

UNITED STATES  
SECURITIES AND EXCHANGE COMMISSION

WASHINGTON, D.C. 20549

FORM 10-K

THE REGISTRANT MEETS THE CONDITIONS SET FORTH IN GENERAL INSTRUCTIONS I (1)(a) AND (b) OF FORM 10-K AND IS THEREFORE FILING THIS FORM WITH THE REDUCED DISCLOSURE FORMAT.

ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d)

OF  
THE SECURITIES EXCHANGE ACT OF 1934  
FOR THE FISCAL YEAR ENDED DECEMBER 31, 2006

OR

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

COMMISSION FILE NUMBER: 0-31248

ALLSTATE LIFE INSURANCE COMPANY  
(EXACT NAME OF REGISTRANT AS SPECIFIED IN ITS CHARTER)

ILLINOIS  
(STATE OF INCORPORATION)

36-2554642  
(I.R.S. EMPLOYER IDENTIFICATION NO.)

3100 SANDERS ROAD  
NORTHBROOK, ILLINOIS  
(ADDRESS OF PRINCIPAL EXECUTIVE OFFICES)

60062  
(ZIP CODE)

REGISTRANT'S TELEPHONE NUMBER, INCLUDING AREA CODE: (847) 402-5000

SECURITIES REGISTERED PURSUANT TO SECTION 12(b) OF THE SECURITIES EXCHANGE ACT OF 1934: NONE

SECURITIES REGISTERED PURSUANT TO SECTION 12(g) OF THE SECURITIES EXCHANGE ACT OF 1934: COMMON STOCK, PAR VALUE \$227.00 PER SHARE

INDICATE BY CHECK MARK IF THE REGISTRANT IS A WELL-KNOWN SEASONED ISSUER, AS DEFINED IN RULE 405 OF THE SECURITIES ACT.

YES  NO

INDICATE BY CHECK MARK IF THE REGISTRANT IS NOT REQUIRED TO FILE REPORTS PURSUANT TO SECTION 13 OR SECTION 15(d) OF THE SECURITIES ACT.

YES  NO

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 IF DISCLOSURE OF DELINQUENT FILERS PURSUANT TO ITEM 405 OF REGULATION S-K IS NOT CONTAINED HEREIN, AND WILL NOT BE CONTAINED, TO THE BEST OF REGISTRANT'S KNOWLEDGE IN DEFINITIVE PROXY OR INFORMATION STATEMENTS INCORPORATED BY REFERENCE IN PART III OF THIS FORM 10-K OR ANY AMENDMENT TO THIS FORM 10-K.

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

NONE OF THE COMMON EQUITY OF THE REGISTRANT IS HELD BY NON-AFFILIATES. THEREFORE, THE AGGREGATE MARKET VALUE OF THE COMMON EQUITY HELD BY NON-AFFILIATES OF THE REGISTRANT IS ZERO.

ALLSTATE LIFE INSURANCE COMPANY  
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DECEMBER 31, 2006

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\* Omitted pursuant to General Instruction I(2) of Form 10-K

## PART I

### ITEM 1. BUSINESS

Allstate Life Insurance Company was organized in 1957 as a stock life insurance company under the laws of the State of Illinois. Allstate Life Insurance Company, together with its subsidiaries, provides life insurance, retirement and investment products for individual and institutional customers. It conducts substantially all of its operations directly or through wholly owned U.S. subsidiaries. In this document, we refer to Allstate Life Insurance Company as "Allstate Life" or "ALIC" and to Allstate Life and its wholly owned subsidiaries as the "Allstate Life Group" or the "Company."

Allstate Life is a wholly owned subsidiary of Allstate Insurance Company, a stock property-liability insurance company organized under the laws of the State of Illinois. All of the outstanding stock of Allstate Insurance Company is owned by The Allstate Corporation, a publicly owned holding company incorporated under the laws of the State of Delaware. In this document, we refer to Allstate Insurance Company as "AIC" and to The Allstate Corporation and its consolidated subsidiaries as "Allstate", the "Parent Group" or the "Corporation". The Allstate Corporation is the largest publicly held personal lines insurer in the United States. Widely known through the "You're In Good Hands With Allstate(R)" slogan, Allstate provides insurance products to more than 17 million households through a distribution network that utilizes a total of approximately 14,800 exclusive agencies and exclusive financial specialists in the United States and Canada. Allstate is the second-largest personal property and casualty insurer in the United States on the basis of 2005 statutory premiums earned. In addition, according to A.M. Best, it is the nation's 13th largest issuer of life insurance business on the basis of 2005 ordinary life insurance in force and 16th largest on the basis of 2005 statutory admitted assets.

The Parent Group has four business segments, one of which is Allstate

Financial. Allstate Financial, which is not a separate legal entity, is comprised of the Allstate Life Group together with the Allstate Bank and other Parent Group subsidiaries that are not part of the Allstate Life Group. This document describes the Allstate Life Group. It does not describe the entire group of companies that form the Allstate Financial segment of the Parent Group.

In this annual report on Form 10-K, we occasionally refer to statutory financial information that has been prepared in accordance with the National Association of Insurance Commissioners ("NAIC") Accounting Practices and Procedure Manual ("Manual"). All domestic U.S. insurance companies are required to prepare statutory-basis financial statements in accordance with the Manual. As a result, industry data is available that enables comparisons between insurance companies, including competitors that are not subject to the requirement to publish financial statements on the basis of accounting principles generally accepted in the U.S. ("GAAP"). We frequently use industry publications containing statutory financial information to assess our competitive position.

#### PRODUCTS AND DISTRIBUTION

The Allstate Life Group provides life insurance, retirement and investment products to individual and institutional customers. Our principal individual products are deferred and immediate fixed annuities, and interest-sensitive, traditional and variable life insurance. We also distribute variable annuities through our bank distribution partners; however, this product is fully reinsured. Our principal institutional product is funding agreements backing medium-term notes issued to institutional and individual investors. The table on page 2 lists our major distribution channels, with the associated products and targeted customers.

As the table indicates, we sell products to individuals through multiple intermediary distribution channels, including Allstate exclusive agencies, independent agents, banks, broker-dealers, and specialized structured settlement brokers. We have distribution relationships with over 60 percent of the 75 largest banks, most of the national broker-dealers, a number of regional brokerage firms and many independent broker-dealers. We sell products through independent agents affiliated with approximately 150 master brokerage agencies. We sell funding agreements to unaffiliated trusts used to back medium-term notes issued to institutional and individual investors.

#### DISTRIBUTION CHANNELS, PRODUCTS AND TARGET CUSTOMERS

##### DISTRIBUTION

CHANNEL

PRIMARY

PRODUCTS

TARGET

CUSTOMERS -

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ALLSTATE

EXCLUSIVE

AGENCIES

Term life

insurance

Moderate and

(Allstate

Exclusive

Agents

Interest-

sensitive

life

insurance

middle-

income

consumers

and Variable

life

insurance  
with  
retirement  
and Allstate  
Exclusive  
Deferred  
fixed  
annuities  
(including  
indexed and  
market value  
family  
financial  
Financial  
Specialists)  
adjusted  
"MVA")  
protection  
needs  
Immediate  
fixed  
annuities  
INDEPENDENT  
AGENTS Term  
life  
insurance  
Affluent and  
(Through  
master  
brokerage  
Interest-  
sensitive  
life  
insurance  
middle-  
income  
consumers  
agencies)  
Variable  
life  
insurance  
with  
retirement  
and Deferred  
fixed  
annuities  
(including  
indexed and  
MVA) family  
financial  
Immediate  
fixed  
annuities  
protection  
needs BANKS  
Deferred  
fixed  
annuities  
(including  
indexed and  
MVA) Middle-  
income  
consumers  
Single  
premium  
fixed life  
insurance  
with  
retirement  
needs  
Variable  
annuities  
(fully  
reinsured)  
BROKER-  
DEALERS  
Deferred  
fixed  
annuities  
(including  
indexed and

MVA)  
Affluent and  
Single  
premium  
variable  
life  
insurance  
middle-  
income  
consumers  
with  
retirement  
needs  
STRUCTURED  
SETTLEMENT  
Structured  
settlement  
annuities  
Typically  
used to fund  
or ANNUITY  
BROKERS  
annuitize  
large claims  
or  
litigation  
settlements  
BROKER-  
DEALERS  
Funding  
agreements  
backing  
medium-term  
notes  
Institutional  
and (Funding  
agreements)  
individual  
investors

## COMPETITION

We compete principally on the basis of the scope of our distribution systems, the breadth of our product offerings, the recognition of our brands, our financial strength and ratings, our product features and prices, and the level of customer service that we provide. With regard to funding agreements, we compete principally on the basis of our financial strength and ratings.

The market for life insurance, retirement and investment products continues to be highly fragmented and competitive. As of December 31, 2006, there were approximately 690 groups of life insurance companies in the United States, most of which offered one or more similar products. According to A.M. Best, as of December 31, 2005, the Allstate Life Group is the nation's 13th largest issuer of life insurance and related business on the basis of 2005 ordinary life insurance in force and 16th largest on the basis of 2005 statutory admitted assets. In addition, because many of these products include a savings or investment component, our competition includes domestic and foreign securities firms, investment advisors, mutual funds, banks and other financial institutions. Competitive pressure continues to grow due to several factors, including cross marketing alliances between unaffiliated businesses, as well as consolidation activity in the financial services industry.

The Allstate Corporation's website for financial professionals, [accessallstate.com](http://accessallstate.com), won DALBAR's Communications Seal beginning in 2004. The site attained DALBAR's highest designation of "Excellent" since the second quarter of 2005 and is ranked second based on its overall quarterly rankings for Life Insurance/Annuity websites for Financial Professionals. DALBAR, Inc., an independent financial services research organization,

recognized [accessallstate.com](http://accessallstate.com) for providing a means by which financial professionals can easily and conveniently develop and manage their business online.

## GEOGRAPHIC MARKETS

We sell life insurance, retirement and investment products throughout the United States. The Allstate Life Group is authorized to sell various types of these products in all 50 states, the District of Columbia, Puerto Rico, the U.S. Virgin Islands and Guam. We sell funding agreements in the United States and in the Cayman Islands.

The following table reflects, in percentages, the principal geographic distribution of statutory premiums and annuity considerations for the Allstate Life Group for the year ended December 31, 2006, based on information contained in statements filed with state insurance departments. Approximately 98.0% of the statutory premiums and annuity considerations generated in Delaware represent deposits received in connection with funding agreements sold to trusts domiciled in Delaware. No other jurisdiction accounted for more than five percent of the statutory premiums and annuity considerations.

Delaware	17.0%
California	9.0%
New York	7.0%
Florida	6.0%
Texas	6.0%

#### REGULATION

The Allstate Life Group is subject to extensive regulation, primarily at the state level. The method, extent and substance of such regulation varies by state but generally has its source in statutes that establish standards and requirements for conducting the business of insurance and that delegate regulatory authority to a state regulatory agency. In general, such regulation is intended for the protection or benefit of those who purchase or use insurance products. These rules have a substantial effect on our business and relate to a wide variety of matters including insurance company licensing and examination, agent and adjuster licensing, price setting, trade practices, policy forms, accounting methods, the nature and amount of investments, claims practices, participation in guaranty funds, reserve adequacy, insurer solvency, transactions with affiliates, the payment of dividends, and underwriting standards. Some of these matters are discussed in more detail below. For a discussion of statutory financial information, see Note 14 of the Consolidated Financial Statements. For a discussion of regulatory contingencies, see Note 11 of the Consolidated Financial Statements. Notes 11 and 14 are incorporated in this Part I, Item 1 by reference.

In recent years the state insurance regulatory framework has come under increased federal scrutiny. Legislation that would provide for federal chartering of insurance companies has been proposed. In addition, state legislators and insurance regulators continue to examine the appropriate nature and scope of state insurance regulation. We cannot predict whether any specific state or federal measures will be adopted to change the nature or scope of the regulation of the insurance business or what effect any such measures would have on the Allstate Life Group.

**AGENT AND BROKER COMPENSATION.** In 2005, several states considered new legislation or regulations regarding the compensation of agents and brokers by insurance companies. The proposals ranged in nature from new disclosure requirements to new duties on insurance agents and brokers in dealing with customers. New disclosure requirements have been imposed in certain circumstances upon some agents and brokers in several states, including Texas.

**LIMITATIONS ON DIVIDENDS BY INSURANCE SUBSIDIARIES.** Allstate Life may receive dividends from time to time from its subsidiaries. When received, these dividends represent a source of cash from which Allstate Life may meet some of its obligations. If a subsidiary is an insurance company, its ability to pay dividends may be restricted by state laws regulating insurance companies. For additional information regarding those restrictions, see Note 14 of the Consolidated Financial Statements.

**GUARANTY FUNDS.** Under state insurance guaranty fund laws, insurers doing business in a state can be assessed, up to prescribed limits, in order to cover certain obligations of insolvent insurance companies.

**INVESTMENT REGULATION.** Our insurance subsidiaries are subject to regulations that require investment portfolio diversification and that limit the amount of investment in certain categories. Failure to comply with these rules leads to the treatment of non-conforming investments as non-admitted assets for purposes of measuring statutory surplus. Further, in some instances, these rules require divestiture of non-conforming investments. As of December 31, 2006, the investment portfolios of our insurance subsidiaries complied with such laws and

regulations in all material respects.

**VARIABLE LIFE INSURANCE, VARIABLE ANNUITIES AND REGISTERED FIXED ANNUITIES.** The sale and administration of variable life insurance, variable annuities and registered fixed annuities with market value adjustment features are subject to extensive regulatory oversight at the federal and state level, including regulation and supervision by the Securities and Exchange Commission and the National Association of Securities Dealers.

**BROKER-DEALERS, INVESTMENT ADVISORS AND INVESTMENT COMPANIES.** The Allstate Life Group entities that operate as broker-dealers, registered investment advisors and investment companies are subject to regulation and supervision by the Securities and Exchange Commission, the National Association of Securities Dealers and/or, in some cases, state securities administrators.

**REGULATION AND LEGISLATION AFFECTING CONSOLIDATION IN THE FINANCIAL SERVICES INDUSTRY.** The Gramm-Leach-Bliley Act of 1999 permits mergers that combine commercial banks, insurers and securities firms within one holding company group. In addition, it allows grandfathered unitary thrift holding companies, including our parent company, to engage in activities that are not financial in nature. The ability of banks to affiliate with insurers may materially adversely affect our business by substantially increasing the number, size and financial strength of potential competitors.

**PRIVACY REGULATION.** Federal law and the laws of some states require financial institutions to protect the security and confidentiality of customer information and to notify customers about their policies and practices relating to collection and disclosure of customer information and their policies relating to protecting the security and confidentiality of that information. Federal law and the laws of some states also regulate disclosures of customer information. Congress, state legislatures and regulatory authorities are expected to consider additional regulation relating to privacy and other aspects of customer information.

#### EMPLOYEES AND OTHER SHARED SERVICES

The Allstate Life Group has no employees. Instead, we primarily use the services of employees of Allstate Insurance Company, our direct parent. We also make use of other services and facilities provided by Allstate Insurance Company and other members of the Parent Group. These services and facilities include space rental, utilities, building maintenance, human resources, investment management, finance, information technology and legal services. We reimburse our affiliates for these services and facilities under a variety of agreements.

#### OTHER INFORMATION

We use the names "Allstate," "Lincoln Benefit Life" and variations of these names extensively in our business, along with related logos and slogans, such as "Goods Hands." Our rights in the United States to these names, logos and slogans continue so long as we continue to use them in commerce. Most of these service marks are the subject of renewable U.S. and/or foreign service mark registrations. We believe that these service marks are important to our business and we intend to maintain our rights to them by continued use.

"Allstate" is one of the most recognized brand names in the U.S. According to independent market research conducted in 2004, "You're in Good Hands with Allstate" was recognized by 87% of consumers, making it the most recognized company tagline in the U.S.

#### 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, 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.

In addition to the normal risks of business, we are subject to significant risks and uncertainties, including those listed below, which apply to us as an insurer and a provider of other financial services. These risks constitute our cautionary statements under the Private Securities Litigation Reform Act of 1995 and readers should carefully review such cautionary statements as they identify certain important factors that could cause actual results to differ materially from those in the forward-looking statements and historical trends. These cautionary statements are not exclusive and are in addition to other factors discussed elsewhere in this document, in our filings with the Securities and Exchange Commission ("SEC") or in materials incorporated therein by reference. Our business operations could also be affected by additional factors that are not presently known to us or that we currently consider to be immaterial to our operations.

#### CHANGES IN UNDERWRITING AND ACTUAL EXPERIENCE COULD MATERIALLY AFFECT PROFITABILITY

Our product pricing includes long-term assumptions regarding investment returns, mortality, morbidity, persistency and operating costs and expenses of the business. Management establishes target returns for each product based upon these factors and the average amount of capital that the company must hold to support in-force contracts, satisfy rating agencies and meet regulatory requirements. We monitor and manage our pricing and overall sales mix to achieve target returns on a portfolio basis. Profitability from new business emerges over a period of years depending on the nature and life of the product and is subject to variability as actual results may differ from pricing assumptions.

Our profitability depends on the adequacy of investment margins, the management of market and credit risks associated with investments, the sufficiency of premiums and contract charges to cover mortality and morbidity benefits, the persistency of policies to ensure recovery of acquisition expenses, and the management of operating costs and expenses within anticipated pricing allowances. Legislation and regulation of the insurance marketplace and products could also affect our profitability.

#### CHANGES IN RESERVE ESTIMATES MAY REDUCE PROFITABILITY

Reserve for life-contingent contract benefits is computed on the basis of long-term actuarial assumptions of future investment yields, mortality, morbidity, policy terminations and expenses. We periodically review the adequacy of these reserves on an aggregate basis and if future experience differs significantly from assumptions, adjustments to reserves may be required which could have a material adverse effect on our operating results and financial condition.

#### CHANGES IN MARKET INTEREST RATES MAY LEAD TO A SIGNIFICANT DECREASE IN THE SALES AND PROFITABILITY OF SPREAD-BASED PRODUCTS

Our ability to manage our investment margin for spread-based products, such as fixed annuities and institutional products, is dependent upon maintaining profitable spreads between investment yields and interest crediting rates. When market interest rates decrease or remain at relatively low levels, proceeds from investments that have matured, prepaid or been sold may be reinvested at lower yields, reducing investment margin. Lowering interest crediting rates in such an environment can offset decreases in investment yield on some products. However, these changes could be limited by market conditions, regulatory or contractual minimum rate guarantees on many contracts and may not match the timing or magnitude of changes in asset yields. Decreases in the rates offered on products could make those products less attractive, leading to lower sales and/or changes in the level of surrenders and withdrawals for these products. Non-parallel shifts in interest rates, such as increases in short-term rates without

accompanying increases in medium- and long-term rates, can influence customer demand for fixed annuities, which could impact the level and profitability of new customer deposits. Increases in market interest rates can also have negative effects, for example by increasing the attractiveness of other investments to our customers, which can lead to higher surrenders at a time when fixed income investment asset values are lower as a result of the increase in interest rates. For certain products, principally fixed annuity and interest-sensitive life products, the earned rate on assets could lag behind rising market yields. We may react to market conditions by increasing crediting rates, which could narrow spreads. Unanticipated surrenders could result in deferred policy acquisition

costs ("DAC") unlocking or affect the recoverability of DAC and thereby increase expenses and reduce profitability.

#### CHANGES IN ESTIMATES OF PROFITABILITY ON INTEREST-SENSITIVE LIFE, FIXED ANNUITIES AND OTHER INVESTMENT PRODUCTS MAY HAVE AN ADVERSE EFFECT ON RESULTS THROUGH INCREASED AMORTIZATION OF DAC

DAC related to interest-sensitive life, fixed annuities and other investment contracts is amortized in proportion to actual historical gross profits ("AGP") and estimated future gross profits ("EGP") over the estimated lives of the contracts. Assumptions underlying EGP, including those relating to margins from mortality, investment margin, contract administration, surrender and other contract charges, are updated from time to time in order to reflect actual and expected experience and its potential effect on the valuation of DAC. Updates to these assumptions could result in DAC unlocking, which in turn could adversely affect our net income and financial condition.

#### A LOSS OF KEY PRODUCT DISTRIBUTION RELATIONSHIPS COULD MATERIALLY AFFECT SALES

Certain products are distributed under agreements with other members of the financial services industry that are not affiliated with us. Termination of one or more of these agreements due to, for example, a change in control of one of these distributors, could have a detrimental effect on sales.

#### CHANGES IN TAX LAWS MAY DECREASE SALES AND PROFITABILITY OF PRODUCTS

Under current federal and state income tax law, certain products we offer, primarily life insurance and annuities, receive favorable tax treatment. This favorable treatment may give certain of our products a competitive advantage over noninsurance products. Congress from time to time considers legislation that would reduce or eliminate the favorable policyholder tax treatment currently applicable to life insurance and annuities. Congress also considers proposals to reduce the taxation of certain products or investments that may compete with life insurance and annuities. Legislation that increases the taxation on insurance products or reduces the taxation on competing products could lessen the advantage or create a disadvantage for certain of our products making them less competitive. Such proposals, if adopted, could have a material adverse effect on our financial position or ability to sell such products and could result in the surrender of some existing contracts and policies. In addition, changes in the federal estate tax laws could negatively affect the demand for the types of life insurance used in estate planning.

#### RISKS RELATING TO THE INSURANCE INDUSTRY

##### OUR FUTURE RESULTS ARE DEPENDENT IN PART ON OUR ABILITY TO SUCCESSFULLY OPERATE IN AN INSURANCE INDUSTRY THAT IS HIGHLY COMPETITIVE

The insurance industry is highly competitive. Our competitors include other insurers and, because many of our products include a savings or investment component, securities firms, investment advisers, mutual funds, banks and other financial institutions. Many of our competitors have well-established national reputations and market similar products. Because of the competitive nature of the insurance industry, including competition for producers such as exclusive and independent agents, there can be no assurance that we will continue to effectively compete with our industry rivals, or that competitive pressures will not have a material adverse effect on our business, operating results or financial condition. The ability of banks to affiliate with insurers may have a material adverse effect on all of our product lines by substantially increasing the number, size and financial strength of potential competitors. Furthermore, certain competitors operate using a mutual insurance company structure and therefore, may have dissimilar profitability and return targets.

##### WE ARE SUBJECT TO MARKET RISK AND DECLINES IN CREDIT QUALITY

We are subject to market risk, the risk that we will incur losses due to adverse changes in equity, interest, foreign currency exchange rates and prices. Our primary market risk exposures are to changes in interest rates and, to a lesser degree, equity prices and changes in foreign currency exchange rates. In addition, we are subject to potential declines in credit quality, either related to issues specific to certain industries or to a weakening in the economy in general. For additional information on market risk, see the "Market Risk" section of Management's Discussion and Analysis.

A decline in market interest rates could have an adverse effect on our investment income as we invest cash in new investments that may yield less than the portfolio's average rate. In a declining interest rate environment,

borrowers may prepay or redeem securities more quickly than expected as they seek to refinance at lower rates. A decline could also lead us to purchase longer-term assets in order to obtain adequate investment yields resulting in a duration gap when compared to the duration of liabilities. An increase in market interest rates could have an adverse effect on the value of our investment portfolio by decreasing the fair values of the fixed income securities that comprise a substantial majority of our investment portfolio. Increases in interest rates also may lead to an increase in policy loans, surrenders and withdrawals that generally would be funded at a time when fair values of fixed income securities are lower. A decline in the quality of our investment portfolio as a result of adverse economic conditions or otherwise could cause additional realized losses on securities, including realized losses relating to derivative strategies.

#### CONCENTRATION OF OUR INVESTMENT PORTFOLIOS IN ANY PARTICULAR SEGMENT OF THE ECONOMY MAY HAVE ADVERSE EFFECTS

The concentration of our investment portfolios in any particular industry, group of related industries or geographic sector could have an adverse effect on our investment portfolios and consequently on our results of operations and financial position. While we seek to mitigate this risk by having a broadly diversified portfolio, events or developments that have a negative impact on any particular industry, group of related industries or geographic region may have a greater adverse effect on the investment portfolios to the extent that the portfolios are concentrated rather than diversified.

#### WE MAY SUFFER LOSSES FROM LITIGATION

As is typical for a large company, we are involved in a substantial amount of litigation, including class action litigation challenging a range of company practices and coverage provided by our insurance products. 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 our operating results or cash flows for a particular quarter or annual period. For a description of our current legal proceedings, see Note 11 of the consolidated financial statements.

In some circumstances, we may be able to collect on third-party insurance that we carry to recover all or part of the amounts that we may be required to pay in judgments, settlements and litigation expenses. However, we may not be able to resolve issues concerning the availability, if any, or the ability to collect such insurance concurrently with the underlying litigation. Consequently, the timing of the resolution of a particular piece of litigation and the determination of our insurance recovery with respect to that litigation may not coincide and, therefore, may be reflected in our financial statements in different fiscal quarters.

#### WE ARE SUBJECT TO EXTENSIVE REGULATION AND POTENTIAL FURTHER RESTRICTIVE REGULATION MAY INCREASE OUR OPERATING COSTS AND LIMIT OUR GROWTH

As insurance companies, broker-dealers, investment advisers and/or investment companies, many of our subsidiaries are subject to extensive laws and regulations. These laws and regulations are complex and subject to change. Moreover, they are administered and enforced by a number of different governmental authorities, including state insurance regulators, state securities administrators, the SEC, the National Association of Securities Dealers, the U.S. Department of Justice, and state attorneys general, each of which exercises a degree of interpretive latitude. Consequently, we are subject to the risk that compliance with any particular regulator's or enforcement authority's interpretation of a legal issue may not result in compliance with another regulator's or enforcement authority's interpretation of the same issue, particularly when compliance is judged in hindsight. In addition, there is risk that any particular regulator's or enforcement authority's interpretation of a legal issue may change over time to our detriment, or that changes in the overall legal environment may, even absent any particular regulator's or enforcement authority's interpretation of a legal issue changing, cause us to change our views regarding the actions we need to take from a legal risk management perspective, thus necessitating changes to our practices that may, in some cases, limit our ability to grow and improve the profitability of our business. Furthermore, in some cases, these laws and regulations are designed to protect or benefit the interests of a specific constituency rather than a range of constituencies. For example, state insurance laws and regulations are generally intended to protect or benefit purchasers or users of insurance products. In many respects, these laws and regulations limit our ability to grow and improve the profitability of our business.

In recent years, the state insurance regulatory framework has come under public scrutiny and members of Congress have discussed proposals to provide for optional federal chartering of insurance companies. We can make

no assurances regarding the potential impact of state or federal measures that may change the nature or scope of insurance regulation.

REINSURANCE MAY BE UNAVAILABLE AT CURRENT LEVELS AND PRICES, WHICH MAY LIMIT OUR ABILITY TO WRITE NEW BUSINESS

Market conditions beyond our control determine the availability and cost of the reinsurance we purchase. No assurances can be made that reinsurance will remain continuously available to us to the same extent and on the same terms and rates as are currently available. If we were unable to maintain our current level of reinsurance or purchase new reinsurance protection in amounts that we consider sufficient and at prices that we consider acceptable, we would have to either accept an increase in our exposure risk, reduce our insurance writings, or develop or seek other alternatives.

REINSURANCE SUBJECTS US TO THE CREDIT RISK OF OUR REINSURERS AND MAY NOT BE ADEQUATE TO PROTECT US AGAINST LOSSES ARISING FROM CEDED INSURANCE

The collectibility of reinsurance recoverables is subject to uncertainty arising from a number of factors, including whether insured losses meet the qualifying conditions of the reinsurance contract and whether reinsurers, or their affiliates, have the financial capacity and willingness to make payments under the terms of a reinsurance treaty or contract. Our inability to collect a material recovery from a reinsurer could have a material adverse effect on our operating results and financial condition.

THE CONTINUED THREAT OF TERRORISM AND ONGOING MILITARY ACTIONS MAY ADVERSELY AFFECT THE LEVEL OF CLAIM LOSSES WE INCUR AND THE VALUE OF OUR INVESTMENT PORTFOLIO

The continued threat of terrorism, both within the United States and abroad, and ongoing military and other actions and heightened security measures in response to these types of threats, may cause significant volatility and losses from declines in the equity markets and from interest rate changes in the United States, Europe and elsewhere, and result in loss of life, additional disruptions to commerce and reduced economic activity. Some of the assets in our investment portfolio may be adversely affected by declines in the equity markets and reduced economic activity caused by the continued threat of terrorism. We seek to mitigate the potential impact of terrorism on our commercial mortgage portfolio by limiting geographical concentrations in key metropolitan areas and by requiring terrorism insurance to the extent that it is commercially available. Additionally, in the event that terrorist acts occur, we could be adversely affected, depending on the nature of the event.

ANY DECREASE IN OUR FINANCIAL STRENGTH RATINGS MAY HAVE AN ADVERSE EFFECT ON OUR COMPETITIVE POSITION

Financial strength ratings are important factors in establishing the competitive position of insurance companies and generally have an effect on an insurance company's business. On an ongoing basis, rating agencies review the financial performance and condition of insurers and could downgrade or change the outlook on an insurer's ratings due to, for example, a change in an insurer's statutory capital; a change in a rating agency's determination of the amount of risk-adjusted capital required to maintain a particular rating; an increase in the perceived risk of an insurer's investment portfolio; a reduced confidence in management or a host of other considerations that may or may not be under the insurer's control. The insurance financial strength ratings of both AIC and Allstate Life Insurance Company ("ALIC") are A+, AA and Aa2 from A.M. Best, Standard & Poor's and Moody's, respectively. Because all of these ratings are subject to continuous review, the retention of these ratings cannot be assured. A multiple level downgrade in any of these ratings could have a material adverse effect on our sales, our competitiveness, the marketability of our product offerings, and our liquidity, operating results and financial condition.

CHANGES IN ACCOUNTING STANDARDS ISSUED BY THE FINANCIAL ACCOUNTING STANDARDS BOARD ("FASB") OR OTHER STANDARD-SETTING BODIES MAY ADVERSELY AFFECT OUR FINANCIAL STATEMENTS

Our financial statements are subject to the application of generally accepted accounting principles, which are periodically revised and/or expanded. Accordingly, we are required to adopt new or revised accounting standards from time to time issued by recognized authoritative bodies, including the FASB. It is possible that future changes we are required to adopt could change the current accounting treatment that we apply to our consolidated financial statements and that such changes could have a material adverse effect on our results and financial condition. For a description of potential changes in

accounting standards that could affect us currently, see Note 2 of the consolidated financial statements.

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#### THE OCCURRENCE OF EVENTS UNANTICIPATED IN OUR DISASTER RECOVERY SYSTEMS AND MANAGEMENT CONTINUITY PLANNING COULD IMPAIR OUR ABILITY TO CONDUCT BUSINESS EFFECTIVELY

In the event of a disaster such as a natural catastrophe, an industrial accident, a terrorist attack or war, events unanticipated in our disaster recovery systems could have an adverse impact on our ability to conduct business and on our results of operations and financial condition, particularly if those events affect our computer-based data processing, transmission, storage and retrieval systems. In the event that a significant number of our managers could be unavailable in the event of a disaster, our ability to effectively conduct our business could be severely compromised.

#### ITEM 1B. UNRESOLVED STAFF COMMENTS

None

#### ITEM 2. PROPERTIES

Our home office is part of the Parent Group's home office complex in Northbrook, Illinois. As of December 31, 2006, the complex consists of several buildings totaling approximately 2.3 million square feet of office space on a 250-acre site. In addition, we operate from various administrative, data processing, claims handling and support facilities.

All of the facilities from which we operate are owned or leased by our direct parent, Allstate Insurance Company, except for office space in Lincoln, Nebraska that is leased by Lincoln Benefit Life Company, a wholly owned subsidiary of ALIC, for general operations, file storage and information technology. Expenses associated with facilities owned or leased by Allstate Insurance Company are allocated to us on both a direct and an indirect basis, depending on the nature and use of each particular facility. We believe that these facilities are suitable and adequate for our current operations.

The locations out of which the Parent Group exclusive agencies operate in the U.S. are normally leased by the agencies as lessees.

#### ITEM 3. LEGAL PROCEEDINGS

Information required for Item 3 is incorporated by reference to the discussion under the heading "Regulation" and under the heading "Legal and regulatory proceedings and inquiries" in Note 11 of the Consolidated Financial Statements.

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## PART II

#### ITEM 5. MARKET FOR REGISTRANT'S COMMON EQUITY, RELATED STOCKHOLDER MATTERS AND ISSUER PURCHASES OF EQUITY SECURITIES

No established public trading market exists for Allstate Life's common stock. All of its outstanding common stock is owned by its parent, Allstate Insurance Company ("AIC"). All of the outstanding common stock of AIC is owned by The Allstate Corporation.

From January 1, 2005 through March 10, 2007, Allstate Life paid the following amounts to AIC in the aggregate on the dates specified as dividends on its common stock:

PAYMENT DATE	AGGREGATE AMOUNT
April 12, 2005	\$ 25,000,000
July 20, 2005	25,000,000
December 15, 2005	49,350,136
December 16, 2005	100,000,000
December 23, 2005	61,000,000
June 27, 2006	125,000,000
September 21, 2006	300,000,000
December 15, 2006	250,000,000

For additional information on dividends, including restrictions on the payment of dividends by Allstate Life and its subsidiaries, see the Limitations on Dividends by Insurance Subsidiaries subsection of the "Regulation" section of Item 1. Business of this Form 10-K and the discussion under the heading "Dividends" in Note 14 of our consolidated financial statements, which are incorporated herein by reference.

ITEM 6. SELECTED FINANCIAL DATA.

ALLSTATE LIFE  
INSURANCE  
COMPANY AND  
SUBSIDIARIES

5-YEAR  
SUMMARY OF  
SELECTED  
FINANCIAL  
DATA (IN  
MILLIONS)  
2006 2005  
2004 2003

2002 -----  
-----  
-----

CONSOLIDATED  
OPERATING  
RESULTS

Premiums \$  
576 \$ 474 \$  
637 \$ 959 \$  
1,023

Contract  
charges 1,009  
1,079 961 872  
853 Net

investment  
income 4,057  
3,707 3,260  
3,082 2,978

Realized  
capital gains  
and losses  
(79) 19 (11)  
(84) (422)

Total  
revenues  
5,563 5,279  
4,847 4,829  
4,432 Income

before  
cumulative  
effect of  
change in  
accounting  
principle,  
after-tax 428  
417 356 291  
245

Cumulative  
effect of  
change in  
accounting  
principle,  
after-tax --  
-- (175) (13)  
-- Net income  
428 417 181  
278 245

CONSOLIDATED  
FINANCIAL  
POSITION

Investments  
\$74,160  
\$72,756  
\$69,689

\$59,989  
 \$52,670 Total  
 assets 98,758  
 95,022 90,401  
 78,812 68,846  
 Reserve for  
 life-  
 contingent  
 contract  
 benefits and  
 contractholder  
 funds 72,769  
 70,071 65,142  
 55,394 48,591  
 Long-term  
 debt 206 181  
 104 45 --  
 Shareholder's  
 equity 5,498  
 6,008 6,309  
 6,429 6,362

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ITEM 7. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATION

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2006 HIGHLIGHTS	13
CONSOLIDATED NET INCOME AND INVESTMENTS	14
APPLICATION OF CRITICAL ACCOUNTING ESTIMATES	14
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MARKET RISK	36
CAPITAL RESOURCES AND LIQUIDITY	39
REGULATION AND LEGAL PROCEEDINGS	44
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OVERVIEW

The following discussion highlights significant factors influencing the consolidated financial position and results of operations of Allstate Life Insurance Company (referred to in this document as "we", "our", "us" or the "Company"). It should be read in conjunction with the 5-year summary of selected financial data, consolidated financial statements and related notes found under Part II, Item 6 and Item 8 contained herein. We operate as a single segment entity, based on the manner in which financial information is used internally to evaluate performance and determine the allocation of resources.

