NAIC Group Code 0008
NAIC Company Code 00086
Employer's ID Number 36-07196665

Allstate Insurance Group
Combined Management Discussion and Analysis
For the Year Ended December 31, 2008

The Allstate Insurance Group (referred to in this document as "Allstate", the "Group" or the "Company") consists of the Allstate Insurance Company ("AIC"), Allstate Indemnity Company ("AI"), Allstate Texas Lloyd's ("ATL"), Deerbrook Insurance Company ("DIC"), Allstate Property and Casualty Insurance Company ("APC"), Allstate County Mutual Insurance Company ("ACM"), Allstate Fire and Casualty Insurance Company ("AFCIC"), Northbrook Indemnity Company ("NIC"), Allstate North American Insurance Company ("ANAIC"), Encompass Insurance Company ("EIC"), Encompass Indemnity Company ("EI"), Encompass Independent Insurance Company ("EIIC"), Encompass Home and Auto Insurance Company ("EHAIC"), Encompass Insurance Company of America ("EICA"), Encompass Insurance Company of Massachusetts ("EICMA") and Encompass Property and Casualty Company ("EPC"). Since these insurers are part of a consolidated group that utilize 100% intercompany reinsurance agreements, regulatory approval was obtained to prepare a combined Management Discussion and Analysis ("MD&A"). Accordingly, the combined results of the aforementioned companies have been analyzed in this MD&A.

In addition to the affiliated property-liability insurers listed above, Allstate has several unconsolidated subsidiaries, the largest of which is the Allstate Life Insurance Company ("Allstate Life"). Allstate Life and its subsidiaries market a broad line of life insurance and investment products. Allstate also has several unconsolidated property casualty insurers, the two largest being Allstate New Jersey Insurance Company ("ANJ") and Allstate Floridian Insurance Company ("AFIC"). ANJ writes homeowners and auto exclusively in New Jersey, while AFIC writes only homeowners in Florida. Allstate also has an affiliated foreign insurer, Allstate Insurance Company of Canada ("AICC"), which has three subsidiary insurance companies. Separate MD&As were filed for Allstate Life and certain of its subsidiaries, and ANJ and AFIC.

AIC is an Illinois domiciled insurer licensed to write property and casualty business in 49 states, the District of Columbia, and Puerto Rico and offers a broad range of personal and commercial insurance products. Allstate Insurance Holdings, LLC , a Delaware Corporation, owns all of AIC's outstanding 42,000 shares of common stock and is wholly-owned by The Allstate Corporation (the "Corporation").

Catastrophe losses are an inherent risk of the property-liability insurance industry that have contributed, and will continue to contribute, to potentially material year-to-year fluctuations in our results of operations and financial position. The Group defines a catastrophe as an event that produces pretax losses before reinsurance in excess of $1 million and involves multiple first party policyholders, or an event that produces a number of claims in excess of a preset, per-event threshold of average claims in a specific area, occurring within a certain amount of time following the event. Catastrophes are caused by various natural events including high winds, winter storms, tornadoes, hailstorms, wildfires, tropical storms, hurricanes, earthquakes, and volcanoes. The Group is also exposed to certain man-made catastrophic events, such as certain acts of terrorism or industrial accidents. The nature and level of catastrophes in any period cannot be predicted.

Over time the Group has limited its aggregate insurance exposure to catastrophe losses in certain regions of the country that are subject to high levels of natural catastrophes. Limitations include our participation in various state facilities, such as the California Earthquake Authority, which provides insurance for California earthquake losses; the Florida Hurricane Catastrophe Fund, which provides reimbursements on certain qualifying Florida hurricane losses; and other state facilities, such as wind pools. However, the impact of these actions may be diminished by the growth in insured values, the effect of state insurance laws and regulations. In addition, in various states the Group is required to participate in assigned risk plans, reinsurance facilities and joint underwriting associations that provide insurance coverage to individuals or entities that otherwise are unable to purchase such coverage from private insurers. Because of Allstate's participation in these and other state facilities such as wind pools, there may be exposure to losses that surpass the capitalization of these facilities and/or to assessments from these facilities.

