

ALLSTATE CORP

Form 10-Q

November 02, 2015

UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-Q

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

For the quarterly period ended September 30, 2015

OR

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

For the transition period from \_\_\_\_\_ to \_\_\_\_\_

Commission file number 1-11840

THE ALLSTATE CORPORATION

(Exact name of registrant as specified in its charter)

Delaware

36-3871531

(State or other jurisdiction of incorporation or organization)

(I.R.S. Employer Identification No.)

2775 Sanders Road, Northbrook, Illinois 60062

(Address of principal executive offices) (Zip Code)

(847) 402-5000

(Registrant's telephone number, including area code)

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

Yes  No

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files).

Yes  No

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

Large accelerated filer  Accelerated filer

Non-accelerated filer (Do not check if a smaller reporting company)  Smaller reporting company

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

Yes  No

As of October 19, 2015, the registrant had 387,306,176 common shares, \$.01 par value, outstanding.

THE ALLSTATE CORPORATION  
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September 30, 2015

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PART I. FINANCIAL INFORMATION  
ITEM 1. FINANCIAL STATEMENTS  
THE ALLSTATE CORPORATION AND SUBSIDIARIES  
CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS

(\$ in millions, except per share data)	Three months ended		Nine months ended	
	September 30, 2015 (unaudited)	2014 (unaudited)	September 30, 2015 (unaudited)	2014 (unaudited)
Revenues				
Property-liability insurance premiums	\$7,650	\$7,307	\$22,625	\$21,575
Life and annuity premiums and contract charges	538	512	1,611	1,637
Net investment income	807	823	2,446	2,680
Realized capital gains and losses:				
Total other-than-temporary impairment (“OTTI”) losses	(186 )	(53 )	(286 )	(177 )
OTTI losses reclassified to (from) other comprehensive income	12	—	20	(2 )
Net OTTI losses recognized in earnings	(174 )	(53 )	(266 )	(179 )
Sales and other realized capital gains and losses	207	347	546	767
Total realized capital gains and losses	33	294	280	588
	9,028	8,936	26,962	26,480
Costs and expenses				
Property-liability insurance claims and claims expense	5,255	4,909	15,835	14,810
Life and annuity contract benefits	460	433	1,347	1,334
Interest credited to contractholder funds	194	198	578	717
Amortization of deferred policy acquisition costs	1,092	1,030	3,248	3,100
Operating costs and expenses	992	1,068	3,143	3,185
Restructuring and related charges	9	3	32	13
Loss on extinguishment of debt	—	—	—	1
Interest expense	73	78	219	249
	8,075	7,719	24,402	23,409
Gain (loss) on disposition of operations	2	(27 )	2	(77 )
Income from operations before income tax expense	955	1,190	2,562	2,994
Income tax expense	305	409	880	968
Net income	650	781	1,682	2,026
Preferred stock dividends	29	31	87	75
Net income available to common shareholders	\$621	\$750	\$1,595	\$1,951
Earnings per common share:				
Net income available to common shareholders per common share - Basic	\$1.56	\$1.77	\$3.92	\$4.49
Weighted average common shares - Basic	397.0	424.5	406.5	435.0
Net income available to common shareholders per common share - Diluted	\$1.54	\$1.74	\$3.87	\$4.42
Weighted average common shares - Diluted	402.1	431.2	412.4	441.6
Cash dividends declared per common share	\$0.30	\$0.28	\$0.90	\$0.84

See notes to condensed consolidated financial statements.

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THE ALLSTATE CORPORATION AND SUBSIDIARIES  
 CONDENSED CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME

(\$ in millions)	Three months ended		Nine months ended	
	September 30,		September 30,	
	2015	2014	2015	2014
	(unaudited)		(unaudited)	
Net income	\$650	\$781	\$1,682	\$2,026
Other comprehensive (loss) income, after-tax				
Changes in:				
Unrealized net capital gains and losses	(540	) (323	) (1,047	) 181
Unrealized foreign currency translation adjustments	(14	) (17	) (50	) (20
Unrecognized pension and other postretirement benefit cost	25	12	74	31
Other comprehensive (loss) income, after-tax	(529	) (328	) (1,023	) 192
Comprehensive income	\$121	\$453	\$659	\$2,218

See notes to condensed consolidated financial statements.