The most important factors that we monitor to evaluate the financial condition and performance of our Company include:

- For operations: premiums, deposits, gross margin including investment and benefit margins, amortization of deferred policy acquisition costs, expenses, operating income, invested assets, and profitably growing distribution partner relationships;
- For investments: credit quality/experience, stability of long-term returns, cash flows and asset and liability duration; and
- For financial condition: our financial strength ratings and statutory capital levels and ratios.

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2006 HIGHLIGHTS

- Net income increased 2.6% to \$428 million in 2006 compared to \$417 million in 2005.
- Gross margin increased 6.6% to \$1.83 billion in 2006 compared to \$1.72 billion in 2005. Gross margin, a measure that is not based on GAAP, is defined on page 20.

- - Contractholder fund deposits totaled \$9.54 billion for 2006 compared to \$11.41 billion in 2005.
- - Investments as of December 31, 2006 increased 1.9% from December 31, 2005 and net investment income increased 9.4% in 2006 compared to 2005.
- - Deposits on Allstate(R) Treasury-Linked Annuity contracts in 2006 totaled \$883 million, a \$546 million increase compared to 2005.
- - Dividends of \$675 million in 2006 were paid by the Company to AIC.
- - Return on average beginning and ending period shareholder's equity increased 0.6 points to 7.4%.
- - On June 1, 2006, we completed the disposition of substantially all of our variable annuity business through reinsurance. This event resulted in a net reduction to the Company's income from operations, before income taxes, of \$112 million when comparing 2006 to 2005, primarily due to the loss on disposition of operations for the sale of the variable annuity business and DAC amortization deceleration recognized in 2005 for variable annuities. The following table presents the differences between the 2006 and 2005 results of operations attributable to the variable annuity business.

(IN MILLIONS)	2006	2005	CHANGE
	----	-----	-----
FAVORABLE/(UNFAVORABLE)			
Life and annuity premiums and contract charges	\$136	\$ 276	\$(140)
Net investment income	17	50	(33)
Periodic settlements and accruals on non-hedge derivative instruments (1)	1	4	(3)
Contract benefits	(13)	(64)	51
Interest credited to contractholder funds (2)	(21)	(57)	36
	----	-----	-----
Gross margin (4)	120	209	(89)
Realized capital gains and losses	(9)	(11)	2
Amortization of DAC and DSI (3)	(47)	(53)	6
Operating costs and expenses	(43)	(101)	58
Loss on disposition of operations	(89)	--	(89)
	----	-----	-----
Income from operations before income tax expense	\$(68)	\$ 44	\$(112)
	=====	=====	=====
Investment margin	\$ (3)	\$ (3)	\$ --
Benefit margin	13	(24)	37
Contract charges and fees	110	236	(126)
	----	-----	-----
Gross margin (4)	\$120	\$ 209	\$ (89)
	=====	=====	=====

- - - - -
- (1) Periodic settlements and accruals on non-hedge derivative instruments are reflected as a component of realized capital gains and losses on the Consolidated Statements of Operations and Comprehensive Income.
  - (2) For purposes of calculating gross margin, amortization of deferred sales inducements ("DSI") is excluded from interest credited to contractholder funds and aggregated with amortization of DAC due to the similarity in the substance of the two items. Amortization of DSI for variable annuities totaled \$3 million and \$6 million in 2006 and 2005, respectively.
  - (3) Amortization deceleration of \$55 million was recognized in 2005 for variable annuities.
  - (4) Gross margin and its components are measures that are not based on GAAP. Gross margin, investment margin and benefit margin are defined on pages 20, 22 and 23, respectively.

CONSOLIDATED NET INCOME AND INVESTMENTS

AS OF AND FOR  
THE YEARS  
ENDED  
DECEMBER 31,

(IN MILLIONS)

2006 2005

2004 -----

-----

-- REVENUES

Premiums \$

576 \$ 474 \$

637 Contract  
charges 1,009

1,079 961 Net  
investment

income 4,057

3,707 3,260

Realized

capital gains  
and losses

(79) 19 (11)

-----

-- -----

Total

revenues

5,563 5,279

4,847 COSTS

AND EXPENSES

Contract

benefits

(1,372)

(1,340)

(1,359)

Interest

credited to  
contractholder

funds (2,543)

(2,340)

(1,923)

Amortization  
of deferred

policy

acquisition

costs (538)

(568) (534)

Operating

costs and

expenses

(374) (432)

(457)

Restructuring  
and related

charges (24)

(1) (5) -----

-----

----- Total

costs and

expenses

(4,851)

(4,681)

(4,278) Loss

on

disposition

of operations

(88) (7) (24)

Income tax

expense (196)

(174) (189) -

-----

- -----

Income before

cumulative

effect of

change in

accounting

principle,

after-tax 428

417 356

Cumulative

effect of

change in

accounting

principle,

after-tax --

-- (175) -----

----  
 ----- NET  
 INCOME \$ 428  
 \$ 417 \$ 181  
 =====  
 =====  
 =====  
 Investments  
 \$74,160  
 \$72,756  
 \$69,689  
 =====  
 =====  
 =====

APPLICATION OF CRITICAL ACCOUNTING ESTIMATES

We have identified four accounting policies that require us to make estimates that are significant to the consolidated financial statements. It is reasonably likely that changes in these estimates could occur from period to period and result in a material impact on our consolidated financial statements. A brief summary of each of these critical accounting policies follows. For a more detailed discussion of the effect of these estimates on our consolidated financial statements, and the judgments and assumptions related to these estimates, see the referenced sections of the MD&A. For a complete summary of our significant accounting policies see Note 2 of the consolidated financial statements.

**INVESTMENT VALUATION** The fair value of publicly traded fixed income and equity securities is based on independent market quotations, whereas the fair value of non-publicly traded securities is based on either widely accepted pricing valuation models, which use internally developed ratings and independent third party data as inputs, or independent third party pricing sources. Factors used in our internally developed models, such as liquidity risk associated with privately-placed securities, are difficult to independently observe and quantify. Because of this, judgment is required in developing certain of these estimates and, as a result, the estimated fair value of non-publicly traded securities may differ from amounts that would be realized upon an immediate sale of the securities.

For investments classified as available for sale, the difference between fair value and amortized cost for fixed income securities or cost for equity securities, net of deferred income taxes and certain other items (as disclosed in Note 6), is reported as a component of accumulated other comprehensive income on the Consolidated Statements of Financial Position and is not reflected in the operating results of any period until reclassified to net income upon the consummation of a transaction with an unrelated third party or when declines in fair values are deemed other-than-temporary. The assessment of other-than-temporary impairment of a security's fair value is performed on a portfolio review as well as a case-by-case basis considering a wide range of factors. For our portfolio review evaluations, we ascertain whether there are any approved programs involving the disposition of investments such as changes in duration, revision to strategic asset allocations and liquidity actions; and any dispositions anticipated by

the portfolio managers. In these instances, we recognize impairment on securities being considered for these approved anticipated actions if the security is in an unrealized loss position. There are a number of assumptions and estimates inherent in evaluating impairments and determining if they are other-than-temporary, including 1) our ability and intent to hold the investment for a period of time sufficient to allow for an anticipated recovery in value; 2) the expected recoverability of principal and interest; 3) the duration and extent to which the fair value has been less than amortized cost for fixed income securities or cost for equity securities; 4) the financial condition, near-term and long-term prospects of the issuer, including relevant industry conditions and trends, and implications of rating agency actions and offering prices; and 5) the specific reasons that a security is in a significant unrealized loss position, including market conditions which could affect liquidity. Additionally, once assumptions and estimates are made, any number of changes in facts and circumstances could cause us to later determine that an impairment is other-than-temporary, including 1) general economic conditions that are worse than previously assumed or that have a greater adverse effect on a particular issuer than originally estimated; 2) changes in the facts and circumstances related to a particular issuer's ability to meet all of its contractual obligations; and 3) changes in facts and circumstances or new

information obtained which causes a change in our ability or intent to hold a security to maturity or until it recovers in value. Changes in assumptions, facts and circumstances could result in additional charges to earnings in future periods to the extent that losses are realized. The charge to earnings, while potentially significant to net income, would not have a significant effect on shareholder's equity since the majority of our portfolio is carried at fair value and as a result, any related unrealized loss would already be reflected as a component of accumulated other comprehensive income in shareholder's equity.

For a more detailed discussion of the risks relating to changes in investment values and levels of investment impairment, and the potential causes of such changes, see Note 6 of the consolidated financial statements and the Investments, Market Risk, and Forward-looking Statements and Risk Factors sections of this document.

**DERIVATIVE INSTRUMENT HEDGE EFFECTIVENESS** We primarily use derivative financial instruments to reduce our exposure to market risk and in conjunction with asset/liability management. The fair value of exchange traded derivative contracts is based on independent market quotations, whereas the fair value of non-exchange traded derivative contracts is based on either widely accepted pricing valuation models which use independent third party data as inputs or independent third party pricing sources.

When derivatives meet specific criteria, they may be designated as accounting hedges and accounted for as fair value, cash flow, foreign currency fair value, or foreign currency cash flow hedges. When designating a derivative as an accounting hedge, we formally document the hedging relationship, risk management objective and strategy. The documentation identifies the hedging instrument, the hedged item, the nature of the risk being hedged and the assumptions used to assess how effective the hedging instrument is in offsetting the exposure to changes in the hedged item's fair value attributable to the hedged risk. In the case of a cash flow hedge, this documentation includes the exposure to changes in the hedged transaction's variability in cash flows attributable to the hedged risk. We do not exclude any component of the change in fair value of the hedging instrument from the effectiveness assessment. At each reporting date, we confirm that the hedging instrument continues to be highly effective in offsetting the hedged risk. For further discussion of these policies and quantification of the impact of these estimates and assumptions, see Note 7 of the consolidated financial statements and the Investments, Market Risk, and Forward-looking Statements and Risk Factors sections of this document.

**DEFERRED POLICY ACQUISITION COST ("DAC") AMORTIZATION** We incur significant costs in connection with acquiring business. In accordance with generally accepted accounting principles ("GAAP"), costs that vary with and are primarily related to acquiring business are deferred and recorded as an asset on the Consolidated Statements of Financial Position.

DAC related to traditional life insurance is amortized over the premium paying period of the related policies in proportion to the estimated revenues on such business. Significant assumptions relating to estimated premiums, investment income and realized capital gains and losses, as well as to all other aspects of DAC are determined based upon conditions as of the date of policy issuance and are generally not revised during the life of the policy. Any deviations from projected business in force resulting from actual policy terminations differing from expected levels and any estimated premium deficiencies change the rate of amortization in the period such events occur. Generally, the amortization periods for these contracts approximate the estimated lives of the policies.

DAC related to interest-sensitive life, annuities and other investment contracts is amortized in proportion to the incidence of the total present value of gross profits which includes both actual historical gross profits ("AGP") and estimated future gross profits ("EGP") expected to be earned over the estimated lives of the contracts. Actual amortization periods range from 15-30 years; however, incorporating estimates of customer surrender rates, partial withdrawals and deaths generally results in the majority of the DAC being amortized over the surrender charge

period. AGP and EGP consist of the following components: benefit margins primarily from mortality, investment margin including realized capital gains and losses; and contract administration, surrender and other contract charges, less maintenance expenses. We periodically review and make revisions to EGPs resulting in changes in the cumulative amounts expensed as a component of amortization of DAC in the period in which the revision is made. This is commonly known as "DAC unlocking".

For quantification of the impact of these estimates and assumptions, see the Forward-looking Statements and Risk Factors sections of this document and Note 2 of the consolidated financial statements.

**RESERVE FOR LIFE-CONTINGENT CONTRACT BENEFITS ESTIMATION** Long-term actuarial assumptions of future investment yields, mortality, morbidity, policy terminations and expenses are used when establishing the reserve for life-contingent contract benefits. These assumptions, which for life contingent annuities and traditional life insurance are applied using the net level premium method, include provisions for adverse deviation and generally vary by such characteristics as type of annuity benefit or coverage, year of issue and policy duration. Future investment yield assumptions are determined at the time the policy is issued based upon prevailing investment yields as well as estimated reinvestment yields. Mortality, morbidity and policy termination assumptions are based on our experience and industry experience prevailing at the time the policies are issued. Expense assumptions include the estimated effects of inflation and expenses to be incurred beyond the premium-paying period.

For further discussion of these policies, see Note 8 of the consolidated financial statements and the Forward-looking Statements and Risk Factors section of this document.

## OPERATIONS

**OVERVIEW AND STRATEGY** We are a major provider of life insurance, retirement and investment products to individual and institutional customers. Our mission is to assist financial services professionals in meeting their clients' financial protection, retirement and investment needs by providing consumer-focused products delivered with reliable and efficient service.

Our primary objectives are to improve our return on equity and position the Company for profitable growth. In the near-term, this will require us to balance sales goals with new business return targets. Our actions to accomplish these objectives include improving returns on new business by increasing sales of products through Allstate Agencies, increasing sales of life insurance products, and maintaining cost discipline through scale and efficiencies, while improving capital efficiency. The execution of our business strategies has and may continue to involve simplifying our business model, and focusing on those products and distribution relationships where we can secure strong leadership positions while generating acceptable returns and bringing to market a selection of innovative, consumer-focused products.

We plan to continue offering a suite of products that protects consumers financially and helps them better prepare for retirement. Our retail products include deferred and immediate fixed annuities; interest-sensitive, traditional and variable life insurance; and funding agreements backing retail medium-term notes. Individual retail products are sold through several distribution channels including Allstate exclusive agencies, independent agents (including master brokerage agencies), and financial service firms such as banks, broker/dealers and specialized structured settlement brokers. Our institutional product line consists primarily of funding agreements sold to unaffiliated trusts that use them to back medium-term notes issued to institutional and individual investors.

**PREMIUMS** Premiums represent revenues generated from traditional life, immediate annuities with life contingencies 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 Financial Inc. ("Prudential") on June 1, 2006, variable annuity contract charges on the business subject to the transaction are fully reinsured to Prudential and presented net of reinsurance on the Consolidated Statements of Operations (see Note 3 to the Consolidated Financial Statements).

The following table summarizes premiums and contract charges by product.

(IN MILLIONS)	2006 -----	2005 -----	2004 -----
<b>PREMIUMS</b>			
Traditional life	\$ 257	\$ 250	\$ 302

Immediate annuities with life contingencies	278	197	316
Other	41	27	19
	-----	-----	-----
TOTAL PREMIUMS	576	474	637
CONTRACT CHARGES			
Interest-sensitive life	797	734	663
Fixed annuities	73	65	52
Variable annuities	139	280	246
	-----	-----	-----
TOTAL CONTRACT CHARGES	1,009	1,079	961
	-----	-----	-----
TOTAL PREMIUMS AND CONTRACT CHARGES	\$1,585	\$1,553	\$1,598
	=====	=====	=====

Total premiums increased 21.5% in 2006 compared to 2005 due primarily to increased premiums on immediate annuities with life contingencies, due to certain pricing refinements and a more favorable pricing environment in 2006. Also contributing to the increase to lesser extent were higher premiums on traditional life and other products due to increased sales.

Total premiums decreased 25.6% in 2005 compared to 2004 as lower premiums on immediate annuities with life contingencies and traditional life products. Premiums on immediate annuities with life contingencies declined primarily as a result of pricing actions taken to improve our returns on new business and reflect our current expectations of mortality. Pricing changes led to a shift in our sales mix from immediate annuities with life contingencies to immediate annuities without life contingencies, which are accounted for as deposits rather than as premiums. The decline in traditional life premiums was primarily due to the absence of certain premiums in 2005 resulting from the disposal of our direct response distribution business in 2004.

Contract charges declined 6.5% in 2006 compared to 2005. Excluding contract charges on variable annuities, substantially all of which are reinsured to Prudential effective June 1, 2006, contract charges increased 8.9% in 2006 compared to 2005. The increase was 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 2006 due to increased surrender charges.

Contract charges increased 12.3% in 2005 compared to 2004. The increase was due to higher contract charges on interest-sensitive life, variable annuities and, to a lesser extent, fixed annuities. The increase in the interest-sensitive life contract charges was attributable to in-force business growth resulting from deposits and credited interest more than offsetting surrenders and benefits. Higher variable annuity contract charges were primarily the result of higher account values and fund manager participation fees. Fixed annuity contract charges in 2005 reflect higher surrender charges compared with the prior year.

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CONTRACTHOLDER FUNDS represent interest-bearing liabilities arising from the sale of individual and institutional products, such as interest-sensitive life, fixed annuities 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)
2006 2005(1)
2004(1) -----
-- -----
-----
CONTRACTHOLDER
FUNDS,
BEGINNING
BALANCE
\$58,190
\$53,939
\$44,914
Impact of
adoption of
SOP 03-1(2) -
- - - 421
DEPOSITS

Fixed annuities	6,006	5,924
	7,319	
Institutional products (funding agreements)	2,100	3,773
	3,987	
Interest-sensitive life	1,336	
	1,318	1,275
Variable annuity and life deposits allocated to fixed accounts	99	
	395	495
-----		
----- Total deposits		
	9,541	11,410
	13,076	
INTEREST CREDITED	2,600	2,340
	1,912	
MATURITIES, BENEFITS, WITHDRAWALS AND OTHER ADJUSTMENTS		
Maturities of institutional products	(2,726)	
	(3,090)	
	(2,518)	
Benefits	(1,500)	
	(1,336)	
	(1,047)	
Surrenders and partial withdrawals	(4,627)	
	(3,839)	
	(2,385)	
Contract charges	(697)	
	(649)	(593)
Net transfers to separate accounts	(145)	(339)
	(412)	
Fair value hedge adjustments	38	(289)
	45	
Other adjustments	(109)	43
	526	
-----		
-----		
Total maturities, benefits, withdrawals and other adjustments	(9,766)	
	(9,499)	
	(6,384)	-----
-----		
-----		
CONTRACTHOLDER FUNDS, ENDING BALANCE		

\$60,565  
\$58,190  
\$53,939  
=====  
=====  
=====

- - - - -
- (1) To conform to the current period presentation, certain prior year balances have been reclassified.
  - (2) The increase in contractholder funds due to the adoption of Statement of Position No. 03-1, "Accounting and Reporting by Insurance Enterprises for Certain Nontraditional Long-Duration Contracts and for Separate Accounts" ("SOP 03-1") reflects the reclassification of certain products previously included as a component of separate accounts to contractholder funds, the reclassification of DSI from contractholder funds to other assets and the establishment of reserves for certain liabilities that are primarily related to income and other guarantees provided under fixed annuity, variable annuity and interest-sensitive life contracts.

Contractholder funds increased 4.1% and 7.9% in 2006 and 2005, respectively. Average contractholder funds increased 5.9% in 2006 compared to 2005 and 13.9% in 2005 compared to 2004. The reduction in the rate at which contractholder funds grew was due primarily to lower contractholder deposits and increased contractholder surrenders and withdrawals.

Contractholder deposits decreased 16.4% in 2006 compared to 2005 due to decreased deposits on funding agreements and, to a lesser extent, lower variable annuity and life deposits allocated to fixed accounts due to the disposition of substantially all of our variable annuity business through reinsurance effective June 1, 2006. These items were partially offset by higher fixed annuity deposits. The Company 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. Consequently, sales of institutional products may vary from period to period. In 2006, deposits on institutional products declined 44.3% compared to 2005. Higher fixed annuity deposits in 2006 were the result of a \$546 million increase in deposits on Allstate(R) Treasury-Linked Annuity contracts. This increase was partially offset by modest declines in deposits on traditional deferred annuities and market value adjusted annuities. These declines were in part impacted by our actions to improve new business returns and reduced consumer demand. Consumer demand for fixed annuities is influenced by market interest rates on short-term deposit products and equity market conditions, which can increase the relative attractiveness of competing investment alternatives.

Contractholder deposits decreased 12.7% in 2005 compared to 2004 due to lower deposits on fixed annuities. Fixed annuity deposits declined 19.1% in 2005 as lower deposits on traditional deferred fixed annuities and market value adjusted annuities were partially offset by increased deposits on immediate annuities without life contingencies. The decline in fixed annuity deposits resulted from reduced consumer demand relative to other short-term deposit products due to increases in short-term interest rates without corresponding increases in longer term rates, and pricing actions to increase fixed annuity product returns. Institutional product deposits decreased 5.4% in 2005 compared to 2004.

Surrenders and partial withdrawals on deferred fixed annuities and interest-sensitive life products increased 20.5% in 2006 compared to 2005, while the withdrawal rate, based on the beginning of the period contractholder funds balance, increased to 11.3% for 2006 from 9.9% and 7.4%, for 2005 and 2004, respectively. The increase in the surrender rate in 2006 was influenced by multiple factors, including the relatively low interest rate environment during the last several years, which reduced reinvestment opportunities and increased the number of policies with little or no surrender charge protection. Also influencing the increase was our crediting rate strategies related to renewal business implemented to improve investment spreads on selected contracts. The increase in surrenders and partial withdrawals in 2006 is consistent with management's expectation that in the current interest rate environment and with a larger number of contractholders with relatively low or no surrender charges, more contractholders may choose to move their funds to competing investment alternatives. The aging of our in-force business may cause this trend to continue.

Surrenders and partial withdrawals increased 61.0% in 2005 compared to 2004

driven mostly by higher surrenders of market value adjusted annuities due to a portion of these contracts entering a 30-45 day window in which there were no surrender charges or market value adjustments. The lack of surrender charges and market value adjustments combined with the interest rate environment, which included a relatively small difference between short-term and long-term interest rates, caused contractholders to choose competing short-term investment alternatives.

NET INVESTMENT INCOME increased 9.4% in 2006 compared to 2005 and 13.7% in 2005 compared to 2004. The 2006 increase was 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 short-term market interest rates and improved yields on assets supporting deferred fixed annuities. In 2005, the increase compared to 2004 was primarily the result of increased portfolio balances and, to a lesser extent, increased yields on floating rate assets due to higher short-term interest rates and increased income on partnership interests, partially offset by lower yields on fixed income securities. Higher average portfolio balances in both years 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. Investment balances as of December 31, 2006, increased 1.9% from December 31, 2005 and increased 4.4% as of December 31, 2005 compared to December 31, 2004.

Net income analysis is presented in the following table.

(IN MILLIONS)	2006	2005	2004
Premiums	\$ 576	\$ 474	\$ 637
Contract charges	1,009	1,079	961
Net investment income	4,057	3,707	3,260
Periodic settlements and accruals on non-hedge derivative instruments (1)	56	63	49
Contract benefits	(1,372)	(1,340)	(1,359)
Interest credited to contractholder funds (2)	(2,495)	(2,266)	(1,878)
Gross margin	1,831	1,717	1,670
Amortization of DAC and DSI (2) (3)	(641)	(484)	(441)
Operating costs and expenses	(374)	(432)	(457)
Restructuring and related charges	(24)	(1)	(5)
Income tax expense	(253)	(249)	(265)
Realized capital gains and losses, after-tax	(51)	12	(8)
DAC and DSI amortization relating to realized capital gains and losses, after-tax (3)	36	(103)	(89)
Reclassification of periodic settlements and accruals on non-hedge derivative instruments, after-tax	(36)	(40)	(32)
Loss on disposition of operations, after-tax	(60)	(3)	(17)
Cumulative effect of change in accounting principle, after-tax	--	--	(175)
NET INCOME	\$ 428	\$ 417	\$ 181

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

(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 \$48 million, \$74 million and \$45 million in 2006, 2005 and 2004, 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 was \$55 million, \$(158) million and \$(138) million in 2006, 2005 and 2004, respectively.

GROSS MARGIN, a non-GAAP measure, is comprised of premiums and contract charges, and net investment income, less contract benefits and interest credited to contractholder funds excluding amortization of DSI. Gross margin also includes periodic settlements and accruals on certain non-hedge derivative

instruments (see additional discussion under "INVESTMENT MARGIN"). We use gross margin as a component of our evaluation of the profitability of our 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 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.

2006	-----	
	-----	
	-----	
	-----	
--	INVESTMENT	
	BENEFIT	
	CONTRACT	
	GROSS (IN	
	MILLIONS)	
	MARGIN MARGIN	
	CHARGES AND	
	FEES MARGIN -	
	-----	
	-----	
	-----	
---	Premiums	
\$ --	\$ 576	\$
--	\$ 576	
	Contract	
	charges --	
600	409	1,009
	Net	
	investment	
	income 4,057	
-- --	4,057	
	Periodic	
	settlements	
	and accruals	
	on non-hedge	
	derivative	
	instruments	
(1)	56 -- --	
	56 Contract	
	benefits	
(539)	(833) -	
	- (1,372)	
	Interest	
	credited to	
	contractholder	
	funds(2)	
(2,495)	-- --	
(2,495)	-----	
	-----	
	-----	
	\$	
1,079	\$ 343	
\$409	\$ 1,831	
=====	=====	
=====	=====	

2005	-----	
	-----	
	-----	
	-----	
--	INVESTMENT	
	BENEFIT	
	CONTRACT	
	GROSS (IN	

MILLIONS)  
MARGIN MARGIN  
CHARGES AND  
FEES MARGIN -  
-----  
-----  
-----  
--- Premiums  
\$ -- \$ 474 \$  
-- \$ 474  
Contract  
charges --  
621 458 1,079  
Net  
investment  
income 3,707  
-- -- 3,707  
Periodic  
settlements  
and accruals  
on non-hedge  
derivative  
instruments  
(1) 63 -- --  
63 Contract  
benefits  
(529) (811) -  
- (1,340)  
Interest  
credited to  
contractholder  
funds(2)  
(2,266) -- --  
(2,266) -----  
-----  
----- \$ 975  
\$ 284 \$458 \$  
1,717 =====  
=====

2004 -----  
-----  
-----  
--- INVESTMENT  
BENEFIT  
CONTRACT  
GROSS (IN  
MILLIONS)  
MARGIN MARGIN  
CHARGES AND  
FEES MARGIN -  
-----  
-----  
-----  
--- Premiums  
\$ -- \$ 637 \$  
-- \$ 637  
Contract  
charges --  
539 422 961  
Net  
investment  
income 3,260  
-- -- 3,260  
Periodic  
settlements  
and accruals  
on non-hedge  
derivative  
instruments  
(1) 49 -- --  
49 Contract  
benefits  
(530) (829) -  
- (1,359)  
Interest  
credited to  
contractholder

funds(2)  
(1,878) -- --  
(1,878) -----  
-----  
----- \$ 901  
\$ 347 \$422 \$  
1,670 =====  
=====

- - - - -
- (1) Periodic settlements and accruals on non-hedge derivative instruments are reflected as a component of realized capital gains and losses on the Consolidated Statements of Operations and Comprehensive Income.
  - (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 \$48 million, \$74 million and \$45 million for the years ended December 31, 2006, 2005 and 2004, respectively.

Gross margin increased 6.6% in 2006 compared to 2005 due to increased investment and benefit margin, partially offset by lower contract charges and fees. The decline in contract charges and fees was driven by the absence of contract charges on variable annuities that were reinsured effective June 1, 2006 in conjunction with the disposition of substantially all of our variable annuity business. Excluding the impact of the reinsurance of our variable annuity business, gross margin increased 13.5% in 2006 compared to 2005. Gross margin increased 2.8% in 2005 compared to 2004 due to higher investment margin and contract charges and fees, partially offset by lower benefit margin.

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. We utilize derivative instruments as economic hedges of investments or contractholder funds or to replicate fixed income securities. These instruments either do not qualify for hedge accounting or are not designated as hedges for accounting purposes. Such derivatives are accounted for at fair value, and reported in realized capital gains and losses. Periodic settlements and accruals on these derivative instruments are included as a component of gross margin, consistent with their intended use to enhance or maintain investment income and margin, and together with the economically hedged investments or product attributes (e.g., net investment income or interest credited to contractholders funds) or replicated investments, to appropriately reflect trends in product performance. Amortization of DSI is excluded from interest credited to contractholder funds for purposes of calculating investment margin. We use investment margin to evaluate our 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)	2006	2005	2004
	-----	----	----
Annuities	\$ 770	\$682	\$620
Life insurance	183	171	160
Institutional products	126	122	121
	-----	----	----
Total investment margin	\$1,079	\$975	\$901
	=====	=====	=====

Investment margin increased 10.7% in 2006 compared to 2005 primarily due to improved yields on assets supporting deferred fixed annuities, crediting rate actions relating to renewal business and growth in contractholder funds. Investment margin increased 8.2% in 2005 compared to 2004 primarily due to higher contractholder funds and actions to reduce crediting rates, partially offset by lower portfolio yields.

The following table summarizes the annualized weighted average investment yield, interest crediting rates and investment spreads during 2006, 2005 and 2004.



- -----  
 Reserve for  
   life-  
   contingent  
   contracts  
   \$12,204  
   \$11,881  
   \$11,203  
   =====

Interest-  
 sensitive  
 life \$ 8,397  
 \$ 7,917 \$  
   7,397  
 Deferred  
   fixed  
   annuities  
 35,498 33,853  
   31,347  
 Immediate  
   annuities  
 without life  
 contingencies  
   3,779 3,598  
   3,243  
 Institutional  
   12,467 12,431  
   11,279 Market  
       value  
   adjustments  
   related to  
   derivative  
   instruments  
   and other 424  
   391 673 -----  
 - - - - -  
   -----  
 Contractholder  
 funds \$60,565  
   \$58,190  
   \$53,939  
   =====

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 the benefit margin to evaluate our 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)	2006	2005	2004
Life insurance	\$386	\$364	\$400
Annuities	(43)	(80)	(53)
Total benefit margin	\$343	\$284	\$347
	====	====	====

Benefit margin increased 20.8% in 2006 compared to 2005. Benefit margin for 2005 includes \$60 million of amounts that were classified as contract charges and fees beginning in 2006. Excluding this reclassification, benefit margin increased 53.1% in 2006 compared to 2005 due primarily to improved life insurance mortality experience in 2006 and to a lesser extent, in force business growth.



(55) \$ -- \$--  
 \$ 595  
 Interest-  
 sensitive  
 life 1,530 --  
 257 (183)  
 (18) 46 1,632  
 Variable  
 annuities 731  
 (726) 45 (46)  
 -- -- 4  
 Investment  
 contracts  
 1,084 -- 362  
 (248) 16 13  
 1,227  
 Accident,  
 health and  
 other 22 -- 9  
 (4) -- -- 27  
 -----  
 -----  
 -----  
 Total \$3,948  
 \$(726) \$742  
 \$(536) \$ (2)  
 \$59 \$3,485  
 =====  
 =====  
 =====  
 =====  
 =====

AMORTIZATION  
 EFFECT OF  
 BEGINNING  
 (ACCELERATION)  
 UNREALIZED  
 ENDING  
 BALANCE  
 ACQUISITION  
 AMORTIZATION  
 DECELERATION  
 CAPITAL  
 BALANCE  
 DECEMBER  
 COSTS CHARGED  
 TO CHARGED TO  
 GAINS AND  
 DECEMBER (IN  
 MILLIONS) 31,  
 2004 DEFERRED  
 INCOME (1)  
 INCOME (2)  
 LOSSES 31,  
 2005 -----  
 -----  
 -----  
 -----  
 -----

Traditional  
 life \$ 564 \$  
 64 \$ (47) \$ -  
 - \$ -- \$ 581  
 Interest-  
 sensitive  
 life 1,380  
 226 (134) (2)  
 60 1,530  
 Variable  
 annuities 628  
 111 (106) 55  
 43 731  
 Investment  
 contracts 600  
 346 (282)  
 (51) 471  
 1,084  
 Accident,  
 health and

other 4 19  
 (1) -- -- 22  
 -----  
 -----  
 -----  
 -----  
 -----  
 Total \$3,176  
 \$766 \$(570) \$  
 2 \$574 \$3,948  
 =====  
 =====  
 =====

- 
- (1) The amortization of DAC for interest-sensitive life, variable annuities and investment contracts is proportionate to the recognition of gross profits, which include realized capital gains and losses. Fluctuations in amortization for these products may result as actual realized capital gains and losses differ from the amounts utilized in the determination of estimated gross profits. Amortization related to realized capital gains and losses was \$50 million and \$(126) million in 2006 and 2005, respectively.
  - (2) Included as a component of amortization of DAC on the Consolidated Statements of Operations and Comprehensive Income.

OPERATING COSTS AND EXPENSES decreased 13.4% in 2006 compared to 2005 and 5.5% in 2005 compared to 2004. The following table summarizes operating costs and expenses.

(IN MILLIONS)	2006	2005	2004
	----	----	----
Non-deferrable acquisition costs	\$118	\$149	\$146
Other operating costs and expenses	256	283	311
	----	----	----
Total operating costs and expenses	\$374	\$432	\$457
	=====	=====	=====
Restructuring and related charges	\$ 24	\$ 1	\$ 5
	=====	=====	=====

Total operating costs and expenses declined in 2006 compared to 2005 primarily as a result of the disposition through reinsurance of substantially all of our variable annuity business effective June 1, 2006.

The decline in total operating costs and expenses in 2005 compared to 2004 was primarily attributable to lower employee and technology expenses reflecting continuing actions to simplify operations and reduce costs.

Restructuring and related charges for 2006 reflect costs related to the Voluntary Termination Offer ("VTO"). The VTO was offered to most employees located at the Company's headquarters and was completed during 2006.

Net income was favorably impacted in 2006 and 2005 by adjustments to prior years' tax liabilities totaling \$10 million and \$23 million, respectively. These amounts are presented as a component of income tax expense in the Consolidated Statements of Operations and Comprehensive income.

**REINSURANCE CEDED** We enter into reinsurance agreements with unaffiliated carriers to limit our risk of mortality losses. As of December 31, 2006 and 2005, approximately 50% of our face amount of life insurance in force is reinsured. As of December 31, 2006, for certain term life insurance policies, we cede up to 90% of the mortality risk depending on the length of the term. Comparatively, as of December 31, 2005, for certain term life insurance, we ceded 25-90% of the mortality risk depending on the length of the term and policy premium guarantees. Additionally, we cede substantially all of the risk associated with variable annuity contracts and 100% of the morbidity risk on our long-term care contracts. Beginning in 2006, we increased our mortality risk retention to \$5 million per individual life for certain insurance applications meeting certain criteria. From October 1998 through December 2005, we ceded mortality risk on new life contracts that exceeded \$2 million per individual life. For business sold prior to October 1998, we ceded mortality risk in excess of specific amounts up to \$1 million per individual life. We retain primary liability as a direct insurer for all risks ceded to reinsurers.

The impacts of reinsurance on our reserve for life-contingent contract benefits and contractholder funds at December 31, are summarized in the

following table.