Allstate continues to take actions to maintain an appropriate level of exposure to catastrophic events, including the following:

- A reduction of property policies in force ("PIF") in coastal management areas thereby lowering hurricane exposures. This includes Texas and Louisiana where the combination of reduced property PIF and ceded wind coverage in the coastal regions reduced our loss exposures to wind by 43.5% and 34.9%, respectively, below 2006 levels.
- Increased utilization of wind storm pools, including in Texas where Allstate cedes all wind exposure related to insured property located in all wind pool eligible areas along the coast including the Galveston Islands.
- No writing of new homeowners business in California, however, renewals of current policyholders will continue.
- Renewals are no longer offered on certain homeowners insurance policies in New York in certain down-state geographical locations.

Allstate is working for changes in the regulatory environment, including fewer restrictions on underwriting, recognizing the need for and improving appropriate risk based pricing and promoting the creation of government sponsored, privately funded solutions for large catastrophes. While the actions taken will be primarily focused on reducing the catastrophe exposure on property business, the impact on marketing auto lines will also be considered.

The Group believes the greatest areas of potential catastrophe losses due to hurricanes to generally be major metropolitan centers in counties along the eastern and gulf coasts of the United States. Generally, the average premium on a property policy near these coasts is greater than other areas. However, average premiums are not considered commensurate with the inherent risk of loss.

BUSINESS SEGMENTS

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

The Company maintains a comprehensive marketing approach throughout the U.S. Agency and management compensation and the overall strategies of the Allstate brand have been aligned to best serve our customers by basing certain incentives on Allstate brand profitability, PIF growth, retention, and sales of financial products. The Allstate brand is differentiated from competitors by offering a choice of products, including Allstate® Your Choice Auto Insurance ("YCA") with options such as safe driving deductibles and a safe driving bonus, Allstate® Your Choice Home ("YCH") with options such as claims-free bonus and greater ability to tailor insurance coverage and Allstate Blue℠, a non-standard auto product with features such as a loyalty bonus and roadside assistance coverage.

Both pricing and underwriting are designed to enhance the Company's competitive position and profit potential, and produce a broader range of premiums that is more refined than the range generated by the standard/non-standard model. Pricing sophistication which underlies our Strategic Risk Management program uses a number of risk evaluation factors including, to the extent legally permissible, insurance scoring based on information that is obtained from credit reports. The Company continues to expand the number of price points with successive rating program releases.

Substantially all of new and approximately 88% of renewal business written for Allstate brand auto are rated using our pricing sophistication methods. For Allstate brand homeowners, approximately 94% of new and 60% of renewal business written are rated using pricing sophistication methods. For Allstate brand auto and homeowners business, results indicate that over time, use of these methods has improved the mix of customers towards those who are considered high lifetime value that generally have better retention and more favorable loss experience.

Allstate is pursuing improvements in the overall customer experience through actions targeted to increase customer satisfaction and retention. These programs are designed around establishing customer service expectations and customer relationship building. Our claims strategy focuses on delivering fast, fair and consistent claim service while achieving loss cost management and customer satisfaction.

Allstate continues to enhance technology to integrate our distribution channels, improve customer service, facilitate the introduction of new products and services and reduce infrastructure costs related to supporting agencies and handling claims. These actions and others are designed to optimize the effectiveness of the distribution and service channels by increasing the productivity of the Allstate brand's exclusive agencies and direct channels.

Pricing of property products is typically intended to establish returns that are deemed acceptable over a long-term period. Losses, including losses from catastrophic events and weather-related losses (such as wind, hail, lightning and freeze losses not meeting the stated criteria to be declared a catastrophe), are accrued on an occurrence basis within the policy period. Therefore, in any reporting period, loss experience from catastrophic events and weather-related losses may contribute to negative or positive underwriting performance relative to the expectations that were incorporated into the products' pricing. Accordingly, property products are more capital intensive than other personal lines products.

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

FINANCIAL POSITION

Cash and invested assets

Allstate's investment strategy emphasizes safety of principal and consistent income generation, within a total return framework. This approach is designed to produce competitive returns over time, and to ensure financial strength and stability for paying claims, while maximizing economic value and surplus growth. We employ a strategic asset allocation model, which considers the nature of the liabilities and risk tolerances, as well as the risk and return parameters of the various asset classes in which we invest. The model's recommended asset allocation, along with duration and liquidity considerations, guides our initial asset allocation. This is further adjusted based on an analysis of other potential market opportunities available. Portfolio performance is measured against benchmarks at target allocation weights.