THE ALLSTATE CORPORATION AND SUBSIDIARIES  
CONDENSED CONSOLIDATED STATEMENTS OF FINANCIAL POSITION

(\$ in millions, except par value data)	September 30, 2015 (unaudited)	December 31, 2014
Assets		
Investments		
Fixed income securities, at fair value (amortized cost \$56,918 and \$59,672)	\$58,257	\$62,440
Equity securities, at fair value (cost \$4,123 and \$3,692)	4,236	4,104
Mortgage loans	4,402	4,188
Limited partnership interests	4,823	4,527
Short-term, at fair value (amortized cost \$3,036 and \$2,540)	3,036	2,540
Other	3,588	3,314
Total investments	78,342	81,113
Cash	905	657
Premium installment receivables, net	5,711	5,465
Deferred policy acquisition costs	3,811	3,525
Reinsurance recoverables, net	8,468	8,490
Accrued investment income	575	591
Property and equipment, net	1,050	1,031
Goodwill	1,219	1,219
Other assets	2,091	2,046
Separate Accounts	3,677	4,396
Total assets	\$105,849	\$108,533
Liabilities		
Reserve for property-liability insurance claims and claims expense	\$23,757	\$22,923
Reserve for life-contingent contract benefits	12,229	12,380
Contractholder funds	21,559	22,529
Unearned premiums	12,343	11,655
Claim payments outstanding	804	784
Deferred income taxes	243	715
Other liabilities and accrued expenses	5,558	5,653
Long-term debt	5,175	5,194
Separate Accounts	3,677	4,396
Total liabilities	85,345	86,229
Commitments and Contingent Liabilities (Note 10)		
Shareholders' equity		
Preferred stock and additional capital paid-in, \$1 par value, 25 million shares authorized, 72.2 thousand shares issued and outstanding, and \$1,805 aggregate liquidation preference	1,746	1,746
Common stock, \$.01 par value, 2.0 billion shares authorized and 900 million issued, 390 million and 418 million shares outstanding	9	9
Additional capital paid-in	3,224	3,199
Retained income	39,068	37,842
Deferred ESOP expense	(23	) (23
Treasury stock, at cost (510 million and 482 million shares)	(23,058	) (21,030
Accumulated other comprehensive income:		
Unrealized net capital gains and losses:		
Unrealized net capital gains and losses on fixed income securities with OTTI	57	72
Other unrealized net capital gains and losses	886	1,988
Unrealized adjustment to DAC, DSI and insurance reserves	(64	) (134

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Total unrealized net capital gains and losses	879	1,926	
Unrealized foreign currency translation adjustments	(52	) (2	)
Unrecognized pension and other postretirement benefit cost	(1,289	) (1,363	)
Total accumulated other comprehensive (loss) income	(462	) 561	
Total shareholders' equity	20,504	22,304	
Total liabilities and shareholders' equity	\$105,849	\$108,533	

See notes to condensed consolidated financial statements.

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THE ALLSTATE CORPORATION AND SUBSIDIARIES  
CONDENSED CONSOLIDATED STATEMENTS OF SHAREHOLDERS' EQUITY

(\$ in millions)	Nine months ended September	
	30, 2015 (unaudited)	2014
Preferred stock par value	\$—	\$—
Preferred stock additional capital paid-in		
Balance, beginning of period	1,746	780
Preferred stock issuance	—	966
Balance, end of period	1,746	1,746
Common stock	9	9
Additional capital paid-in		
Balance, beginning of period	3,199	3,143
Forward contract on accelerated share repurchase agreement	—	(113 )
Equity incentive plans activity	25	29
Balance, end of period	3,224	3,059
Retained income		
Balance, beginning of period	37,842	35,580
Net income	1,682	2,026
Dividends on common stock	(369 )	(367 )
Dividends on preferred stock	(87 )	(75 )
Balance, end of period	39,068	37,164
Deferred ESOP expense		
Balance, beginning of period	(23 )	(31 )
Payments	—	—
Balance, end of period	(23 )	(31 )
Treasury stock		
Balance, beginning of period	(21,030 )	(19,047 )
Shares acquired	(2,230 )	(2,054 )
Shares reissued under equity incentive plans, net	202	245
Balance, end of period	(23,058 )	(20,856 )
Accumulated other comprehensive income		
Balance, beginning of period	561	1,046
Change in unrealized net capital gains and losses	(1,047 )	181
Change in unrealized foreign currency translation adjustments	(50 )	(20 )
Change in unrecognized pension and other postretirement benefit cost	74	31
Balance, end of period	(462 )	1,238
Total shareholders' equity	\$20,504	\$22,329

See notes to condensed consolidated financial statements.

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THE ALLSTATE CORPORATION AND SUBSIDIARIES  
CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS

(\$ in millions)	Nine months ended September 30,	
	2015	2014
	(unaudited)	
Cash flows from operating activities		
Net income	\$1,682	\$2,026
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation, amortization and other non-cash items	275	277
Realized capital gains and losses	(280	) (588
Loss on extinguishment of debt	—	1
(Gain) loss on disposition of operations	(2	) 77
Interest credited to contractholder funds	578	717
Changes in:		
Policy benefits and other insurance reserves	500	50
Unearned premiums	762	822
Deferred policy acquisition costs	(219	) (189
Premium installment receivables, net	(290	) (386
Reinsurance recoverables, net	(133	) (110
Income taxes	(60	) 175
Other operating assets and liabilities	(127	) (307
Net cash provided by operating activities	2,686	2,565
Cash flows from investing activities		
Proceeds from sales		
Fixed income securities	22,796	27,648
Equity securities	2,688	5,263
Limited partnership interests	795	1,084
Mortgage loans	6	10
Other investments	178	292
Investment collections		
Fixed income securities	3,248	2,787
Mortgage loans	305	868
Other investments	254	158
Investment purchases		
Fixed income securities	(22,928	) (30,650
Equity securities	(3,238	) (4,208
Limited partnership interests	(930	) (892
Mortgage loans	(524	) (218
Other investments	(743	) (652
Change in short-term investments, net	(577	) 265
Change in other investments, net	(16	) 58
Purchases of property and equipment, net	(219	) (207
Disposition of operations	—	378
Net cash provided by investing activities	1,095	1,984
Cash flows from financing activities		
Repayments of long-term debt	(20	) (1,006
Proceeds from issuance of preferred stock	—	965
Contractholder fund deposits	784	926
Contractholder fund withdrawals	(1,793	) (2,831
Dividends paid on common stock	(365	) (360