(IN MILLIONS)	REINSURANCE RECOVERABLE ON PAID AND UNPAID CLAIMS	
	2006	2005
Annuities (1)	\$1,654	\$ 172
Life insurance	1,217	1,115
Long-term care	427	324
Other	94	88
Total	\$3,392	\$1,699

(1) Reinsurance recoverables as of December 31, 2006 include \$1.49 billion for general account reserves related to variable annuities. Substantially all of our variable annuity business was reinsured effective June 1, 2006.

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The estimation of reinsurance recoverables is impacted by the uncertainties involved in the establishment of reserves. Our reinsurance recoverables, summarized by reinsurer as of December 31, are shown in the following table.

(IN MILLIONS)	S&P FINANCIAL STRENGTH RATING	REINSURANCE RECOVERABLE ON PAID AND UNPAID CLAIMS	
		2006	2005
Prudential Insurance Company of America	AA-	\$1,490	\$ --
Employers Reassurance Corporation	A+	439	336
RGA Reinsurance Company	AA-	293	261
Transamerica Life Group	AA	232	185
Swiss Re Life and Health America, Inc.	AA-	160	153
Paul Revere Life Insurance Company	BBB+	147	152
Scottish Re Group	BB	127	123
Munich American Reassurance	A+	92	83
Manulife Insurance Company	AAA	82	87
Security Life of Denver	AA	73	70
Triton Insurance Company	NR	65	62
Lincoln National Life Insurance	AA	59	55
American Health & Life Insurance Co.	NR	50	50
Other (1)		83	82
Total		\$3,392	\$1,699

(1) As of December 31, 2006 and 2005, the other category includes \$59 million and \$57 million, respectively, of recoverables due from reinsurers with an investment grade credit rating from Standard & Poor's ("S&P").

We continuously monitor the creditworthiness of reinsurers in order to determine our risk of recoverability on an individual and aggregate basis, and a provision for uncollectible reinsurance is recorded if needed. No amounts have been deemed unrecoverable in the three years ended December 31, 2006.

ALIC's insurance subsidiaries are domiciled in Illinois, New York, South Carolina and Nebraska. Except for those domiciled in New York and South Carolina, ALIC has 100% intercompany reinsurance agreements in place with most of its domestic insurance subsidiaries. With the exception of Allstate Life Insurance Company of New York, which retains substantially all of its business up to its per life limit, and ALIC Reinsurance Company, which is a special purpose financial captive, only invested assets supporting capital and relating to Separate Accounts remain in ALIC's other subsidiaries. All significant intercompany transactions have been eliminated in consolidation.

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## INVESTMENTS

An important component of our financial results is the return on our

investment portfolio. The investment portfolio is managed based upon the nature of the business and its corresponding liability structure.

**OVERVIEW AND STRATEGY** The investment strategy focuses on the need for risk-adjusted spread on the underlying liabilities while maximizing return on capital. We believe investment spread is maximized by selecting assets that perform favorably on a long-term basis and by disposing of certain assets to minimize the effect of downgrades and defaults. We believe this strategy maintains the investment margin necessary to sustain income over time. The portfolio management approach employs a combination of recognized market, analytical and proprietary modeling, including a strategic asset allocation model, as the primary basis for the allocation of interest sensitive, illiquid and credit assets as well as for determining overall below investment grade exposure and diversification requirements. Within the ranges set by the strategic asset allocation model, tactical investment decisions are made in consideration of prevailing market conditions.

As a result of tactical decisions, 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. Portfolio monitoring, which includes identifying securities that are other-than-temporarily impaired and recognizing impairment on securities in an unrealized loss position for which we do not have the intent and ability to hold until recovery, are conducted regularly. For more information, see the Portfolio Monitoring section of the MD&A.

**PORTFOLIO COMPOSITION** The composition of the investment portfolio at December 31, 2006 is presented in the table below. Also see Notes 2 and 6 to the consolidated financial statements for investment accounting policies and additional information.

(IN MILLIONS)	INVESTMENTS	PERCENT TO TOTAL
	-----	-----
Fixed income securities (1)	\$62,439	84.2%
Mortgage loans	8,690	11.7
Equity securities	533	0.7
Short-term	805	1.1
Policy loans	752	1.0
Other	941	1.3
	-----	-----
Total	\$74,160	100.0%
	=====	=====

(1) Fixed income securities are carried at fair value. Amortized cost basis for these securities was \$60.85 billion.

Total investments increased to \$74.16 billion at December 31, 2006, from \$72.76 billion at December 31, 2005, primarily due to positive cash flows from operating activities, partially offset by payments totaling approximately \$826 million related to the disposition through reinsurance of substantially all of our variable annuity business, decreased net unrealized capital gains on fixed income securities and dividends of \$675 million paid to AIC. The Company paid these dividends as a result of excess capital resulting primarily from the disposition of substantially all of our variable annuity business through reinsurance.

Total investments at amortized cost related to collateral received in connection with securities lending business activities, funds received in connection with securities repurchase agreements, and collateral posted by counterparties related to derivative transactions, increased to \$2.29 billion at December 31, 2006, from \$2.23 billion at December 31, 2005.

We use different methodologies to estimate the fair value of publicly and non-publicly traded marketable investment securities and exchange traded and non-exchange traded derivative contracts. For a discussion of these methods, see the Application of Critical Accounting Estimates section of MD&A.

The following table shows total investments, categorized by the method used to determine fair value at December 31, 2006.

DERIVATIVE  
INVESTMENTS  
CONTRACTS(1)  
-----  
-----

-----  
 CARRYING  
 PERCENT  
 FAIR (IN  
 MILLIONS)  
 VALUE TO  
 TOTAL VALUE  
 -----

-----  
 -- Fair  
 value based

on  
 independent  
 market

quotations  
 \$50,597

68.2% \$ 126

Fair value  
 based on  
 models and  
 other  
 valuation  
 methods

12,655 17.1  
 907

Mortgage  
 loans,  
 policy  
 loans,  
 certain  
 limited

partnership  
 and other

investments,  
 valued at

cost,  
 amortized

cost and  
 the equity

method  
 10,908 14.7

-----  
 -----

- Total  
 \$74,160

100.0%  
 \$1,033

=====

=====

=====

-----

(1) Derivative fair value includes derivatives classified as assets and liabilities on the Consolidated Statements of Financial Position and excludes derivatives related to our products (see Note 7 of the consolidated financial statements).

FIXED INCOME SECURITIES See Note 6 of the consolidated financial statements for a table showing the amortized cost, unrealized gains, unrealized losses and fair value for each type of fixed income security for the years ended December 31, 2006 and 2005.

Municipal bonds, including tax-exempt and taxable securities, totaled \$4.79 billion, all of which were rated investment grade at December 31, 2006. Approximately 56.6% of the municipal bond portfolio was insured by six bond insurers and accordingly have a Moody's equivalent rating of Aaa or Aa. The municipal bond portfolio at December 31, 2006 consisted of approximately 283 issues from approximately 239 issuers. The largest exposure to a single issuer was approximately 4.0% of the municipal bond portfolio. Corporate entities were the ultimate obligors of approximately 14.9% of the municipal bond portfolio.

Corporate bonds totaled \$34.31 billion and 91.1% were rated investment grade at December 31, 2006. As of December 31, 2006, the portfolio contained \$16.53 billion of privately placed corporate obligations or 48.2%, compared with \$16.31 billion or 47.5% at December 31, 2005. Included within privately placed corporate obligations are bank loans, which are primarily senior secured corporate loans, and other non-publicly traded corporate obligations. Approximately \$14.52 billion or 87.8% of the privately placed corporate obligations consisted of fixed rate privately placed securities. The primary benefits of fixed rate privately placed securities when compared to publicly

issued securities may include generally higher yields, improved cash flow predictability through pro-rata sinking funds, and a combination of covenant and call protection features designed to better protect the holder against losses resulting from credit deterioration, reinvestment risk or fluctuations in interest rates. A disadvantage of fixed rate privately placed securities when compared to publicly issued securities is relatively reduced liquidity. At December 31, 2006, 88.6% of the privately placed securities were rated investment grade.

Foreign government securities totaled \$2.02 billion and 95.0% were rated investment grade at December 31, 2006.

Mortgage-backed securities ("MBS") totaled \$4.52 billion, all of which were investment grade at December 31, 2006. The credit risk associated with MBS is mitigated due to the fact that 59.4% of the portfolio consists of securities that were issued by, or have underlying collateral that is guaranteed by U.S. government agencies or U.S. government sponsored entities. The MBS portfolio is subject to interest rate risk since price volatility and the ultimate realized yield are affected by the rate of prepayment of the underlying mortgages.

Commercial mortgage-backed securities ("CMBS") totaled \$7.60 billion at December 31, 2006, nearly all were rated investment grade. CMBS investments primarily represent pools of commercial mortgages, broadly diversified across property types and geographical area. The CMBS portfolio is subject to credit risk, but unlike other structured products, is generally not subject to prepayment risk due to protections within the underlying commercial mortgages, whereby borrowers are effectively restricted from prepaying their mortgages due to changes in interest rates. Credit defaults can result in credit directed prepayments. Approximately 72.0% of the CMBS portfolio had a Moody's rating of Aaa or a S&P or Fitch rating of AAA, the highest rating categories, at December 31, 2006.

Asset-backed securities ("ABS") totaled \$5.68 billion and 98.3% were rated investment grade at December 31, 2006. Our ABS portfolio is subject to credit and interest rate risk. Credit risk is managed by monitoring the performance of the collateral. In addition, many of the securities in the ABS portfolio are credit enhanced with features such as over-collateralization, subordinated structures, reserve funds, guarantees and/or insurance. Approximately 54.2% of the ABS portfolio had a Moody's rating of Aaa or a Standard & Poor's or Fitch rating of AAA, the highest rating categories. A portion of the ABS portfolio is also subject to interest rate risk since, for

example, price volatility and ultimate realized yield are affected by the rate of prepayment of the underlying assets. As of December 31, 2006, 90.5% of the portfolio was less sensitive to interest rate risk due to the payment terms or underlying collateral of the securities. The ABS portfolio includes bonds that are secured by a variety of asset types, predominately home equity loans, credit card receivables and auto loans as well as collateralized debt obligations that are predominately secured by corporate bonds and loans.

We may utilize derivative financial instruments to help manage the exposure to interest rate risk from the fixed income securities portfolio. For a more detailed discussion of interest rate risk and our use of derivative financial instruments, see the Market Risk section of MD&A and Note 7 to the consolidated financial statements.

At December 31, 2006, 94.8% of the 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 Standard & Poor's, Fitch or Dominion or a rating of aaa, aa, a or bbb from A.M. Best; or a comparable internal rating if an externally provided rating is not available.

The following table summarizes the credit quality of the fixed income securities portfolio at December 31, 2006.

(IN MILLIONS)

NAIC RATING	MOODY'S EQUIVALENT	FAIR VALUE	PERCENT TO TOTAL
1	Aaa/Aa/A	\$43,037	68.9%
2	Baa	16,143	25.9
3	Ba	2,413	3.9
4	B	758	1.2
5	Caa or lower	71	0.1

6	In or near default	17	--
		-----	-----
	Total	\$62,439	100.0%
		=====	=====

EQUITY SECURITIES Equity securities include limited partnership investments, non-redeemable preferred stocks and common stocks. The equity securities portfolio was \$533 million at December 31, 2006 compared to \$324 million at December 31, 2005. Investments in limited partnership interests had a carrying value of \$461 million and \$257 million at December 31, 2006 and 2005, respectively. Non-redeemable preferred and common stocks had a carrying value of \$72 million and \$67 million, and cost of \$61 million and \$62 million at December 31, 2006 and 2005, respectively. Gross unrealized gains on common stocks and non-redeemable preferred stocks totaled \$11 million at December 31, 2006 compared to \$6 million at December 31, 2005. There were no unrealized losses at December 31, 2006. Gross unrealized losses totaled \$1 million at December 31, 2005.

UNREALIZED GAINS AND LOSSES See Note 6 of the consolidated financial statements for further disclosures regarding unrealized losses on fixed income and equity securities and factors considered in determining whether the securities are not other-than-temporarily impaired. The unrealized net capital gains on fixed income and equity securities at December 31, 2006 totaled \$1.60 billion, a decrease of \$666 million since December 31, 2005. Gross unrealized gains and losses on fixed income securities by type and sector are provided in the table below.

GROSS UNREALIZED AMORTIZED --- -----	
FAIR (IN MILLIONS) COST GAINS LOSSES VALUE -----	-----
----- AT DECEMBER 31, 2006	-----
Corporate:	
Utilities \$	
5,596 \$ 258 \$	
(55) \$ 5,799	
Consumer goods (cyclical and non-cyclical)	
5,292 77 (61)	
5,308 Banking	
5,252 102	
(49) 5,305	
Financial services	
4,257 58 (36)	
4,279 Capital goods 3,400	
60 (33) 3,427	
Communications	
2,253 52 (18)	
2,287 Basic industry	
2,078 37 (16)	
2,099 Other	
1,770 67 (15)	
1,822 Energy	
1,622 35 (20)	
1,637	
Transportation	
1,565 52 (16)	
1,601	
Technology	
738 13 (6)	
745 ----- -	
----- -	
----- Total	

corporate  
 fixed income  
 portfolio  
 33,823 811  
 (325) 34,309  
 U.S.  
 government  
 and agencies  
 2,763 736 (3)  
 3,496  
 Municipal  
 4,732 101  
 (43) 4,790  
 Foreign  
 government  
 1,709 317 (3)  
 2,023  
 Mortgage-  
 backed  
 securities  
 4,543 31 (56)  
 4,518  
 Commercial  
 mortgage-  
 backed  
 securities  
 7,597 64 (61)  
 7,600 Asset-  
 backed  
 securities  
 5,663 34 (16)  
 5,681  
 Redeemable  
 preferred  
 stock 21 1 --  
 22 ----- --  
 ----- --  
 ----- Total  
 fixed income  
 securities  
 \$60,851  
 \$2,095 \$(507)  
 \$62,439  
 =====  
 =====  
 =====

The consumer goods, utilities, banking, financial services, and capital goods sectors had the highest concentration of gross unrealized losses in our corporate fixed income securities portfolio at December 31, 2006. The gross unrealized losses in these sectors were primarily interest rate related and company specific. As of December 31, 2006, \$300 million or 92.3% of the gross unrealized losses in the corporate fixed income portfolio and substantially all of the gross unrealized losses for the remaining fixed income securities were rated investment grade. Unrealized losses on investment grade securities are principally related to rising interest rates or changes in credit spreads since the securities were acquired. All securities in an unrealized loss position at December 31, 2006 were included in our portfolio monitoring process for determining which declines in value were not other-than-temporary.

The following table shows the composition by credit quality of the fixed income securities with gross unrealized losses at December 31, 2006.

(IN MILLIONS)					
NAIC RATING	MOODY'S EQUIVALENT	UNREALIZED LOSS	PERCENT TO TOTAL	FAIR VALUE	PERCENT TO TOTAL
1	Aaa/Aa/A	\$(326)	64.3%	\$16,666	70.1%
2	Baa	(155)	30.6	6,307	26.6
3	Ba	(21)	4.1	656	2.8
4	B	(3)	0.6	100	0.4
5	Caa or lower	(2)	0.4	31	0.1
6	In or near default	--	--	5	--
	Total	\$(507)	100.0%	\$23,765	100.0%

The table above includes 22 securities that have not yet received an NAIC rating, for which we have assigned a comparable internal rating, with a fair value totaling \$254 million and an unrealized loss of \$7 million. Due to lags between the funding of an investment, execution of final legal documents, filing with the Securities Valuation Office ("SVO") of the NAIC, and rating by the SVO, we will always have a small number of securities that have a pending rating.

At December 31, 2006, \$481 million, or 94.9%, of the gross unrealized losses were related to investment grade fixed income securities. Unrealized losses on investment grade securities principally relate to changes in interest rates or changes in sector-related credit spreads since the securities were acquired.

As of December 31, 2006, \$26 million of the gross unrealized losses were related to below investment grade fixed income securities. Of this amount, there were no significant unrealized loss positions (greater than or equal to 20% of amortized cost) for six or more consecutive months prior to December 31, 2006. Included among the securities rated below investment grade are both public and privately placed high-yield bonds and securities that were investment grade when originally acquired. We mitigate the credit risk of investing in below investment grade fixed income securities by limiting the percentage of our fixed income portfolio invested in such securities, through diversification of the portfolio, and active credit monitoring and portfolio management.

The scheduled maturity dates for fixed income securities in an unrealized loss position at December 31, 2006 are shown below. Actual maturities may differ from those scheduled as a result of prepayments by the issuers.

UNREALIZED PERCENT FAIR PERCENT (IN MILLIONS) LOSS TO TOTAL VALUE TO TOTAL --- ----- -----	
----- Due in one year or less \$ (3) 0.6%	\$ 413
1.7% Due after one year through five years (75) 14.8	4,070
17.1 Due after five years through ten years (177)	34.9
7,147 30.1 Due after ten years (180)	35.5
8,045 33.9 Mortgage- and asset- backed securities(1)	(72)
14.2 4,090 17.2 - ----- -----	
Total \$(507)	
100.0%	
\$23,765	
100.0% ===== =====	
=====	

(1) Because of the potential for prepayment, mortgage- and asset-backed securities are not categorized based on their contractual maturities.

PORTFOLIO MONITORING We have a comprehensive portfolio monitoring process to



-- 2,916  
2,558 144  
2 2,704  
Fair Value  
\$22,973  
\$788 \$--  
\$23,761  
\$22,393  
\$705 \$ 9  
\$23,107  
Unrealized  
\$ (481)  
\$(25) \$--  
\$ (506) \$  
(416)  
\$(27) \$(1)  
\$ (444)  
Category  
(ii):  
Unrealized  
loss  
greater  
than or  
equal to  
20% of  
cost for a  
period of  
less than  
6  
consecutive  
months (1)  
Number of  
Issues --  
2 -- 2 6 2  
-- 8 Fair  
Value \$ --  
\$ 4 \$-- \$  
4 \$ 37 \$ 6  
\$-- \$ 43  
Unrealized  
\$ -- \$ (1)  
\$-- \$ (1)  
\$ (10) \$  
(1) \$-- \$  
(11)  
Category  
(iii):  
Unrealized  
loss  
greater  
than or  
equal to  
20% of  
cost for a  
period of  
6 or more  
consecutive  
months,  
but less  
than 12  
consecutive  
months (1)  
Number of  
Issues --  
-- -- -- --  
-- -- -- --  
Fair Value  
\$ -- \$ --  
\$-- \$ -- \$  
-- \$ -- \$--  
- \$ --  
Unrealized  
\$ -- \$ --  
\$-- \$ -- \$  
-- \$ -- \$--  
- \$ --  
Category  
(iv):  
Unrealized  
loss  
greater

than or  
 equal to  
 20% of  
 cost for  
 twelve or  
 more  
 consecutive  
 months (1)  
 Number of  
 Issues --  
 ---  
 - 2 -- 2  
 Fair Value  
 \$ -- \$ --  
 \$-- \$ -- \$  
 -- \$ 7 \$--  
 \$ 7  
 Unrealized  
 \$ -- \$ --  
 \$-- \$ -- \$  
 -- \$ (7)  
 \$-- \$ (7)  
 Total  
 Number of  
 Issues  
 2,804 114  
 -- 2,918  
 2,564 148  
 2 2,714  
 =====  
 =====  
 =====  
 =====  
 =====  
 Total Fair  
 Value  
 \$22,973  
 \$792 \$--  
 \$23,765  
 \$22,430  
 \$718 \$ 9  
 \$23,157  
 =====  
 =====  
 =====  
 =====  
 =====  
 Total  
 Unrealized  
 Losses \$  
 (481)  
 \$(26) \$--  
 \$ (507) \$  
 (426)  
 \$(35) \$(1)  
 \$ (462)  
 =====  
 =====  
 =====  
 =====  
 =====

-----  
 (1) For fixed income securities, cost represents amortized cost.  
  
 The largest individual unrealized loss was \$3 million for category (i) and \$0.7 million for category (ii) as of December 31, 2006.  
  
 Categories (i) and (ii) have generally been adversely affected by overall economic conditions including interest rate increases and the market's evaluation of certain sectors. The degree to which and/or length of time that the securities have been in an unrealized loss position does not suggest that these securities pose a high risk of being other-than-temporarily impaired.  
  
 Whenever our initial analysis indicates that a fixed income security's unrealized loss of 20% or more for at least 36 months or any equity security's unrealized loss of 20% or more for at least 12 months is temporary, additional



135 0.2 ---  
 - ---- -  
 ---- -  
 -- Total  
 net  
 carrying  
 value \$124  
 \$138 0.2%  
 \$196 \$219  
 0.3% ====

(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 December 31, 2006 compared to December 31, 2005. The decrease was primarily due to dispositions and the removal of securities upon improving conditions.

We evaluated each of these securities through our portfolio monitoring process at December 31, 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 for the years ended December 31.

(IN MILLIONS)	2006	2005	2004
Investment write-downs	\$(21)	\$ (24)	\$(81)
Dispositions	(89)	88	129
Valuation of derivative instruments	(17)	(105)	(66)
Settlement of derivative instruments	48	60	7
Realized capital gains and losses, pretax	(79)	19	(11)
Income tax benefit (expense)	28	(7)	3
Realized capital gains and losses, after-tax	\$(51)	\$ 12	\$ (8)

Dispositions in the above table include sales, losses recognized in anticipation of dispositions and other transactions such as calls and prepayments. We may sell impaired fixed income or equity securities that were in an unrealized loss position at the previous reporting date in situations where new factors such as negative developments, subsequent credit deterioration, changing liquidity needs, and newly identified market opportunities cause a change in our previous intent to hold a security to recovery or maturity.

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, 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 Company.

Dispositions included net realized losses on sales and other transactions such as calls and prepayments of \$29 million and losses recorded in connection with anticipated dispositions of \$60 million. The net realized losses on sales and other transactions were comprised of gross gains of \$214 million and gross losses of \$243 million. The \$243 million in gross losses primarily consisted of \$237 million of losses from sales of fixed income securities.

During our comprehensive portfolio reviews, we ascertain whether there are any approved programs involving the disposition of investments such as changes in duration, revision to strategic asset allocation and liquidity actions; and any dispositions anticipated by the portfolio managers resulting from their on-going comprehensive reviews of the portfolios. Upon approval of such programs, we identify a population of suitable investments, typically larger than needed to execute the disposition, from which specific securities are selected to sell. Due to our change in intent to hold until recovery, we recognize impairments, which are included in losses from dispositions, on any of these securities in an unrealized loss position. When the objectives of the programs are accomplished, any remaining securities are redesignated as intent to hold until recovery.

For the year ended December 31, 2006, we recognized \$60 million of losses related to a change in our intent to hold certain securities with unrealized losses until they recover in value. The change in our intent was driven by certain approved programs, including funding for the disposition through reinsurance of substantially all of our variable annuity business and yield enhancement strategies. These programs were completed during 2006. Additionally, ongoing comprehensive reviews of our portfolio resulted in the identification of anticipated dispositions by the portfolio managers. At December 31, 2006, the fair value of securities for which we did not have the intent to hold until recovery totaled \$242 million.

At December 31, 2005, the fair value of the securities for which we did not have the intent to hold until recovery totaled \$190 million. Approved programs involving the disposition of securities included asset-liability management strategies, on-going comprehensive reviews of our portfolios, changes to our strategic asset allocations and yield enhancement strategies on which we recognized \$67 million of losses during 2005. These objectives were accomplished during 2006.

The ten largest losses from sales of individual securities for the year ended December 31, 2006 totaled \$21 million with the largest loss being \$3 million and the smallest loss being \$2 million. None of the securities that comprise these ten largest losses were in an unrealized loss position greater than or equal to 20% of amortized cost for fixed income securities or cost for equity securities at the time of sale.

Our largest aggregate loss from disposition and writedowns are shown in the following table by issuer and its affiliates. No other issuer together with its affiliates had an aggregated loss on disposition and writedowns greater than 0.9% of the total gross loss on disposition and writedowns on fixed income and equity securities.

FAIR VALUE
DECEMBER 31,
NET AT
DISPOSITION
LOSS ON WRITE-
2006 UNREALIZED
(IN MILLIONS)
("PROCEEDS")
DISPOSITIONS(1)
DOWNS HOLDINGS
(2) GAIN (LOSS)
-----
-----
-----
-----
- Household
Product
Retailer \$ 34 \$
(4) \$ -- \$ 30
\$-- Aircraft
Securitized
Trust -- -- (4)

2 -- Aircraft  
 Securitized  
 Trust -- -- (4)  
 4 -- Financial  
 Services  
 Company 81 (3)  
 -- 141 1  
 Insurance and  
 Financial  
 Services 60 (3)  
 -- 256 --  
 Company  
 Financial  
 Services  
 Company 43 (3)  
 -- 86 (2) Paper  
 Products  
 Manufacturer 14  
 (3) -- -- --  
 Capital Goods  
 Manufacturer --  
 -- (3) 4 -- ---  
 - - - - -  
 - --- Total  
 \$232 \$(16)  
 \$(11) \$523 \$(1)  
 =====  
 =====  
 =====

- - - - -
- (1) Dispositions include losses recognized in anticipation of dispositions.
  - (2) Holdings include fixed income securities at amortized cost or equity securities at cost.

The circumstances of the above losses are considered to be company specific and are not expected to have an effect on other holdings in our portfolio.

**MORTGAGE LOANS** Our mortgage loan portfolio was \$8.69 billion at December 31, 2006 and \$8.11 billion at December 31, 2005, and comprised primarily of loans secured by first mortgages on developed commercial real estate. Geographical and property type diversification are key considerations used to manage our mortgage loan risk.

We closely monitor our commercial mortgage loan portfolio on a loan-by-loan basis. Loans with an estimated collateral value less than the loan balance, as well as loans with other characteristics indicative of higher than normal credit risk, are reviewed by financial and investment management at least quarterly for purposes of establishing valuation allowances and placing loans on non-accrual status. The underlying collateral values are based upon either discounted property cash flow projections or a commonly used valuation method that utilizes a one-year projection of expected annual income divided by an expected rate of return. We had no net realized capital losses related to write-downs on mortgage loans for the years ended December 31, 2006 and 2005 and had \$1 million for the year ended December 31, 2004.

**SHORT-TERM INVESTMENTS** Our short-term investment portfolio was \$805 million and \$927 million at December 31, 2006 and 2005, respectively. We invest available cash balances primarily in taxable short-term securities having a final maturity date or redemption date of less than one year.

As one of our business activities, we conduct securities lending, primarily as an investment yield enhancement, with third parties such as brokerage firms. We obtain collateral in an amount equal to 102% of the fair value of the securities and monitor the market value of the securities loaned on a daily basis with additional collateral obtained as necessary. The cash we receive is invested in short-term and fixed income investments, and an offsetting liability is recorded in other liabilities and accrued expense. At December 31, 2006, the amount of securities lending collateral reinvested in short-term investments had a carrying value of \$273 million. This compares to \$178 million at December 31, 2005.

OUTLOOK

- - We plan to continue to balance targeted improvements in return on equity

with growth in sales and profitability. Initially, our actions to improve returns may reduce the price competitiveness of certain products, such as our fixed annuities, and slow or reduce the growth in sales and income.

- - We expect that the near-term improvements in our returns will be generated mostly by improved capital efficiency and will later be accompanied by improved profitability.
- - We plan to continue to maintain discipline over expenses and improve our operating efficiency.
- - We plan to increase sales of our financial products by Allstate exclusive agencies by further tailoring products for our customers and making it easier for our agents to distribute our products.
- - We expect to continue to prioritize the allocation of fixed income investments to support sales of products with the best sustainable growth and margins and to maintain a market presence for fixed annuity and life products in our retail distribution channels. Sales of our institutional products may vary as a result.
- - We plan to develop and bring to market new innovative life insurance products or features designed to increase sales of this product line.

#### MARKET RISK

Market risk is the risk that we will incur losses due to adverse changes in interest, equity, or currency exchange rates and prices. Our primary market risk exposures are to changes in interest rates and equity prices, although we also have a smaller exposure to changes in foreign currency exchange rates.

The active management of market risk is integral to our results of operations. We may use the following approaches to manage exposure to market risk within defined tolerance ranges: 1) rebalancing existing asset or liability portfolios, 2) changing the character of investments purchased in the future and 3) using derivative instruments to modify the market risk characteristics of existing assets and liabilities or assets expected to be purchased. For a more detailed discussion of our use of derivative financial instruments, see Note 7 of the consolidated financial statements.

OVERVIEW We generate substantial investible funds from our business. In formulating and implementing guidelines for investing funds, we seek to earn returns that enhance our ability to offer competitive rates and prices to customers while contributing to attractive and stable profits and long-term capital growth. Accordingly, our investment decisions and objectives are a function of the underlying risks and our product profiles.

Investment policies define the overall framework for managing market and other investment risks, including accountability and control over risk management activities. These investment activities follow policies that have been approved by our board of directors. These investment policies specify the investment limits and strategies that are appropriate given our liquidity, surplus, product profile and regulatory requirements. Executive oversight of investment activities are conducted primarily through our board of directors and investment committee. Asset-liability management ("ALM") policies further define the overall framework for managing market and investment risks. ALM focuses on strategies to enhance yields, mitigate investment risks and optimize capital to improve profitability and returns. ALM activities follow asset-liability policies that have been approved by our board of directors. These ALM policies specify limits, ranges and/or targets for investments that best meet our business objectives in light of our product liabilities.

We manage our exposure to market risk through the use of asset allocation, duration and value-at-risk limits, through the use of simulation and, as appropriate, through the use of stress tests. We have asset allocation limits that place restrictions on the total funds that may be invested within an asset class. We have duration limits on our investment portfolio and, as appropriate, on individual components of the portfolio. These duration limits place restrictions on the amount of interest rate risk that may be taken. Our value-at-risk limits are intended to restrict the potential loss in fair value that could arise from adverse movements in the fixed income, equity, and currency markets based on historical volatilities and correlations among market risk factors. Comprehensive day-to-day management of market risk within defined tolerance ranges occurs as portfolio managers buy and sell within their respective markets based upon the acceptable boundaries established by investment policies. This day-to-day management is integrated with and informed by the activities of the ALM organization. This integration results in a prudent, methodical and effective adjudication of market risk and return, conditioned by the unique demands and dynamics of our product liabilities and supported by the application of advanced risk technology and analytics.

INTEREST RATE RISK is the risk that we will incur a loss due to adverse changes in interest rates. This risk arises from many of our primary activities, as we invest substantial funds in interest rate-sensitive assets and issue interest rate-sensitive liabilities.

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We manage the interest rate risk in our assets relative to the interest rate risk in our liabilities. One of the measures used to quantify this exposure is duration. Duration measures the price sensitivity of the assets and liabilities to changes in interest rates. For example, if interest rates increase 100 basis points, the fair value of an asset exhibiting a duration of 5 is expected to decrease in value by approximately 5%. At December 31, 2006, the difference between our asset and liability duration was approximately 0.35, compared to a 0.63 gap at December 31, 2005. A positive duration gap indicates that the fair value of our assets is more sensitive to interest rate movements than the fair value of our liabilities.

We seek to invest premiums, contract charges and deposits to generate future cash flows that will fund future claims, benefits and expenses, and that will earn stable margins across a wide variety of interest rate and economic scenarios. In order to achieve this objective and limit interest rate risk, we adhere to a philosophy of managing the duration of assets and related liabilities. This philosophy may include using interest rate swaps, futures, forwards, caps, floors and swaptions to reduce the interest rate risk resulting from mismatches between existing assets and liabilities, and financial futures and other derivative instruments to hedge the interest rate risk of anticipated purchases and sales of investments and product sales to customers.

We pledge and receive collateral on certain types of derivative contracts. For futures and option contracts traded on exchanges, we have pledged securities as margin deposits totaling \$22 million as of December 31, 2006. For over-the-counter derivative transactions including interest rate swaps, foreign currency swaps, interest rate caps, interest rate floor agreements, credit default swaps and certain options, master netting agreements are used. These agreements allow us to net payments due for transactions covered by the agreements, and when applicable, we are required to post collateral. As of December 31, 2006, we held \$357 million of cash pledged by counterparties as collateral for over-the-counter instruments and pledged \$10 million in securities as collateral to counterparties.

To calculate duration gap between assets and liabilities, we project asset and liability cash flows and calculate their net present value using a risk-free market interest rate adjusted for credit quality, sector attributes, liquidity and other specific risks. Duration is calculated by revaluing these cash flows at alternative interest rates and determining the percentage change in aggregate fair value. The cash flows used in this calculation include the expected maturity and repricing characteristics of our derivative financial instruments, all other financial instruments (as described in Note 7 of the consolidated financial statements), and certain other items including interest-sensitive liabilities and annuity liabilities. The projections include assumptions (based upon historical market experience and our experience) that reflect the effect of changing interest rates on the prepayment, lapse, leverage and/or option features of instruments, where applicable. Such assumptions relate primarily to mortgage-backed securities, collateralized mortgage obligations, municipal housing bonds, callable municipal and corporate obligations, and fixed rate single and flexible premium deferred annuities.

Based upon the information and assumptions we use in this duration calculation, and interest rates in effect at December 31, 2006, we estimate that a 100 basis point immediate, parallel increase in interest rates ("rate shock") would decrease the net fair value of the assets and liabilities by approximately \$371 million, compared to \$615 million at December 31, 2005. The selection of a 100 basis point immediate parallel change in interest rates should not be construed as our prediction of future market events, but only as an illustration of the potential effect of such an event. There are \$7.04 billion of assets supporting life insurance products such as traditional and interest-sensitive life that are not financial instruments. These assets and the associated liabilities have not been included in the above estimate. The \$7.04 billion of assets excluded from the calculation has increased from the \$6.34 billion reported at December 31, 2005 due to an increase in the in-force account value of interest-sensitive life products. Based on assumptions described above, in the event of a 100 basis point immediate increase in interest rates, the assets supporting life insurance products would decrease in value by \$455 million, compared to a decrease of \$419 million at December 31, 2005.

To the extent that conditions differ from the assumptions we used in these calculations, duration and rate shock measures could be significantly impacted.

Additionally, our calculations assume that the current relationship between short-term and long-term interest rates (the term structure of interest rates) will remain constant over time. As a result, these calculations may not fully capture the effect of non-parallel changes in the term structure of interest rates and/or large changes in interest rates.

EQUITY PRICE RISK is the risk that we will incur losses due to adverse changes in the general levels of the equity markets. At December 31, 2006, we held approximately \$27 million in common stocks and \$1.39 billion in other securities with equity risk (including primarily convertible securities, limited partnership funds, non-redeemable preferred securities and equity-linked notes), compared to approximately \$21 million in common stocks and \$957 million in other equity investments at December 31, 2005.

