the third quarter and first nine months of 2005 include \$5 million and \$16 million, respectively, related to the loan protection business. The third quarter and first nine months of 2006 reflect reduced tax benefits for adjustments to prior years' tax liabilities compared to the same periods in the prior year.

Restructuring and related charges for the first nine months of 2006 reflect costs related to the VTO (for more information on the VTO, see Note 6 to the Condensed Consolidated Financial Statements).

Net realized capital gains and losses are presented in the following table.

| (in millions)                                | Three Months Ended<br>September 30, |              | Nine Months Ended<br>September 30, |              |
|--|-------------------------------------|--------------|------------------------------------|--------------|
|  | 2006                                | 2005         | 2006                               | 2005         |
| Investment write-downs                       | \$ (8)                              | \$ (10)      | \$ (17)                            | \$ (23)      |
| Dispositions                                 | 33                                  | 24           | (118)                              | 122          |
| Valuation of derivative instruments          | (47)                                | (32)         | (33)                               | (101)        |
| Settlement of derivative instruments         | (8)                                 | 45           | 30                                 | 54           |
| Realized capital gains and losses, pretax    | <u>(30)</u>                         | <u>27</u>    | <u>(138)</u>                       | <u>52</u>    |
| Income tax benefit (expense)                 | 11                                  | (10)         | 49                                 | (19)         |
| Realized capital gains and losses, after-tax | <u>\$ (19)</u>                      | <u>\$ 17</u> | <u>\$ (89)</u>                     | <u>\$ 33</u> |

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

## INVESTMENTS

An important component of our financial results is the return on our investment portfolios. Investment portfolios are segmented between the Property-Liability, Allstate Financial and Corporate and Other operations. The investment portfolios are managed based upon the nature of each respective business and its corresponding liability structure. The composition of the investment portfolios at September 30, 2006 is presented in the table below.

| (in millions)              | Property-Liability |                  | Allstate Financial(3) |                  | Corporate and Other(3) |                  | Total             |                  |
|----------------------------|--------------------|------------------|-----------------------|------------------|------------------------|------------------|-------------------|------------------|
|                            |                    | Percent to total |                       | Percent to total |                        | Percent to total |                   | Percent to total |
| Fixed income securities(1) | \$ 33,285          | 78.9%            | \$ 64,606             | 83.8%            | \$ 2,028               | 70.6%            | \$ 99,919         | 81.8%            |
| Equity securities(2)       | 6,818              | 16.2             | 476                   | 0.6              | 83                     | 2.9              | 7,377             | 6.0              |
| Mortgage loans             | 590                | 1.4              | 8,526                 | 11.0             | —                      | —                | 9,116             | 7.5              |
| Short-term                 | 1,488              | 3.5              | 1,595                 | 2.1              | 762                    | 26.5             | 3,845             | 3.1              |
| Other                      | 2                  | —                | 1,922                 | 2.5              | —                      | —                | 1,924             | 1.6              |
| Total                      | <u>\$ 42,183</u>   | <u>100.0%</u>    | <u>\$ 77,125</u>      | <u>100.0%</u>    | <u>\$ 2,873</u>        | <u>100.0%</u>    | <u>\$ 122,181</u> | <u>100.0%</u>    |

(1) Fixed income securities are carried at fair value. Amortized cost basis for these securities was \$32.43 billion, \$62.87 billion and \$1.88 billion for Property-Liability, Allstate Financial and Corporate and Other, respectively.

(2) Equity securities are carried at fair value. Cost basis for these securities was \$5.37 billion, \$466 million, and \$83 million for Property-Liability, Allstate Financial and Corporate and Other, respectively.

(3) Balances reflect the elimination of related party investments between Allstate Financial and Corporate and Other.

Total investments increased to \$122.18 billion at September 30, 2006 from \$118.30 billion at December 31, 2005, primarily due to positive cash flows from operating activities including increased funds associated with securities lending, partially offset by decreased net unrealized gains on fixed income securities and the transfer of funds in conjunction with the disposition of substantially all of our variable annuity business.

The Property-Liability investment portfolio increased to \$42.18 billion at September 30, 2006, from \$39.57 billion at December 31, 2005, primarily due to positive cash flows from operating activities.