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Dividends paid on preferred stock	(87	) (56	)
Treasury stock purchases	(2,216	) (2,189	)
Shares reissued under equity incentive plans, net	121	204	
Excess tax benefits on share-based payment arrangements	44	22	
Other	(1	) (14	)
Net cash used in financing activities	(3,533	) (4,339	)
Net increase in cash	248	210	
Cash at beginning of period	657	675	
Cash at end of period	\$905	\$885	
See notes to condensed consolidated financial statements.			

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THE ALLSTATE CORPORATION AND SUBSIDIARIES  
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

(Unaudited)

1. General

Basis of presentation

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

The condensed consolidated financial statements and notes as of September 30, 2015 and for the three-month and nine-month periods ended September 30, 2015 and 2014 are unaudited. The condensed consolidated financial statements reflect all adjustments (consisting only of normal recurring accruals) which are, in the opinion of management, necessary for the fair presentation of the financial position, results of operations and cash flows for the interim periods. These condensed consolidated financial statements and notes should be read in conjunction with the consolidated financial statements and notes thereto included in the Company’s Annual Report on Form 10-K for the year ended December 31, 2014. The results of operations for the interim periods should not be considered indicative of results to be expected for the full year. All significant intercompany accounts and transactions have been eliminated.

Adopted accounting standard

Accounting for Investments in Qualified Affordable Housing Projects

In January 2014, the Financial Accounting Standards Board (“FASB”) issued guidance which allows entities that invest in certain qualified affordable housing projects through limited liability entities the option to account for these investments using the proportional amortization method if certain conditions are met. Under the proportional amortization method, the entity amortizes the initial cost of the investment in proportion to the tax credits and other tax benefits received and recognizes the net investment performance in the income statement as a component of income tax expense or benefit. Adoption of the new guidance in the first quarter of 2015 resulted in a one-time \$45 million increase in income tax expense.

Pending accounting standards

Revenue from Contracts with Customers

In May 2014, the FASB issued guidance which revises the criteria for revenue recognition. Insurance contracts are excluded from the scope of the new guidance. Under the guidance, the transaction price is attributed to underlying performance obligations in the contract and revenue is recognized as the entity satisfies the performance obligations and transfers control of a good or service to the customer. Incremental costs of obtaining a contract may be capitalized to the extent the entity expects to recover those costs. The guidance is effective for reporting periods beginning after December 15, 2017 and is to be applied retrospectively. The Company is in the process of evaluating the impact of adoption, which is not expected to be material to the Company’s results of operations or financial position.

Accounting for Share-Based Payments When the Terms of an Award Provide That a Performance Target Could Be Achieved after the Requisite Service Period

In June 2014, the FASB issued guidance which clarifies that a performance target that affects vesting and could be achieved after the requisite service period should be treated as a performance condition and should not be reflected in estimating the grant-date fair value of the award. Compensation costs should reflect the amount attributable to the periods for which the requisite service has been rendered. Total compensation expense recognized during and after the requisite service period (which may differ from the vesting period) should reflect the number of awards that are expected to vest and should be adjusted to reflect the number of awards that ultimately vest. The guidance is effective for reporting periods beginning after December 15, 2015 and may be applied either prospectively or retrospectively. The Company’s existing accounting policy for performance targets that affect the vesting of share-based payment awards is consistent with the proposed guidance and as such the impact of adoption is not expected to impact the Company’s results of operations or financial position.

Amendments to the Consolidation Analysis

In February 2015, the FASB issued guidance affecting the consolidation evaluation for limited partnerships and similar entities, fees paid to a decision maker or service provider, and variable interests in a variable interest entity held by related parties of the reporting enterprise. The guidance is effective for annual and interim reporting periods beginning after December 15, 2015. The Company is in the process of assessing the impact of adoption which is not expected to be material to the Company's results of operations or financial position.

### Presentation of Debt Issuance Costs

In April 2015, the FASB issued guidance that amends the accounting for debt issuance costs. The amended guidance requires that debt issuance costs related to a recognized debt liability be presented as a direct reduction in the carrying amount of the debt liability. The amortization of debt issuance costs shall be classified as interest expense. In August 2015, the FASB expanded the guidance on debt issuance costs to address debt issuance costs associated with line-of-credit agreements. The guidance allows reporting entities to defer and present debt issuance costs as an asset and subsequently amortize the deferred debt issuance costs ratably over the term of the line-of-credit arrangement, regardless of whether there are any outstanding borrowings on the line-of-credit arrangement. The guidance is effective for reporting periods beginning after December 15, 2015 and is to be applied retrospectively. The impact of adoption of the new guidance is not expected to be material to the Company's results of operations or financial position.