At December 31, 2006, our portfolio of securities with equity risk had a beta of approximately 0.84, compared to a beta of approximately 0.75 at December 31, 2005. Beta represents a widely used methodology to describe, quantitatively, an investment's market risk characteristics relative to an index such as the Standard & Poor's 500

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Composite Price Index ("S&P 500"). Based on the beta analysis, we estimate that if the S&P 500 decreases by 10%, the fair value of our equity investments will decrease by approximately 8.4%. Likewise, we estimate that if the S&P 500 increases by 10%, the fair value of our equity investments will increase by approximately 8.4%. Based upon the information and assumptions we used to calculate beta at December 31, 2006, we estimate that an immediate decrease in the S&P 500 of 10% would decrease the net fair value of our equity investments identified above by approximately \$117 million, compared to \$71 million at December 31, 2005. The selection of a 10% immediate decrease in the S&P 500 should not be construed as our prediction of future market events, but only as an illustration of the potential effect of such an event.

The beta of our securities with equity risk was determined by comparing the monthly total returns of these investments to monthly total returns of the S&P 500 over a three-year historical period. Since beta is historically based, projecting future price volatility using this method involves an inherent assumption that historical volatility and correlation relationships between stocks and the composition of our portfolio will not change in the future. Therefore, the illustrations noted above may not reflect our actual experience if future volatility and correlation relationships differ from the historical relationships.

At December 31, 2006 and 2005, we had separate accounts assets related to variable annuity and variable life contracts with account values totaling \$16.17 billion and \$15.24 billion, respectively. Equity risk exists for contract charges based on separate account balances and guarantees for death and/or income benefits provided by our variable products. In 2006, we disposed of substantially all of the variable annuity business through a reinsurance agreement with Prudential as described in Note 3 of the consolidated financial statements, and therefore mitigated this aspect of our risk. Equity risk of our variable life business relates to contract charges and policyholder benefits. Total variable life contract charges for 2006 and 2005 were \$86 million and \$79 million, respectively. Separate account liabilities related to variable life contracts were \$826 million and \$721 million in December 31, 2006 and 2005, respectively.

At December 31, 2006 and 2005 we had approximately \$3.47 billion and \$2.72 billion, respectively, in equity-indexed annuity liabilities that provide customers with interest crediting rates based on the performance of the S&P 500. We hedge the risk associated with these liabilities through the purchase and sale of equity-indexed options and futures, interest rate swaps, and eurodollar futures, maintaining risk within specified value-at-risk limits.

FOREIGN CURRENCY EXCHANGE RATE RISK is the risk that we will incur economic losses due to adverse changes in foreign currency exchange rates. This risk primarily arises from the foreign component of our limited partnership interests. We also have funding agreement programs and a small amount of fixed income securities that are denominated in foreign currencies, but we use derivatives to effectively hedge the foreign currency risk of these funding agreements and securities. At December 31, 2006 and 2005, we had approximately \$1.02 billion and \$1.17 billion, respectively, in funding agreements denominated in foreign currencies.

At December 31, 2006, the foreign component of our limited partnership interests totaled approximately \$22 million, compared to \$9 million at December 31, 2005.

Based upon the information and assumptions we used at December 31, 2006, we estimate that a 10% immediate unfavorable change in each of the foreign currency exchange rates that we are exposed to would decrease the value of the foreign component of our limited partnership interests by approximately \$2 million, compared with an estimated \$1 million decrease at December 31, 2005. The selection of a 10% immediate decrease in all currency exchange rates should not be construed as our prediction of future market events, but only as an illustration of the potential effect of such an event. Our currency exposure is diversified across 11 currencies, compared to 12 currencies at December 31, 2005. Our largest individual currency exchange exposures at December 31, 2006 were to the Canadian Dollar (20.1%) and the Mexican Peso (19.5%). The largest individual currency exchange exposures at December 31, 2005 were to the Mexican Peso (38.0%) and the Japanese Yen (14.5%). Our primary regional exposure is to Western Europe, approximately 20.4% at December 31, 2006, compared to 38.0% in Central America at December 31, 2005.

The modeling technique we use to report our currency exposure does not take into account correlation among foreign currency exchange rates. Even though we believe it is very unlikely that all of the foreign currency exchange rates that we are exposed to would simultaneously decrease by 10%, we nonetheless stress test our portfolio under this and other hypothetical extreme adverse market scenarios. Our actual experience may differ from these results because of assumptions we have used or because significant liquidity and market events could occur that we did not foresee.

#### CAPITAL RESOURCES AND LIQUIDITY

CAPITAL RESOURCES consist of shareholder's equity and debt, representing funds deployed or available to be deployed to support business operations. The following table summarizes our capital resources at December 31.

	2006	2005	2004
	-----	-----	-----
(IN MILLIONS)			
Redeemable preferred stock	\$ 5	\$ 5	\$ 5
Common stock, retained earnings and other shareholder's equity items	5,168	5,415	5,291
Accumulated other comprehensive income	325	588	1,013
	-----	-----	-----
Total shareholder's equity	5,498	6,008	6,309
Debt	706	181	104
	-----	-----	-----
Total capital resources	\$6,204	\$6,189	\$6,413
	=====	=====	=====

SHAREHOLDER'S EQUITY declined in 2006, due to dividends and lower unrealized net capital gains on fixed income securities, partially offset by net income. The Company paid dividends of \$675 million to Allstate Insurance Company ("AIC", the Company's parent) in 2006. Shareholder's equity declined in 2005 when compared to 2004, due to lower unrealized net capital gains on fixed income securities and dividends, partially offset by net income. The Company paid dividends of \$260 million to AIC in 2005. In addition, a dividend of \$16 million was recorded in 2005 in connection with the purchase of fixed income securities from AIC and a non-cash dividend of \$15 million was recorded as a result of the settlement of certain reinsurance transactions with an unconsolidated affiliate.

DEBT increased \$525 million in 2006, due to the issuance of an intercompany note to AIC and a surplus note to an unconsolidated affiliate, partially offset by the redemption of debt associated with a consolidated variable interest entity ("VIE") and the redemption of mandatorily redeemable preferred stock.

During 2006, the Company issued an intercompany note in the amount of \$500 million payable to its parent, AIC, on demand and, in any event, by March 30, 2007. This note is reflected as note payable to parent on the Company's Statements of Financial Position. The Company used the funds to accelerate purchases of investments based on its outlook of the availability of acceptable investments in the beginning of 2007. The Company will repay the loan with funds generated in the normal course of business, primarily by sales, investment income and cash collected for investment calls and maturities.

During 2006, under an existing agreement with Kennett Capital, Inc. ("Kennett"), an unconsolidated affiliate of ALIC, ALIC sold Kennett a \$100 million redeemable surplus note issued by ALIC Reinsurance Company ("ALIC Re"), a wholly owned subsidiary of ALIC. The surplus note is due June 1, 2036 with an

initial rate of 6.18% that will reset once every ten years to the then current ten year Constant Maturity Treasury yield ("CMT"), plus 1.14%. As payment, Kennett issued a full recourse note due June 1, 2036 to ALIC for the same amount with an initial interest rate of 5.98% that will reset once every ten years to the then current ten year CMT, plus 0.94%. The note due from Kennett is classified as other investments and the related surplus note is classified as long-term debt in the Consolidated Statements of Financial Position.

The Company was the primary beneficiary of a consolidated structured investment security VIE. The Company's Consolidated Statements of Financial Position included \$54 million of investments and \$49 million of long-term debt as of December 31, 2005. In 2006, the debt associated with the VIE was redeemed. Also redeemed during 2006 was mandatorily redeemable preferred stock totaling \$26 million (see Note 5 to the consolidated financial statements).

Debt increased \$77 million in 2005, primarily as a result of the issuance of surplus notes totaling \$100 million by ALIC Re, a wholly owned subsidiary of ALIC, partially offset by the redemption of \$26 million of mandatorily redeemable preferred stock (see note 5 to the consolidated financial statements).

**FINANCIAL RATINGS AND STRENGTH** The following table summarizes our financial strength ratings at December 31, 2006.

RATING AGENCY	RATING
Moody's Investors Service, Inc.	Aa2 ("Excellent")
Standard & Poor's Ratings Services	AA ("Very Strong")
A.M. Best Company, Inc.	A+ ("Superior")

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), risk exposures, operating leverage, AIC's ratings and other factors.

State laws specify regulatory actions if an insurer's risk-based capital ("RBC"), a measure of an insurer's solvency, falls below certain levels. The NAIC has a standard formula for annually assessing RBC. The formula for calculating RBC for life insurance companies takes into account factors relating to insurance, business, asset and interest rate risks. At December 31, 2006, our RBC and the RBC for each of our insurance companies was above levels that would require regulatory actions.

The NAIC has also developed a set of financial relationships or tests known as the Insurance Regulatory Information System to assist state regulators in monitoring the financial condition of insurance companies and identifying companies that require special attention or actions by insurance regulatory authorities. The NAIC analyzes financial data provided by insurance companies using prescribed ratios, each with defined "usual ranges". Generally, regulators will begin to monitor an insurance company if its ratios fall outside the usual ranges for four or more of the ratios. If an insurance company has insufficient capital, regulators may act to reduce the amount of insurance it can issue. The ratios of our insurance companies are within these ranges.

**LIQUIDITY SOURCES AND USES** Our potential sources of funds principally include the following activities.

- Receipt of insurance premiums
- Contractholder fund deposits
- Reinsurance recoveries
- Receipts of principal, interest and dividends on investments
- Sales of investments
- Funds from investment repurchase agreements, securities lending, dollar roll and lines of credit agreements
- Inter-company loans
- Capital contributions from parent

Our potential uses of funds principally include the following activities.

- Payment of contract benefits, maturities, surrenders and withdrawals
- Reinsurance cessions and payments
- Operating costs and expenses
- Purchase of investments
- Repayment of investment repurchase agreements, securities lending, dollar roll and lines of credit agreements
- Payment or repayment of inter-company loans
- Dividends to parent
- Tax payments/settlements

As reflected in our Consolidated Statements of Cash Flows, higher operating cash flows in 2006, compared to 2005, primarily related to higher investment income. Higher operating cash flows in 2005, compared to 2004, were primarily related to higher investment income, partially offset by lower premiums.

Cash flows used in investing activities decreased in 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 in 2006 also include the settlements related to the disposition through reinsurance of substantially all our variable annuity business. Cash flows used in investing activities decreased in 2005 due to lower cash provided by financing in 2005 compared to 2004, increased proceeds from sales of securities and higher investment collections, partially offset by the investment of higher operating cash flows.

Cash used in financing activities increased in 2006 as a result of lower contractholder fund deposits and higher surrenders and partial withdrawals. Lower cash flows provided by financing activities in 2005, compared to 2004, were primarily due to higher surrenders of market value adjusted annuities, lower deposits on fixed annuities and institutional products, and increased maturities of institutional products. For quantification of the changes in contractholder funds, see the Operations section of MD&A.

A portion of our product portfolio, primarily fixed annuity and interest-sensitive life insurance products, is subject to surrender and withdrawal at the discretion of contractholders. The following table summarizes our liabilities for these products by their contractual withdrawal provisions at December 31, 2006.

(IN MILLIONS)	2006
	-----
Not subject to discretionary withdrawal	\$16,608
Subject to discretionary withdrawal with adjustments:	
Specified surrender charges (1)	25,791
Market value (2)	10,001
Subject to discretionary withdrawal without adjustments	8,165
	-----
Total contractholder funds (3)	\$60,565
	=====

- 
- (1) Includes \$8.96 billion of liabilities with a contractual surrender charge of less than 5% of the account balance.
  - (2) Approximately \$8.99 billion of the contracts with market value adjusted surrenders have a 30-45 day period during which there is no surrender charge or market value adjustment including approximately \$1.87 billion with a period commencing during 2007.
  - (3) Includes \$1.37 billion of contractholder funds on variable annuities reinsured to Prudential effective June 1, 2006.

To ensure we have the appropriate level of liquidity, we perform actuarial tests on the impact to cash flows of policy surrenders and other actions under various scenarios. Depending upon the years in which certain policy types were sold with specific surrender provisions, our cash flow could vary due to higher surrender of policies exiting their surrender charge periods.

We have entered into an intercompany loan agreement with The Allstate Corporation. The amount of intercompany loans available to us is at the discretion of The Allstate Corporation. The maximum amount of loans The Allstate Corporation will have outstanding to all its eligible subsidiaries at any given point in time is limited to \$1.00 billion. We had no amounts outstanding under the intercompany loan agreement at December 31, 2006 or 2005. The Allstate Corporation uses commercial paper borrowings and bank lines of credit to fund intercompany borrowings.

The Allstate Corporation has established external sources of short-term liquidity that include a commercial paper program, lines-of-credit, dollar rolls and repurchase agreements. In the aggregate, at December 31, 2006, these sources could provide over \$3.89 billion of additional liquidity. For additional liquidity, we can also issue new insurance contracts, incur additional debt and sell assets from our investment portfolio. The liquidity of our investment portfolio varies by type of investment. For example, \$16.53 billion of privately placed corporate obligations that represent 22.3% of the investment portfolio, and \$8.69 billion of mortgage loans that represent 11.7% of the investment portfolio, generally are considered to be less liquid than many of our other types of investments, such as our U.S. government and agencies, municipal and public corporate fixed income security portfolios.

We have access to additional borrowing to support liquidity through The Allstate Corporation as follows:

- - A commercial paper program with a borrowing limit of \$1.00 billion to cover short-term cash needs. As of December 31, 2006, there were no balances outstanding and therefore the remaining borrowing capacity was \$1.00 billion; however, the outstanding balance fluctuates daily.
- - 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, nonguaranteed long-term debt. There were no borrowings under this line of credit during 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.
- - A universal shelf registration statement filed with the Securities and Exchange Commission ("SEC") in May 2006. The Allstate Corporation can use it to issue an unspecified amount of debt securities, common stock (including 278 million shares of treasury stock as of December 31, 2006), preferred stock, depository shares, warrants, stock purchase contracts, stock purchase units and securities of subsidiaries. The specific terms of any securities The Allstate Corporation issues under this registration statement will be provided in the

applicable prospectus supplements. The Allstate Corporation has not yet issued any securities under this registration statement.

The Allstate Corporation's only financial covenant exists with respect to its primary credit facility and its synthetic lease VIE obligations. The covenant requires that The Allstate Corporation not exceed a 37.5% debt to capital resources ratio as defined in the agreements. This ratio at December 31, 2006 was 18.4%.

We closely monitor and manage our liquidity through long and short-term planning that is integrated throughout our underwriting and investment operations. We manage the duration of assets and related liabilities through our ALM organization, using a dynamic process that addresses liquidity utilizing the investment portfolio, and components of the portfolio as appropriate, which is routinely subjected to stress testing. We also have access to funds from The Allstate Corporation's commercial paper program.

Certain remote events and circumstances could constrain our or The Allstate Corporation's liquidity. Those events and circumstances include, for example, a catastrophe resulting in extraordinary losses, a downgrade in The Allstate Corporation's long-term debt rating of A1, A+ and a (from Moody's, Standard & Poor's and A.M. Best, respectively) to non-investment grade status of below Baa3/BBB-/bb, a downgrade in AIC's financial strength rating from Aa2, AA and A+ (from Moody's, Standard & Poor's and A.M. Best, respectively) to below



the availability of a sufficient amount of liquid assets to extinguish short-term liabilities as they come due in the normal course of business.

- (2) Contractholder funds represent interest-bearing liabilities arising from the sale of products such as interest-sensitive life, fixed annuities, including immediate annuities without life contingencies and institutional products. These amounts reflect estimated cash payments to be made to policyholders and contractholders. Certain of these contracts, such as immediate annuities without life contingencies and institutional products, involve payment obligations where the amount and timing of the payment is essentially fixed and determinable. These amounts relate to (i) policies or contracts where we are currently making payments and will continue to do so and (ii) contracts where the timing of payments has been determined by the contract. In addition, as of December 31, 2006, we had \$4.70 billion of extendible funding agreements in force, which provide contractholders the ability to elect a maturity extension each month so long as the extension period does not extend beyond the contractually specified final maturity dates. The contractually specified final maturity dates begin in 2009 and are definitive unless the contracts are paid out earlier in accordance with an election to not extend the contracts, in which case the contracts mature 12 months thereafter. Extendible funding agreements are reflected in the table above at the contractually specified final maturity dates. Other contracts, such as interest-sensitive life and fixed deferred annuities, involve payment obligations where the amount and timing of future payments is uncertain. For these contracts, the Company is not currently making payments and will not make payments until (i) the occurrence of an insurable event, such as death, or (ii) the occurrence of a payment triggering event, such as the surrender of or partial withdrawal on a policy or deposit contract, which is outside of the control of the Company. We have estimated the timing of payments related to these contracts based on historical experience and our expectation of future payment patterns. Uncertainties relating to these liabilities include mortality, customer lapse and withdrawal activity, and estimated additional deposits for interest-sensitive life contracts, which may significantly impact both the timing and amount of future payments. Such cash outflows reflect adjustments for the estimated timing of mortality, retirement, and other appropriate factors, but are undiscounted with respect to interest. As a result, the sum of the cash outflows shown for all years in the table exceeds the corresponding liability amount of \$60.57 billion included in the Consolidated Statements of Financial Position as of December 31, 2006 for contractholder funds. The liability amount in the Consolidated Statements of Financial Position reflects the discounting for interest as well as adjustments for the timing of other factors as described above.
- (3) The reserve for life-contingent contract benefits relates primarily to traditional life and immediate annuities with life contingencies and reflects the present value of estimated cash payments to be made to policyholders and contractholders. Immediate annuities with life contingencies include (i) contracts where we are currently making payments and will continue to do so until the occurrence of a specific event such as death and (ii) contracts where the timing of a portion of the payments has been determined by the contract. Other contracts, such as traditional life and accident and health insurance, involve payment obligations where the amount and timing of future payments is uncertain. For these contracts, the Company is not currently making payments and will not make payments until (i) the occurrence of an insurable event, such as death or illness, or (ii) the occurrence of a payment triggering event, such as a surrender of a policy or contract, which is outside of the control of the Company. We have estimated the timing of cash outflows related to these contracts based on historical experience and our expectation of future payment patterns. Uncertainties relating to these liabilities include mortality, morbidity, expenses, customer lapse and withdrawal activity, and renewal premium for life policies, which may significantly impact both the timing and amount of future payments. Such cash outflows reflect adjustments for the estimated timing of mortality, retirement, and other appropriate factors, but are undiscounted with respect to interest. As a result, the sum of the cash outflows shown for all years in the table exceeds the corresponding liability amount of \$12.20 billion included in the Consolidated Statements of Financial Position as of December 31, 2006 for reserve for life-contingent contract benefits. The liability amount in the Consolidated Statements of Financial Position reflects the discounting for interest as well as adjustments for the timing of other factors as described above.
- (4) Other liabilities and accrued expenses primarily include accrued expenses, claim payments and other checks outstanding.
- (5) Balance sheet liabilities not included in the table above include unearned and advanced premiums of \$42 million and deferred income tax liabilities. These items were excluded as they do not meet the definition of a contractual liability as we are not contractually obligated to pay these amounts to third parties. Rather, they represent an accounting mechanism

that allows us to present our financial statements on an accrual basis of accounting. In addition, other liabilities of \$107 million were not included in the table above because they did not represent a contractual obligation or the amount and timing of their eventual payment was sufficiently uncertain.

The following is a distribution in U.S. Dollars of funding agreements (non-putable) by currency at December 31. All foreign currency denominated funding agreements have been swapped to U.S. Dollars.

(IN MILLIONS)	2006	2005
CURRENCY		
United States Dollar	\$11,300	\$10,855
British Pound	696	696
Swiss Franc	278	278
Singapore Dollar	41	41
Australian Dollar	--	152
	-----	-----
	\$12,315	\$12,022
	=====	=====

Our contractual commitments as of December 31, 2006 and the payments due by period are shown in the following table.

LESS THAN OVER 5 (IN MILLIONS)		
TOTAL 1 YEAR		
1-3 YEARS 4- 5 YEARS		
YEARS -----		
-----		
-----		
Other Commitments	-	-
Conditional (1) \$ 640	\$607	\$ 33
-- \$-- Other Commitments	-	-
Unconditional (1) 707 26	430 214 37	-
-----	-----	-----
-----	-----	-----
Total Commitments	\$1,347	\$633
	\$463	\$214
	\$37	=====
	=====	=====
	=====	=====

(1) Represents investment commitments such as private placements and mortgage loans.

We have agreements in place for services we conduct, generally at cost, between subsidiaries relating to insurance, reinsurance, loans and capitalization. All material inter-company transactions have appropriately been eliminated in consolidation. Inter-company transactions among insurance subsidiaries and affiliates have been approved by the appropriate departments of insurance as required.

For a more detailed discussion of our off-balance sheet arrangements, see Note 7 of the consolidated financial statements.

REGULATION AND LEGAL PROCEEDINGS

We are subject to extensive regulation and we are involved in various legal and regulatory actions, all of which have an effect on specific aspects of our

business. For a detailed discussion of the legal and regulatory actions in which we are involved, see Note 11 of the consolidated financial statements.

#### PENDING ACCOUNTING STANDARDS

As of December 31, 2006, there are several pending accounting standards that we have not implemented either because the standard has not been finalized or the implementation date has not yet occurred. For a discussion of these pending standards, see Note 2 of the consolidated financial statements.

The effect of implementing certain accounting standards on our financial results and financial condition is often based in part on market conditions at the time of implementation of the standard and other factors we are unable to determine prior to implementation. For this reason, we are sometimes unable to estimate the effect of certain pending accounting standards until the relevant authoritative body finalizes these standards or until we implement them.

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#### ITEM 7A. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

Information required for Item 7A is incorporated by reference to the material under caption "Market Risk" in Part II, Item 7 of this report.

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#### ITEM 8. FINANCIAL STATEMENTS AND SUPPLEMENTARY DATA

ALLSTATE LIFE  
INSURANCE  
COMPANY AND  
SUBSIDIARIES  
CONSOLIDATED  
STATEMENTS OF  
OPERATIONS  
AND  
COMPREHENSIVE  
INCOME YEAR  
ENDED  
DECEMBER 31,  
-----  
-----

(IN MILLIONS)  
2006 2005  
2004 ----- -  
-----

REVENUES  
Premiums (net  
of  
reinsurance  
ceded of  
\$617, \$606  
and \$526) \$  
576 \$ 474 \$  
637 Contract  
charges (net  
of  
reinsurance  
ceded of  
\$170, \$ - and  
\$ -) 1,009  
1,079 961 Net  
investment  
income 4,057  
3,707 3,260  
Realized  
capital gains  
and losses  
(79) 19 (11)  
-----  
----- 5,563  
5,279 4,847  
COSTS AND  
EXPENSES  
Contract

benefits (net  
of  
reinsurance  
recoverable  
of \$548, \$515  
and \$418)  
1,372 1,340  
1,359  
Interest  
credited to  
contractholder  
funds 2,543  
2,340 1,923  
Amortization  
of deferred  
policy  
acquisition  
costs 538 568  
534 Operating  
costs and  
expenses 398  
433 462 -----  
- -----  
-- 4,851  
4,681 4,278  
Loss on  
disposition  
of operations  
(88) (7) (24)  
-----  
----- INCOME  
FROM  
OPERATIONS  
BEFORE INCOME  
TAX EXPENSE  
AND  
CUMULATIVE  
EFFECT OF  
CHANGE IN  
ACCOUNTING  
PRINCIPLE,  
AFTER-TAX 624  
591 545  
Income tax  
expense 196  
174 189 -----  
- -----  
-- INCOME  
BEFORE  
CUMULATIVE  
EFFECT OF  
CHANGE IN  
ACCOUNTING  
PRINCIPLE,  
AFTER-TAX 428  
417 356  
Cumulative  
effect of  
change in  
accounting  
principle,  
after-tax --  
-- (175) -----  
-----  
--- NET  
INCOME 428  
417 181 -----  
- -----  
-- OTHER  
COMPREHENSIVE  
LOSS, AFTER-  
TAX Change  
in:  
Unrealized  
net capital  
gains and  
losses (263)  
(425) (40) --  
-----  
----- OTHER  
COMPREHENSIVE

LOSS, AFTER-  
TAX (263)  
(425) (40) --  
-----  
-----  
COMPREHENSIVE  
INCOME (LOSS)  
\$ 165 \$ (8) \$  
141 =====  
=====

See notes to consolidated financial statements.

ALLSTATE LIFE  
INSURANCE  
COMPANY AND  
SUBSIDIARIES  
CONSOLIDATED  
STATEMENTS OF  
FINANCIAL  
POSITION  
DECEMBER 31,  
-----  
----- (IN  
MILLIONS,  
EXCEPT SHARE  
AND PAR VALUE  
DATA) 2006  
2005 -----  
-----  
ASSETS  
Investments  
Fixed income  
securities,  
at fair value  
(amortized  
cost \$60,851  
and \$59,717)  
\$62,439  
\$61,977  
Mortgage  
loans 8,690  
8,108 Equity  
securities  
533 324  
Short-term  
805 927  
Policy loans  
752 729 Other  
941 691 -----  
-----  
Total  
investments  
74,160 72,756  
Cash 273 154  
Deferred  
policy  
acquisition  
costs 3,485  
3,948  
Reinsurance  
recoverables,  
net 3,392  
1,699 Accrued  
investment  
income 689  
648 Other  
assets 585  
582 Separate  
Accounts  
16,174 15,235  
-----  
-- TOTAL  
ASSETS  
\$98,758

\$95,022

=====

=====

LIABILITIES

Contractholder  
funds \$60,565

\$58,190

Reserve for  
life-  
contingent  
contract  
benefits

12,204 11,881

Unearned  
premiums 34

35 Payable to  
affiliates,  
net 84 98

Other  
liabilities  
and accrued  
expenses

3,235 3,054

Deferred  
income taxes  
258 340 Note

payable to  
parent 500 --

Long-term  
debt 206 181

Separate  
Accounts

16,174 15,235

-----

-- TOTAL

LIABILITIES

93,260 89,014

-----

--

COMMITMENTS  
AND

CONTINGENT  
LIABILITIES

(NOTES 7 AND  
11)

SHAREHOLDER'S  
EQUITY

Redeemable  
preferred  
stock -

series A,  
\$100 par  
value,  
1,500,000

shares  
authorized,

49,230 shares  
issued and

outstanding 5

5 Redeemable  
preferred  
stock -

series B,  
\$100 par  
value,

1,500,000  
shares

authorized,  
none issued -

- -- Common  
stock, \$227

par value,  
23,800 shares

authorized  
and

outstanding 5

5 Additional  
capital paid-

in 1,108  
1,108

Retained

income 4,055  
 4,302  
 Accumulated  
 other  
 comprehensive  
 income:  
 Unrealized  
 net capital  
 gains and  
 losses 325  
 588 -----  
 ----- Total  
 accumulated  
 other  
 comprehensive  
 income 325  
 588 -----  
 ----- TOTAL  
 SHAREHOLDER'S  
 EQUITY 5,498  
 6,008 -----  
 ----- TOTAL  
 LIABILITIES  
 AND  
 SHAREHOLDER'S  
 EQUITY  
 \$98,758  
 \$95,022  
 =====  
 =====

See notes to consolidated financial statements.

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ALLSTATE LIFE INSURANCE COMPANY AND SUBSIDIARIES  
 CONSOLIDATED STATEMENTS OF SHAREHOLDER'S EQUITY

(IN MILLIONS)	YEAR ENDED DECEMBER 31,		
	2006	2005	2004
REDEEMABLE PREFERRED STOCK - SERIES A			
Balance, beginning of year	\$ 5	\$ 5	\$ 82
Redemption of stock	--	--	(7)
Reclassification to long-term debt	--	--	(70)
Balance, end of year	5	5	5
REDEEMABLE PREFERRED STOCK - SERIES B	--	--	--
COMMON STOCK	5	5	5
ADDITIONAL CAPITAL PAID-IN			
Balance, beginning of year	1,108	1,108	1,067
Capital contributions	--	--	41
Balance, end of year	1,108	1,108	1,108
RETAINED INCOME			
Balance, beginning of year	4,302	4,178	4,222
Net income	428	417	181
Dividends	(675)	(293)	(225)
Balance, end of year	4,055	4,302	4,178
ACCUMULATED OTHER COMPREHENSIVE INCOME			
Balance, beginning of year	588	1,013	1,053
Change in unrealized net capital gains and losses	(263)	(425)	(40)
Balance, end of year	325	588	1,013

TOTAL SHAREHOLDER'S EQUITY

-----  
\$5,498  
=====

-----  
\$6,008  
=====

-----  
\$6,309  
=====

See notes to consolidated financial statements.

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ALLSTATE LIFE  
INSURANCE  
COMPANY AND  
SUBSIDIARIES  
CONSOLIDATED  
STATEMENTS OF  
CASH FLOWS  
YEAR ENDED  
DECEMBER 31,  
-----

-----  
---- (IN  
MILLIONS)  
2006 2005  
2004 -----  
-----

---- CASH  
FLOWS FROM  
OPERATING  
ACTIVITIES

Net income \$  
428 \$ 417 \$  
181

Adjustments  
to reconcile  
net income to  
net cash

provided by  
operating  
activities:  
Amortization  
and other  
non-cash  
items (280)  
(175) (145)

Realized  
capital gains  
and losses 79  
(19) 11 Loss  
on  
disposition  
of operations  
88 7 24

Cumulative  
effect of  
change in  
accounting  
principle --  
-- 175

Interest  
credited to  
contractholder  
funds 2,543  
2,340 1,923

Changes in:  
Policy  
benefit and  
other  
insurance  
reserves  
(199) (200)

(85) Unearned  
premiums (1)  
4 2 Deferred  
policy

acquisition  
costs (205)  
(198) (279)  
Reinsurance  
recoverables

(218) (197)  
(241) Income  
taxes payable  
(122) 18 40  
Other  
operating  
assets and  
liabilities  
93 95 (86) --  
-----

Net cash  
provided by  
operating  
activities  
2,206 2,092  
1,520 -----  
-----

----- CASH  
FLOWS FROM  
INVESTING  
ACTIVITIES

Proceeds from  
sales Fixed  
income  
securities  
12,555 10,881  
9,040 Equity  
securities  
137 57 349  
Investment  
collections  
Fixed income  
securities  
3,174 4,575  
4,314

Mortgage  
loans 1,618  
1,172 729  
Investment  
purchases  
Fixed income  
securities  
(17,000)  
(18,756)  
(20,295)  
Equity  
securities  
(304) (203)  
(334)

Mortgage  
loans (2,159)  
(1,976)  
(1,711)  
Change in  
short-term  
investments,  
net 362 (352)  
11 Change in  
other  
investments,  
net 9 (108)  
(46)

Disposition  
of operations  
(826) (2) 40  
-----

Net cash used  
in investing  
activities  
(2,434)  
(4,712)  
(7,903) -----  
-----

----- CASH  
FLOWS FROM  
FINANCING  
ACTIVITIES

Note payable  
to parent 500

```

-- --
Redemption of
long-term
debt (26)
(26) (20)
Contractholder
fund deposits
9,546 11,374
13,076
Contractholder
fund
withdrawals
(8,998)
(8,604)
(6,352)
Dividends
paid (675)
(211) (201) -
-----
Net cash
provided by
financing
activities
347 2,533
6,503 -----
-----
----- NET
INCREASE
(DECREASE) IN
CASH 119 (87)
120 CASH AT
BEGINNING OF
YEAR 154 241
121 -----
-----
---- CASH AT
END OF YEAR $
273 $ 154 $
241 =====
=====
=====

```

See notes to consolidated financial statements.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

1. GENERAL

BASIS OF PRESENTATION

The accompanying consolidated financial statements include the accounts of Allstate Life Insurance Company ("ALIC") and its wholly owned subsidiaries (collectively referred to as the "Company"). ALIC is wholly owned by Allstate Insurance Company ("AIC"), a wholly owned subsidiary of The Allstate Corporation (the "Corporation"). These consolidated financial statements have been prepared in conformity with accounting principles generally accepted in the United States of America ("GAAP"). All significant intercompany accounts and transactions have been eliminated.

Effective January 1, 2005, Glenbrook Life and Annuity Company ("GLAC"), a wholly owned subsidiary of ALIC, was merged into ALIC to achieve cost savings and operational efficiency. The merger had no impact on the Company's results of operations, financial position or cash flows.

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

The preparation of financial statements in conformity with GAAP requires management to make estimates and assumptions that affect the amounts reported in the consolidated financial statements and accompanying notes. Actual results could differ from those estimates.

NATURE OF OPERATIONS

The Company sells life insurance, retirement and investment products to individual and institutional customers. The principal individual products are deferred and immediate fixed annuities, and interest-sensitive, traditional and variable life insurance. The principal institutional product is funding agreements backing medium-term notes issued to institutional and individual investors.

The Company, through several subsidiaries, is authorized to sell life insurance and retirement products in all 50 states, the District of Columbia, Puerto Rico, the U.S. Virgin Islands and Guam. For 2006, the top geographic locations for statutory premiums and annuity considerations were Delaware, California, New York, Florida and Texas. No other jurisdiction accounted for more than 5% of statutory premiums and annuity considerations. The Company distributes its products to individuals through several distribution channels, including Allstate exclusive agencies, independent agents (including master brokerage agencies), and financial services firms, such as broker/dealers and specialized structured settlement brokers. Although the Company currently benefits from agreements with financial services entities that market and distribute its products, change in control of these non-affiliated entities could negatively impact the Company's sales.

The Company monitors economic and regulatory developments that have the potential to impact its business. The ability of banks to affiliate with insurers may have a material adverse effect on all of the Company's product lines by substantially increasing the number, size and financial strength of potential competitors. Furthermore, federal and state laws and regulations affect the taxation of insurance companies and life insurance and annuity products. Congress and various state legislatures have considered proposals that, if enacted, could impose a greater tax burden on the Company or could have an adverse impact on the tax treatment of some insurance products offered by the Company, including favorable policyholder tax treatment currently applicable to life insurance and annuities. Legislation that reduced the federal income tax rates applicable to certain dividends and capital gains realized by individuals, or other proposals, if adopted, that reduce the taxation, or permit the establishment, of certain products or investments that may compete with life insurance or annuities could have an adverse effect on the Company's financial position or ability to sell such products and could result in the surrender of some existing contracts and policies. In addition, changes in the federal estate tax laws could negatively affect the demand for the types of life insurance used in estate planning.

## 2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

### INVESTMENTS

Fixed income securities include bonds and bank loans, which are primarily senior secured corporate loans, and redeemable preferred stocks. Fixed income securities may be sold prior to their contractual maturity ("available for sale") and are carried at fair value, with the exception of bank loans that are carried at amortized cost. The fair value of publicly traded fixed income securities is based upon independent market quotations. The fair value of non-publicly traded securities is based on either widely accepted pricing valuation models which use internally developed ratings and independent third party data (e.g., term structures of interest rates and current publicly traded bond prices) as inputs or independent third party pricing sources. The valuation models use security specific information such as ratings, industry, coupon and maturity along with third party data and publicly traded bond prices to determine security specific spreads. These spreads are then adjusted for illiquidity based on historical analysis and broker surveys. The difference between amortized cost and fair value, net of deferred income taxes, certain life and annuity deferred policy acquisition costs, certain deferred sales inducement costs, and certain reserves for life-contingent contract benefits, are reflected as a component of accumulated other comprehensive income. Cash received from calls, principal payments and make-whole payments is reflected as a component of proceeds from sales. Cash received from maturities and pay-downs is reflected as a component of investment collections.