As a result of tactical decisions in managing the portfolio, the Company may sell securities during the period in which fair value has declined below amortized cost for fixed income securities or cost for equity securities. The Company has a comprehensive portfolio monitoring process to identify and evaluate investments whose carrying value may be other-than-temporarily impaired.

The composition of the investment portfolio at December 31 was:

(in millions)	2008	2007
Bonds	$ 22,129	$ 27,981
Preferred stocks	233	612
Common stocks	6,511	8,021
Mortgage loans on real estate	104	795
Real estate	310	292
Cash and cash equivalents	742	278
Short-term investments	320	101
Other invested assets	2,641	1,885
Total	$ 32,990	$ 39,965

Cash and invested assets decreased 17.5%, or $6.9 billion, primarily due to dividends paid to the Corporation, other-than-temporary impairment writedowns caused by market conditions and lower underwriting results.

Bonds

The Group's bond portfolio consists of U.S. government bonds, municipal bonds, corporate bonds, asset-backed securities ("ABS") and mortgage-backed securities ("MBS"). Allstate generally holds its bonds to maturity, but has classified all bonds as available for sale to allow maximum flexibility in portfolio management.

Municipal bonds totaled $17.0 billion at December 31, 2008 compared to $16.8 billion at December 31, 2007. Municipal bonds, including tax-exempt and taxable securities, comprise $17.0 billion, or 76.9%, of the bond portfolio at December 31, 2008. The municipal bond portfolio at December 31, 2008 consisted of 4,490 issues from 1,949 issuers. The largest exposure to a single issuer was 1% of the municipal bond portfolio. Corporate entities were the ultimate obligors of 12% of the municipal bond portfolio.

Corporate bonds totaled $1.6 billion at December 31, 2008 compared to $3.4 billion at December 31, 2007. As of December 31, 2008, the portfolio also contained $559 million of privately placed corporate obligations, compared with $1.6 billion at December 31, 2007. Privately placed securities primarily consist of corporate issued senior debt securities that are in unregistered form and are directly negotiated with the borrower. All privately placed corporate securities are rated by the National Association of Insurance Commissioners ("NAIC") Securities Valuation Office based on information provided to them and are also internally rated. Additionally, 40.7% of the privately placed corporate securities in our portfolio are rated by an independent rating agency.

ABS totaled $1.5 billion at December 31, 2008 compared to $3.0 billion at December 31, 2007. 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. A portion of the ABS portfolio is also subject to interest rate risk since ultimate realized yields are affected by the rate of prepayment of the underlying assets.

The Company identified it had exposure to subprime residential mortgage related risk in the form of asset-backed residential mortgage-backed securities ("ABS RMBS"). The ABS RMBS portfolio includes securities that are collateralized by mortgage loans issued to borrowers that cannot qualify for prime or alternative financing terms due in part to an impaired or limited credit history. It also includes securities that are collateralized by certain second lien mortgages regardless of the borrower's credit profile. At December 31, 2008, the ABS RMBS portfolio had net unrealized losses of $393 million, of which $397 million were gross unrealized losses and $4 million were gross unrealized gains. At December 31, 2007, the ABS RMBS portfolio had net unrealized losses of $126 million, of which $136 million were gross unrealized losses and $10 million were gross unrealized gains.

The Company continues to believe that the unrealized losses on these securities are not predictive of the ultimate performance of the underlying collateral. In the absence of further deterioration in the collateral relative to its positions in the securities' respective capital structures, which could be other than temporary, the unrealized losses should reverse over the remaining lives of the securities.

MBS totaled $1.1 billion at December 31, 2008 compared to $2.6 billion at December 31, 2007, of which 93.7% were investment grade in 2008. The credit risk associated with MBS is mitigated due to the fact that 73.1% 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.

At December 31, 2008, 93.2% of the consolidated bond portfolio was rated investment grade, which is defined as a security having a rating from the NAIC Securities Valuation Office rating of 1 or 2; a rating of Aaa, Aa, A or Baa from Moody's or a rating of AAA, AA, A or BBB from S&P, Fitch or Dominion; or a comparable internal rating. There were no material changes in the investment mix or, quality distribution from the prior year.

Bonds are carried at amortized cost. The fair value of bonds was $20.9 billion and $28.5 billion at December 31, 2008 and 2007, respectively. At December 31, 2008, unrealized net capital losses on the bond portfolio, which are measured as the difference between statement value and fair value, were $1.2 billion compared to unrealized net capital gains of $468 million as of December 31, 2007.