### Disclosures about Short-Duration Contracts

In May 2015, the FASB issued guidance requiring expanded disclosures for insurance entities that issue short-duration contracts. The expanded disclosures are designed to provide additional insight into an insurance entity's ability to underwrite and anticipate costs associated with insurance claims. The disclosures include information about incurred and paid claims development by accident year, on a net basis after reinsurance, for the number of years claims incurred typically remain outstanding, not to exceed ten years. Each period presented in the disclosure about claims development that precedes the current reporting period is considered required supplementary information. The expanded disclosures also include information about significant changes in methodologies and assumptions, a reconciliation of incurred and paid claims development to the carrying amount of the liability for unpaid claims and claim adjustment expenses, the total amount of incurred but not reported liabilities plus expected development, claims frequency information including the methodology used to determine claim frequency and any changes to that methodology, and claim duration. The guidance is effective for annual periods beginning after December 15, 2015, and interim periods beginning after December 15, 2016, and is to be applied retrospectively. The new guidance affects disclosures only and will have no impact on the Company's results of operations or financial position.

### 2. Earnings per Common Share

Basic earnings per common share is computed using the weighted average number of common shares outstanding, including unvested participating restricted stock units. Diluted earnings per common share is computed using the weighted average number of common and dilutive potential common shares outstanding. For the Company, dilutive potential common shares consist of outstanding stock options and unvested non-participating restricted stock units and contingently issuable performance stock awards.

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

(\$ in millions, except per share data)	Three months ended		Nine months ended	
	September 30, 2015	September 30, 2014	September 30, 2015	September 30, 2014
Numerator:				
Net income	\$650	\$781	\$1,682	\$2,026
Less: Preferred stock dividends	29	31	87	75
Net income available to common shareholders	\$621	\$750	\$1,595	\$1,951
Denominator:				
Weighted average common shares outstanding	397.0	424.5	406.5	435.0
Effect of dilutive potential common shares:				
Stock options	3.6	4.8	4.2	4.7
Restricted stock units (non-participating) and performance stock awards	1.5	1.9	1.7	1.9
Weighted average common and dilutive potential common shares outstanding	402.1	431.2	412.4	441.6

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Earnings per common share - Basic	\$1.56	\$1.77	\$3.92	\$4.49
Earnings per common share - Diluted	\$1.54	\$1.74	\$3.87	\$4.42

The effect of dilutive potential common shares does not include the effect of options with an anti-dilutive effect on earnings per common share because their exercise prices exceed the average market price of Allstate common shares during the period or for which the unrecognized compensation cost would have an anti-dilutive effect. Options to purchase 2.2 million and 3.3 million Allstate common shares, with exercise prices ranging from \$52.22 to \$71.29 and \$49.96 to \$62.42, were outstanding for the three-month periods ended September 30, 2015 and 2014, respectively, but were not included in the computation of diluted earnings per common share in those periods. Options to purchase 2.2 million and 4.5 million Allstate common shares, with exercise prices



ranging from \$57.98 to \$71.29 and \$45.61 to \$62.42, were outstanding for the nine-month periods ended September 30, 2015 and 2014, respectively, but were not included in the computation of diluted earnings per common share in those periods.

### 3. Supplemental Cash Flow Information

Non-cash investing activities include \$84 million and \$105 million related to modifications of certain mortgage loans, fixed income securities and other investments, as well as mergers completed with equity securities for the nine months ended September 30, 2015 and 2014, respectively, and a \$90 million obligation to fund a limited partnership investment for the nine months ended September 30, 2015. Non-cash financing activities include \$74 million and \$46 million related to the issuance of Allstate common shares for vested restricted stock units and performance stock awards for the nine months ended September 30, 2015 and 2014, respectively.

Liabilities for collateral received in conjunction with the Company's securities lending program and over-the-counter ("OTC") and cleared derivatives are reported in other liabilities and accrued expenses or other investments. The accompanying cash flows are included in cash flows from operating activities in the Condensed Consolidated Statements of Cash Flows along with the activities resulting from management of the proceeds, which are as follows: (\$ in millions)

	Nine months ended September 30,	
	2015	2014
Net change in proceeds managed		
Net change in short-term investments	\$(2	) \$(162
Operating cash flow used	(2	) (162
Net change in cash	1	7
Net change in proceeds managed	\$(1	) \$(155
Net change in liabilities		
Liabilities for collateral, beginning of period	\$(782	) \$(624
Liabilities for collateral, end of period	(783	) (779
Operating cash flow provided	\$1	\$155