Equity securities include limited partnership interests and non-redeemable preferred and common stocks. Investments in limited partnership interests had a carrying value of \$461 million and \$257 million at December 31, 2006 and 2005, respectively, and are accounted for in accordance with the equity method of accounting except for instances in which the Company's interest is so minor that it exercises virtually no influence over operating and financial policies, in which case, the Company applies the cost method of accounting. Common and non-redeemable preferred stocks had a carrying value of \$72 million and \$67 million, and cost of \$61 million and \$62 million at December 31, 2006 and 2005,

respectively. Common and non-redeemable preferred stocks are classified as available for sale and are carried at fair value. The difference between cost and fair value, net of deferred income taxes, is reflected as a component of accumulated other comprehensive income.

Mortgage loans are carried at outstanding principal balances, net of unamortized premium or discount and valuation allowances. Valuation allowances are established for impaired loans when it is probable that contractual principal and interest will not be collected. Valuation allowances for impaired loans reduce the carrying value to the fair value of the collateral or the present value of the loan's expected future repayment cash flows discounted at the loan's original effective interest rate.

Short-term investments are carried at cost or amortized cost that approximates fair value, and include the investment of collateral received in connection with securities lending business activities, funds received in connection with securities repurchase agreements and collateral received from counterparties related to derivative transactions. For these transactions, the Company records an offsetting liability in other liabilities and accrued expenses for the Company's obligation to return the collateral or funds received. We also purchase securities under agreements to resell.

Policy loans are carried at the unpaid principal balances. Other investments consist primarily of derivative financial instruments.

Investment income consists primarily of interest and dividends, net investment income from partnership interests and income from certain derivative transactions. Interest is recognized on an accrual basis and dividends are recorded at the ex-dividend date. Interest income is determined using the effective yield method, considering estimated principal repayments when applicable. Interest income on certain beneficial interests in securitized financial assets is determined using the prospective yield method, based upon projections of expected future cash flows. Income from investments in partnership interests accounted for on the cost basis is recognized upon receipt of amounts distributed by the partnerships as income. Income from investments in partnership interests accounted for utilizing the equity method of accounting is recognized based on the financial results of the entity and the Company's investment interest. Accrual of income is suspended for fixed income securities and mortgage loans that are in default or when the receipt of interest payments is in doubt.

Realized capital gains and losses include gains and losses on investment dispositions, write-downs in value due to other-than-temporary declines in fair value and changes in the fair value of certain derivatives including related periodic and final settlements. Dispositions include sales, losses recognized in anticipation of dispositions and other transactions such as calls and prepayments. Realized capital gains and losses on investment dispositions are determined on a specific identification basis.

The Company recognizes other-than-temporary impairment losses on fixed income securities, equity securities and short-term investments when the decline in fair value is deemed other-than-temporary (see Note 6).

#### DERIVATIVE AND EMBEDDED DERIVATIVE FINANCIAL INSTRUMENTS

Derivative financial instruments include swaps, futures (interest rate), options (including swaptions), interest rate caps and floors, warrants, certain forward contracts for purchases of to-be-announced ("TBA") mortgage securities, and certain investment risk transfer reinsurance agreements. Derivatives that are required to be separated from the host instrument and accounted for as derivative financial instruments ("subject to bifurcation") are embedded in convertible and equity indexed fixed income securities, equity-indexed annuity contracts, variable annuity contracts which are reinsured, and certain funding agreements (see Note 7).

All derivatives are accounted for on a fair value basis and reported as other investments, other assets, other liabilities and accrued expenses or contractholder funds. Embedded derivative instruments subject to bifurcation are also accounted for on a fair value basis and are reported together with the host contracts. The change in the fair value of derivatives embedded in certain fixed income securities and subject to bifurcation is reported in realized capital gains and losses. The change in the fair value of derivatives embedded in liabilities and subject to bifurcation is reported in contract benefits, interest credited to contractholder funds or realized capital gains and losses.

When derivatives meet specific criteria, they may be designated as

accounting hedges and accounted for as fair value, cash flow, foreign currency fair value or foreign currency cash flow hedges. The hedged item may be either all or a specific portion of a recognized asset, liability or an unrecognized firm commitment attributable to a particular risk. At the inception of the hedge, the Company formally documents the hedging relationship and risk management objective and strategy. The documentation identifies the hedging instrument, the hedged item, the nature of the risk being hedged and the methodology used to assess the effectiveness of the hedging instrument in offsetting the exposure to changes in the hedged item's fair value attributable to the hedged risk, or in the case of a cash flow hedge, the exposure to changes in the hedged item's or transaction's variability in cash flows attributable to the hedged risk. The Company does not exclude any component of the change in fair value of the hedging instrument from the effectiveness assessment. At each reporting date, the Company confirms that the hedging instrument continues to be highly effective in offsetting the hedged risk. Ineffectiveness in fair value hedges and cash flow hedges is reported in realized capital gains and losses. The hedge ineffectiveness reported as realized capital gains and losses amounted to losses of \$7 million, \$7 million and \$8 million in 2006, 2005 and 2004, respectively.

**FAIR VALUE HEDGES** The Company designates certain of its interest rate and foreign currency swap contracts and certain investment risk transfer reinsurance agreements as fair value hedges when the hedging instrument is highly effective in offsetting the risk of changes in the fair value of the hedged item.

For hedging instruments used in fair value hedges, when the hedged items are investment assets or a portion thereof, the change in the fair value of the derivatives is reported in net investment income, together with the change in the fair value of the hedged items. The change in the fair value of hedging instruments used in fair value hedges of contractholder funds liabilities or a portion thereof is reported in interest credited to contractholder funds, together with the change in the fair value of the hedged item. Accrued periodic settlements on swaps are reported together with the changes in fair value of the swaps in net investment income, or interest credited to contractholder funds. The book value of the hedged asset or liability is adjusted for the change in the fair value of the hedged risk.

**CASH FLOW HEDGES** The Company designates certain of its foreign currency swap contracts as cash flow hedges when the hedging instrument is highly effective in offsetting the exposure of variations in cash flows for the hedged risk that could affect net income. The Company's cash flow exposure may be associated with an existing asset, liability or a forecasted transaction. Anticipated transactions must be probable of occurrence and their significant terms and specific characteristics must be identified.

For hedging instruments used in cash flow hedges, the changes in fair value of the derivatives are reported in accumulated other comprehensive income. Amounts are reclassified to net investment income or realized capital gains and losses as the hedged transaction affects net income or when the forecasted transaction affects net income. Accrued periodic settlements on derivatives used in cash flow hedges are reported in net investment income. The amount reported in accumulated other comprehensive income for a hedged transaction is limited to the lesser of the cumulative gain or loss on the derivative less the amount reclassified to net income; or the cumulative gain or loss on the derivative needed to offset the cumulative change in the expected future cash flows on the hedged transaction from inception of the hedge less the derivative gain or loss previously reclassified from accumulated other comprehensive income to net income. If the Company expects at any time that the loss reported in accumulated other comprehensive income would

lead to a net loss on the combination of the hedging instrument and the hedged transaction which may not be recoverable, a loss is recognized immediately in realized capital gains and losses. If an impairment loss is recognized on an asset or an additional obligation is incurred on a liability involved in a hedge transaction, any offsetting gain in accumulated other comprehensive income is reclassified and reported together with the impairment loss or recognition of the obligation.

**TERMINATION OF HEDGE ACCOUNTING** If, subsequent to entering into a hedge transaction, the derivative becomes ineffective (including if the hedged item is sold or otherwise extinguished, the occurrence of a hedged forecasted transaction is no longer probable, or the hedged asset becomes other-than-temporarily impaired), the Company may terminate the derivative position. The Company may also terminate derivative instruments or redesignate them as non-hedge as a result of other events or circumstances. If the derivative financial instrument is not terminated when a fair value hedge is no

longer effective, the future gains and losses recognized on the derivative are reported in realized capital gains and losses. When a fair value hedge is no longer effective, is redesignated as a non-hedge, or when the derivative has been terminated, the fair value gain or loss on the hedged asset, liability or portion thereof used to adjust the book value of the asset, liability or portion thereof, which has already been recognized in income while the hedge was in place, is amortized over the remaining life of the hedged asset, liability or portion thereof to net investment income or interest credited to contractholder funds beginning in the period that hedge accounting is no longer applied. If the hedged item of a fair value hedge is an asset which has become other than temporarily impaired, the adjustment made to the book value of the asset is subject to the accounting policies applied to other than temporarily impaired assets. When a derivative financial instrument used in a cash flow hedge of an existing asset or liability is no longer effective or is terminated, the gain or loss recognized on the derivative is reclassified from accumulated other comprehensive income to net income as the hedged risk impacts net income, beginning in the period hedge accounting is no longer applied or the derivative instrument is terminated. If the derivative financial instrument is not terminated when a cash flow hedge is no longer effective, the future gains and losses recognized on the derivative are reported in realized capital gains and losses. When a derivative financial instrument used in a cash flow hedge of a forecasted transaction is terminated because the forecasted transaction is no longer probable, the gain or loss recognized on the derivative is immediately reclassified from accumulated other comprehensive income to realized capital gains and losses in the period that hedge accounting is no longer applied. If a cash flow hedge is no longer effective, the gain or loss recognized on the derivative during the period the hedge was effective is reclassified from accumulated other comprehensive income to net income as the remaining hedged item affects net income.

**NON-HEDGE DERIVATIVE FINANCIAL INSTRUMENTS** The Company also has certain derivatives that are used in interest rate, equity price and credit risk management strategies for which hedge accounting is not applied. These derivatives primarily consist of certain interest rate swap agreements, equity and financial futures contracts, interest rate cap and floor agreements, swaptions, option contracts, certain forward contracts for TBA mortgage securities and credit default swaps.

The Company replicates fixed income securities using a combination of a credit default swap and one or more highly rated fixed income securities to synthetically replicate the economic characteristics of one or more cash market securities. Fixed income securities are replicated when they are either unavailable in the cash market or more economical to acquire in synthetic form.

Based upon the type of derivative instrument and strategy, the income statement effects of these derivatives are reported in a single line item, with the results of the associated risk. Therefore, the derivatives' fair value gains and losses and accrued periodic settlements are recognized together in one of the following during the reporting period: net investment income, realized capital gains and losses, operating costs and expenses, contract benefits or interest credited to contractholder funds. Cash flows from embedded derivatives requiring bifurcation and derivatives receiving hedge accounting are reported consistently with the host contracts and hedged risks respectively within the Consolidated Statement of Cash Flows. Cash flows on other derivatives are reported in cash flows from investing activities within the Consolidated Statement of Cash Flows.

#### **SECURITIES LOANED AND SECURITY REPURCHASE**

The Company's business activities, which include securities lending transactions, and securities sold under agreements to repurchase that primarily include a mortgage dollar roll program ("repurchase agreements"), and are used primarily to generate net investment income. The proceeds received from repurchase agreements also provide a source of liquidity. For repurchase agreements and securities lending transactions used to generate net investment income, the proceeds received are reinvested in short-term investments or fixed income securities. These transactions are short-term in nature (usually 30 days or less).

The Company receives collateral for securities loaned in an amount generally equal to 102% of the fair value of securities and records the related obligations to return the collateral in other liabilities and accrued expenses. The carrying value of these obligations approximates fair value because of their relatively short-term nature. The Company monitors the market value of securities loaned on a daily basis and obtains additional collateral as necessary under the terms of the agreements to mitigate counterparty credit

risk. The Company maintains the right and ability to redeem the securities loaned on short notice. Substantially all of the Company's securities loaned are placed with large brokerage firms.

Securities to be repurchased under repurchase agreements are the same, or substantially the same, as the securities transferred. The Company's obligations to return the funds received under repurchase agreements are carried at the amount at which the securities will subsequently be reacquired, including accrued interest, as specified in the respective agreements and are classified as other liabilities and accrued expenses. The carrying value of these obligations approximates fair value because of their relatively short-term nature.

#### RECOGNITION OF PREMIUM REVENUES AND CONTRACT CHARGES, AND RELATED BENEFITS AND INTEREST CREDITED

Traditional life insurance products consist principally of products with fixed and guaranteed premiums and benefits, primarily term and whole life insurance products. Premiums from these products are recognized as revenue when due from policyholders. Benefits are recognized in relation to such revenue so as to result in the recognition of profits over the life of the policy and are reflected in contract benefits.

Immediate annuities with life contingencies, including certain structured settlement annuities, provide insurance protection over a period that extends beyond the period during which premiums are collected. Premiums from these products are recognized as revenue when received at the inception of the contract. Benefits and expenses are recognized in relation to such revenue such that profits are recognized over the lives of the contracts.

Interest-sensitive life contracts, such as universal life and single premium life, are insurance contracts whose terms are not fixed and guaranteed. The terms that may be changed include premiums paid by the contractholder, interest credited to the contractholder account balance and any amounts assessed against the contractholder account balance. Premiums from these contracts are reported as contractholder fund deposits. Contract charges consist of fees assessed against the contractholder account balance for cost of insurance (mortality risk), contract administration and early surrender. These revenues are recognized when assessed against the contractholder account balance. Contract benefits include life-contingent benefit payments in excess of the contractholder account balance.

Contracts that do not subject the Company to significant risk arising from mortality or morbidity are referred to as investment contracts. Fixed annuities, including market value adjusted annuities, equity-indexed annuities and immediate annuities without life contingencies, funding agreements (primarily backing medium-term notes) are considered investment contracts. Consideration received for such contracts is reported as contractholder fund deposits. Contract charges for investment contracts consist of fees assessed against the contractholder account balance for maintenance, administration and surrender of the contract prior to contractually specified dates, and are recognized when assessed against the contractholder account balance.

Interest credited to contractholder funds represents interest accrued or paid on interest-sensitive life contracts and investment contracts. Crediting rates for certain fixed annuities and interest-sensitive life contracts are adjusted periodically by the Company to reflect current market conditions subject to contractually guaranteed minimum rates. Crediting rates for indexed annuities and indexed funding agreements are based on a specified interest-rate index, such as LIBOR, or an equity index, such as the S&P 500. Pursuant to the adoption of Statement of Position No. 03-1, "Accounting and Reporting by Insurance Enterprises for Certain Nontraditional Long-Duration Contracts and for Separate Accounts" ("SOP 03-1") in 2004, interest credited also includes amortization of deferred sales inducement ("DSI") expenses. DSI is amortized into interest credited using the same method used to amortize deferred policy acquisition costs ("DAC").

Contract charges for variable life and variable annuity products consist of fees assessed against the contractholder account values for contract maintenance, administration, mortality, expense and early surrender. Contract benefits incurred include guaranteed minimum death, income, withdrawal and accumulation benefits. Subsequent to our disposal of substantially all of our variable annuity business through reinsurance agreements with Prudential in 2006 (see Note 3), the contract charges and contract benefits related thereto are reported net of reinsurance ceded.

#### DEFERRED POLICY ACQUISITION AND SALES INDUCEMENT COSTS

Costs that vary with and are primarily related to acquiring life insurance and investment contracts are deferred and

recorded as DAC. These costs are principally agents' and brokers' remuneration and certain underwriting costs. DSI costs, which are deferred and recorded as other assets, relate to sales inducements offered on sales to new customers, principally on annuities and primarily in the form of additional credits to the customer's account value or enhancements to interest credited for a specified period, which are beyond amounts currently being credited to existing contracts. All other acquisition costs are expensed as incurred and included in operating costs and expenses on the Consolidated Statements of Operations and Comprehensive Income. DAC is amortized to income and included in amortization of deferred policy acquisition costs on the Consolidated Statements of Operations and Comprehensive Income. DSI is reported in other assets and amortized to income using the same methodology and assumptions as DAC and is included in interest credited to contractholder funds on the Consolidated Statements of Operations and Comprehensive Income. DAC and DSI are periodically reviewed for recoverability and written down if necessary.

For traditional life insurance and other premium paying contracts, DAC is amortized in proportion to the estimated revenues on such business. Assumptions used in amortization of DAC and reserve calculations are determined based upon conditions as of the date of policy issuance and are generally not revised during the life of the policy. Any deviations from projected business in force resulting from actual policy terminations differing from expected levels and any estimated premium deficiencies change the rate of amortization in the period such events occur. Generally, the amortization period for these contracts approximates the estimated lives of the policies.

For internal exchanges of traditional life insurance, the unamortized balance of acquisition costs previously deferred under the original contracts are charged to income. The new acquisition costs associated with the exchange are deferred and amortized to income.

For interest-sensitive life, annuities and other investment contracts, DAC and DSI are amortized in proportion to the incidence of the total present value of gross profits, which includes both actual historical gross profits ("AGP") and estimated future gross profits ("EGP") expected to be earned over the estimated lives of the contracts. Actual amortization periods range from 15-30 years; however, incorporating estimates of customer surrender rates, partial withdrawals and deaths generally result in the majority of deferred costs being amortized over the surrender charge period. The rate of amortization during this term is matched to the pattern of total gross profits. AGP and EGP consists of the following components: benefit margins, primarily from mortality; investment margin including realized capital gains and losses; and contract administration, surrender and other contract charges, less maintenance expenses.

Changes in the amount or timing of EGP result in adjustments to the cumulative amortization of DAC and DSI. All such adjustments are reflected in the current results of operations.

The Company performs quarterly reviews of DAC and DSI recoverability for interest-sensitive life, annuities and investment contracts in the aggregate using current assumptions. If a change in the amount of EGP is significant, it could result in the unamortized DAC and DSI not being recoverable, resulting in a charge which is included as a component of amortization of deferred policy acquisition costs or interest credited to contractholder funds, respectively, on the Consolidated Statements of Operations and Comprehensive Income.

Any amortization of DAC or DSI that would result from changes in unrealized gains or losses had those gains or losses actually been realized during the reporting period is recorded net of tax in other comprehensive income.

The costs assigned to the right to receive future cash flows from certain business purchased from other insurers are also classified as deferred policy acquisition costs in the Consolidated Statements of Financial Position. The costs capitalized represent the present value of future profits expected to be earned over the life of the contracts acquired. These costs are amortized as profits emerge over the life of the acquired business and are periodically evaluated for recoverability. The present value of future profits was \$25 million and \$37 million at December 31, 2006 and 2005, respectively. Amortization expense on the present value of future profits was \$6 million, \$8 million and \$6 million for the years ended December 31, 2006, 2005 and 2004 respectively.

#### REINSURANCE

In the normal course of business, the Company seeks to limit aggregate and single exposure to losses on large risks by purchasing reinsurance from

reinsurers (see Note 9). The Company has also used reinsurance to effect the acquisition or disposition of certain blocks of business. The amounts reported in the Consolidated Statements of Financial Position as reinsurance recoverables include amounts billed to reinsurers on losses paid as well as estimates of amounts expected to be recovered from reinsurers on insurance liabilities and contractholder funds that have not yet been paid. Reinsurance recoverables on unpaid losses are estimated based upon assumptions consistent with those used in establishing the liabilities related to the underlying reinsured contract. Insurance liabilities are reported gross of

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reinsurance recoverables. Reinsurance premiums are generally reflected in income in a manner consistent with the recognition of premiums on the reinsured contracts or are earned ratably over the contract period to the extent coverage remains available. Reinsurance does not extinguish the Company's primary liability under the policies written. Therefore, the Company regularly evaluates the financial condition of the reinsurers and establishes allowances for uncollectible reinsurance recoverables as appropriate.

#### GOODWILL

Goodwill represents the excess of amounts paid for acquiring businesses over the fair value of the net assets acquired. The Company annually evaluates goodwill for impairment using a trading multiple analysis, which is a widely accepted valuation technique to estimate the fair value of its reporting units. The Company also reviews its goodwill for impairment whenever events or changes in circumstances indicate that it is more likely than not that the carrying amount of goodwill may be less than its fair value. Goodwill impairment evaluations indicated no impairment at December 31, 2006.

#### INCOME TAXES

The income tax provision is calculated under the liability method. Deferred tax assets and liabilities are recorded based on the difference between the financial statement and tax bases of assets and liabilities at the enacted tax rates. The principal assets and liabilities giving rise to such differences are unrealized capital gains and losses on certain investments, insurance reserves and DAC. A deferred tax asset valuation allowance is established when there is uncertainty that such assets would be realized.

#### RESERVE FOR LIFE-CONTINGENT CONTRACT BENEFITS

The reserve for life-contingent contract benefits, which relates to traditional life and accident and health insurance and immediate annuities with life contingencies, is computed on the basis of long-term actuarial assumptions as to future investment yields, mortality, morbidity, policy terminations and expenses (see Note 8). These assumptions, which for traditional life insurance are applied using the net level premium method, include provisions for adverse deviation and generally vary by such characteristics as type of coverage, year of issue and policy duration. To the extent that unrealized gains on fixed income securities would result in a premium deficiency had those gains actually been realized, the related increase in reserves for certain immediate annuities with life contingencies is recorded net of tax as a reduction of the unrealized net capital gains included in accumulated other comprehensive income.

#### CONTRACTHOLDER FUNDS

Contractholder funds represent interest-bearing liabilities arising from the sale of products, such as interest-sensitive life, fixed annuities and funding agreements. Contractholder funds are comprised primarily of deposits received and interest credited to the benefit of the contractholder less surrenders and withdrawals, mortality charges and administrative expenses (see Note 8). Contractholder funds also include reserves for secondary guarantees on interest-sensitive life insurance and certain fixed annuity contracts.

#### SEPARATE ACCOUNTS

Separate accounts assets and liabilities are carried at fair value. The assets of the separate accounts are legally segregated and available only to settle separate account contract obligations. Separate accounts liabilities represent the contractholders' claims to the related assets. Investment income and realized capital gains and losses of the separate accounts accrue directly to the contractholders and therefore, are not included in the Company's Consolidated Statements of Operations and Comprehensive Income. Deposits to, and surrenders and withdrawals from the separate accounts are reflected in separate accounts liabilities and are not included in consolidated cash flows.

Absent any contract provision wherein the Company provides a guarantee, which for variable annuities was reinsured to Prudential in 2006, variable annuity and variable life insurance contractholders bear the investment risk that the separate accounts' funds may not meet their stated investment objectives.

#### OFF-BALANCE-SHEET FINANCIAL INSTRUMENTS

Commitments to invest, commitments to purchase private placement securities, commitments to extend mortgage loans and credit guarantees have off-balance-sheet risk because their contractual amounts are not recorded in the Company's Consolidated Statements of Financial Position (see Note 7 and Note 11).

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#### CONSOLIDATION OF VARIABLE INTEREST ENTITIES ("VIEs")

The Company consolidates VIEs when it is the primary beneficiary of a VIE. A primary beneficiary has a variable interest that will absorb a majority of the expected losses or receive a majority of the entity's expected returns, or both (see Note 13).

#### 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.

SECURITIES AND EXCHANGE COMMISSION ("SEC") STAFF ACCOUNTING BULLETIN NO. 108, "CONSIDERING THE EFFECTS OF PRIOR YEAR MISSTATEMENTS WHEN QUANTIFYING MISSTATEMENTS IN CURRENT YEAR FINANCIAL STATEMENTS" ("SAB 108")

In September 2006, the SEC issued SAB 108 in order to eliminate the diversity of practice in the process by which misstatements are quantified for purposes of assessing materiality on the financial statements. SAB 108 is intended to eliminate the potential for the build up of improper amounts on the balance sheet due to the limitations of certain methods of materiality assessment utilized in current practice. SAB 108 establishes a single quantification framework wherein the significance measurement is based on the effects of the misstatements on each of the financial statements as well as the related financial statement disclosures. If a company's existing methods for assessing the materiality of misstatements are not in compliance with the provisions of SAB 108, the initial application of the provisions may be adopted by restating prior period financial statements under certain circumstances or otherwise by recording the cumulative effect of initially applying the provisions of SAB 108 as adjustments to the carrying values of assets and liabilities as of January 1, 2006 with an offsetting adjustment recorded to the opening balance of retained 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 did not have any effect on its results of operations or financial position.

STATEMENT OF POSITION 03-1, "ACCOUNTING AND REPORTING BY INSURANCE ENTERPRISES FOR CERTAIN NONTRADITIONAL LONG-DURATION CONTRACTS AND FOR SEPARATE ACCOUNTS" ("SOP 03-1")

On January 1, 2004, the Company adopted SOP 03-1. The major provisions of the SOP that affected the Company at the time of adoption are listed below. These provisions were primarily applicable to the business that was subsequently substantially reinsured on June 1, 2006 (see Note 3).

- Establishment of reserves primarily related to death benefit and income benefit guarantees provided under variable annuity contracts;
- Deferral of sales inducements that meet certain criteria, and amortization using the same method used for DAC; and

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- Reporting and measuring assets and liabilities of certain separate accounts products as investments and contractholder funds rather than as separate accounts assets and liabilities when specified criteria are present.

The cumulative effect of the change in accounting principle from implementing SOP 03-1 was a loss of \$175 million, after-tax (\$269 million, pre-tax). It was comprised of an increase in benefit reserves (primarily for variable annuity contracts) of \$145 million, pre-tax, and a reduction in DAC and DSI of \$124 million, pre-tax.

The SOP required consideration of a range of potential results to estimate the cost of variable annuity death benefits and income benefits, which generally necessitated the use of stochastic modeling techniques. To maintain consistency with the assumptions used in the establishment of reserves for variable annuity guarantees, the Company utilized the results of this stochastic modeling to estimate expected gross profits, which form the basis for determining the amortization of DAC and DSI. This new modeling approach resulted in a lower estimate of expected gross profits, and therefore resulted in a write-down of DAC and DSI.

DSI and related amortization is classified within the Consolidated Statements of Financial Position and Operations and Comprehensive Income as other assets and interest credited to contractholder funds, respectively (see Note 10). Pursuant to adopting this guidance, the Company also reclassified \$204 million of separate accounts assets and liabilities to investments and contractholder funds, respectively.

AMERICAN INSTITUTE OF CERTIFIED PUBLIC ACCOUNTANTS ("AICPA") TECHNICAL PRACTICE AID ("TPA") RE. SOP 03-1

In September 2004, the staff of the AICPA, aided by industry experts, issued a set of technical questions and answers on financial accounting and reporting issues related to SOP 03-1. The TPAs address a number of issues related to SOP 03-1 including when it was necessary to establish a liability in addition to the account balance for certain contracts such as single premium and universal life that meet the definition of an insurance contract and have amounts assessed against the contractholder in a manner that is expected to result in profits in earlier years and losses in subsequent years from the insurance benefit function. The impact of adopting the provisions of the TPAs did not have a material effect on the results of operations or financial position of the Company.

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 American Institute of Certified Public Accountants ("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. In February 2007, the AICPA issued a set of eleven TPAs that provide interpretive guidance to be utilized, if applicable, at the date of adoption. The provisions of SOP 05-1 are effective

for internal replacements occurring in fiscal years beginning after December 15, 2006. Based on the issued standard and the TPAS released in February 2007, the Company's estimated impacts of adoption will not have a material effect on its results of operations or financial position.

SFAS NO. 155, "ACCOUNTING FOR CERTAIN HYBRID FINANCIAL INSTRUMENTS - AN AMENDMENT OF FASB STATEMENTS NO. 133 AND 140" ("SFAS NO. 155")

In February 2006, the FASB issued SFAS No. 155, which permits the fair value remeasurement at the date of adoption of any hybrid financial instrument containing an embedded derivative that otherwise would require bifurcation under paragraph 12 or 13 of SFAS No. 133, "Accounting for Derivative Instruments and Hedging Activities"; clarifies which interest-only strips and principal-only strips are not subject to the requirements of SFAS No. 133; establishes a requirement to evaluate interests in securitized financial assets to identify interests that are freestanding derivatives or hybrid financial instruments that contain embedded derivatives requiring bifurcation; and clarifies that concentrations of credit risk in the form of subordination are not embedded derivatives. The provisions of SFAS No. 155 are effective for all financial instruments acquired, issued or subject to a remeasurement event occurring after the beginning of the first fiscal year that begins after September 15, 2006. The Company elected not to remeasure its existing hybrid financial instruments at the date of adoption that contained embedded derivatives requiring bifurcation pursuant to paragraph 12 or 13 of SFAS No 133. The adoption of SFAS No. 155 is not

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expected to have a material effect on the results of operations or financial position of the Company.

FINANCIAL ACCOUNTING STANDARDS BOARD INTERPRETATION NO. 48, "ACCOUNTING FOR UNCERTAINTY IN INCOME TAXES", ("FIN 48")

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

SFAS NO. 157, "FAIR VALUE MEASUREMENTS" ("SFAS NO. 157")

In September 2006, the FASB issued SFAS No. 157 which redefines fair value, establishes a framework for measuring fair value in generally accepted accounting principles ("GAAP"), and expands disclosures about fair value measurements. SFAS No. 157 applies where other accounting pronouncements require or permit fair value measurements. SFAS No. 157 is effective for fiscal years beginning after November 15, 2007. The effects of adoption will be determined by the types of instruments carried at fair value in the Company's financial statements at the time of adoption as well as the 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. 159, THE FAIR VALUE OPTION FOR FINANCIAL ASSETS AND FINANCIAL LIABILITIES ("SFAS NO. 159")

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

application of the standard is optional, any impacts are limited to those financial assets and liabilities to which SFAS No. 159 would be applied, which has yet to be determined, as is any decision concerning the early adoption of the standard.

### 3. DISPOSITIONS

#### VARIABLE ANNUITY BUSINESS

On June 1, 2006, ALIC, its subsidiary, Allstate Life Insurance Company of New York ("ALNY"), and the Corporation completed the disposal of substantially all of its 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"). 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 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 Consolidated Statements of Operations and Comprehensive Income. In contrast, \$1.37 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 \$1.49 billion as of December 31, 2006, however, remain on the Consolidated Statements of Financial Position with a corresponding reinsurance recoverable. For purposes of presentation in the Consolidated Statements of Cash Flows, the Company treated the reinsurance of substantially all the variable annuity business of ALIC and ALNY to Prudential as a disposition of operations, consistent with the substance of the transaction which was the disposition of a block of business accomplished through reinsurance. Accordingly, the net consideration transferred

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to Prudential of \$744 million (computed as \$1.37 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 of \$69 million, pre-tax, and the costs of executing the transaction of \$13 million, pre-tax, were classified as a disposition of operations in the cash flows from investing activities section of the Consolidated Statements of Cash Flows. The Reinsurance Agreements do not extinguish the Company's primary liability under the variable annuity contracts.

Under the Agreement, ALIC, ALNY and the Corporation 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, ALIC, ALNY and the Corporation 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 \$77 million pretax for ALIC, which was deferred as a result of the disposition being executed through reinsurance. The deferred gain is included as a component of other liabilities and accrued expenses on the Consolidated Statements of Financial Position, and is amortized to loss on disposition of operations on the Consolidated Statements of Operations and Comprehensive Income over the life of the reinsured business which is estimated to be approximately 18 years. For ALNY, the transaction resulted in a loss of \$9 million pretax. ALNY's reinsurance loss and other amounts related to the disposal of the business, including the initial costs and final market value settlements of the derivatives acquired by ALIC to economically hedge substantially all of the exposure related to market adjustments between the effective date of the Agreement and the closing of the transaction, transactional expenses incurred and amortization of ALIC's deferred reinsurance gain, were included as a component of loss on disposition of operations on the Consolidated Statements of Operations and Comprehensive Income

and amounted to \$61 million, after-tax during 2006. During 2006, loss on disposition of operations on the Consolidated Statements of Operations and Comprehensive Income included \$1 million, after-tax, of amortization of ALIC's deferred gain. DAC and DSI were reduced by \$726 million and \$70 million, respectively, as of the effective date of the transaction for balances related to the variable annuity business subject to the Reinsurance Agreements.

The separate account balances related to the modified coinsurance reinsurance were \$15.07 billion as of December 31, 2006. Separate account balances totaling approximately \$1.10 billion at December 31, 2006 relate primarily to the variable life business that is being retained by ALIC and ALNY, and some minimal variable annuity business in three affiliated companies that the Company plans to sell.

In the five-months of 2006, prior to the disposition of ALIC's and ALNY's variable annuity business, ALIC's and ALNY's variable annuity business generated approximately \$127 million in contract charges. In 2005 and 2004, ALIC's and ALNY's variable annuity business generated approximately \$278 million and \$244 million in contract charges, respectively. The separate account balances were \$14.23 billion and general account balances were \$1.81 billion as of December 31, 2005.

CHARTER NATIONAL LIFE INSURANCE COMPANY ("CHARTER") AND INTRAMERICA LIFE INSURANCE COMPANY ("INTRAMERICA")

In 2005, the Company entered into negotiations to sell two of its wholly owned subsidiaries, Charter National Life Insurance Company ("Charter") and Intramerica Life Insurance Company ("Intramerica"), and recognized an estimated loss on disposition of \$4 million (\$1 million, after-tax). During 2005, a definitive agreement was reached for which the buyer failed to gain regulatory approval. The subsidiaries whose assets, excluding reinsurance recoverables due from ALIC, totaled approximately \$427 million at December 31, 2006 (\$106 million and \$292 million are classified as reinsurance recoverables and separate accounts, respectively) are still held for sale.

4. SUPPLEMENTAL CASH FLOW INFORMATION

Non-cash investment exchanges and modifications, which primarily reflect refinancings of fixed income securities and mergers completed with equity securities, totaled \$39 million, \$51 million and \$79 million for the years ended December 31, 2006, 2005 and 2004, respectively.

Liabilities for collateral received in conjunction with the Company's securities lending and other business activities and for funds received from the Company's security repurchase business activities were \$2.29 billion, \$2.23 billion and \$2.93 billion at December 31, 2006, 2005, and 2004, respectively, and are reported in other liabilities and accrued expenses in the Consolidated Statements of Financial Position. The accompanying cash flows are included in cash flows from operating activities in the Consolidated Statements of Cash Flows along with the activities resulting from management of the proceeds, which for the years ended December 31 are as follows:

(IN	
MILLIONS)	
2006	2005
2004	-----
--	-----
-----	
NET CHANGE	
IN	
PROCEEDS	
MANAGED	
Net change	
in fixed	
income	
securities	
\$ 96	\$
(221)	\$
(305)	Net
	change in
	short-term
	investments
(159)	918
(705)	----
---	-----
-	-----

Operating  
cash flow  
(used)  
provided \$  
(63) \$ 697  
\$(1,010)  
=====  
=====  
=====

NET CHANGE  
IN

LIABILITIES  
Liabilities  
for  
collateral  
and  
security  
repurchase,  
beginning  
of year  
\$(2,231)  
\$(2,928)  
\$(1,918)

Liabilities  
for  
collateral  
and  
security  
repurchase,  
end of  
year  
(2,294)  
(2,231)  
(2,928) --  
-----  
-----  
-

Operating  
cash flow  
provided  
(used) \$  
63 \$ (697)  
\$ 1,010  
=====  
=====  
=====

The Company paid dividends of \$49 million and \$24 million in the form of investment securities to AIC in 2005 and 2004, respectively. In 2004, the Company received non-cash capital contributions of \$41 million related to certain reinsurance transactions with American Heritage Life Insurance Company ("AHL"), an unconsolidated affiliate of the Company, and Columbia Universal Life Insurance Company ("Columbia"), a former unconsolidated affiliate of the Company, in 2004 (see Note 5).