The Allstate Financial investment portfolio increased to \$77.13 billion at September 30, 2006, from \$75.23 billion at December 31, 2005, primarily due to positive cash flows from operating and financing activities including increased funds associated with securities lending, partially offset by decreased net unrealized gains on fixed income securities and payments totaling approximately \$812 million related to the disposition of substantially all of our variable annuity business.

The Corporate and Other investment portfolio decreased to \$2.87 billion at September 30, 2006, from \$3.49 billion at December 31, 2005, primarily due to cash flows used in financing activities, partially offset by proceeds from our debt issuance. For further information on our debt issuance, see the Capital Resources and Liquidity section of the MD&A.

Total investments at amortized cost related to collateral received in connection with securities lending activities, funds received in connection with securities repurchase agreements, and collateral posted by counterparties related to derivative transactions, increased to \$5.47 billion at September 30, 2006, from \$4.10 billion at December 31, 2005.

At September 30, 2006, 94.8% of the consolidated fixed income securities portfolio was rated investment grade, which is defined as a security having a rating from the National Association of Insurance Commissioners ("NAIC") of 1 or 2; a rating of Aaa, Aa, A or Baa from Moody's or a rating of AAA, AA, A or BBB from S&P, Fitch or Dominion; or a comparable internal rating if an externally provided rating is not available.

The unrealized net capital gains on fixed income and equity securities at September 30, 2006 were \$4.19 billion, a decrease of \$393 million or 8.6% since December 31, 2005. The net unrealized gain for the fixed income portfolio totaled \$2.73 billion, comprised of \$3.38 billion of unrealized gains and \$645 million of unrealized losses at September 30, 2006. This is compared to a net unrealized gain for the fixed income portfolio totaling \$3.29 billion at December 31, 2005, comprised of \$3.90 billion of unrealized gains and \$614 million of unrealized losses.

Of the gross unrealized losses in the fixed income portfolio at September 30, 2006, \$607 million or 94.1% were related to investment grade securities and are believed to be primarily a result of a rising interest rate environment. Of the remaining \$38 million of losses in the fixed income portfolio, \$29 million or 76.3% were in the corporate fixed income portfolio. The \$29 million of corporate fixed income gross unrealized losses were primarily comprised of securities in the consumer goods, communications and capital goods sectors. The gross unrealized losses in these sectors were primarily company specific and interest rate related. Approximately \$13 million of the total gross unrealized losses in the corporate fixed income portfolio were associated with the automobile industry, which includes direct debt issuances of automobile manufacturers, captive automotive financing companies and automobile parts and equipment suppliers, which are reported in the consumer goods and financial services sectors. Fixed income security values in the automobile industry were depressed primarily due to company specific conditions. Additionally, approximately \$5 million of the total gross unrealized losses were associated with the airline industry for which values were depressed due to economic issues and industry conditions.

The net unrealized gain for the equity portfolio totaled \$1.46 billion, comprised of \$1.49 billion of unrealized gains and \$34 million of unrealized losses at September 30, 2006. This is compared to a net unrealized gain for the equity portfolio totaling \$1.29 billion at December 31, 2005, comprised of \$1.31 billion of unrealized gains and \$22 million of unrealized losses. Within the equity portfolio, the losses were primarily concentrated in the consumer goods, technology, energy and capital goods sectors. The losses in these sectors were company specific.

Our portfolio monitoring process identifies and evaluates, on a case-by-case basis, fixed income and equity securities whose carrying value may be other-than-temporarily impaired. The process includes a quarterly review of all securities using a screening process to identify those securities whose fair value compared to amortized cost for fixed income securities or cost for equity securities is below established thresholds for certain time periods, or which are identified through other monitoring criteria such as ratings downgrades or payment defaults. As a result of approved programs involving the disposition of investments such as changes in duration and revisions to strategic asset allocations, and certain dispositions anticipated by portfolio managers, we also conduct a portfolio review to recognize impairment on securities in an unrealized loss position for which we do not have the intent and ability to hold until recovery. All securities in an unrealized loss position at September 30, 2006 were included in our portfolio monitoring process for determining which declines in value were not other-than-temporary.

We also monitor the quality of our fixed income portfolio by categorizing certain investments as "problem", "restructured" or "potential problem." Problem fixed income securities are securities in default with respect to principal or interest and/or securities issued by companies that have gone into bankruptcy subsequent to our acquisition of the security. Restructured fixed income securities have rates and terms that are not consistent with market rates or terms prevailing at the time of the restructuring. Potential problem fixed income securities are current with respect to contractual principal and/or interest, but because of other facts and circumstances, we have concerns regarding the borrower's ability to pay future principal and interest, which causes us to believe these securities may be classified as problem or restructured in the future.