The ratings of securities in the Company's portfolio are influenced by many factors, including the impact of the economic environment on individual securities. The Investment Manager closely monitors the bond portfolio for ratings changes or other declines in value that are other than temporary. Fixed income securities are placed on non-accrual status when they are in default or when the timing or receipt of principal or interest payments are in doubt. Write-downs of bonds are recorded when the decline in value is considered to be other than temporary.

Equity securities

Equity securities include common and non-redeemable preferred stocks, and investments in affiliates. The $1.9 billion decrease in common stocks was attributable to the current market conditions and a decrease in subsidiaries' underlying book value.

Mortgage loans on real estate

Allstate's investment in mortgage loans decreased from $795 million at December 31, 2007 to $104 million at December 31, 2008. The decrease was primarily the result of an intercompany transfer of loans between AIC and Allstate Life of $634M as part of the enterprise asset reallocation strategy. The Company closely monitors the 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 risks, are reviewed at least quarterly for purposes of establishing valuation allowances and placing loans on non-accrual status as necessary. 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 a market based expected rate of return.

Short-term investments

The short-term investment portfolio was $320 million and $101 million at December 31, 2008 and 2007, respectively. Allstate invests available cash balances primarily in taxable short-term securities having a final maturity date or redemption date of less than one year.

Other invested assets

Allstate's other invested asset portfolio increased $756 million, or 40.1%, from $1.9 billion to $2.6 billion from prior year driven primarily by the addition of a $400 million surplus note from Allstate Life and a $350 million increase in receivables for securities due to the high volume of sale trades near the end of December. All of the receivables were settled in January.

Other assets

The Company is in a current federal income tax recoverable position of $713 million at December 31, 2008. In the prior year, the Company was in a payable position of $2.7 million. The change was primarily related to the decrease in net income. Net deferred tax asset increased $292 million, $225 million of which was driven by an accounting permitted practice approved by the Illinois Division of Insurance. The permitted practice increased the amount of deferred tax assets that can be recognized as an admitted asset and included in statutory surplus to the lesser of deferred taxes that can be realized within three years or 15% of adjusted statutory surplus.

Reserves for losses and loss adjustment expenses

Activity in the reserve for losses and loss adjustment expenses, on a net basis, was summarized as follows at December 31:

(in millions)	2008	2007
Balance at January 1	$ 14,232	$ 14,346
Current year	18,197	16,326
Prior years	212	(82)
Total incurred	18,409	16,244
Paid related to:		
Current year	11,609	10,356
Prior years	6,168	6,002
Total paid	17,777	16,358
Balance at December 31	$ 14,864	$ 14,232

Incurred losses and loss adjustment expenses attributable to insured events of prior years were $212 million and $(82) million as a result of the reestimation of unpaid losses and loss adjustment expenses for the years ending December 31, 2008 and 2007, respectively. During 2008, incurred losses and loss adjustment expenses related to prior years were primarily composed of litigation settlements and catastrophe losses. During 2007, incurred losses and loss adjustment expenses related to prior years were primarily composed of net decreases in auto reserves due to claim severity development that was better than expected, partially offset by increases in environmental reserves.

Other liabilities

Aggregate write-ins for liabilities decreased $1.68 billion, or 80.23%, primarily the result of decreased securities lending transactions due to reduced loan activity.

Capital and surplus

The following table summarizes Allstate's capital position at the end of the last two years.

(in millions)	2008	2007
Common capital stock	$ 4	$ 4
Gross paid in and contributed surplus	3,364	2,358
Unassigned funds (surplus)	9,638	15,656
Aggregate write-ins for special surplus funds	29	29
Total surplus as regards policyholders	$ 13,035	$ 18,047

Total surplus as regards policyholders decreased 27.8%, or $5.0 billion, and was comprised of the following main items:

- $3.4 billion in dividends paid to the Corporation.
- $2.5 billion decrease in unrealized capital gain due to a $1.2 billion decrease in affiliated common stock, primarily from the increased investment in ALIC in the form of a $1.4 billion capital contribution, a $1.1 billion decrease in unaffiliated common stock, and a $510 million decrease from bonds (LOCOM adjustment). These amounts were partially offset by a $703 million increase in deferred tax on unrealized losses.
- $879 million in additional minimum pension liability.
- $369 million decrease in deferred income tax driven by decreases from the tax effect of unrealized losses ($703 million) and additional minimum pension liability ($458 million), partially offset by an increase of $791 million in net deferred tax assets.