5. RELATED PARTY TRANSACTIONS

BUSINESS OPERATIONS

The Company uses services performed by its affiliates, AIC and Allstate Investments LLC, and business facilities owned or leased and operated by AIC in conducting its business activities. In addition, the Company shares the services of employees with AIC. The Company reimburses its affiliates for the operating expenses incurred on behalf of the Company. The Company is charged for the cost of these operating expenses based on the level of services provided. Operating expenses, including compensation, retirement and other benefit programs allocated to the Company (see Note 15), were \$494 million, \$410 million, and \$322 million in 2006, 2005 and 2004, respectively. A portion of these expenses relate to the acquisition of business, which are deferred and amortized into income as described in Note 2.

STRUCTURED SETTLEMENT ANNUITIES

The Company issued \$72 million, \$235 million and \$98 million of structured settlement annuities, a type of immediate annuity, in 2006, 2005 and 2004, respectively, at prices determined based upon interest rates in effect at the time of purchase, to fund structured settlements in matters involving AIC. Of these amounts, \$10 million, \$9 million and \$27 million relate to structured settlement annuities with life contingencies and are included in premium income for 2006, 2005, and 2004, respectively. In most cases, these annuities were

issued under a "qualified assignment" whereby prior to July 1, 2001 Allstate Settlement Corporation ("ASC"), and on and subsequent to July 1, 2001 Allstate Assignment Corporation ("AAC"), both wholly owned subsidiaries of ALIC, purchased annuities from ALIC and assumed AIC's obligation to make future payments.

AIC issued surety bonds to guarantee the payment of structured settlement benefits assumed by ASC (from both AIC and non-related parties) and funded by certain annuity contracts issued by the Company through June 30, 2001. ASC entered into a General Indemnity Agreement pursuant to which it indemnified AIC for any liabilities associated with the surety bonds and gave AIC certain collateral security rights with respect to the annuities and certain other rights in the event of any defaults covered by the surety bonds. For contracts written on or after July 1, 2001, AIC no longer issues surety bonds to guarantee the payment of structured settlement benefits. Alternatively, ALIC guarantees the

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payment of structured settlement benefits on all contracts issued on or after July 1, 2001.

Reserves recorded by the Company for annuities that are guaranteed by the surety bonds of AIC were \$4.92 billion and \$4.94 billion at December 31, 2006 and 2005, respectively.

#### BROKER/DEALER AGREEMENT

The Company receives underwriting and distribution services from Allstate Financial Services, LLC ("AFS"), an affiliated broker/dealer company, for certain variable annuity and variable life insurance contracts sold by Allstate exclusive agencies. The Company incurred \$44 million, \$46 million and \$44 million of commission and other distribution expenses for the years ending December 31, 2006, 2005 and 2004, respectively.

#### INVESTMENTS

In 2005, the Company purchased fixed income securities from AIC. The Company paid \$655 million in cash for the securities, which includes the fair value of the securities of \$649 million and \$6 million for accrued investment income. Since the transaction was between affiliates under common control, the securities were recorded at the amortized cost of \$623 million as of the date of sale. The difference between the amortized cost and fair value of the securities, which increased accumulated other comprehensive income by \$26 million, was recorded as a dividend of \$26 million (\$16 million, after-tax). Thus, the net effect on shareholder's equity was zero.

#### REINSURANCE TRANSACTIONS

In 2005, the Company received fixed income securities with a fair value and amortized cost of \$381 million and \$358 million, respectively, and \$5 million of accrued investment income for the settlement of a \$386 million premium receivable due from AHL, an unconsolidated affiliate of the Company. The receivable related to two coinsurance agreements entered into in 2004 whereby the Company assumed certain interest-sensitive life insurance and fixed annuity contracts from AHL. Since the transaction was between affiliates under common control, the securities were recorded at amortized cost as of the date of settlement. The difference between the amortized cost and fair value of the securities, which increased accumulated other comprehensive income by \$23 million, was recorded as a non-cash dividend of \$23 million (\$15 million, after-tax). Thus, the net effect on shareholder's equity was zero. In 2004, as a result of the transaction, the Company recorded a premium receivable of \$386 million, DAC of \$24 million, policy loans of \$16 million, and contractholder funds of \$379 million. Since the Company received assets in excess of net liabilities from an affiliate under common control, the Company recognized a gain of \$47 million (\$31 million, after-tax), which was recorded as a non-cash capital contribution. In accordance with the coinsurance agreements, for 2006, 2005 and 2004, the Company assumed premiums and contract charges of \$16 million, \$17 million and \$14 million, respectively; contract benefits of \$11 million, \$10 million and \$11 million, respectively; and interest credited to contractholder funds of \$24 million, \$32 million and \$36 million, respectively.

The Company has reinsurance contracts with Columbia, a former unconsolidated affiliate of the Company. In November 2004, the Corporation disposed of Columbia pursuant to a stock purchase agreement with Verde Financial Corporation. As of June 1, 2004, the Company converted a modified coinsurance contract with Columbia to a coinsurance contract to assume 100% of fixed annuity business in force as of June 30, 2000 and new business written prior to the

disposition of Columbia. In addition, the Company entered into a coinsurance contract with Columbia to assume 100% of traditional life and accident and health business in force as of June 1, 2004. As a result of these transactions, the Company received assets in excess of net liabilities from an affiliate under common control and recognized a gain of \$15 million (\$10 million, after-tax), which was recorded as a non-cash capital contribution. Both agreements are continuous but may be terminated by the Company in the event of Columbia's non-payment of reinsurance amounts due. As of May 31, 2001, Columbia ceased issuing new contracts. During 2006, 2005 and 2004, the Company assumed \$0.1 million, \$0.2 million and \$14 million, respectively, in premiums and contract charges from Columbia.

The Company has a contract to assume nearly all credit insurance written by AIC. This agreement is continuous but may be terminated by either party with 60 days notice. The Company did not assume premiums from AIC in 2006 and 2005. The Company assumed premiums from AIC in the amount of \$0.3 million in 2004.

ALIC enters into certain intercompany reinsurance transactions with its wholly owned subsidiaries. ALIC enters into these transactions in order to maintain underwriting control and spread risk among various legal entities. These reinsurance agreements have been approved by the appropriate regulatory authorities. All significant intercompany transactions have been eliminated in consolidation.

#### INCOME TAXES

The Company is a party to a federal income tax allocation agreement with the Corporation (see Note 12).

#### DEBT

On December 27, 2006, the Company issued an intercompany note in the amount of \$500 million payable to its parent, AIC, on demand and, in any event, by March 30, 2007. This note has an interest rate of 5.25% and is reflected as note payable to parent on the Company's Consolidated Statements of Financial Position.

On June 30, 2006, under an existing agreement with Kennett Capital, Inc. ("Kennett"), an unconsolidated affiliate of ALIC, ALIC sold Kennett a \$100 million redeemable surplus note issued by ALIC Reinsurance Company, a wholly owned subsidiary of ALIC. The surplus note is due June 1, 2036 with an initial rate of 6.18% that will reset once every ten years to the then current ten year Constant Maturity Treasury yield ("CMT"), plus 1.14%. As payment, Kennett issued a full recourse note due June 1, 2036 to ALIC for the same amount with an initial interest rate of 5.98% that will reset once every ten years to the then current ten year CMT, plus 0.94%. The note due from Kennett is classified as other investments and the related surplus note is classified as long-term debt in the Condensed Consolidated Statements of Financial Position. In 2006, the Company incurred \$4 million of interest expense related to this surplus note, which is reflected as a component of operating costs and expenses on the Consolidated Statements of Operations and Comprehensive Income.

On August 1, 2005, ALIC entered into an agreement with Kennett, whereby ALIC sold to Kennett a \$100 million 5.06% surplus note due July 1, 2035 issued by ALIC Re. As payment, Kennett issued a full recourse 4.86% note due July 1, 2035 to ALIC for the same amount. As security for the performance of Kennett's obligations under the agreement and note, Kennett granted ALIC a pledge of and security interest in Kennett's right, title and interest in the surplus notes and their proceeds. Under the terms of the agreement, ALIC may sell and Kennett may choose to buy additional surplus notes, if and when additional surplus notes are issued. The note due from Kennett is classified as other investments and the related surplus notes are classified as long-term debt in the Consolidated Statements of Financial Position (see Note 13). In 2006 and 2005, the Company incurred \$5 million and \$2 million of interest expense related to this surplus note, which is reflected as a component of operating costs and expenses on the Consolidated Statements of Operations and Comprehensive Income.

As of December 31, 2006 and 2005, the Company's Consolidated Statements of Financial Position included redeemable preferred stock - Series A ("redeemable preferred stock") issued to Northbook Holdings, LLC, a wholly owned subsidiary of AIC. The Company's Board of Directors declared and paid cash dividends on the redeemable preferred stock from time to time, but not more frequently than quarterly. The dividends were based on the three-month LIBOR rate. Dividends of \$1 million, \$2 million and \$2 million were incurred and paid during 2006, 2005, and 2004, respectively, and included as a component of operating costs and expenses on the Consolidated Statements of Operations. At December 31, 2006 and

2005, redeemable preferred stock totaling \$6 million and \$32 million, respectively, was classified as mandatorily redeemable and therefore was included as a component of long-term debt on the Consolidated Statements of Financial Position. During both 2006 and 2005, \$26 million of mandatorily redeemable preferred stock was redeemed. In addition to the portion of the redeemable preferred stock that was classified as mandatorily redeemable, redeemable preferred stock totaling \$5 million was included as a component of shareholder's equity on the Consolidated Statements of Financial Position as of December 31, 2006 and 2005. All remaining redeemable preferred stock, including the portion classified as mandatorily redeemable and included as a component of long-term debt and the portion classified as shareholder's equity as of December 31, 2006, was redeemed in the first quarter of 2007.

The Company has an intercompany loan agreement with The Allstate Corporation. The amount of intercompany loans available to the Company is at the discretion of The Allstate Corporation. The maximum amount of loans the Corporation will have outstanding to all its eligible subsidiaries at any given point in time is limited to \$1.00 billion. The Company had no amounts outstanding under the intercompany loan agreement at December 31, 2006 and 2005. The Corporation uses commercial paper borrowings, bank lines of credit and repurchase agreements to fund intercompany borrowings.

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## 6. INVESTMENTS

### FAIR VALUES

The amortized cost, gross unrealized gains and losses, and fair value for fixed income securities are as follows:

(IN MILLIONS)	AMORTIZED COST	GROSS UNREALIZED		FAIR VALUE
		GAINS	LOSSES	
AT DECEMBER 31, 2006				
U.S. government and agencies	\$ 2,763	\$ 736	\$ (3)	\$ 3,496
Municipal	4,732	101	(43)	4,790
Corporate (1)	33,823	811	(325)	34,309
Foreign government	1,709	317	(3)	2,023
Mortgage-backed securities	4,543	31	(56)	4,518
Commercial mortgage-backed securities	7,597	64	(61)	7,600
Asset-backed securities	5,663	34	(16)	5,681
Redeemable preferred stock	21	1	--	22
Total fixed income securities	\$60,851	\$2,095	\$(507)	\$62,439
AT DECEMBER 31, 2005				
U.S. government and agencies	\$ 2,639	\$ 850	\$ (2)	\$ 3,487
Municipal	4,291	167	(15)	4,443
Corporate (1)	33,437	1,216	(273)	34,380
Foreign government	1,727	374	(2)	2,099
Mortgage-backed securities	5,742	29	(78)	5,693
Commercial mortgage-backed securities	6,745	50	(63)	6,732
Asset-backed securities	5,114	32	(28)	5,118
Redeemable preferred stock	22	3	--	25
Total fixed income securities	\$59,717	\$2,721	\$(461)	\$61,977

(1) Amortized cost and fair value of Corporate fixed income securities include bank loans which are reflected at amortized cost of \$982 million and \$945 million at December 31, 2006 and 2005, respectively.

### SCHEDULED MATURITIES

The scheduled maturities for fixed income securities are as follows at December 31, 2006:

(IN MILLIONS)	AMORTIZED COST	FAIR VALUE
Due in one year or less	\$ 1,209	\$ 1,213
Due after one year through five years	11,306	11,415
Due after five years through ten years	16,087	16,372
Due after ten years	22,043	23,240

	50,645	52,240
Mortgage- and asset-backed securities	10,206	10,199
	-----	-----
Total	\$60,851	\$62,439
	=====	=====

Actual maturities may differ from those scheduled as a result of prepayments by the issuers. Because of the potential for prepayment on mortgage and asset-backed securities, they are not categorized by contractual maturity. The commercial mortgage-backed securities are categorized by contractual maturity because they generally are not subject to prepayment risk.

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#### NET INVESTMENT INCOME

Net investment income for the years ended December 31 is as follows:

(IN MILLIONS)	2006	2005	2004
	-----	-----	-----
Fixed income securities	\$3,578	\$3,377	\$3,072
Mortgage loans	508	469	435
Equity securities	44	37	24
Other	184	19	(143)
	-----	-----	-----
Investment income, before expense	4,314	3,902	3,388
Investment expense	257	195	128
	-----	-----	-----
Net investment income	\$4,057	\$3,707	\$3,260
	=====	=====	=====

Net investment income from equity securities includes income from partnership interests of \$42 million, \$35 million and \$19 million for the years ended December 31, 2006, 2005 and 2004, respectively.

#### REALIZED CAPITAL GAINS AND LOSSES, AFTER-TAX

Realized capital gains and losses by security type for the years ended December 31 are as follows:

(IN MILLIONS)	2006	2005	2004
	----	----	----
Fixed income securities	\$(96)	\$(94)	\$(87)
Equity securities	4	7	11
Other investments	13	106	65
	----	----	----
Realized capital gains and losses, pre-tax	(79)	19	(11)
Income tax (expense) benefit	28	(7)	3
	----	----	----
Realized capital gains and losses, after-tax	\$(51)	\$ 12	\$ (8)
	====	====	====

Realized capital gains and losses by transaction type for the years ended December 31 are as follows:

(IN MILLIONS)	2006	2005	2004
	----	----	----
Write-downs	\$(21)	\$ (24)	\$(81)
Dispositions (1)	(89)	88	129
Valuation of derivative instruments	(17)	(105)	(66)
Settlement of derivative instruments	48	60	7
	----	----	----
Realized capital gains and losses, pre-tax	(79)	19	(11)
Income tax benefit (expense)	28	(7)	3
	----	----	----
Realized capital gains and losses, after-tax	\$(51)	\$ 12	\$ (8)
	====	=====	=====

(1) Dispositions include sales, losses recognized in anticipation of dispositions and other transactions such as calls and prepayments. The Company recognized losses of \$60 million and \$67 million in 2006 and 2005, respectively, due to changes in intent to hold impaired securities. There were no losses recognized due to a change in intent during 2004.

Gross gains of \$104 million, \$199 million and \$189 million and gross losses of \$233 million, \$132 million and \$157 million were realized on sales of fixed income securities during 2006, 2005 and 2004, respectively.

## UNREALIZED NET CAPITAL GAINS AND LOSSES

Unrealized net capital gains and losses included in accumulated other comprehensive income are as follows:

GROSS  
UNREALIZED  
FAIR -----  
-----  
-  
UNREALIZED  
NET (IN  
MILLIONS)  
VALUE  
GAINS  
LOSSES  
GAINS  
(LOSSES) -  
-----  
-----  
----- AT  
DECEMBER  
31, 2006  
Fixed  
income  
securities  
\$62,439  
\$2,095  
\$(507) \$  
1,588  
Equity  
securities  
533 11 --  
11  
Derivative  
instruments  
(1) (16) 2  
(18) (16)  
-----  
Total  
1,583  
Amount  
recognized  
for: (2)  
Premium  
deficiency  
reserve  
(1,129)  
Deferred  
policy  
acquisition  
and sales  
inducement  
costs 46 -  
-----  
Total  
(1,083)  
Deferred  
income  
taxes  
(175) ----  
---  
Unrealized  
net  
capital  
gains and  
losses \$  
325  
=====

GROSS  
UNREALIZED  
FAIR -----

-----  
 -  
 UNREALIZED  
 NET (IN  
 MILLIONS)  
 VALUE  
 GAINS  
 LOSSES  
 GAINS  
 (LOSSES) -  
 -----  
 ---  
 -----  
 ----- AT  
 DECEMBER  
 31, 2005  
 Fixed  
 income  
 securities  
 \$61,977  
 \$2,721  
 \$(461) \$  
 2,260  
 Equity  
 securities  
 324 6 (1)  
 5  
 Derivative  
 instruments  
 (1) (6) --  
 (6) (6) --  
 -----  
 Total  
 2,259  
 Amount  
 recognized  
 for: (2)  
 Premium  
 deficiency  
 reserve  
 (1,343)  
 Deferred  
 policy  
 acquisition  
 and sales  
 inducement  
 costs (12)  
 -----  
 Total  
 (1,355)  
 Deferred  
 income  
 taxes  
 (316) ----  
 ---  
 Unrealized  
 net  
 capital  
 gains and  
 losses \$  
 588  
 =====

-----  
 (1) Included in the fair value of derivative securities are \$(7) million and  
 \$(4) million classified as assets and \$9 million and \$2 million classified  
 as liabilities at December 31, 2006 and 2005, respectively.

(2) See Note 2, Summary of Significant Accounting Policies for deferred policy  
 acquisition and sales inducement costs and reserve for life-contingent  
 contract benefits.

#### CHANGE IN UNREALIZED NET CAPITAL GAINS AND LOSSES

The change in unrealized net capital gains and losses for the years ended  
 December 31 is as follows:

(IN  
 MILLIONS)  
 2006 2005

2004 -----  
 -----  
 --- Fixed  
   income  
 securities  
   \$(672)  
 \$(1,067) \$  
 150 Equity  
 securities  
   6 (4) 5  
 Derivative  
 instruments  
   (10) 17  
 (21) -----  
 -----  
 --- Total  
   (676)  
   (1,054)  
   134  
 Amounts  
 recognized  
 for:  
   Premium  
 deficiency  
 reserve  
   214 (254)  
   (157)  
   Deferred  
   policy  
 acquisition  
 and sales  
 inducement  
 costs 58  
 653 (39) -  
 -----  
 -- -----  
 Total 272  
 399 (196)  
 Deferred  
 income  
 taxes 141  
 230 22 ---  
 -----  
 -----  
 Decrease  
 in  
 unrealized  
 net  
 capital  
 gains and  
 losses  
   \$(263) \$  
   (425) \$  
 (40) =====  
   =====

PORTFOLIO MONITORING

Inherent in the Company's evaluation of a particular security are assumptions and estimates about the operations of the issuer and its future earnings potential. Some of the factors considered in evaluating whether a decline in fair value is other-than-temporary are: 1) the Company's ability and intent to retain the investment for a period of time sufficient to allow for an anticipated recovery in value; 2) the recoverability of principal and interest; 3) the duration and extent to which the fair value has been less than cost for equity securities or amortized cost for fixed income securities; 4) the financial condition, near-term and long-term prospects of the issuer, including relevant industry conditions and trends, and implications of rating agency actions and offering prices; and 5) the specific reasons that a security is in a significant unrealized loss position, including market conditions which could affect access to liquidity.

The following table summarizes the gross unrealized losses and fair value of fixed income and equity securities by the length of time that individual

securities have been in a continuous unrealized loss position.

LESS THAN  
12 MONTHS  
12 MONTHS  
OR MORE --  
-----  
-----  
-----  
-----

-----  
NUMBER  
NUMBER  
TOTAL OF  
FAIR  
UNREALIZED  
OF FAIR  
UNREALIZED  
UNREALIZED  
\$ IN  
MILLIONS  
ISSUES  
VALUE  
LOSSES  
ISSUES  
VALUE  
LOSSES  
LOSSES ---  
-----  
-----  
-----  
-----  
-----

AT  
DECEMBER  
31, 2006  
Fixed  
income  
securities  
U.S.  
government  
and  
agencies  
11 \$ 177 \$  
(1) 12 \$  
87 \$ (2) \$  
(3)  
Municipal  
184 1,018  
(20) 143  
558 (23)  
(43)  
Corporate  
477 6,114  
(80) 607  
7,665  
(245)  
(325)  
Foreign  
government  
7 40 (1) 8  
113 (2)  
(3)  
Mortgage-  
backed  
securities  
232 753  
(6) 722  
1,933 (50)  
(56)  
Commercial  
mortgage-  
backed  
securities  
131 1,624  
(10) 224  
2,272 (51)  
(61)  
Asset-

backed  
securities  
100 881  
(5) 59 523  
(11) (16)  
Redeemable  
preferred  
stock 1 7

-----  
-----  
-----  
-----  
-----

Total  
fixed  
income  
securities  
1,143  
10,614  
(123)  
1,775  
13,151  
(384)  
(507)

Equity  
securities  
-----  
-----  
-----  
-----

Total  
fixed  
income &  
equity  
securities  
1,143  
\$10,614  
\$(123)  
1,775  
\$13,151  
\$(384)  
\$(507)

=====  
=====  
=====  
=====  
=====  
=====

Investment  
grade  
fixed  
income  
securities  
1,081  
\$10,169  
\$(113)  
1,723  
\$12,804  
\$(368)  
\$(481)

Below  
investment  
grade  
fixed  
income  
securities  
62 445  
(10) 52  
347 (16)  
(26) -----  
-----  
-----  
-----

Total  
fixed

income  
 securities  
 1,143  
 \$10,614  
 \$(123)  
 1,775  
 \$13,151  
 \$(384)  
 \$(507)  
 =====  
 =====  
 =====  
 =====  
 =====  
 =====  
 ===== AT  
 DECEMBER  
 31, 2005  
 Fixed  
 income  
 securities  
 U.S.  
 government  
 and  
 agencies  
 13 \$ 99 \$  
 (2) 3 \$ 8  
 \$ -- \$ (2)  
 Municipal  
 160 878  
 (12) 25 96  
 (3) (15)  
 Corporate  
 819 9,936  
 (193) 168  
 1,962 (80)  
 (273)  
 Foreign  
 government  
 21 291 (2)  
 2 20 --  
 (2)  
 Mortgage-  
 backed  
 securities  
 755 3,694  
 (60) 222  
 587 (18)  
 (78)  
 Commercial  
 mortgage-  
 backed  
 securities  
 321 3,727  
 (53) 36  
 329 (10)  
 (63)  
 Asset-  
 backed  
 securities  
 119 1,162  
 (12) 48  
 359 (16)  
 (28)  
 Redeemable  
 preferred  
 stock -- -  
 - - - - -  
 - - - - -  
 - - - - -  
 - - - - -  
 - - - - -  
 - Total  
 fixed  
 income  
 securities  
 2,208  
 19,787  
 (334) 504  
 3,361

```

(127)
(461)
Equity
securities
2 9 (1) --
-- -- (1)
-----
-----
-----
-----
-----
-----
Total
fixed
income &
equity
securities
2,210
$19,796
$(335) 504
$3,361
$(127)
$(462)
=====
=====
=====
=====
=====
Investment
grade
fixed
income
securities
2,076
$19,203
$(314) 488
$ 3,227
$(112)
$(426)
Below
investment
grade
fixed
income
securities
132 584
(20) 16
134 (15)
(35) -----
-----
-----
-----
-----
-----
Total
fixed
income
securities
2,208
$19,787
$(334) 504
$ 3,361
$(127)
$(461)
=====
=====
=====
=====
=====

```

As of December 31, 2006, \$506 million of unrealized losses related to securities with an unrealized loss position less than 20% of cost or amortized cost, the degree of which suggests that these securities do not pose a high risk of being other-than-temporarily impaired. Of the \$506 million, \$481 million related to unrealized losses on investment grade fixed income securities. Investment grade 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 Standard & Poor's

("S&P"), Fitch or Dominion; or aaa, aa, a or bbb from A.M. Best; or a comparable internal rating if an externally provided rating is not available. Unrealized losses on investment grade securities are principally related to rising interest rates or changes in credit spreads since the securities were acquired.

As of December 31, 2006, the remaining \$1 million of unrealized losses related to securities in unrealized loss positions greater than or equal to 20% of cost or amortized cost and related to below investment grade fixed income securities. These securities were evaluated based on factors such as the financial condition and near-term and long-term prospects of the issuer and were determined to have adequate resources to fulfill contractual obligations. The Company expects eventual recovery of these securities. Every security was included in our portfolio monitoring process.

As of December 31, 2006, the Company had the intent and ability to hold the fixed income and equity securities with unrealized losses for a period of time sufficient for them to recover.

As of December 31, 2006 and 2005, the carrying value for cost method investments was \$362 million and \$213 million, respectively, which primarily included limited partnership interests in fund investments. Each cost method investment was evaluated utilizing certain criteria such as a measurement of the Company's percentage share of the investee's equity relative to the carrying value and certain financial trends to determine if an event or change in circumstance occurred that could indicate an other-than-temporary impairment existed. Investments meeting any one of these criteria were further evaluated and, if it was determined that an other-than-temporary impairment existed, the investment was written down to the estimated fair value. The estimated fair value was generally based on the fair value of the underlying investments in the limited partnership funds. It is not practicable to estimate the fair value of each cost method investment in accordance with paragraphs 14 and 15 of SFAS 107, "Disclosures about Fair Value of Financial Instruments" ("SFAS No. 107") because the investments are private in nature and do not trade frequently. In addition, the information that would be utilized to estimate fair value is not readily available. In both 2006 and 2005, the Company had write-downs of \$0.1 million related to cost method investments that were other-than-temporarily impaired.

**MORTGAGE LOAN IMPAIRMENT**

A mortgage loan is impaired when it is probable that the Company will be unable to collect all amounts due according to the contractual terms of the loan agreement.

The net carrying value of impaired loans at December 31, 2006 and 2005 was \$5 million and \$3 million, respectively. No valuation allowances were held at December 31, 2006 or 2005 because the fair value of the collateral was greater than the recorded investment in the loans.

Interest income for impaired loans is recognized on an accrual basis if payments are expected to continue to be received; otherwise the cash basis is used. The Company recognized interest income on impaired loans of \$0.4 million, \$0.2 million and \$2 million during 2006, 2005 and 2004, respectively. The average balance of impaired loans was \$5 million, \$6 million and \$29 million during 2006, 2005 and 2004, respectively.

No valuation allowances were charged to operations in 2006 or 2005. In 2004, a valuation allowance of \$1 million was charged to operations and \$1 million of a balance previously written off was recovered.

**INVESTMENT CONCENTRATION FOR MUNICIPAL BOND AND COMMERCIAL MORTGAGE PORTFOLIOS**

The Company maintains a diversified portfolio of municipal bonds. The following table shows the principal geographic distribution of municipal bond issuers represented in the Company's portfolio. No other state represents more than 5% of the portfolio at December 31, 2006 and 2005.

(% OF MUNICIPAL BOND PORTFOLIO CARRYING VALUE)	2006	2005
California	20.4%	22.2%
New York	10.6	6.5
New Jersey	7.8	9.6
Texas	5.4	6.8
Pennsylvania	5.2	5.4

The Company's mortgage loans are collateralized by a variety of commercial real estate property types located throughout the United States. Substantially all of the commercial mortgage loans are non-recourse to the borrower. The following table shows the principal geographic distribution of commercial real estate represented in the Company's mortgage portfolio. No other state represented more than 5% of the portfolio at December 31, 2006 and 2005.

(% OF COMMERCIAL MORTGAGE PORTFOLIO CARRYING VALUE)	2006	2005
	----	----
California	19.3%	16.6%
Illinois	9.7	8.5
Texas	7.6	8.1
Pennsylvania	5.7	6.6
New York	5.1	5.7

The types of properties collateralizing the commercial mortgage loans at December 31 are as follows:

(% OF COMMERCIAL MORTGAGE PORTFOLIO CARRYING VALUE)	2006	2005
	-----	-----
Office buildings	34.7%	32.4%
Retail	25.7	22.6
Warehouse	20.5	23.2
Apartment complex	15.5	18.4
Industrial	1.1	1.2
Other	2.5	2.2
	-----	-----
Total	100.0%	100.0%
	=====	=====

The contractual maturities of the commercial mortgage loan portfolio as of December 31, 2006 for loans that were not in foreclosure are as follows:

(\$ IN MILLIONS)	NUMBER OF LOANS	CARRYING VALUE	PERCENT
	-----	-----	-----
2007	39	\$ 301	3.5%
2008	75	576	6.6
2009	118	1,156	13.3
2010	103	1,299	14.9
2011	101	1,248	14.4
Thereafter	453	4,110	47.3
	---	-----	-----
Total	889	\$8,690	100.0%
	===	=====	=====

In 2006, \$419 million of commercial mortgage loans were contractually due. Of these, 70% were paid as due, 24% were refinanced at prevailing market terms and 6% were extended for less than one year. None were foreclosed or in the process of foreclosure, and none were in the process of refinancing or restructuring discussions.

#### CONCENTRATION OF CREDIT RISK

At December 31, 2006, the Company is not exposed to any credit concentration of risk of a single issuer and its affiliates greater than 10% of the Company's shareholder's equity.

#### SECURITIES LOANED AND SECURITY REPURCHASE

The Company's business activities include securities lending programs with third parties, mostly large brokerage firms. At December 31, 2006 and 2005, fixed income securities with a carrying value of \$1.74 billion and \$1.81 billion, respectively, were on loan under these agreements. In return, the Company receives cash that it invests and includes in short-term investments and fixed income securities, with an offsetting liability recorded in other liabilities and accrued expenses to account for the Company's obligation to return the collateral. Interest income on collateral, net of fees, was \$5 million, \$5 million and \$4 million, for the years ended December 31, 2006, 2005 and 2004, respectively.

As part of its business activities, the Company sells securities under agreements to repurchase, primarily including a mortgage dollar roll program. At December 31, 2006 and 2005, the Company had \$143 million and \$87 million, respectively, of securities that were subject to repurchase agreements. For repurchase agreements, an offsetting liability is recorded in other liabilities and accrued expenses to account for the Company's obligation to return these funds.

Interest income recorded as a result of the program was \$1 million, \$9 million and \$23 million for the years ended December 31, 2006, 2005 and 2004, respectively.

#### OTHER INVESTMENT INFORMATION

Included in fixed income securities are below investment grade assets totaling \$3.26 billion and \$3.13 billion at December 31, 2006 and 2005, respectively.

At December 31, 2006, fixed income securities with a carrying value of \$58 million were on deposit with regulatory authorities as required by law.

At December 31, 2006, the carrying value of fixed income securities that were non-income producing was \$10 million. No other investments were non-income producing at December 31, 2006.

#### 7. FINANCIAL INSTRUMENTS

In the normal course of business, the Company invests in various financial assets, incurs various financial liabilities and enters into agreements involving derivative financial instruments and other off-balance-sheet financial instruments. The fair value estimates of financial instruments presented below are not necessarily indicative of the amounts the Company might pay or receive in actual market transactions. Potential taxes and other transaction costs have not been considered in estimating fair value. The disclosures that follow do not reflect the fair value of the Company as a whole since a number of the Company's significant assets (including DAC and DSI and reinsurance recoverables, net) and liabilities (including reserve for life-contingent contract benefits, contractholder funds pertaining to interest-sensitive life contracts and deferred income taxes) are not included in accordance with SFAS No. 107. Other assets and liabilities considered financial instruments such as accrued investment income and cash are generally of a short-term nature. Their carrying values are deemed to approximate fair value.

#### FINANCIAL ASSETS

(IN MILLIONS)	DECEMBER 31, 2006		DECEMBER 31, 2005	
	CARRYING VALUE	FAIR VALUE	CARRYING VALUE	FAIR VALUE
Fixed income securities	\$62,439	\$62,439	\$61,977	\$61,977
Mortgage loans	8,690	8,761	8,108	8,290
Equity securities	72	72	67	67
Short-term investments	805	805	927	927
Policy loans	752	752	729	729
Separate accounts	16,174	16,174	15,235	15,235

Fair values of publicly traded fixed income securities are based upon quoted market prices or dealer quotes. The fair value of non-publicly traded securities, primarily privately placed corporate obligations, is based on either widely accepted pricing valuation models, which use internally developed ratings and independent third party data (e.g., term structures and current publicly traded bond prices) as inputs, or independent third party pricing sources. Mortgage loans are valued based on discounted contractual cash flows. Discount rates are selected using current rates at which similar loans would be made to borrowers with similar characteristics, using similar properties as collateral. Loans that exceed 100% loan-to-value are valued at the estimated fair value of the underlying collateral. At December 31, 2006 and 2005, equity securities in the table above exclude \$461 million and \$257 million, respectively, of limited partnership interests, which are accounted for based on the cost method or equity method of accounting (see Notes 2 and 6). The remaining equity securities reflect common and preferred stocks, which are valued based principally on quoted market prices. Short-term investments are highly liquid investments with maturities of one year or less whose carrying values are deemed to approximate fair value. The carrying value of policy loans is deemed to approximate fair value. Separate accounts assets are carried in the Consolidated Statements of Financial Position at fair value based on quoted market prices.



Asset-liability management is a risk management strategy that is principally employed to align the respective interest-rate sensitivities of assets and liabilities. Depending upon the attributes of the assets acquired and liabilities issued, derivative instruments such as interest rate swaps, caps and floors are acquired to change the interest rate characteristics of existing assets and liabilities to ensure a properly matched relationship is maintained and to reduce exposure to rising or falling interest rates. The Company uses financial futures to hedge anticipated asset and liability purchases and financial futures and options for hedging the Company's equity exposure contained in equity indexed and variable annuity product contracts that offer equity returns to contractholders. In addition, the Company also uses interest rate swaps to hedge interest rate risk inherent in funding agreements and foreign currency swaps primarily to reduce the foreign currency risk associated with issuing foreign currency denominated funding agreements.

Asset replication refers to the "synthetic" creation of an asset through the use of a credit derivative and a high quality cash instrument to replicate fixed income securities that are either unavailable in the cash bond market or more economical to acquire in synthetic form. The Company replicates fixed income securities using a combination of a credit default swap and one or more highly rated fixed income securities to synthetically replicate the economic characteristics of one or more cash market securities.

The Company has derivatives that are embedded in non-derivative "host" contracts. The Company's primary embedded derivatives are conversion options in fixed income investments, which provide the Company with the right to convert the instrument into a predetermined number of shares of common stock; equity options in annuity product contracts, which provide equity returns to contractholders; and equity-indexed notes containing equity call options, which provide a coupon payout based upon one or more indices.

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In the tables that follow:

The notional amounts specified in the contracts are used to calculate the exchange of contractual payments under the agreements and are not representative of the potential for gain or loss on these agreements.

Fair value, which is equal to the carrying value, is the estimated amount that the Company would receive (pay) to terminate the derivative contracts at the reporting date. For exchange traded derivative contracts, the fair value is based on dealer or exchange quotes. The exchange requires margin deposits as well as daily cash settlements of margin. As of December 31, 2006, the Company pledged \$22 million of securities in the form of margin deposits. The fair value of non-exchange traded derivative contracts, including embedded derivative financial instruments subject to bifurcation, is based on either independent third party pricing sources, including broker quotes, or widely accepted pricing and valuation models which use independent third party data as inputs.

Carrying value amounts include the fair value of the derivatives, including the embedded derivatives, and exclude the accrued periodic settlements which are short-term in nature and are reported in accrued investment income or other invested assets. The carrying value amounts for freestanding derivatives have been further adjusted for the effects, if any, of legally enforceable master netting agreements.