The following table summarizes problem, restructured and potential problem fixed income securities.

| (in millions)     | September 30, 2006 |            |   | December 31, 2005 |            |   |
|-------------------|--------------------|------------|---|-------------------|------------|---|
|                   | Amortized cost     | Fair value | Percent of total Fixed Income portfolio | Amortized cost    | Fair value | Percent of total Fixed Income portfolio |
| Problem           | \$ 61              | \$ 71      | 0.1%                                    | 172               | \$ 188     | 0.2%                                    |
| Restructured      | 33                 | 34         | —                                       | 33                | 34         | —                                       |
| Potential problem | 130                | 138        | 0.1                                     | 178               | 191        | 0.2                                     |

|                                   |        |        |      |        |        |      |
|-----------------------------------|--------|--------|------|--------|--------|------|
| Total net carrying value          | \$ 224 | \$ 243 | 0.2% | \$ 383 | \$ 413 | 0.4% |
| Cumulative write-downs recognized | \$ 280 |        |      | \$ 304 |        |      |

(1) Cumulative write-downs recognized only reflects write-downs related to securities within the problem, potential problem and restructured categories.

We have experienced a decrease in the amortized cost of fixed income securities categorized as problem and potential problem as of September 30, 2006 compared to December 31, 2005. The decrease was primarily due to dispositions and the removal of securities upon improving conditions.

We also evaluated each of these securities through our portfolio monitoring process at September 30, 2006 and recorded write-downs when appropriate. We further concluded that any remaining unrealized losses on these securities were temporary in nature and that we have the intent and ability to hold the securities until recovery. While these balances may increase in the future, particularly if economic conditions are unfavorable, management expects that the total amount of securities in these categories will remain low relative to the total fixed income securities portfolio.

**Net Realized Capital Gains and Losses** The following table presents the components of realized capital gains and losses and the related tax effect.

| (in millions)                                | Three Months Ended<br>September 30, |         | Nine Months Ended<br>September 30, |         |
|--|-------------------------------------|---------|------------------------------------|---------|
|  | 2006                                | 2005    | 2006                               | 2005    |
| Investment write-downs                       | \$ (16)                             | \$ (16) | \$ (39)                            | \$ (43) |
| Dispositions                                 | 97                                  | 158     | 186                                | 518     |
| Valuation of derivative instruments          | (28)                                | (9)     | (11)                               | (105)   |
| Settlement of derivative instruments         | (114)                               | 66      | (46)                               | 78      |
| Realized capital gains and losses, pretax    | (61)                                | 199     | 90                                 | 448     |
| Income tax benefit (expense)                 | 22                                  | (78)    | (29)                               | (160)   |
| Realized capital gains and losses, after-tax | \$ (39)                             | \$ 121  | \$ 61                              | \$ 288  |

Dispositions in the above table include sales, losses recognized in anticipation of dispositions and other transactions such as calls and prepayments. The loss for the three months ended September 30, 2006 on the settlement of derivative instruments was primarily driven by \$89 million of realized losses from commodity-based excess return swaps and futures contracts. For portfolio diversification, we enter into commodity-based investments through the use of excess return swaps and futures contracts whose return are tied to a commodity-based index which declined in value. We may sell securities during the period in which fair value has declined below amortized cost for fixed income securities or cost for equity securities. In certain situations new factors such as negative developments, subsequent credit deterioration, relative value opportunities, market liquidity concerns and portfolio reallocations can subsequently change our previous intent to continue holding a security.

A changing interest rate environment will drive changes in our portfolio duration targets at a tactical level. A duration target and range is established with an economic view of liabilities relative to a long-term portfolio view. Tactical duration adjustments within management's approved ranges are accomplished through both cash market transactions and derivative activities that generate realized gains and losses and through new purchases. As a component of our approach to managing portfolio duration, certain realized gains and losses on derivative instruments are most appropriately considered in conjunction with the unrealized gains and losses on the fixed income portfolio. This approach mitigates the impacts of general interest rate changes to the overall financial condition of the corporation.