### 4. 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 Gains	Losses	Fair value
September 30, 2015				
U.S. government and agencies	\$3,642	\$118	\$—	\$3,760
Municipal	7,082	431	(19	) 7,494
Corporate	40,997	1,322	(690	) 41,629
Foreign government	1,026	60	(1	) 1,085
Asset-backed securities ("ABS")	2,727	19	(35	) 2,711
Residential mortgage-backed securities ("RMBS")	913	108	(10	) 1,011
Commercial mortgage-backed securities ("CMBS")	510	35	(3	) 542
Redeemable preferred stock	21	4	—	25
Total fixed income securities	\$56,918	\$2,097	\$(758	) \$58,257
December 31, 2014				
U.S. government and agencies	\$4,192	\$139	\$(3	) \$4,328
Municipal	7,877	645	(25	) 8,497
Corporate	40,386	1,998	(240	) 42,144
Foreign government	1,543	102	—	1,645
ABS	3,971	38	(31	) 3,978
RMBS	1,108	112	(13	) 1,207

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CMBS	573	44	(2	) 615
Redeemable preferred stock	22	4	—	26
Total fixed income securities	\$59,672	\$3,082	\$(314	) \$62,440

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Scheduled maturities

The scheduled maturities for fixed income securities are as follows as of September 30, 2015:

(\$ in millions)	Amortized cost	Fair value
Due in one year or less	\$4,465	\$4,494
Due after one year through five years	25,511	26,082
Due after five years through ten years	16,859	16,944
Due after ten years	5,933	6,473
	52,768	53,993
ABS, RMBS and CMBS	4,150	4,264
Total	\$56,918	\$58,257

Actual maturities may differ from those scheduled as a result of calls and make-whole payments by the issuers. ABS, RMBS and CMBS are shown separately because of the potential for prepayment of principal prior to contractual maturity dates.

Net investment income

Net investment income is as follows:

(\$ in millions)	Three months ended September 30,		Nine months ended September 30,	
	2015	2014	2015	2014
Fixed income securities	\$546	\$581	\$1,681	\$1,870
Equity securities	23	28	77	91
Mortgage loans	53	54	165	206
Limited partnership interests	167	162	483	499
Short-term investments	4	1	8	5
Other	49	41	143	127
Investment income, before expense	842	867	2,557	2,798
Investment expense	(35	) (44	) (111	) (118
Net investment income	\$807	\$823	\$2,446	\$2,680

Realized capital gains and losses

Realized capital gains and losses by asset type are as follows:

(\$ in millions)	Three months ended September 30,		Nine months ended September 30,	
	2015	2014	2015	2014
Fixed income securities	\$221	\$23	\$361	\$121
Equity securities	(150	) 213	(24	) 474
Mortgage loans	1	2	2	3
Limited partnership interests	(55	) 59	(52	) 10
Derivatives	24	(8	) 4	(27
Other	(8	) 5	(11	) 7
Realized capital gains and losses	\$33	\$294	\$280	\$588

Realized capital gains and losses by transaction type are as follows:

(\$ in millions)	Three months ended September 30,		Nine months ended September 30,	
	2015	2014	2015	2014
Impairment write-downs	\$(47	) \$10	\$(77	) \$(12
Change in intent write-downs	(127	) (63	) (189	) (167
Net other-than-temporary impairment losses recognized in earnings	(174	) (53	) (266	) (179
Sales and other	183	355	545	792

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Valuation and settlements of derivative instruments	24	(8	) 1	(25	)
Realized capital gains and losses	\$33	\$294	\$280	\$588	

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Gross gains of \$357 million and \$353 million and gross losses of \$120 million and \$48 million were realized on sales of fixed income and equity securities during the three months ended September 30, 2015 and 2014, respectively. Gross gains of \$828 million and \$866 million and gross losses of \$241 million and \$111 million were realized on sales of fixed income and equity securities during the nine months ended September 30, 2015 and 2014, respectively. Other-than-temporary impairment losses by asset type are as follows:

(\$ in millions)	Three months ended September 30, 2015			Three months ended September 30, 2014		
	Gross	Included in OCI	Net	Gross	Included in OCI	Net
Fixed income securities:						
Municipal	\$(1 )	\$—	\$(1 )	\$(3 )	\$—	\$(3 )
Corporate	(9 )	—	(9 )	(6 )	1	(5 )
ABS	(16 )	12	(4 )	—	—	—
RMBS	—	—	—	3	(1 )	2
CMBS	(1 )	—	(1 )	—	—	—
Total fixed income securities	(27 )	12	(15 )	(6 )	—	(6 )
Equity securities	(151 )	—	(151 )	(63 )	—	(63 )
Mortgage loans	—	—	—	2	—	2
Limited partnership interests	(2 )	—	(2 )	14	—	14
Other	(6 )	—	(6 )	—	—	—
Other-than-temporary impairment losses	\$(186 )	\$12	\$(174 )	\$(53 )	\$—	\$(53 )