The net impact to pretax income includes the settlements for derivatives, including the accrued periodic settlements, as well as changes in the fair value of freestanding and embedded derivatives. For those derivatives that qualify for fair value hedge accounting, it also includes the changes in the fair value of the hedged risk, and therefore reflects any hedging ineffectiveness. For cash flow hedges, gains and losses amortized from accumulated other comprehensive income are included. For embedded derivatives in convertibles and equity-indexed notes subject to bifurcation, accretion income related to the host instrument has also been included.

The following table categorizes the accounting hedge (fair value and cash flow) and non-hedge strategies employed by the Company. The notional amount, the fair value of the hedge and the impact on pretax income have been provided to illustrate the relative volume, the Company's exposure and the level of mark-to-market activity, respectively, for the derivative programs as of December 31.

(\$ IN  
MILLIONS)  
2006 2005 -  
-----

-----  
 -----  
 -----  
 -----  
 --- FAIR  
 VALUE FAIR  
 VALUE -----  
 -----  
 -----  
 - IMPACT TO  
 PRETAX FAIR  
 CASH FAIR  
 CASH INCOME  
 NOTIONAL  
 VALUE FLOW  
 NON-  
 NOTIONAL  
 VALUE FLOW  
 NON- -----  
 -----  
 - AMOUNT  
 HEDGE HEDGE  
 HEDGE  
 AMOUNT  
 HEDGE HEDGE  
 HEDGE 2006  
 2005 2004 -  
 -----  
 -----  
 -----  
 -----  
 -----  
 -----  
 -----  
 -----  
 --- RISK  
 REDUCTION  
 Interest  
 rate  
 exposure  
 \$25,819 \$  
 24 \$ -- \$  
 43 \$22,304  
 \$ 12 \$-- \$  
 82 \$(45)  
 \$(161)  
 \$(241)  
 Macro  
 hedging  
 3,425 -- --  
 1 3,319 --  
 -- 1 16 (9)  
 (32)  
 Hedging of  
 equity  
 exposure in  
 annuity  
 contracts  
 4,722 -- --  
 125 4,523 -  
 - -- 66 103  
 20 53  
 Hedging  
 interest  
 rate and  
 foreign  
 currency  
 risk  
 inherent in  
 funding  
 agreements  
 1,948 366 -  
 - -- 2,501  
 327 -- --  
 13 77 143  
 Other 470 3  
 (17) (4)  
 642 3 (6)  
 (1) (75)  
 (10) (8)  
 ASSET  
 REPLICATION



NOTIONAL  
 FAIR -----  
 -----  
 --- (\$ IN  
 MILLIONS)  
 AMOUNT VALUE  
 ASSETS  
 (LIABILITIES)  
 -----  
 -----

INTEREST  
 RATE  
 CONTRACTS  
 Interest  
 rate swap  
 agreements  
 \$14,529 \$ 24  
 \$ 30 \$ (6)  
 Financial  
 futures  
 contracts  
 3,626 1 1 --  
 Interest  
 rate cap and  
 floor  
 agreements  
 12,065 27 26  
 1 ----- --  
 -----

---- Total  
 interest  
 rate  
 contracts  
 30,220 52 57

(5) EQUITY  
 AND INDEX  
 CONTRACTS  
 Options,  
 financial  
 futures, and  
 warrants  
 4,521 125  
 233 (108)

FOREIGN  
 CURRENCY  
 CONTRACTS  
 Foreign  
 currency  
 swap  
 agreements  
 1,551 362  
 375 (13)

CREDIT  
 DEFAULT  
 SWAPS USED  
 FOR ASSET  
 REPLICATION  
 395 2 1 1

EMBEDDED  
 DERIVATIVE  
 FINANCIAL  
 INSTRUMENTS  
 Guaranteed  
 accumulation  
 benefit (1)  
 1,608 7 -- 7  
 Guaranteed  
 withdrawal  
 benefit (1)  
 1,067 1 -- 1  
 Conversion  
 options in  
 fixed income  
 securities  
 488 187 187  
 -- Equity-  
 indexed call  
 options in  
 fixed income  
 securities

625 305 305  
 -- Equity-  
 indexed and  
 forward  
 starting  
 options in  
 life and  
 annuity  
 product  
 contracts  
 3,343 (189)  
 -- (189)  
 Other  
 embedded  
 derivative  
 financial  
 instruments  
 104 10 -- 10  
 -----  
 -----  
 -- Total  
 embedded  
 derivative  
 financial  
 instruments  
 7,235 321  
 492 (171)  
 OTHER  
 DERIVATIVE  
 FINANCIAL  
 INSTRUMENTS  
 92 2 3 (1) -  
 -----  
 -----  
 TOTAL  
 DERIVATIVE  
 FINANCIAL  
 INSTRUMENTS  
 \$44,014 \$  
 864 \$1,161  
 \$(297)  
 =====  
 =====  
 =====

(1) These embedded derivative financial instruments relate to the Company's variable annuity business, which was fully reinsured to Prudential effective June 1, 2006 (see Note 3).

The following table summarizes the notional amount, fair value and carrying value of the Company's derivative financial instruments at December 31, 2005:

CARRYING  
 VALUE  
 NOTIONAL  
 FAIR -----  
 -----  
 --- (\$ IN  
 MILLIONS)  
 AMOUNT VALUE  
 ASSETS  
 (LIABILITIES)  
 -----  
 -----  
 -----  
 INTEREST  
 RATE  
 CONTRACTS  
 Interest  
 rate swap  
 agreements  
 \$11,512 \$ 43  
 \$ 49 \$ (6)  
 Financial  
 futures

contracts  
4,188 1 1 --  
Interest  
rate cap and  
floor  
agreements  
10,792 51 49  
2 ----- --  
--- -----  
-- Total  
interest  
rate  
contracts  
26,492 95 99  
(4) EQUITY  
AND INDEX  
CONTRACTS  
Options,  
financial  
futures, and  
warrants  
3,948 66 101  
(35) FOREIGN  
CURRENCY  
CONTRACTS  
Foreign  
currency  
swap  
agreements  
2,765 321  
323 (2)  
Foreign  
currency  
futures  
contracts 31  
--- -----  
----- -----  
--- -----  
Total  
foreign  
currency  
contracts  
2,796 321  
323 (2)  
CREDIT  
DEFAULT  
SWAPS USED  
FOR ASSET  
REPLICATION  
432 -- -- --  
EMBEDDED  
DERIVATIVE  
FINANCIAL  
INSTRUMENTS  
Guaranteed  
accumulation  
benefit  
1,208 2 -- 2  
Guaranteed  
withdrawal  
benefit 532  
-- -- --  
Conversion  
options in  
fixed income  
securities  
453 159 159  
-- Equity-  
indexed call  
options in  
fixed income  
securities  
325 133 133  
-- Equity-  
indexed and  
forward  
starting  
options in  
life and  
annuity  
product

```

contracts
2,650 (120)
-- (120)
Other
embedded
derivative
financial
instruments
132 4 (1) 5
-----
-----
Total
embedded
derivative
financial
instruments
5,300 178
291 (113)
OTHER
DERIVATIVE
FINANCIAL
INSTRUMENTS
25 3 3 -- --
-----
-----
TOTAL
DERIVATIVE
FINANCIAL
INSTRUMENTS
$38,993 $
663 $817
$(154)
=====
=====
=====

```

The Company manages its exposure to credit risk by utilizing highly rated counterparties, establishing risk control limits, executing legally enforceable master netting agreements and obtaining collateral where appropriate. The Company uses master netting agreements for over-the-counter derivative transactions, including interest rate swap, foreign currency swap, interest rate cap, interest rate floor, credit default swap and certain option agreements. These agreements permit either party to net payments due for transactions covered by the agreements. Under the provisions of the agreements, collateral is either pledged or obtained when certain predetermined exposure limits are exceeded. As of December 31, 2006, counterparties pledged \$357 million in cash to the Company and the Company pledged \$10 million in securities to counterparties. The Company has not incurred any losses on derivative financial instruments due to counterparty nonperformance. Other derivatives including futures and certain option contracts are traded on organized exchanges, which require margin deposits and guarantee the execution of trades, thereby mitigating any associated potential credit risk.

Credit exposure represents the Company's potential loss if all of the counterparties concurrently fail to perform under the contractual terms of the contracts and all collateral, if any, becomes worthless. This exposure is measured by the fair value of freestanding derivative contracts with a positive fair value at the reporting date reduced by the effect, if any, of legally enforceable master netting agreements.

The following table summarizes the counterparty credit exposure by counterparty credit rating at December 31, as it relates to interest rate swap, foreign currency swap, interest rate cap, interest rate floor, credit default swap and certain option agreements.

(\$ IN MILLIONS)

```

($ IN
MILLIONS)
2006 2005
-----
-----
-----
-----
-----

```



Market risk is the risk that the Company will incur losses due to adverse changes in market rates and prices. Market risk exists for all of the derivative financial instruments the Company currently holds, as these instruments may become less valuable due to adverse changes in market conditions. To limit this risk, the Company's senior management has established risk control limits. In addition, changes in fair value of the derivative financial instruments that the Company uses for risk management purposes are generally offset by the change in the fair value or cash flows of the hedged risk component of the related assets, liabilities or forecasted transactions.

OFF-BALANCE-SHEET FINANCIAL INSTRUMENTS AND INVESTMENT VIE NOT CONSOLIDATED

The contractual amounts and fair values of off-balance-sheet financial instruments at December 31 are as follows:

	2006	2005
CONTRACTUAL FAIR CONTRACTUAL FAIR (IN MILLIONS) AMOUNT VALUE AMOUNT VALUE		
Commitments to invest	\$707	\$--
Private placement commitments	112	205
Commitments to extend mortgage loans	5	407

In the above table, the contractual amounts represent the amount at risk if the contract is fully drawn upon, the counterparty defaults and the value of any underlying security becomes worthless. Unless noted otherwise, the Company does not require collateral or other security to support off-balance-sheet financial instruments with credit risk.

Commitments to invest generally represent commitments to acquire financial interests or instruments. The Company enters into these agreements to allow for additional participation in certain limited partnership investments. Because the equity investments in the limited partnerships are not actively traded, it is not practicable to estimate the fair value of these commitments.

Private placement commitments represent conditional commitments to purchase private placement debt and equity securities at a specified future date. The Company regularly enters into these agreements in the normal course of business. The fair value of these commitments generally cannot be estimated on the date the commitment is made as the terms and conditions of the underlying private placement securities are not yet final.

Commitments to extend mortgage loans are agreements to lend to a borrower provided there is no violation of any condition established in the contract. The Company enters into these agreements to commit to future loan fundings at a predetermined interest rate. Commitments generally have fixed expiration dates or other termination clauses. Commitments to extend mortgage loans, which are secured by the underlying properties, are valued based on estimates of fees charged by other institutions to make similar commitments to similar borrowers.

In 2006, the Company participated in the establishment of an investment management variable interest entity ("VIE") that holds assets under the management of Allstate Investment Management Company, an unconsolidated affiliate of the Company, on behalf of unrelated third party investors. The VIE had assets consisting primarily of investment securities and cash totaling \$401

December 31, 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 \$8 million at December 31, 2006.

8. RESERVE FOR LIFE-CONTINGENT CONTRACT BENEFITS AND CONTRACTHOLDER FUNDS

At December 31, the reserve for life-contingent contract benefits consists of the following:

(IN MILLIONS)	2006	2005
	-----	-----
Immediate annuities:		
Structured settlement annuities	\$6,950	\$ 6,813
Other immediate annuities	2,317	2,414
Traditional Life	2,234	2,094
Other	703	560
	-----	-----
Total reserve for life-contingent contract benefits	\$12,204	\$11,881
	=====	=====

The following table highlights the key assumptions generally used in calculating the reserve for life-contingent contract benefits:

INTEREST  
ESTIMATION  
PRODUCT  
MORTALITY  
RATE METHOD  
Structured  
settlement  
annuities  
U.S.  
population  
with  
projected  
Interest  
rate Present  
value of  
calendar  
year  
improvements;  
assumptions  
range  
contractually  
mortality  
rates  
adjusted for  
from 4.1% to  
11.7%  
specified  
future each  
impaired  
life based  
on benefits  
reduction in  
life  
expectancy  
and nature  
of  
impairment  
Other  
immediate  
annuities  
1983 group  
annuity  
mortality  
Interest  
rate Present  
value of  
table  
assumptions  
range  
expected

future 1983  
individual  
annuity from  
1.9% to  
11.5%  
benefits  
based on  
mortality  
table  
historical  
experience  
1983-a  
annuity  
mortality  
table  
Traditional  
life Actual  
company  
experience  
plus  
Interest  
rate Net  
level  
premium  
loading  
assumptions  
range  
reserve  
method using  
from 4.0% to  
11.3% the  
Company's  
withdrawal  
experience  
rates Other:  
Variable  
annuity  
guaranteed  
90% of 1994  
group  
annuity  
Interest  
rate  
Projected  
benefit  
minimum  
death  
benefits  
mortality  
table with  
internal  
assumptions  
range ratio  
applied to  
modifications  
from 6.5% to  
7.0%  
cumulative  
assessments  
Accident &  
health  
Actual  
company  
experience  
plus  
Unearned  
premium;  
loading  
additional  
contract  
reserves for  
traditional  
life

To the extent the unrealized gains on fixed income securities would result in a premium deficiency had those gains actually been realized, a premium deficiency reserve has been recorded for certain immediate annuities with life contingencies. A liability of \$1.13 billion and \$1.34 billion is included in the reserve for life-contingent contract benefits with respect to this deficiency as of December 31, 2006 and 2005, respectively. The offset to this liability is

recorded as a reduction of the unrealized net capital gains included in accumulated other comprehensive income.

At December 31, contractholder funds consists of the following:

(IN MILLIONS)	2006	2005
	-----	-----
Interest-sensitive life	\$ 8,397	\$ 7,917
Investment contracts:		
Fixed annuities	39,277	37,451
Funding agreements backing medium-term notes	12,787	12,454
Other investment contracts	104	368
	-----	-----
Total contractholder funds	\$60,565	\$58,190
	=====	=====

The following table highlights the key contract provisions relating to contractholder funds:

PRODUCT INTEREST RATE  
WITHDRAWAL/SURRENDER CHARGES Interest-sensitive life  
Interest rates credited range  
Either a percentage of account balance or dollar from 2.0% to 6.0% amount grading off generally over 20 years  
Fixed annuities Interest rates credited range  
Either a declining or a level percentage charge from 1.3% to 11.5% for immediate generally over nine years or less.  
Additionally, annuities and 0% to 10.0% for approximately 28.3% of fixed annuities are fixed annuities (which include subject to market value adjustment for equity-indexed annuities whose discretionary withdrawals. returns are indexed to the S&P 500)  
Funding agreements backing Interest rates credited range Not applicable medium-term notes from 2.5% to 7.0% (excluding currency-swapped medium-term notes)  
Other investment contracts: Variable annuity guaranteed Interest rates used in Withdrawal and surrender charges are based on minimum income benefit (1) establishing reserves range from the terms of the

related interest-sensitive life and secondary guarantees on 1.8% to 10.3% or fixed annuity contract. interest-sensitive life and fixed annuities Guaranteed investment contracts Interest rates credited range Generally not subject to discretionary withdrawal from 3.7% to 7.7% Other investment contracts Not applicable Not applicable

(1) In 2006, the Company disposed of substantially all of its variable annuity business through reinsurance agreements with Prudential (see Note 3).

Contractholder funds include funding agreements held by VIEs issuing medium-term notes. The VIEs are Allstate Life Funding, LLC, Allstate Financial Global Funding, LLC, Allstate Life Global Funding and Allstate Life Global Funding II, and their primary assets are funding agreements used exclusively to back medium-term note programs.

Contractholder funds activity for the years ended December 31 is as follows:

(IN MILLIONS)	2006	2005
	-----	-----
Balance, beginning of year	\$58,190	\$53,939
Deposits	9,541	11,410
Interest credited	2,600	2,340
Benefits	(1,500)	(1,336)
Surrenders and partial withdrawals	(4,627)	(3,839)
Maturities of institutional products	(2,726)	(3,090)
Contract charges	(697)	(649)
Net transfers to separate accounts	(145)	(339)
Fair value hedge adjustments for institutional products	38	(289)
Other adjustments	(109)	43
	-----	-----
Balance, end of year	\$60,565	\$58,190
	=====	=====

The Company offers various guarantees to variable annuity contractholders including a return of no less than (a) total deposits made on the contract less any customer withdrawals, (b) total deposits made on the contract less any customer withdrawals plus a minimum return or (c) the highest contract value on a specified anniversary date minus any customer withdrawals following the contract anniversary. These guarantees include benefits that are payable in the event of death (death benefits), upon annuitization (income benefits), upon periodic withdrawal (withdrawal benefits), or at specified dates during the accumulation period (accumulation benefits). Liabilities for variable contract guarantees related to death benefits are included in reserve for life-contingent contract benefits and the liabilities related to the income, withdrawal and accumulation benefits are included in contractholder funds in the Consolidated Statements of Financial Position. All liabilities for variable contracts guarantees are reported on a gross basis on the balance sheet with a corresponding reinsurance recoverable asset for those contracts subject to the Prudential Reinsurance Agreements as disclosed in Note 3.

Absent any contract provision wherein the Company guarantees either a minimum return or account value upon death, a specified contract anniversary date, partial withdrawal or annuitization, variable annuity and variable life insurance contractholders bear the investment risk that the separate accounts' funds may not meet their stated investment objectives. The account balances of variable annuities contracts' separate accounts with guarantees included \$14.64 billion and \$13.90 billion of equity, fixed income and balanced mutual funds and \$674 million and \$580 million of money market mutual funds at December 31, 2006

and 2005, respectively.

The table below presents information regarding the Company's variable annuity contracts with guarantees. The Company's variable annuity contracts may offer more than one type of guarantee in each contract; therefore, the sum of amounts listed exceeds the total account balances of variable annuity contracts' separate accounts with guarantees.

DECEMBER 31, --

-----  
---- (IN  
MILLIONS) 2006  
2005 -----  
----- IN  
THE EVENT OF  
DEATH Separate  
account value \$  
15,269 \$ 14,465  
Net amount at  
risk (1) \$  
1,068 \$ 1,521  
Average  
attained age of  
contractholders  
65 years 65  
years AT  
ANNUITIZATION  
Separate  
account value \$  
3,830 \$ 3,836  
Net amount at  
risk (2) \$ 64 \$  
45 Weighted  
average waiting  
period until  
annuitization  
options  
available 4  
years 6 years  
FOR CUMULATIVE  
PERIODIC  
WITHDRAWALS  
Separate  
account value \$  
1,041 \$ 508 Net  
amount at risk  
(3) \$ -- \$ --  
ACCUMULATION AT  
SPECIFIED DATES  
Separate  
account value \$  
1,595 \$ 1,175  
Net amount at  
risk (4) \$ -- \$  
-- Weighted  
average waiting  
period until  
guarantee date  
11 years 11  
years

- 
- (1) Defined as the estimated current guaranteed minimum death benefit in excess of the current account balance at the balance sheet date.
  - (2) Defined as the estimated present value of the guaranteed minimum annuity payments in excess of the current account balance.
  - (3) Defined as the estimated current guaranteed minimum withdrawal balance (initial deposit) in excess of the current account balance at the balance sheet date.
  - (4) Defined as the estimated present value of the guaranteed minimum accumulation balance in excess of the current account balance.

Pursuant to the adoption of SOP 03-1 in 2004, the liability for death and income benefit guarantees was established equal to a benefit ratio multiplied by the cumulative contract charges earned, plus accrued interest less contract benefit payments. The benefit ratio is calculated as the estimated present value of all expected contract

benefits divided by the present value of all expected contract charges. The establishment of reserves for these guarantees requires the projection of future separate account fund performance, mortality, persistency and customer benefit utilization rates. These assumptions are periodically reviewed and updated. For guarantees related to death benefits, benefits represent the current guaranteed minimum death benefit payments in excess of the current account balance. For guarantees related to income benefits, benefits represent the present value of the minimum guaranteed annuitization benefits in excess of the current account balance.

Projected benefits and contract charges used in determining the liability for certain guarantees are developed using models and stochastic scenarios that are also used in the development of estimated expected gross profits. Underlying assumptions for the liability related to income benefits include assumed future annuitization elections based on factors such as the extent of benefit to the potential annuitant, eligibility conditions and the annuitant's attained age. The liability for guarantees is re-evaluated periodically, and adjustments are made to the liability balance through a charge or credit to life and annuity contract benefits.

Guarantees related to withdrawal and accumulation benefits are considered to be derivative financial instruments; therefore, the liability for these benefits is established based on its fair value.

The following table summarizes the liabilities for guarantees:

LIABILITY	
FOR	
GUARANTEES	
RELATED TO	
LIABILITY	
DEATH	
BENEFITS	
FOR	
LIABILITY	
FOR AND	
GUARANTEES	
GUARANTEES	
INTEREST-	
RELATED TO	
RELATED TO	
SENSITIVE	
INCOME	
ACCUMULATION	
(IN	
MILLIONS)	
LIFE	
PRODUCTS	
BENEFITS	
BENEFITS	
TOTAL -----	
-----	
-----	
-----	
- -----	
Balance at	
December	
31, 2004 \$	
95 \$ 45 \$	
(1) \$139	
Less	
reinsurance	
recoverables	
(10) -- --	
(10) ---- -	
--- ---- -	
-- Net	
balance at	
December	
31, 2004 85	
45 (1) 129	
Incurred	
guaranteed	
benefits 50	
6 (1) 55	

Paid  
 guarantee  
 benefits  
 (48) -- --  
 (48) ---- -  
 ---- ---- -  
 -- Net  
 change 2 6  
 (1) 7 Net  
 balance at  
 December  
 31, 2005 87  
 51 (2) 136  
 Plus  
 reinsurance  
 recoverables  
 10 -- -- 10  
 ---- ---- -  
 ---- ---- -  
 Balance,  
 December  
 31, 2005  
 (1) \$ 97 \$  
 51 \$ (2)  
 \$146 =====  
 =====  
 ===== Less  
 reinsurance  
 recoverables  
 (10) -- --  
 (10) ---- -  
 ---- ---- -  
 -- Net  
 balance at  
 December  
 31, 2005 87  
 51 (2) 136  
 Variable  
 annuity  
 business  
 disposition  
 related  
 reinsurance  
 recoverables  
 (75) (23)  
 12 (86)  
 Incurred  
 guaranteed  
 benefits 23  
 (2) (10) 11  
 Paid  
 guarantee  
 benefits  
 (17) (2) --  
 (19) ---- -  
 ---- ---- -  
 -- Net  
 change (69)  
 (27) 2 (94)  
 Net balance  
 at December  
 31, 2006 18  
 24 -- 42  
 Plus  
 reinsurance  
 recoverables  
 96 23 (8)  
 111 ---- --  
 ---- ---- -  
 - Balance,  
 December  
 31, 2006  
 (2) \$114 \$  
 47 \$ (8)  
 \$153 =====  
 =====  
 =====  
 =====

-----  
 (1) Included in the total liability balance at December 31, 2005 are reserves

for variable annuity death benefits of \$77 million, variable annuity income benefits of \$20 million, variable annuity accumulation benefits of \$(2) million and other guarantees of \$51 million.

- (2) Included in the total liability balance at December 31, 2006 are reserves for variable annuity death benefits of \$89 million, variable annuity income benefits of \$20 million, variable annuity accumulation benefits of \$(8) million and other guarantees of \$51 million.

## 9. REINSURANCE

The Company reinsures certain of its risks to other insurers primarily under yearly renewable term, coinsurance and modified coinsurance agreements. These agreements result in a passing of the agreed-upon percentage of risk to the reinsurer in exchange for negotiated reinsurance premium payments. Modified coinsurance is similar to coinsurance except that the cash and investments that support the liability for contract benefits are not transferred to the assuming company and settlements are made on a net basis between the companies. The Company cedes 100% of the morbidity risk on substantially all of its long-term care contracts. The Company cedes specified percentages of the mortality risk

79

on certain life policies, depending upon the issue date and product, to a pool of fourteen unaffiliated reinsurers. Beginning in 2006, the Company increased its mortality risk retention to \$5 million per life for certain insurance applications meeting specific criteria. From October 1998 through December 2005, the Company ceded mortality risk on new life contracts that exceeded \$2 million per life for individual coverage. For business sold prior to October 1998, the Company ceded mortality risk in excess of specific amounts up to \$1 million per life for individual coverage.

In addition, the Company has used reinsurance to effect the acquisition or disposition of certain blocks of business. As of December 31, 2006, the Company had reinsurance recoverables of \$1.49 billion due from Prudential related to the disposal of substantially all of its variable annuity business that was effected through Reinsurance Agreements (see Note 3). In 2006, premiums and contract charges of \$170 million, contract benefits of \$29 million, interest credited to contractholder funds of \$35 million, and operating costs and expenses of \$64 million were ceded to Prudential pursuant to the Reinsurance Agreements. Prior to this disposal, the Company ceded 100% of the mortality and certain other risks related to product features on certain in-force variable annuity contracts. In addition, as of December 31, 2006 and 2005, the Company had reinsurance recoverables of \$153 million and \$150 million, respectively due from subsidiaries of Citigroup and Scottish Re (U.S.) Inc. in connection with the disposition of substantially all of the direct response distribution business in 2003.

As of December 31, 2006, the gross life insurance in force was \$478 billion of which \$236 billion was ceded to the unaffiliated reinsurers.

The effects of reinsurance on premiums and contract charges for the years ended December 31 are as follows:

(IN MILLIONS)	
2006	2005
2004	-----
-	-----
-----	-
PREMIUMS	
AND	
CONTRACT	
CHARGES	
Direct	
\$2,326	
\$2,115	
\$2,098	
Assumed	
Affiliate	
16	17
14	
Non-	
affiliate	
30	27
12	
Ceded--	
non-	
affiliate	
(787)	

(606)  
(526) ----  
-----  
-----  
Premiums  
and  
contract  
charges,  
net of  
reinsurance  
\$1,585  
\$1,553  
\$1,598  
=====

The effects of reinsurance on contract benefits for the years ended December 31 are as follows:

(IN MILLIONS)	2006	2005	2004
	-----	-----	-----
CONTRACT BENEFITS			
Direct	\$1,886	\$1,824	\$1,762
Assumed			
Affiliate	11	10	11
Non-affiliate	23	21	4
Ceded--non-affiliate	(548)	(515)	(418)
	-----	-----	-----
Contract benefits, net of reinsurance	\$1,372	\$1,340	\$1,359
	=====	=====	=====

Reinsurance recoverables at December 31 are summarized in the following table.

(IN MILLIONS)	REINSURANCE RECOVERABLE ON PAID AND UNPAID CLAIMS	
	2006	2005
	-----	-----
Annuities	\$1,654	\$ 172
Life insurance	1,217	1,115
Long-term care	427	324
Other	94	88
	-----	-----
Total	\$3,392	\$1,699
	=====	=====

At December 31, 2006 and 2005, approximately 88% and 83%, respectively, of the Company's reinsurance recoverables are due from companies rated A- or better by S&P.

#### 10. DEFERRED POLICY ACQUISITION AND SALES INDUCEMENT COSTS

Deferred policy acquisition costs for the years ended December 31 are as follows:

(IN MILLIONS)	2006	2005	2004
	-----	-----	-----
BALANCE, BEGINNING OF YEAR	\$3,948	\$3,176	\$3,202
Disposition of operation (1)(2)	(726)	--	(238)
Impact of adoption of SOP-03-1 (3)	--	--	(144)
Reinsurance (4)	--	--	40
Acquisition costs deferred	742	766	828
Amortization charged to income	(538)	(568)	(534)
Effect of unrealized gains and losses	59	574	22
	-----	-----	-----
BALANCE, END OF YEAR	\$3,485	\$3,948	\$3,176
	=====	=====	=====

(1) In 2006, DAC was reduced in connection with the disposition through reinsurance agreements of substantially all of the Company's variable annuity business (see Note 3).

- (2) In 2004, DAC was reduced in connection with the disposition of substantially all of the Company's direct response distribution business.
- (3) In 2004, the impact of adoption of SOP 03-1 included a write-down in variable annuity DAC of \$108 million, the reclassification of DSI from DAC to other assets resulting in a decrease to DAC of \$44 million, and an increase to DAC of \$8 million for an adjustment to the effect of unrealized capital gains and losses.
- (4) In 2004, DAC was increased as a result of certain reinsurance transactions with AHL and Columbia (see Note 5).

Net amortization charged to income, due to the realization of capital (gains) and losses, includes \$(50) million, \$126 million and \$120 million in 2006, 2005 and 2004, respectively.

As disclosed in Note 3, DAC and DSI balances were reduced during 2006 related to the disposal through reinsurance agreements of substantially all of the variable annuity business. During 2005 and 2004, DAC and DSI amortization was estimated using stochastic modeling and was significantly impacted by the anticipated return on the underlying funds. The Company's long-term expectation of separate accounts fund performance, net of fees, was approximately 7% in 2005 and 8% in 2004. Whenever actual separate accounts fund performance based on the two most recent years varied from the expectation, the Company projected performance levels over the next five years such that the mean return over a seven-year period equaled the long-term expectation. This approach is commonly referred to as "reversion to the mean" and is commonly used by the life insurance industry as an appropriate method for amortizing variable annuity and life DAC and DSI. In applying the reversion to the mean process, the Company did not allow the future mean rates of return including fees projected over the five-year period to exceed 12.75% or fall below 0%. The Company periodically evaluated the results of utilization of this process to confirm that it was reasonably possible that variable annuity and life fund performance would revert to the expected long-term mean within this time horizon.

DSI activity for the twelve months ended December 31 was as follows:

(IN MILLIONS)	2006	2005	2004(2)
	----	----	-----
BALANCE, BEGINNING OF YEAR	\$237	\$134	\$ 99
Disposition of operation (1)	(70)	--	--
Sales inducements deferred	105	99	55
Amortization charged to income	(48)	(74)	(45)
Effects of unrealized gains and losses	1	78	25
	----	----	-----
BALANCE, END OF YEAR	\$225	\$237	\$134
	====	====	=====

(1) In 2006, DSI was reduced in connection with the disposition through reinsurance agreements of substantially all of the Company's variable annuity business (see Note 3).

(2) The January 1, 2004 balance includes a \$16 million write-down of DSI due to the adoption of SOP 03-1 (see Note 2).

## 11. COMMITMENTS, GUARANTEES AND CONTINGENT LIABILITIES

### LEASES

The Company leases certain office equipment. Total rent expense for all leases was \$0.3 million in 2006 and \$1 million in both 2005 and 2004.

### GUARANTY FUNDS

Under state insurance guaranty fund laws, insurers doing business in a state can be assessed, up to prescribed limits, for certain obligations of insolvent insurance companies to policyholders and claimants. Amounts assessed to each company are typically related to its proportion of business written in a particular state. The Company's expenses related to these funds have been immaterial.

### 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 \$260 million at December 31, 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 are entered into in the normal course of business based on an assessment that the risk of loss would be remote. The terms of the indemnifications vary in duration and nature. In many cases, the maximum obligation is not explicitly stated and the contingencies triggering the obligation to indemnify have not occurred and are not expected to occur. Consequently, the maximum amount of the obligation under such indemnifications is not determinable. Historically, the Company has not made any material payments pursuant to these obligations.

The aggregate liability balance related to all guarantees was not material as of December 31, 2006.

## REGULATION

The Company is subject to changing social, economic and regulatory conditions. From time to time, regulatory authorities or legislative bodies seek to 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 affiliates 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 some 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 some 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 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. In our experience, when specific monetary demands are made in pleadings, they 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 these 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

Legal proceedings involving Allstate agencies and AIC may impact the Company, even when the Company is not directly involved, because the Company sells its products through a variety of distribution channels including Allstate agencies. Consequently, information about the more significant of these proceedings is provided in the following paragraph.

AIC is defending certain matters relating to its 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 AIC "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 and on January 16, 2007, the judge denied their request. 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 ("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 AIC 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 AIC had reasonable factors other than age to support the rehire policy. AIC filed a motion for interlocutory appeal from the partial summary judgment, which was granted by the trial court on January 4, 2007. AIC has filed a petition for immediate review of two controlling issues of law to the Court of Appeals for the Eighth Circuit and that petition is currently pending. AIC 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 matters, plaintiffs seek compensatory and punitive damages, and equitable relief. AIC 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 is defending a certified nationwide class action related to certain of its universal life policies written prior to 1992. The breach of

contract claim involves premium increases that the Company charged related to those policies. Other life insurance companies have faced similar suits. The Company is vigorously defending this lawsuit, and the outcome of this dispute is currently uncertain.

The Company is currently undergoing periodic market conduct examinations by state insurance regulators. In a recently concluded examination, regulators in the state of New York focused, as they have with other insurers, on one of the Company's New York subsidiary's compliance with the state's replacement sales and record-keeping processes with regard to life insurance and annuities among other issues. They found that this New York subsidiary failed to meet the requirements of certain applicable regulations. The New York subsidiary has settled this examination and has substantially completed customer remediation related to replacement sales and is completing its other obligations arising from the examination.

#### OTHER MATTERS

The Corporation and some of its subsidiaries, including the Company, 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 Corporation and some of its subsidiaries, including the Company, 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. Moreover, the Corporation has not received any communication from authorities related to the variable annuity market timing and late trading inquiries since November 2005. The Corporation and its subsidiaries have responded and will continue to respond to these inquiries.

Various other legal and regulatory actions 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.

#### 12. INCOME TAXES

ALIC and its eligible domestic subsidiaries (the "Allstate Life Group") join with the Corporation (the "Allstate Group") in the filing of a consolidated federal income tax return and are party to a federal income tax allocation agreement (the "Allstate Tax Sharing Agreement"). Under the Allstate Tax Sharing Agreement, the Allstate Life Group pays to or receives from the Corporation the amount, if any, by which the Allstate Group's federal income tax liability is affected by virtue of inclusion of the Allstate Life Group in the consolidated federal income tax return. Effectively, this results in the Allstate Life Group's annual income tax provision being computed, with adjustments, as if the Allstate Life Group filed a separate return. Any subsidiary not eligible to join in the consolidated federal income tax return files a separate tax return.

The Internal Revenue Service ("IRS") has completed its review of the Corporation's federal income tax returns through the 2002 tax year and the statute of limitations has expired for these years. Any adjustments that may result from IRS examinations of tax returns are not expected to have a material effect on the results of operations, cash flows or financial position of the Company.

The components of the deferred income tax assets and liabilities at December 31 are as follows:

(IN MILLIONS)	2006	2005
	-----	-----
DEFERRED ASSETS		
Life and annuity reserves	\$ 682	\$ 925
Other assets	48	70
	-----	-----
Total deferred assets	730	995
DEFERRED LIABILITIES		
Deferred policy acquisition costs	(784)	(981)
Unrealized net capital gains	(175)	(317)
Other liabilities	(29)	(37)
	-----	-----
Total deferred liabilities	(988)	(1,335)
	-----	-----
Net deferred liability	\$(258)	\$ (340)
	=====	=====

Although realization is not assured, management believes it is more likely than not that the deferred tax assets will be realized based on the assumption that certain levels of income will be achieved.