In the third quarter of 2006, we recognized \$3 million of losses related to a change in our intent to hold certain securities with unrealized losses in the Allstate Protection and Allstate Financial segments until they recover in value. The change in our intent is primarily related to comprehensive reviews of our portfolios. We identified \$2.17 billion of securities that may be sold to achieve these objectives.

## CAPITAL RESOURCES AND LIQUIDITY

**Capital Resources** consist of shareholders' equity and debt, representing funds deployed or available to be deployed to support business operations or for general corporate purposes. The following table summarizes our capital resources.

| (in millions)  | September 30, 2006 | December 31, 2005 |
|--|--------------------|-------------------|
| Common stock, retained earnings and other shareholders' equity items | \$ 20,231          | \$ 18,104         |
| Accumulated other comprehensive income                               | 1,969              | 2,082             |
| Total shareholders' equity   | 22,200             | 20,186            |
| Debt   | 5,529              | 5,300             |
| Total capital resources  | \$ 27,729          | \$ 25,486         |

|                                       |       |       |
|---------------------------------------|-------|-------|
| Ratio of debt to shareholders' equity | 24.9% | 26.3% |
| Ratio of debt to capital resources    | 19.9% | 20.8% |

*Shareholders' equity* increased in the first nine months of 2006, due to net income which was partly offset by share repurchases, dividends paid to shareholders and decreases in unrealized net capital gains on investments. As of September 30, 2006, \$295 million remained on our current \$4.00 billion share repurchase program that commenced in January 2005, and we expect to complete the program in 2006. In October 2006, we announced a \$3.00 billion share repurchase program that will commence upon the completion of our current \$4.00 billion share repurchase program during the fourth quarter of 2006, and is expected to be completed by March 31, 2008.

*Debt* increased in the first nine months 2006, due to increases in long-term debt. In March 2006, we issued \$650 million of 5.95% Senior Notes due 2036, utilizing the registration statement filed with the Securities and Exchange Commission ("SEC") in August 2003. The proceeds of this issuance are being used for general corporate purposes, including to facilitate the repayment of the \$550 million of 5.375% Senior Notes due 2006 at their scheduled maturity on December 1, 2006.

In October 2006, we purchased a headquarters office building previously owned by a consolidated synthetic lease variable interest entity for \$78 million. As a result of this transaction, long-term debt will decrease by \$78 million in the fourth quarter of 2006.

In October 2006, we elected to redeem our \$200 million of 7.83% junior subordinated debentures due in 2045, thereby triggering the redemption of 200,000 shares of the 7.83% mandatorily redeemable preferred securities of subsidiary trust ("trust preferred securities") originally issued by Allstate Financing II, an unconsolidated variable interest entity. The debentures and trust preferred securities will be redeemed on December 1, 2006 at a price of 103.915% plus accrued and unpaid interest from available liquidity. As a result of this transaction, long-term debt will decrease by \$200 million in the fourth quarter of 2006.

**Financial Ratings and Strength** Our ratings are influenced by many factors including our operating and financial performance, asset quality, liquidity, asset/liability management, overall portfolio mix, financial leverage (i.e., debt), exposure to risks such as catastrophes and the current level of operating leverage. There have been no changes to our debt, commercial paper and insurance financial strength ratings since December 31, 2005.

Allstate's domestic property-liability and life insurance subsidiaries prepare their statutory basis financial statements in conformity with accounting practices prescribed or permitted by the insurance department of the applicable state of domicile. Statutory surplus is a measure that is often used as a basis for determining dividend paying capacity, operating leverage and premium growth capacity, and it is also reviewed by rating agencies in determining their ratings. As of September 30, 2006, AIC's statutory surplus is approximately \$18.6 billion compared to \$14.8 billion at December 31, 2005. As of September 30, 2006, AIC's statutory surplus excluding ALIC is approximately \$15.0 billion.

In 2005, Allstate committed to provide capital to AIC, in the form of surplus notes or contributed surplus, to maintain levels of statutory surplus as set forth in a Capital Support Commitment. In accordance with its terms, this agreement terminated when AIC's statutory surplus excluding ALIC exceeded \$13.1 billion. AIC's statutory surplus excluding ALIC was \$13.8 billion at June 30, 2006 and the commitment terminated with no capital contribution having been made.