	Nine months ended September 30, 2015			Nine months ended September 30, 2014		
	Gross	Included in OCI	Net	Gross	Included in OCI	Net
Fixed income securities:						
Municipal	\$(5 )	\$4	\$(1 )	\$(9 )	\$—	\$(9 )
Corporate	(19 )	4	(15 )	(6 )	1	(5 )
ABS	(20 )	13	(7 )	(3 )	—	(3 )
RMBS	1	(1 )	—	9	(3 )	6
CMBS	(1 )	—	(1 )	—	—	—
Total fixed income securities	(44 )	20	(24 )	(9 )	(2 )	(11 )
Equity securities	(226 )	—	(226 )	(149 )	—	(149 )
Mortgage loans	—	—	—	6	—	6
Limited partnership interests	(7 )	—	(7 )	(25 )	—	(25 )
Other	(9 )	—	(9 )	—	—	—
Other-than-temporary impairment losses	\$(286 )	\$20	\$(266 )	\$(177 )	\$(2 )	\$(179 )

The total amount of other-than-temporary impairment losses included in accumulated other comprehensive income at the time of impairment for fixed income securities, which were not included in earnings, are presented in the following table. The amounts exclude \$221 million and \$233 million as of September 30, 2015 and December 31, 2014, respectively, of net unrealized gains related to changes in valuation of the fixed income securities subsequent to the impairment measurement date.

(\$ in millions)	September 30, 2015	December 31, 2014
Municipal	\$(8 )	\$(8 )
ABS	(15 )	(2 )
RMBS	(105 )	(108 )
CMBS	(6 )	(5 )
Total	\$(134 )	\$(123 )



Rollforwards of the cumulative credit losses recognized in earnings for fixed income securities held as of the end of the period are as follows:

(\$ in millions)	Three months ended		Nine months ended	
	September 30,		September 30,	
	2015	2014	2015	2014
Beginning balance	\$ (372)	\$ (424)	\$ (380)	\$ (513)
Additional credit loss for securities previously other-than-temporarily impaired	(7)	(1)	(10)	(2)
Additional credit loss for securities not previously other-than-temporarily impaired	(8)	(5)	(14)	(8)
Reduction in credit loss for securities disposed or collected	23	28	37	61
Reduction in credit loss for securities the Company has made the decision to sell or more likely than not will be required to sell	—	—	—	—
Change in credit loss due to accretion of increase in cash flows	—	1	3	2
Reduction in credit loss for securities sold in Lincoln Benefit Life Company (“LBL”) disposition	—	—	—	59
Ending balance	\$ (364)	\$ (401)	\$ (364)	\$ (401)

The Company uses its best estimate of future cash flows expected to be collected from the fixed income security, discounted at the security’s original or current effective rate, as appropriate, to calculate a recovery value and determine whether a credit loss exists. The determination of cash flow estimates is inherently subjective and methodologies may vary depending on facts and circumstances specific to the security. All reasonably available information relevant to the collectability of the security, including past events, current conditions, and reasonable and supportable assumptions and forecasts, are considered when developing the estimate of cash flows expected to be collected. That information generally includes, but is not limited to, the remaining payment terms of the security, prepayment speeds, foreign exchange rates, the financial condition and future earnings potential of the issue or issuer, expected defaults, expected recoveries, the value of underlying collateral, vintage, geographic concentration, available reserves or escrows, current subordination levels, third party guarantees and other credit enhancements. Other information, such as industry analyst reports and forecasts, sector credit ratings, financial condition of the bond insurer for insured fixed income securities, and other market data relevant to the realizability of contractual cash flows, may also be considered. The estimated fair value of collateral will be used to estimate recovery value if the Company determines that the security is dependent on the liquidation of collateral for ultimate settlement. If the estimated recovery value is less than the amortized cost of the security, a credit loss exists and an other-than-temporary impairment for the difference between the estimated recovery value and amortized cost is recorded in earnings. The portion of the unrealized loss related to factors other than credit remains classified in accumulated other comprehensive income. If the Company determines that the fixed income security does not have sufficient cash flow or other information to estimate a recovery value for the security, the Company may conclude that the entire decline in fair value is deemed to be credit related and the loss is recorded in earnings.





Unrealized net capital gains and losses

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

(\$ in millions)	Fair value	Gross unrealized		Unrealized net gains (losses)
		Gains	Losses	
September 30, 2015				
Fixed income securities	\$58,257	\$2,097	\$(758)	) \$1,339
Equity securities	4,236	274	(161)	) 113
Short-term investments	3,036	—	—	—
Derivative instruments <sup>(1)</sup>	11	11	(4)	) 7
Equity method (“EMA”) limited partnerships <sup>(2)</sup>				(5 )
Unrealized net capital gains and losses, pre-tax				1,454
Amounts recognized for:				
Insurance reserves <sup>(3)</sup>				—
DAC and DSI <sup>(4)</sup>				(98 )
Amounts recognized				(98 )
Deferred income taxes				(477 )
Unrealized net capital gains and losses, after-tax				\$879

(1) Included in the fair value of derivative instruments are \$4 million classified as assets and \$(7) million classified as liabilities.