The components of income tax expense for the years ended December 31 are as follows:

(IN MILLIONS)	2006	2005	2004
	-----	-----	-----
Current	\$ 136	\$ 225	\$ 236
Deferred	60	(51)	(47)
	-----	-----	-----
Total income tax expense	\$ 196	\$ 174	\$ 189
	=====	=====	=====

The Company paid income taxes of \$317 million, \$156 million and \$149 million in 2006, 2005 and 2004, respectively. The Company had a current income tax receivable of \$49 million and a payable of \$133 million at December 31, 2006 and 2005, respectively.

A reconciliation of the statutory federal income tax rate to the effective income tax rate on income from operations for the years ended December 31 is as follows:

	2006	2005	2004
	----	----	----
Statutory federal income tax rate	35.0%	35.0%	35.0%
Adjustment for prior year tax liabilities	(1.6)	(3.9)	(0.1)
Dividends received deduction	(2.7)	(2.5)	(2.4)
Other	0.6	0.8	2.1
	----	----	----
Effective income tax rate	31.3%	29.4%	34.6%
	====	====	====

### 13. CAPITAL STRUCTURE

#### DEBT OUTSTANDING

Total debt outstanding at December 31 consisted of the following:

(IN MILLIONS)	2006	2005
	-----	-----
6.18% Surplus Notes, due 2036	\$100	\$ --
5.06% Surplus Notes, due 2035	100	100
Mandatorily redeemable preferred stock - Series A	6	32
Structured investment security VIE obligations, due 2007	--	49
	-----	-----
Total long-term debt	206	181
Note payable to parent	500	--
	-----	-----
Total debt	\$706	\$181
	=====	=====

Certain of the Company's debt relates to intercompany obligations. These obligations, which include the Surplus Notes, preferred stock-Series A and note payable to parent, are discussed in Note 5 to the consolidated financial statements.

The Company was the primary beneficiary of a consolidated structured investment security VIE. The Company's Consolidated Statements of Financial Position included \$54 million of investments and \$49 million of long-term debt as of December 31, 2005. In 2006, the debt associated with the VIE was redeemed.

#### 14. STATUTORY FINANCIAL INFORMATION

ALIC and its 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. Prescribed statutory accounting practices include a variety of publications of the NAIC, as well as state laws, regulations and general administrative rules. Permitted statutory accounting practices encompass all accounting practices not so prescribed.

All states require domiciled insurance companies to prepare statutory-basis financial statements in conformity with the NAIC Accounting Practices and Procedures Manual, subject to any deviations prescribed or permitted by the applicable insurance commissioner and/or director.

Statutory accounting practices primarily differ from GAAP since they require charging policy acquisition and certain sales inducement costs to expense as incurred, establishing life insurance reserves based on different actuarial assumptions, and valuing investments and establishing deferred taxes on a different basis.

Statutory net income of ALIC and its insurance subsidiaries for 2006, 2005 and 2004 was \$281 million, \$294 million and \$293 million, respectively. Statutory capital and surplus was \$3.36 billion and \$3.66 billion as of December 31, 2006 and 2005, respectively.

#### DIVIDENDS

The ability of ALIC to pay dividends is dependent on business conditions, income, cash requirements of ALIC, receipt of dividends from its subsidiaries and other relevant factors. The payment of shareholder dividends by ALIC to AIC without the prior approval of the state insurance regulator is limited to formula amounts based on net income and capital and surplus, determined in conformity with statutory accounting practices, as well as the timing and amount of dividends paid in the preceding twelve months. Notification and approval of intercompany lending activities is also required by the Illinois Department of Insurance ("IL DOI") for transactions that exceed a level that is based on a formula using statutory admitted assets and statutory surplus.

ALIC paid dividends of \$675 million in 2006. This amount was in excess of the \$366 million that was allowed under Illinois insurance law based on 2005 formula amounts. The Company received approval from the IL DOI for the portion of the 2006 dividends in excess of this amount. Based on 2006 ALIC statutory capital and surplus, the maximum amount of dividends ALIC will be able to pay without prior IL DOI approval at a given point in time during 2007 is \$336 million, less dividends paid during the preceding twelve months measured at that point in time.

#### 15. BENEFIT PLANS

##### PENSION AND OTHER POSTRETIREMENT PLANS

Defined benefit pension plans, sponsored by AIC, cover most full-time employees, certain part-time employees and employee-agents. Benefits under the pension plans are based upon the employee's length of service and eligible annual compensation. A cash balance formula was added to the Allstate Retirement Plan effective January 1, 2003. All eligible employees hired before August 1, 2002 were provided with a one-time opportunity to choose between the cash balance formula and the final average pay formula. The cash balance formula applies to all eligible employees hired after August 1, 2002. AIC's 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 and in accordance with generally accepted actuarial principles. The allocated cost to the Company included in net income for the pension plans in 2006, 2005 and 2004 was \$32 million, \$18 million and \$17 million, respectively.

AIC also provides certain health care and life insurance subsidies for employees hired before January 1, 2003 when they retire ("postretirement benefits"). Qualified employees may become eligible for these benefits if they retire in accordance with AIC's established retirement policy and are continuously insured under AIC's group plans or other approved plans in accordance with the plan's participation requirements. AIC shares the cost of the retiree medical benefits with retirees based on years of service, with AIC's share being subject to a 5% limit on annual medical cost inflation after retirement. AIC has the right to modify or terminate these pension and postretirement benefit plans. The allocated cost to the Company included in net



REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

TO THE BOARD OF DIRECTORS AND SHAREHOLDER OF  
ALLSTATE LIFE INSURANCE COMPANY

We have audited the accompanying Consolidated Statements of Financial Position of Allstate Life Insurance Company and subsidiaries (the "Company", an affiliate of The Allstate Corporation) as of December 31, 2006 and 2005, and the related Consolidated Statements of Operations and Comprehensive Income, Shareholder's Equity, and Cash Flows for each of the three years in the period ended December 31, 2006. Our audits also included the consolidated financial statement schedules listed in the Index at Item 15. These financial statements and financial statement schedules are the responsibility of the Company's management. Our responsibility is to express an opinion on the financial statements and financial statement schedules based on our audits.

We conducted our audits in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. The Company is not required to have, nor were we engaged to perform, an audit of its internal control over financial reporting. Our audit included consideration of internal control over financial reporting as a basis for designing audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Company's internal control over financial reporting. Accordingly, we express no such opinion. An audit also includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, such consolidated financial statements present fairly, in all material respects, the financial position of Allstate Life Insurance Company and subsidiaries as of December 31, 2006 and 2005, and the results of their operations and their cash flows for each of the three years in the period ended December 31, 2006, in conformity with accounting principles generally accepted in the United States of America. Also, in our opinion, such consolidated financial statement schedules, when considered in relation to the basic consolidated financial statements taken as a whole, present fairly in all material respects the information set forth therein.

As discussed in Note 2 to the consolidated financial statements, the Company changed its method of accounting for certain nontraditional long-duration contracts and separate accounts in 2004.

/s/ Deloitte & Touche LLP

Chicago, Illinois  
March 9, 2007

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ITEM 9. CHANGES IN AND DISAGREEMENTS WITH ACCOUNTANTS ON ACCOUNTING AND  
FINANCIAL DISCLOSURE

None

ITEM 9A. 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 recorded, processed, summarized and reported within the time periods specified by the Securities Exchange Act and 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 December 31, 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.

ITEM 9B. OTHER INFORMATION

None

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PART III

ITEM 14. PRINCIPAL ACCOUNTING FEES AND SERVICES

(1), (2), (3) AND (4) DISCLOSURE OF FEES -

The following fees have been, or are anticipated to be billed by Deloitte & Touche LLP, the member firms of Deloitte & Touche Tohmatsu, and their respective affiliates, for professional services rendered to us for the fiscal years ending December 31, 2006 and 2005.

	2006	2005
Audit fees (a)	\$3,207,000	\$3,255,792
Audit related fees (b)	19,250	11,530
TOTAL FEES	\$3,226,250	\$3,267,322

- (a) Fees for audits of annual financial statements including financial statements for the separate accounts, reviews of quarterly financial statements, statutory audits, attest services, comfort letters, consents and review of documents filed with the Securities and Exchange Commission.
- (b) Audit related fees relate to professional services such as accounting consultations relating to new accounting standards and due diligence assistance.

(5)(i) AND (ii) AUDIT COMMITTEE'S PRE-APPROVAL POLICIES AND PROCEDURES -

The Audit Committee of The Allstate Corporation has established pre-approval policies and procedures for itself and its consolidated subsidiaries, including Allstate Life. Those policies and procedures are incorporated into this Item 14 (5) by reference to Exhibit 99 - The Allstate Corporation Policy Regarding Pre-Approval of Independent Auditors' Services (the "Pre-Approval Policy"). In addition, in 2005 the Audit Committee of Allstate Life adopted the Pre-Approval Policy, as it may be amended from time to time by the Audit Committee or the Board of Directors of the Corporation, as its own policy, provided that the Designated Member referred to in such policy need not be independent because the New York Stock Exchange corporate governance standards do not apply to Allstate Life. All of the services provided by Deloitte & Touche LLP to Allstate Life in 2006 and 2005 were pre-approved by The Allstate Corporation and Allstate Life Audit Committees.

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PART IV

ITEM 15. EXHIBITS, FINANCIAL STATEMENT SCHEDULES

- (a)(1) The following consolidated financial statements and notes thereto of Allstate Life Insurance Company are included in Item 8.

Consolidated Statements of Operations and Comprehensive Income  
Consolidated Statements of Financial Position  
Consolidated Statements of Shareholder's Equity  
Consolidated Statements of Cash Flows  
Notes to Consolidated Financial Statements  
Report of Independent Registered Public Accounting Firm

(a)(2) The following additional financial statement schedules are furnished herewith pursuant to the requirements of Form 10-K.

Schedules required to be filed under the provisions of Regulation S-X Article 7:

Schedule I - Summary of Investment Other than Investments in Related Parties	S-1
Schedule IV - Reinsurance	S-2
Schedule V - Valuation and Qualifying Accounts	S-3

All other schedules are omitted because they are not applicable, or not required, or because the required information is included in the Consolidated Financial Statements or notes thereto.

(a)(3) The following is a list of the exhibits filed as part of this Form 10-K. The SEC File Number for the exhibits incorporated by reference is 0-31248 except as otherwise noted.

EXHIBIT NO.	DOCUMENT DESCRIPTION
3(i)	Articles of Amendment to the Articles of Incorporation of Allstate Life Insurance Company dated December 29, 1999. Incorporated herein by reference to Exhibit 3.1 to Allstate Life Insurance Company's Form 10 filed on April 24, 2002.
3(ii)	Amended and Restated By-Laws of Allstate Life Insurance Company effective April 21, 2006. Incorporated herein by reference to Exhibit 3.1 to Allstate Life Insurance Company's Current Report on Form 8-K filed May 3, 2006.
4	See Exhibits 3 (i) and 3 (ii).
10.1	Amended and Restated Service and Expense Agreement between Allstate Insurance Company, The Allstate Corporation and certain affiliates, effective January 1, 2004. Incorporated herein by reference to Exhibit 10.1 to Allstate Life Insurance Company's Quarterly Report on Form 10-Q for quarter ended June 30, 2005.
10.2	New York Insurer Supplement to Amended and Restated Service and Expense Agreement between Allstate Insurance Company, The Allstate Corporation, Allstate Life Insurance Company of New York and Intramerica Life Insurance Company, effective March 5, 2005. Incorporated herein by reference to Exhibit 10.2 to Allstate Life Insurance Company's Quarterly Report on Form 10-Q for quarter ended June 30, 2005.
10.3	Service Agreement between Lincoln Benefit Life Company and Allstate Financial Services, LLC (f/k/a Laughlin Group Advisors, Inc. and LSA Securities, Inc.) effective April 1, 1998. Incorporated herein by reference to Exhibit 10.3 to Lincoln Benefit Life Company's Quarterly Report on Form 10-Q for quarter ended June 30, 2002 (SEC File No. 333-59765).
10.4	Selling Agreement between Allstate Life Insurance Company, ALFS, Inc. (f/k/a Allstate Life Financial Services, Inc.) and Allstate Financial Services, LLC (f/k/a LSA Securities, Inc.) effective July 26, 1999. Incorporated herein by reference to Exhibit 10.6 to Allstate Life Insurance Company's Annual Report on Form 10-K for 2003.
10.5	Amendment effective August 1, 1999 to Selling Agreement between Allstate Life Insurance Company, ALFS, Inc. and Allstate Financial Services, LLC effective July 26, 1999. Incorporated herein by reference to Exhibit 10.1 to Allstate Life Insurance Company's Quarterly Report on Form 10-Q for quarter ended September 30, 2004.
10.6	Amendment effective September 28, 2001 to Selling

Agreement between Allstate Life Insurance Company, ALFS, Inc. and Allstate Financial Services, LLC effective July 26, 1999. Incorporated herein by reference to Exhibit 10.2 to Allstate Life Insurance Company's Quarterly Report on Form 10-Q for quarter ended September 30, 2004.

- 10.7 Amendment effective February 15, 2002 to Selling Agreement between Allstate Life Insurance Company, ALFS, Inc. and Allstate Financial Services, LLC effective July 26, 1999. Incorporated herein by reference to Exhibit 10.3 to Allstate Life Insurance Company's Quarterly Report on Form 10-Q for quarter ended September 30, 2004.
- 10.8 Amendment effective April 21, 2003 to Selling Agreement between Allstate Life Insurance Company, ALFS, Inc. and Allstate Financial Services, LLC effective July 26, 1999. Incorporated herein by reference to Exhibit 10.4 to Allstate Life Insurance Company's Quarterly Report on Form 10-Q for quarter ended September 30, 2004.
- 10.9 Selling Agreement between Allstate Life Insurance Company of New York, ALFS, Inc. and Allstate Financial Services, LLC effective May 1 2005. Incorporated herein by reference to Exhibit 10.7 to Allstate Life Insurance Company's Annual Report on Form 10-K for 2003.
- 10.10 Selling Agreement between Lincoln Benefit Life Company, ALFS, Inc. (f/k/a Allstate Life Financial Services, Inc.) and Allstate Financial Services, LLC (f/k/a LSA Securities, Inc.) effective August 2, 1999. Incorporated herein by reference to Exhibit 10.8 to Allstate Life Insurance Company's Annual Report on Form 10-K for 2003.
- 10.11 First Amendment to Marketing Coordination and Administrative Services Agreement among Allstate Life Insurance Company, Allstate Financial Services, LLC and Allstate Insurance Company dated January 1, 2006. Incorporated herein by reference to Exhibit 10.1 to Allstate Life Insurance Company's Quarterly Report on Form 10-Q for the quarter ended June 30, 2006.
- 10.12 Marketing Coordination and Administrative Services Agreement among Allstate Insurance Company, Allstate Life Insurance Company and Allstate Financial Services, LLC effective January 1, 2003. Incorporated herein by

reference to Exhibit 10.9 to Allstate Life Insurance Company's Annual Report on Form 10-K for 2003.

- 10.13 Investment Management Agreement and Amendment to Certain Service and Expense Agreements Among Allstate Investments, LLC and Allstate Insurance Company and The Allstate Corporation and Certain Affiliates effective as of January 1, 2002. Incorporated herein by reference to Exhibit 10.28 to Allstate Life Insurance Company's Form 10 filed on April 24, 2002.
- 10.14 Investment Advisory Agreement by and between Allstate Insurance Company and Intramerica Life Insurance Company effective July 1, 1999. Incorporated herein by reference to Exhibit 10.29 to Allstate Life Insurance Company's Form 10 filed on April 24, 2002.
- 10.15 Investment Management Agreement between Allstate Investments, LLC and ALIC Reinsurance Company, effective July 1, 2005. Incorporated herein by reference to Exhibit 10.1 to Allstate Life Insurance Company's Quarterly Report on Form 10-Q for quarter ended September 30, 2005.
- 10.16 Assignment and Assumption Agreement dated as of January 1, 2002 among Allstate Insurance Company, Allstate Investments, LLC and Intramerica Life Insurance Company. Incorporated herein by reference to Exhibit 10.30 to Allstate Life Insurance Company's Form 10 filed on April 24, 2002.

- 10.17 Investment Advisory Agreement and Amendment to Service Agreement as of January 1, 2002 between Allstate Insurance Company, Allstate Investments, LLC and Allstate Life Insurance Company of New York. Incorporated herein by reference to Exhibit 10.31 to Allstate Life Insurance Company's Form 10 filed on April 24, 2002.
- 10.18 Cash Management Services Master Agreement between Allstate Insurance Company and Allstate Bank (f/k/a Allstate Federal Savings Bank) dated March 16, 1999. Incorporated herein by reference to Exhibit 10.32 to Allstate Life Insurance Company's Form 10 filed on April 24, 2002.
- 10.19 Amendment No. 1 effective January 5, 2001 to Cash Management Services Master Agreement between Allstate Insurance Company and Allstate Bank dated March 16, 1999. Incorporated herein by reference to Exhibit 10.33 to Allstate Life Insurance Company's Form 10 filed on April 24, 2002.
- 10.20 Agent Access Agreement among Allstate Insurance Company, Allstate New Jersey Insurance Company, Allstate Life Insurance Company and Allstate Bank effective January 1, 2002. Incorporated herein by reference to Exhibit 10.17 to Allstate Life Insurance Company's Annual Report on Form 10-K for 2003.
- 10.21 Tax Sharing Agreement dated as of November 12, 1996 among The Allstate Corporation and certain affiliates. Incorporated herein by reference to Exhibit 10.36 to Allstate Life Insurance Company's Form 10 filed on April 24, 2002.
- 10.22 Surplus Note Purchase Agreement between Allstate Life Insurance Company and Kennett Capital, Inc. effective, August 1, 2005. Incorporated herein by reference to Exhibit 10.2 to Allstate Life Insurance Company's Quarterly Report on Form 10-Q for quarter ended September 30, 2005.
- 10.23 Intercompany note between Allstate Life Insurance Company and Allstate Insurance Company dated December 27, 2006. Incorporated herein by

reference to Exhibit 10.1 to Allstate Life Insurance Company's Current Report on Form 8-K filed December 29, 2006.

- 10.24 Intercompany Loan Agreement among The Allstate Corporation, Allstate Life Insurance Company, Lincoln Benefit Life Company and other certain subsidiaries of The Allstate Corporation dated February 1, 1996.
- 10.25 Pledge and Security Agreement between Allstate Life Insurance Company and Kennett Capital, Inc. effective August 1, 2005. Incorporated herein by reference to Exhibit 10.3 to Allstate Life Insurance Company's Quarterly Report on Form 10-Q for quarter ended September 30, 2005.
- 10.26 Catastrophe Reinsurance Agreement between Allstate Life Insurance Company and American Heritage Life Insurance Company effective July 1, 2003. Incorporated herein by reference to Exhibit 10.29 to Allstate Life Insurance Company's Annual Report on Form 10-K for 2003.
- 10.27 Retrocessional Reinsurance Agreement between Allstate Life Insurance Company and American Heritage Life Insurance Company effective December 31, 2004. Incorporated herein by reference to Exhibit 10.23 to Allstate Life Insurance Company's Annual Report on Form 10-K for 2004.
- 23 Consent of Independent Registered Public Accounting Firm
- 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
- 99 The Allstate Corporation Policy Regarding Pre-Approval of Independent Auditors' Services effective November 10, 2003.

- (b) The exhibits are listed in Item 15. (a) (3) above.
- (c) The financial statement schedules are listed in Item 15. (a) (2) above.

SIGNATURES

Pursuant to the requirements of Section 13 or 15(d) 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.

ALLSTATE LIFE INSURANCE COMPANY  
(Registrant)

March 13, 2007

/s/ SAMUEL H. PILCH

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By: Samuel H. Pilch  
(Controller)

Pursuant to the requirements of the Securities Exchange Act of 1934, this report has been signed below by the following persons on behalf of the registrant and in the capacities and on the dates indicated.

SIGNATURE  
TITLE DATE

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/s/ CASEY  
J. SYLLA  
Chairman  
of the  
Board,  
President  
March 12,  
2007 - ---

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---- and a  
Director  
(Principal  
Casey J.  
Sylla  
Executive  
Officer)

/s/ JOHN  
C.  
PINTOZZI  
Senior  
Vice  
President,  
Chief  
March 12,  
2007 - ---

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Financial  
Officer  
and a  
Director  
John C.  
Pintozzi  
(Principal  
Financial

Officer)  
/s/ DAVID  
A. BIRD  
Director  
March 12,  
2007 - ---  
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-----  
---- David  
A. Bird  
/s/ DANNY  
L. HALE  
Director  
March 12,  
2007 - ---  
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---- Danny  
L. Hale  
/s/ JOHN  
C. LOUNDS  
Director  
March 12,  
2007 - ---  
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---- John  
C. Lounds  
/s/ ERIC  
A.  
SIMONSON  
Director  
March 12,  
2007 - ---  
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---- Eric  
A.  
Simonson  
/s/ KEVIN  
R. SLAWIN  
Director  
March 12,  
2007 - ---  
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---- Kevin  
R. Slawin  
/s/  
MICHAEL J.  
VELOTTA  
Director  
March 12,  
2007 - ---  
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Michael J.  
Velotta  
/s/  
DOUGLAS B.  
WELCH  
Director  
March 12,  
2007 - ---  
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----  
Douglas B.  
Welch /s/  
THOMAS J.  
WILSON, II  
Director  
March 12,

ALLSTATE LIFE  
INSURANCE  
COMPANY AND  
SUBSIDIARIES  
SCHEDULE I--  
SUMMARY OF  
INVESTMENTS  
OTHER THAN  
INVESTMENTS  
IN RELATED  
PARTIES  
DECEMBER 31,  
2006 AMOUNT  
AT COST/  
WHICH SHOWN  
AMORTIZED ON  
BALANCE (IN  
MILLIONS)  
COST FAIR  
VALUE SHEET -  
-----  
-----  
----- Type of  
Investment  
Fixed  
Maturities:  
Bonds: United  
States  
government,  
government  
agencies and  
authorities \$  
2,763 \$ 3,496  
\$ 3,496  
States,  
municipalities  
and political  
subdivisions  
4,732 4,790  
4,790 Foreign  
governments  
1,709 2,023  
2,023 Public  
utilities  
5,590 5,792  
5,792  
Convertibles  
and bonds  
with warrants  
attached  
1,207 1,197  
1,197 All  
other  
corporate  
bonds 27,033  
27,327 27,327  
Asset-backed  
securities  
5,663 5,681  
5,681  
Mortgage-  
backed  
securities  
4,543 4,518  
4,518  
Commercial  
mortgage-

backed  
securities  
7,597 7,600  
7,600  
Redeemable  
preferred  
stocks 14 15  
15 ----- --  
-----  
Total fixed  
maturities  
60,851  
\$62,439  
62,439 -----  
- ===== --  
---- Equity  
Securities:  
Common  
Stocks:  
Public  
utilities 6 \$  
7 7 Banks,  
trusts and  
insurance  
companies 2 2  
2 Industrial,  
miscellaneous  
and all other  
471 479 479  
Non-  
redeemable  
preferred  
stocks 43 45  
45 ----- --  
-----  
Total equity  
securities  
522 \$ 533 533  
-----  
===== -----  
-- Mortgage  
loans on real  
estate 8,690  
8,690 Real  
estate -- --  
Real estate  
acquired in  
satisfaction  
of debt 2 2  
Short-term  
investments  
805 805  
Derivative  
instruments  
737 730  
Policy loans  
752 752 Other  
long-term  
investments  
209 209 -----  
-- -----  
Total  
investments  
\$72,568  
\$74,160  
=====

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ALLSTATE LIFE INSURANCE COMPANY AND SUBSIDIARIES  
SCHEDULE IV--REINSURANCE

PERCENTAGE  
CEDED  
ASSUMED OF  
AMOUNT

GROSS TO  
 OTHER FROM  
 OTHER NET  
 ASSUMED  
 (IN  
 MILLIONS)  
 AMOUNT  
 COMPANIES  
 COMPANIES  
 AMOUNT TO  
 NET -----  
 -- -----  
 -- -----  
 -- -----  
 --- YEAR  
 ENDED  
 DECEMBER  
 31, 2006 -  
 -----  
 -----

Life  
 insurance  
 in force  
 \$465,634  
 \$236,278  
 \$11,942  
 \$241,298  
 5.0%  
 Premiums  
 and  
 contract  
 charges:  
 Life and  
 annuities  
 \$ 2,138 \$  
 639 \$ 45 \$  
 1,544 2.9%  
 Accident  
 and health  
 188 148 1  
 41 2.4% --  
 -----  
 -----

-- Total  
 premiums  
 and  
 contract  
 charges \$  
 2,326 \$  
 787 \$ 46 \$  
 1,585 2.9%  
 =====  
 =====  
 =====  
 =====

YEAR ENDED  
 DECEMBER  
 31, 2005 -  
 -----  
 -----

Life  
 insurance  
 in force  
 \$434,965  
 \$223,194 \$  
 9,400  
 \$221,171  
 4.3%  
 Premiums  
 and  
 contract  
 charges:  
 Life and  
 annuities  
 \$ 1,928 \$  
 445 \$ 43 \$  
 1,526 2.8%

Accident  
and health  
187 161 1  
27 3.7% --  
-----  
-----  
-----

-- Total  
premiums  
and  
contract  
charges \$  
2,115 \$  
606 \$ 44 \$  
1,553 2.8%

=====  
=====  
=====  
=====  
YEAR ENDED  
DECEMBER  
31, 2004 -  
-----  
-----  
-----

Life  
insurance  
in force  
\$406,901  
\$205,595 \$  
6,814  
\$208,120  
3.3%

Premiums  
and  
contract  
charges:  
Life and  
annuities  
\$ 1,917 \$  
363 \$ 25 \$  
1,579 1.6%  
Accident  
and health  
181 163 1  
19 5.3% --  
-----  
-----  
-----

-- Total  
premiums  
and  
contract  
charges \$  
2,098 \$  
526 \$ 26 \$  
1,598 1.6%

=====  
=====  
=====  
=====

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ALLSTATE LIFE INSURANCE COMPANY AND SUBSIDIARIES  
SCHEDULE V--VALUATION AND QUALIFYING ACCOUNTS

BALANCE AT  
CHARGED TO  
BALANCE AT  
BEGINNING  
COSTS AND  
END OF (IN  
MILLIONS)  
OF PERIOD  
EXPENSES  
DEDUCTIONS

PERIOD ---  
 -----  
 -----  
 -----  
 YEAR ENDED  
 DECEMBER  
 31, 2006 -  
 -----  
 -----  
 Allowance  
 for  
 estimated  
 losses on  
 mortgage  
 loans and  
 real  
 estate \$--  
 \$-- \$-- \$--  
 - YEAR  
 ENDED  
 DECEMBER  
 31, 2005 -  
 -----  
 -----  
 Allowance  
 for  
 estimated  
 losses on  
 mortgage  
 loans and  
 real  
 estate \$--  
 \$-- \$-- \$--  
 - YEAR  
 ENDED  
 DECEMBER  
 31, 2004 -  
 -----  
 -----  
 Allowance  
 for  
 estimated  
 losses on  
 mortgage  
 loans and  
 real  
 estate \$ 1  
 \$ 1 \$ 2 \$--  
 -

## INTERCOMPANY LOAN AGREEMENT

THIS AGREEMENT, is made and entered into as of the 1st day of February, 1996, by and between THE ALLSTATE CORPORATION, a Delaware corporation (hereinafter called "ALLCORP"), and each of its direct and indirect wholly-owned subsidiaries (individually, "Subsidiary" and collectively, "Subsidiaries"),

## WITNESSETH

WHEREAS, ALLCORP, from time to time during the period commencing on February 1, 1996, may obtain financing by various means including, but not limited to, issuing commercial paper notes in private placement transactions, drawing on bank credit lines and entering into repurchase agreements;

WHEREAS, the Subsidiaries, from time to time during said period, may have need of additional short-term funding for general corporate purposes;

WHEREAS, ALLCORP, in order to provide such short-term funding, may advance some or all of the proceeds of such financings to one or more of the Subsidiaries; and

WHEREAS, the parties hereto desire to enter into this Agreement for the purpose of setting forth their respective undertakings concerning such advances.

NOW, THEREFORE, in consideration of the premises, the parties hereto agree as follows:

1. ALLCORP agrees, from time to time during the period commencing on February 1, 1996, upon the written request of Subsidiary, and subject to the terms hereof, to advance funds to Subsidiary to the extent that ALLCORP, in its sole judgment, shall have funds available for that purpose. This undertaking by ALLCORP shall be limited to an aggregate amount to all Subsidiaries not in excess of \$1 billion outstanding at any one time.

2. Each advance shall bear interest on the outstanding principal amount thereof, for each day from the date such advance is made until paid. Interest on outstanding advances shall be due when the advance is paid.

3. Subsidiary shall pay to ALLCORP, in consideration for each such advance, interest on the aggregate unpaid principal amount of such advance at a rate equal to the rate paid by ALLCORP on the transaction used by ALLCORP to obtain financing to provide such funding to Subsidiary. Subsidiary shall repay to ALLCORP, upon demand of ALLCORP and in any event on the maturity date, the

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aggregate principal amount of all such advances together with accrued interest to the date of repayment. Subsidiary shall also have the right to prepay all or any part of any advances at any time without penalty but with interest accrued to the date of prepayment.

4. The obligation of any Subsidiary to repay each advance shall be evidenced by a single promissory note of such Subsidiary substantially in the form of Exhibit A attached hereto. The date, amount, interest rate and duration of each advance made by ALLCORP to any Subsidiary, and each payment made on account of such Subsidiary shall be recorded by ALLCORP on the schedule attached to such note or any continuation thereof.

5. No Subsidiary shall use any advance or any portion of any advance, directly or indirectly, for the purpose of buying, carrying or trading tax-exempt securities.

6. This Agreement may be terminated by ALLCORP at any time upon written notice to the Subsidiaries of its desire to terminate. This Agreement may be terminated by any Subsidiary only as to itself at any time upon written notice to ALLCORP of its desire to terminate. This Agreement shall terminate automatically as to any Subsidiary immediately upon such Subsidiary ceasing to be a Subsidiary. No termination shall affect any outstanding advances,

which shall be repaid or honored in accordance with the terms of this Agreement.

IN WITNESS WHEREOF, the parties hereto have caused this Agreement to be signed as of the day and year first above written.

THE ALLSTATE CORPORATION

/s/ Thomas J. Wilson  
-----  
Thomas J. Wilson  
Vice President and Chief Financial  
Officer

ALLSTATE INSURANCE COMPANY

/s/ James P. Zils  
-----  
James P. Zils  
Vice President and Treasurer

ALLSTATE INDEMNITY COMPANY

/s/ James P. Zils  
-----  
James P. Zils  
Vice President and Treasurer

ALLSTATE PROPERTY AND CASUALTY INSURANCE  
COMPANY

/s/ James P. Zils  
-----  
James P. Zils  
Vice President and Treasurer

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DEERBROOK INSURANCE COMPANY

/s/ James P. Zils  
-----  
James P. Zils  
Vice President and Treasurer

ALLSTATE LIFE INSURANCE COMPANY

/s/ James P. Zils  
-----  
James P. Zils  
Vice President and Treasurer

NORTHBROOK LIFE INSURANCE COMPANY

/s/ James P. Zils  
-----  
James P. Zils  
Vice President and Treasurer

GLENBROOK LIFE INSURANCE COMPANY

/s/ James P. Zils  
-----  
James P. Zils  
Vice President and Treasurer

/s/ James P. Zils  
-----  
James P. Zils  
Vice President and Treasurer

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NORTHBROOK PROPERTY AND CASUALTY  
INSURANCE COMPANY

/s/ James P. Zils  
-----  
James P. Zils  
Vice President and Treasurer

NORTHBROOK INDEMNITY COMPANY

/s/ James P. Zils  
-----  
James P. Zils  
Vice President and Treasurer

NORTHBROOK NATIONAL INSURANCE COMPANY

/s/ James P. Zils  
-----  
James P. Zils  
Vice President and Treasurer

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EXHIBIT A

NOTE

Northbrook, Illinois  
February 1, 1996

For value received, ALLSTATE INSURANCE COMPANY, an Illinois corporation (the "Borrower"), promises to pay to the order of THE ALLSTATE CORPORATION (the "Lender") the aggregate unpaid principal amount of the advances made by the Lender to the Borrower under the Intercompany Loan Agreement on the dates and in the principal amounts provided in the Intercompany Loan Agreement with and to pay interest on unpaid principal amounts at the rates and on the dates specified in the Intercompany Loan Agreement. All such payments of principal and interest shall be made in lawful money of the United States in federal or other immediately available funds at the office of the Lender, Allstate Plaza, Northbrook, Illinois. This instrument shall be governed by and construed in accordance with the laws of the state of Illinois.

The date, amount, interest rate and maturity date of each advance made by Lender to Borrower and each payment made on account of Borrower shall be recorded by Lender on the schedule attached hereto or any continuation thereof.

ALLSTATE INSURANCE COMPANY

By \_\_\_\_\_  
Title:

SCHEDULE  
OF  
ADVANCES  
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## CONSENT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

We consent to the incorporation by reference in the following registration statements of our report dated March 9, 2007, relating to the financial statements and financial statement schedules of Allstate Life Insurance Company (which report expresses an unqualified opinion and includes an explanatory paragraph relating to a change in method of accounting for certain nontraditional long-duration contracts and for separate accounts in 2004), appearing in this Annual Report on Form 10-K of Allstate Life Insurance Company for the year ended December 31, 2006.

## FORM S-3 REGISTRATION STATEMENT NOS.

## FORM N-4 REGISTRATION STATEMENT NOS.

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 333-100068  
 333-102319  
 333-102325  
 333-104789  
 333-105331  
 333-112233  
 333-112249  
 333-117685  
 333-119296  
 333-119706  
 333-121739  
 333-121741  
 333-121742  
 333-121745  
 333-121811  
 333-121812  
 333-123847  
 333-125937  
 333-129157  
 333-132999  
 333-137625

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 333-102934  
 333-114560  
 333-114561  
 333-114562  
 333-121691  
 333-121693

/s/ Deloitte & Touche LLP

Chicago, Illinois  
 March 9, 2007

I, Casey J. Sylla, certify that:

1. I have reviewed this report on Form 10-K of Allstate Life Insurance Company;
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)) 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) 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
  - c) 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.
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.

March 13, 2007

/s/ Casey J. Sylla

-----  
Casey J. Sylla  
Chairman of the Board and President

I, John C. Pintozzi, certify that:

1. I have reviewed this report on Form 10-K of Allstate Life Insurance Company;
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)) 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) 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
  - c) 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.
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.

March 13, 2007

/s/ John C. Pintozzi

-----  
John C. Pintozzi  
Senior Vice President and  
Chief Financial Officer

CERTIFICATIONS PURSUANT TO 18 UNITED STATES CODE SECTION 1350

Each of the undersigned hereby certifies that to his knowledge the report on Form 10-K for the fiscal year ended December 31, 2006 of Allstate Life Insurance Company 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 Allstate Life Insurance Company.

March 13, 2007

/s/ Casey J. Sylla

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Casey J. Sylla  
Chairman of the Board and President

/s/ John C. Pintozzi

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John C. Pintozzi  
Senior Vice President and Chief  
Financial Officer