We have distinct groups of subsidiaries licensed to sell property and casualty insurance in New Jersey and Florida that maintain separate group ratings. A.M. Best confirmed the rating and outlook of Allstate Floridian in August 2006. AFIC and its subsidiary, Allstate Floridian Indemnity Company, have Demotech financial stability ratings of A<sup>+</sup> that were confirmed in April 2006. Encompass Floridian Insurance Company and Encompass Floridian Indemnity Company, both subsidiaries of AFIC, have Demotech financial stability ratings of A that were

confirmed in April 2006. AIC's commitment to make as much as \$375 million of additional capital available to AFIC expired on May 31, 2006. A total of \$159 million had been contributed under the commitment. As of September 30, 2006, AFIC's statutory surplus is approximately \$259 million compared to \$233 million at December 31, 2005.

**Liquidity Sources and Uses** The following table summarizes consolidated cash flow activities by business unit for the first nine months ended September 30.

| (in millions)                                | Property-Liability |          | Allstate Financial |          | Corporate and Other |         | Consolidated |          |
|--|--------------------|----------|--------------------|----------|---------------------|---------|--------------|----------|
|  | 2006               | 2005     | 2006               | 2005     | 2006                | 2005    | 2006         | 2005     |
| Net cash provided by (used in):              |                    |          |                    |          |                     |         |              |          |
| Operating activities                         | \$ 1,737           | \$ 3,288 | \$ 1,780           | \$ 1,639 | \$ 128              | \$ 342  | \$ 3,645     | \$ 5,269 |
| Investing activities                         | (1,525)            | (873)    | (2,112)            | (3,541)  | 670                 | 220     | (2,967)      | (4,194)  |
| Financing activities                         | (293)              | (43)     | 747                | 1,944    | (1,118)             | (2,982) | (664)        | (1,081)  |
| Net increase (decrease) in consolidated cash |                    |          |                    |          |                     |         | \$ 14        | \$ (6)   |

*Property-Liability* Lower cash provided by operating activities for Property-Liability in the first nine months of 2006, compared to the first nine months of 2005 were primarily due to higher claim payments related to the prior year hurricanes, partially offset by increased premiums.

Cash flows used in investing activities increased in the first nine months of 2006 as a result of higher investment purchases, partially offset by proceeds from sales of securities.

Cash flows used in financing activities increased in the first nine months of 2006 as the result of repayment of short-term debt.

*Allstate Financial* Higher operating cash flows for Allstate Financial in the first nine months of 2006, compared to the first nine months of 2005, primarily related to higher investment income.

Cash flows used in investing activities decreased in the first nine months of 2006 primarily due to decreased net cash provided by financing activities, partially offset by the investment of higher operating cash flows. Cash flows used in investing activities also include the settlement of the disposal of substantially all of our variable annuity business.

Cash provided by financing activities declined in the first nine months of 2006 as a result of lower contractholder fund deposits and higher surrenders and partial withdrawals. For quantification of the changes in contractholder funds, see the Allstate Financial Segment section of the MD&A.

Dividends of \$300 million and \$125 million in the third quarter and second quarter of 2006, respectively, were paid by ALIC to its parent, AIC, primarily as a result of the disposal of substantially all of Allstate Financial's variable annuity business, which was completed in the second quarter of 2006. Subject to regulatory approval, ALIC expects to pay additional dividends of approximately \$150 million during the fourth quarter of 2006.

*Corporate and Other* Fluctuations in the Corporate and Other operating cash flows were primarily due to the timing of intercompany settlements. Investing activities primarily relate to activity in the portfolio of Kennett Capital, Inc. ("Kennett Capital"). Financing cash flows of the Corporate and Other segment reflect actions such as fluctuations in short-term debt, repayment of debt, proceeds from the issuance of debt, dividends to shareholders of The Allstate Corporation and share repurchases; therefore, financing cash flows are affected when we increase or decrease the level of these activities.

The sources of liquidity for The Allstate Corporation include but are not limited to dividends from AIC and \$2.52 billion of investments at Kennett Capital at September 30, 2006.

We have access to additional borrowing to support liquidity as follows:

- A commercial paper program with a borrowing limit of \$1.00 billion to cover short-term cash needs. As of September 30, 2006, there were no balances outstanding and therefore the remaining borrowing capacity was \$1.00 billion; however, the outstanding balance fluctuates daily.