Unrealized net capital gains and losses for limited partnership interests represent the Company’s share of EMA

(2) limited partnerships’ other comprehensive income. Fair value and gross unrealized gains and losses are not applicable.

The insurance reserves adjustment represents the amount by which the reserve balance would increase if the net unrealized gains in the applicable product portfolios were realized and reinvested at current lower interest rates,

(3) resulting in a premium deficiency. Although the Company evaluates premium deficiencies on the combined performance of life insurance and immediate annuities with life contingencies, the adjustment primarily relates to structured settlement annuities with life contingencies, in addition to annuity buy-outs and certain payout annuities with life contingencies.

(4) The DAC and DSI adjustment balance represents the amount by which the amortization of DAC and DSI would increase or decrease if the unrealized gains or losses in the respective product portfolios were realized.

(\$ in millions)	Fair value	Gross unrealized		Unrealized net gains (losses)
		Gains	Losses	
December 31, 2014				
Fixed income securities	\$62,440	\$3,082	\$(314)	) \$2,768
Equity securities	4,104	467	(55)	) 412
Short-term investments	2,540	—	—	—
Derivative instruments <sup>(1)</sup>	2	3	(5)	) (2 )
EMA limited partnerships				(5 )
Unrealized net capital gains and losses, pre-tax				3,173
Amounts recognized for:				
Insurance reserves				(28 )
DAC and DSI				(179 )
Amounts recognized				(207 )
Deferred income taxes				(1,040 )
Unrealized net capital gains and losses, after-tax				\$1,926

(1) Included in the fair value of derivative instruments are \$3 million classified as assets and \$1 million classified as liabilities.



## Change in unrealized net capital gains and losses

The change in unrealized net capital gains and losses for the nine months ended September 30, 2015 is as follows:

(\$ in millions)

Fixed income securities	\$(1,429	)
Equity securities	(299	)
Derivative instruments	9	
Total	(1,719	)
Amounts recognized for:		
Insurance reserves	28	
DAC and DSI	81	
Amounts recognized	109	
Deferred income taxes	563	
Decrease in unrealized net capital gains and losses, after-tax	\$(1,047	)

## Portfolio monitoring

The Company has a comprehensive portfolio monitoring process to identify and evaluate each fixed income and equity security whose carrying value may be other-than-temporarily impaired.

For each fixed income security in an unrealized loss position, the Company assesses whether management with the appropriate authority has made the decision to sell or whether it is more likely than not the Company will be required to sell the security before recovery of the amortized cost basis for reasons such as liquidity, contractual or regulatory purposes. If a security meets either of these criteria, the security's decline in fair value is considered other than temporary and is recorded in earnings.

If the Company has not made the decision to sell the fixed income security and it is not more likely than not the Company will be required to sell the fixed income security before recovery of its amortized cost basis, the Company evaluates whether it expects to receive cash flows sufficient to recover the entire amortized cost basis of the security. The Company calculates the estimated recovery value by discounting the best estimate of future cash flows at the security's original or current effective rate, as appropriate, and compares this to the amortized cost of the security. If the Company does not expect to receive cash flows sufficient to recover the entire amortized cost basis of the fixed income security, the credit loss component of the impairment is recorded in earnings, with the remaining amount of the unrealized loss related to other factors recognized in other comprehensive income.

For equity securities, the Company considers various factors, including whether it has the intent and ability to hold the equity security for a period of time sufficient to recover its cost basis. Where the Company lacks the intent and ability to hold to recovery, or believes the recovery period is extended, the equity security's decline in fair value is considered other than temporary and is recorded in earnings.

For fixed income and equity securities managed by third parties, either the Company has contractually retained its decision making authority as it pertains to selling securities that are in an unrealized loss position or it recognizes any unrealized loss at the end of the period through a charge to earnings.

The Company's portfolio monitoring process includes a quarterly review of all securities to identify instances where the fair value of a security compared to its amortized cost (for fixed income securities) or cost (for equity securities) is below established thresholds. The process also includes the monitoring of other impairment indicators such as ratings, ratings downgrades and payment defaults. The securities identified, in addition to other securities for which the Company may have a concern, are evaluated for potential other-than-temporary impairment using all reasonably available information relevant to the collectability or recovery of the security. Inherent in the Company's evaluation of other-than-temporary impairment for these fixed income and equity securities are assumptions and estimates about the financial condition and future earnings potential of the issue or issuer. Some of the factors that may be considered in evaluating whether a decline in fair value is other than temporary are: 1) the financial condition, near-term and long-term prospects of the issue or issuer, including relevant industry specific market conditions and trends, geographic location and implications of rating agency actions and offering prices; 2) the specific reasons that a security is in an unrealized loss position, including overall market conditions which could affect liquidity; and 3) the length of time and extent to which the fair value has been less than amortized cost or cost.



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.