Offsetting these decreases were a $1.0 billion capital contribution from the Corporation, $687 million of net income for the year, and a $434 million decrease in non-admitted assets.

RESULTS OF OPERATIONS

(in millions)		2008		2007
Premiums earned	$	24,776	$	25,063
Losses incurred		15,233		13,298
Loss expenses incurred		3,086		2,946
Other underwriting expenses incurred		6,210		6,449
Total underwriting deductions		24,619		22,693
Net underwriting gain (loss)		157		2,370
Net investment income earned		1,439		2,636
Net realized capital gains (losses)		(860)		989
Net investment gain (loss)		579		3,625
Total other income		213		224
Net income, after dividends to policyholders but before federal and foreign income taxes		949		6,219
Federal and foreign income taxes incurred		253		1,345
Net income	$	696	$	4,874

Net underwriting gain

The decrease in underwriting gain was primarily due to increased catastrophe losses, increases in auto severities, increases in homeowners loss frequencies and unfavorable prior year reserve reestimates in the current year compared to favorable prior year reserve reestimates in 2007. These increases were partially offset by favorable auto loss frequencies and higher standard auto average premium.

The Discontinued Lines and Coverages segment generated an underwriting loss of $25 million in 2008 primarily related to a $13 million unfavorable reestimate of reserves as a result of the annual third quarter ground-up reserve review and an $8 million reestimate of asbestos reserves.

Net investment income earned

Net investment income earned decreased from $2.6 billion in 2007 to $1.4 billion in 2008. The change was primarily due to the decrease of $1.1 billion in dividend income from AIC's subsidiaries with only $3.1 million in dividend income in 2008 compared to $1.1 billion in 2007. In addition, interest income on fixed income securities decreased $193 million. The average cash and invested asset base decreased approximately 10.6%, reflecting dividends to the Corporation.

Net realized capital gains (losses)

Net realized capital gains of $989 million in 2007 decreased $1.8 billion resulting in net realized capital losses of $860 million in 2008. This dramatic change was primarily due to the broad S&P 500 market decrease of 38.5% in 2008 as well as impairments, while the 2007 results reflected harvesting of gains accumulated through positive equity returns in previous years. The fixed income portfolios were impacted by the credit crisis and severe widening of spreads. The risk mitigation program implemented in 2008 helped offset some of the losses through the use of derivatives.

CASH FLOW AND LIQUIDITY

The following table summarizes cash flow.

(in millions)	2008	2007
Net cash from operations	$ 1,751	$ 2,966
Net cash from investments	3,198	1,752
Net cash from financing and miscellaneous sources	(4,266)	(4,439)
Net change in cash, cash equivalents and short-term investments	$ 683	$ 279

The Company's operations typically generate substantial positive cash flows from operations as most premiums are received in advance of the time when claim payments are made. Lower operating cash flows in 2008 were mainly due to increased claim payments and lower net investment income, partially offset by a decrease in federal income taxes. Cash provided from investments increased in 2008 as a result of increased proceeds from sales of securities and decreased costs from investments acquired.

Financial strength ratings and outlook

Allstate's financial strength ratings and outlook were Aa3 (stable), AA- (negative) and A+ (stable) by Moody's, S&P and A.M. Best, respectively, at December 31, 2008.

Risk based capital

The NAIC has a standard to help assess the solvency of insurance companies, which is referred to as risk based capital ("RBC"). The standard is based on a formula for determining each insurer's RBC and a model law specifying regulatory actions if an insurer's RBC falls below specified levels. The formula for calculating RBC takes into account asset and credit risks, but places more emphasis on underwriting factors for reserving and pricing. At December 31, 2008, the RBC for each of the insurers comprising the Group was significantly above levels that would require regulatory action.

IRIS ratios

The NAIC has also developed a set of financial relationships or tests known as the Insurance Regulatory Information System ("IRIS") to assist state regulators in monitoring the financial condition of insurance companies and identifying companies that require special attention or action by insurance regulatory authorities. The NAIC analyzes financial data provided by insurance companies using prescribed ratios, each with a defined usual range. Additional regulatory scrutiny may occur if a company's ratio results fall outside the usual range for four or more of the ratios. At December 31, 2008, none of the insurers comprising the AIC group had four or more ratio results outside the usual range.