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- A five-year revolving credit facility expiring in 2009 totaling \$1.00 billion to cover short-term liquidity requirements. This facility contains an increase provision that would make up to an additional \$500 million available for borrowing provided the increased portion could be fully syndicated at a later date among existing or new lenders. Although the right to borrow under the facility is not subject to a minimum rating requirement, the costs of maintaining the facility and borrowing under it are based on the ratings of our senior, unsecured, non-guaranteed long-term debt. There were no borrowings under this line of credit during the first nine months of 2006. The total amount outstanding at any point in time under the combination of the commercial paper program and the credit facility cannot exceed the amount that can be borrowed under the credit facility.
  - In May 2006, we filed a universal shelf registration statement with the SEC. In accordance with rules adopted by the SEC in 2005, this registration statement covers an unspecified amount of securities. We can use it to issue debt securities, common stock, preferred stock, depository shares, warrants, stock purchase contracts, stock purchase units and securities of subsidiaries. The specific terms of any securities we issue under this registration statement will be provided in the applicable prospectus supplements. This registration statement, under which we have not yet issued any securities, replaced our 2003 universal shelf registration statement.

*Pension Plans* In September 2006, the Financial Accounting Standards Board ("FASB") issued Statement of Financial Accounting Standard No. 158 ("SFAS No. 158"). For further information on SFAS No. 158, see Note 1 to the Condensed Consolidated Financial Statements. Based on our current interpretation and the most recent measurement date of our plans as of October 31, 2005, if the standard had been effective and adopted as of December 31, 2005, the impact of adoption would have resulted in a decrease in shareholders' equity of \$1.37 billion and book value per share of \$2.10, and an increase in the debt to shareholders' equity ratio and the debt to capital resources ratio of 1.9 points and 1.2 points, respectively. Adoption impacts will be based on the most recent measurement date of the plans as of December 31, 2006, which is October 31, 2006.

Certain rating agencies explicitly consider the funded status of the pension plans in the development of non-GAAP debt to capital ratios as part of the determination of company ratings. While we do not expect any near-term change in our financial strength ratings as a result of these changes, the long term effects of these changes on the ratings process remains uncertain. Upon adoption, we plan to revise our non-GAAP measure of book value excluding the effects of unrealized gains and losses on fixed income securities to also exclude the effects of this new guidance.

Also during the third quarter of 2006, the federal government enacted the Pension Protection Act of 2006 (the "Act") which changes the manner in which pension funding is determined. The new rules are effective for funding beginning in 2008. We are currently reviewing the implications of the Act, but do not expect it to have a material impact on funding.

Our funding policy for the pension plans is to make annual contributions at a minimum level that is at least in accordance with regulations under the Internal Revenue Code ("IRC") and in accordance with generally accepted actuarial principles. There was no minimum funding requirement under the IRC for the tax qualified pension plans as of December 31, 2005.

Our obligations have not changed as a result of these developments. The pension and other postretirement plans are subject to revision at the discretion of management. Any revisions could result in significant changes to our pension plan obligations and our obligation to fund the plans.

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#### Item 4. Controls and Procedures

*Evaluation of Disclosure Controls and Procedures.* We maintain disclosure controls and procedures as defined in Rule 13a-15(e) and 15(d)-15(e) under the Securities Exchange Act of 1934. Under the supervision and with the participation of our management, including our principal executive officer and principal financial officer, we conducted an evaluation of the effectiveness of our disclosure controls and procedures as of the end of the period covered by

this report. Based upon this evaluation, the principal executive officer and the principal financial officer concluded that our disclosure controls and procedures are effective in providing reasonable assurance that material information required to be disclosed in our reports filed with or submitted to the Securities and Exchange Commission under the Securities Exchange Act is made known to management, including the principal executive officer and the principal financial officer, as appropriate to allow timely decisions regarding required disclosure.

*Changes in Internal Control over Financial Reporting.* During the fiscal quarter ended September 30, 2006, there have been no changes in our internal control over financial reporting that have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

## PART II. OTHER INFORMATION

### Item 1. Legal Proceedings

Information required for Part II, Item 1 is incorporated by reference to the discussion under the heading "Regulation" and under the heading "Legal and regulatory proceedings and inquiries" in Note 7 of the Condensed Consolidated Financial Statements in Part I, Item 1 of this Form 10-Q.

### Item 1A. Risk Factors

This document contains "forward-looking statements" that anticipate results based on our estimates, assumptions and plans that are subject to uncertainty. These statements are made subject to the safe-harbor provisions of the Private Securities Litigation Reform Act of 1995. We assume no obligation to update any forward-looking statements as a result of new information or future events or developments.

These forward-looking statements do not relate strictly to historical or current facts and may be identified by their use of words like "plans," "seeks," "expects," "will," "should," "anticipates," "estimates," "intends," "believes," "likely," "targets" and other words with similar meanings. These statements may address, among other things, our strategy for growth, catastrophe exposure management, product development, regulatory approvals, market position, expenses, financial results, litigation and reserves. We believe that these statements are based on reasonable estimates, assumptions and plans. However, if the estimates, assumptions or plans underlying the forward-looking statements prove inaccurate or if other risks or uncertainties arise, actual results could differ materially from those communicated in these forward-looking statements. Risk factors which could cause actual results to differ materially from those suggested by such forward-looking statements include but are not limited to those discussed or identified in this document, in our public filings with the Securities and Exchange Commission, and those in Part I, Item 1A of The Allstate Corporation Annual Report on Form 10-K for 2005, which are hereby incorporated herein by reference. There have been no material changes from the risk factors previously disclosed in our Annual Report on Form 10-K.

### Item 2. Unregistered Sales of Equity Securities and Use of Proceeds

#### Issuer Purchases of Equity Securities

| Period                                 | Total Number of Shares (or Units) Purchased(1) | Average Price Paid per Share (or Unit) | Total Number of Shares (or Units) Purchased as Part of Publicly Announced Plans or Programs(2) | Maximum Number (or Approximate Dollar Value) of Shares (or Units) that May Yet Be Purchased Under the Plans or Programs |
|--|--|--|--|---|
| July 1, 2006 - July 31, 2006           | 1,888,847                                      | \$ 55.7185                             | 1,885,000  | \$ 498 million  |
| August 1, 2006 - August 31, 2006       | 1,763,001                                      | \$ 56.7961                             | 1,730,000  | \$ 400 million  |
| September 1, 2006 - September 30, 2006 | 1,784,939                                      | \$ 60.4427                             | 1,740,800  | \$ 295 million  |
| Total                                  | 5,436,787                                      | \$ 57.6189                             | 5,355,800  |   |

(1) In accordance with the terms of its equity compensation plans, Allstate acquired the following shares in connection with stock option exercises by employees and/or directors. The stock was received in payment of the exercise price of the options and in satisfaction of withholding taxes due upon exercise or vesting.

|            |        |
|------------|--------|
| July:      | 3,847  |
| August:    | 33,001 |
| September: | 44,139 |

(2) Repurchases under our programs are, from time to time, executed under the terms of a pre-set trading plan meeting the requirements of Rule 10b5-1(c) of the Securities Exchange Act of 1934.

On November 9, 2004, Allstate announced the approval of a new repurchase program for \$4.00 billion, which is expected to be completed in 2006.

On October 18, 2006, Allstate announced the approval of a new share repurchase program for \$3.00 billion, which is expected to be completed by March 31, 2008.

**Item 6. Exhibits**

## (a) Exhibits

An Exhibit Index has been filed as part of this report on page E-1.

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**SIGNATURE**

Pursuant to the requirements of the Securities Exchange Act of 1934, the Registrant has duly caused this report to be signed on its behalf by the undersigned thereunto duly authorized.

November 1, 2006

The Allstate Corporation  
(Registrant)

By /s/ Samuel H. Pilch

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Samuel H. Pilch  
(chief accounting officer and duly  
authorized officer of Registrant)

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| <b>Exhibit No.</b> | <b>Description</b>  |
|--------------------|---|
| 4                  | Registrant hereby agrees to furnish the Commission, upon request, with the instruments defining the rights of holders of each issue of long-term debt of the Registrant and its consolidated subsidiaries.                                  |
| 10.1               | Form of Option Award Agreement under The Allstate Corporation Amended and Restated 2001 Equity Incentive Plan, incorporated herein by reference to Exhibit 10.1 to The Allstate Corporation current report on Form 8-K filed July 20, 2006. |
| 10.2               | Summary of Non-Employee Director Compensation, incorporated herein by reference to Exhibit 10.1 to The Allstate Corporation current report on Form 8-K filed September 12, 2006.  |
| 10.3               | The Allstate Corporation Amended and Restated 2001 Equity Incentive Plan, incorporated herein by reference to Exhibit 10.2 to The Allstate Corporation current report on Form 8-K filed September 12, 2006.                                 |
| 10.4               | The Allstate Corporation 2006 Equity Compensation Plan for Non-Employee Directors, incorporated herein by reference to Exhibit 10.3 to The Allstate Corporation current report on Form 8-K filed September 12, 2006.                        |
| 10.5               | The Allstate Corporation Equity Incentive Plan for Non-Employee Directors, incorporated herein by reference to Exhibit 10.4 to The Allstate Corporation current report on Form 8-K filed September 12, 2006.                                |
| 10.6               | The Allstate Corporation Equity Incentive Plan, incorporated herein by reference to Exhibit 10.5 to The Allstate Corporation current report on Form 8-K filed September 12, 2006.   |
| 15                 | Acknowledgment of awareness from Deloitte & Touche LLP, dated November 1, 2006, concerning unaudited interim financial information.   |
| 31.1               | Rule 13a-14(a) Certification of Principal Executive Officer   |
| 31.2               | Rule 13a-14(a) Certification of Principal Financial Officer   |
| 32                 | Section 1350 Certifications   |





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

We have reviewed, in accordance with the standards of the Public Company Accounting Oversight Board (United States), the unaudited interim financial information of The Allstate Corporation and subsidiaries for the periods ended September 30, 2006 and 2005, as indicated in our report dated November 1, 2006; because we did not perform an audit, we expressed no opinion on that information.

We are aware that our report referred to above, which is included in your Quarterly Report on Form 10-Q for the quarter ended September 30, 2006, is incorporated by reference in the following Registration Statements:

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**Forms S-3 Registration Nos.**

333-34583  
333-134230

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**Forms S-8 Registration Nos.**

33-77928  
33-93762  
33-99132  
33-99136  
33-99138  
333-04919  
333-16129  
333-40283  
333-40285  
333-40289  
333-49022  
333-60916  
333-73202  
333-100405  
333-100406  
333-105632  
333-120343  
333-120344  
333-134242  
333-134243

We also are aware that the aforementioned report, pursuant to Rule 436(c) under the Securities Act of 1933, is not considered a part of the Registration Statement prepared or certified by an accountant or a report prepared or certified by an accountant within the meaning of Sections 7 and 11 of that Act.

/s/ Deloitte & Touche LLP

Chicago, Illinois  
November 1, 2006

**CERTIFICATIONS**

I, Edward M. Liddy, certify that:

1. I have reviewed this quarterly report on Form 10-Q of The Allstate Corporation;
2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;
3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;
4. The registrant's other certifying officer(s) and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) for the registrant and have:
  - a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;
  - b) Designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;
  - c) Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and
  - d) Disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and
5. The registrant's other certifying officer(s) and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of registrant's board of directors (or persons performing the equivalent functions):
  - a) All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and
  - b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

November 1, 2006

/s/ Edward M. Liddy

Edward M. Liddy  
Chairman of the Board and Chief Executive Officer

I, Danny L. Hale, certify that:

1. I have reviewed this quarterly report on Form 10-Q of The Allstate Corporation;
2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;
3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;
4. The registrant's other certifying officer(s) and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) for the registrant and have:
  - a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;
  - b) Designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;
  - c) Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and
  - d) Disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and
5. The registrant's other certifying officer(s) and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of registrant's board of directors (or persons performing the equivalent functions):
  - a) All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and
  - b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

November 1, 2006

/s/ Danny L. Hale

Danny L. Hale  
Vice President and Chief Financial Officer

**SECTION 1350 CERTIFICATIONS**

Each of the undersigned hereby certifies that to his knowledge the quarterly report on Form 10-Q for the fiscal period ended September 30, 2006 of The Allstate Corporation filed with the Securities and Exchange Commission fully complies with the requirements of Section 13(a) or 15(d) of the Securities Exchange Act of 1934 and that the information contained in such report fairly presents, in all material respects, the financial condition and result of operations of The Allstate Corporation.

November 1, 2006

/s/ Edward M. Liddy

Edward M. Liddy  
Chairman of the Board and Chief Executive  
Officer

/s/ Danny L. Hale

Danny L. Hale  
Vice President and Chief Financial Officer