(\$ in millions)	Less than 12 months			12 months or more			Total unrealized losses
	Number of issues	Fair value	Unrealized losses	Number of issues	Fair value	Unrealized losses	
September 30, 2015							
Fixed income securities							
U.S. government and agencies	5	\$364	\$—	—	\$—	\$—	\$—
Municipal	171	495	(5	) 9	48	(14	) (19
Corporate	1,078	12,371	(563	) 82	800	(127	) (690
Foreign government	14	73	(1	) —	—	—	(1
ABS	53	738	(17	) 21	281	(18	) (35
RMBS	76	13	—	) 176	132	(10	) (10
CMBS	7	32	(1	) 2	4	(2	) (3
Total fixed income securities	1,404	14,086	(587	) 290	1,265	(171	) (758
Equity securities	354	1,619	(137	) 25	84	(24	) (161
Total fixed income and equity securities	1,758	\$15,705	\$(724	) 315	\$1,349	\$(195	) \$(919
Investment grade fixed income securities							
Below investment grade fixed income securities	498	4,939	(370	) 78	503	(91	) (461
Total fixed income securities	1,404	\$14,086	\$(587	) 290	\$1,265	\$(171	) \$(758
December 31, 2014							
Fixed income securities							
U.S. government and agencies	21	\$1,501	\$(3	) —	\$—	\$—	\$(3
Municipal	252	1,008	(9	) 19	116	(16	) (25
Corporate	576	7,545	(147	) 119	1,214	(93	) (240
Foreign government	2	13	—	) 1	19	—	—
ABS	81	1,738	(11	) 26	315	(20	) (31
RMBS	75	70	(1	) 188	156	(12	) (13
CMBS	8	33	—	) 3	32	(2	) (2
Total fixed income securities	1,015	11,908	(171	) 356	1,852	(143	) (314
Equity securities	258	866	(53	) 1	11	(2	) (55
Total fixed income and equity securities	1,273	\$12,774	\$(224	) 357	\$1,863	\$(145	) \$(369
Investment grade fixed income securities							
Below investment grade fixed income securities	261	1,957	(100	) 75	408	(56	) (156
Total fixed income securities	1,015	\$11,908	\$(171	) 356	\$1,852	\$(143	) \$(314

As of September 30, 2015, \$652 million of the \$919 million unrealized losses are related to securities with an unrealized loss position less than 20% of amortized cost or cost, the degree of which suggests that these securities do not pose a high risk of being other-than-temporarily impaired. Of the \$652 million, \$223 million are related to unrealized losses on investment grade fixed income securities and \$105 million are related to equity securities. Of the remaining \$324 million, \$276 million have been in an unrealized loss position for less than 12 months. Investment

grade is defined as a security having a rating of Aaa, Aa, A or Baa from Moody's, a rating of AAA, AA, A or BBB from Standard and Poor's ("S&P"), Fitch, Dominion, Kroll or Realpoint, 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. Unrealized losses on investment grade securities are principally related to increasing risk-free interest rates or widening credit spreads since the time of initial purchase.

As of September 30, 2015, the remaining \$267 million of unrealized losses are related to securities in unrealized loss positions greater than or equal to 20% of amortized cost or cost. Investment grade fixed income securities comprising \$74 million of these unrealized losses were evaluated based on factors such as discounted cash flows and the financial condition and near-term and long-term prospects of the issue or issuer and were determined to have adequate resources to fulfill contractual obligations. Of the \$267 million, \$137 million are related to below investment grade fixed income securities and \$56 million are related to equity securities. Of these amounts, \$10 million are related to below investment grade fixed income securities that had been in an

unrealized loss position greater than or equal to 20% of amortized cost for a period of twelve or more consecutive months as of September 30, 2015.

ABS, RMBS and CMBS in an unrealized loss position were evaluated based on actual and projected collateral losses relative to the securities' positions in the respective securitization trusts, security specific expectations of cash flows, and credit ratings. This evaluation also takes into consideration credit enhancement, measured in terms of (i) subordination from other classes of securities in the trust that are contractually obligated to absorb losses before the class of security the Company owns, (ii) the expected impact of other structural features embedded in the securitization trust beneficial to the class of securities the Company owns, such as overcollateralization and excess spread, and (iii) for ABS and RMBS in an unrealized loss position, credit enhancements from reliable bond insurers, where applicable. Municipal bonds in an unrealized loss position were evaluated based on the underlying credit quality of the primary obligator, obligation type and quality of the underlying assets. Unrealized losses on equity securities are primarily related to temporary equity market fluctuations of securities that are expected to recover. As of September 30, 2015, the Company has not made the decision to sell and it is not more likely than not the Company will be required to sell fixed income securities with unrealized losses before recovery of the amortized cost basis. As of September 30, 2015, the Company had the intent and ability to hold equity securities with unrealized losses for a period of time sufficient for them to recover.

#### Limited partnerships

As of September 30, 2015 and December 31, 2014, the carrying value of equity method limited partnerships totaled \$3.68 billion and \$3.41 billion, respectively. The Company recognizes an impairment loss for equity method limited partnerships when evidence demonstrates that the loss is other than temporary. Evidence of a loss in value that is other than temporary may include the absence of an ability to recover the carrying amount of the investment or the inability of the investee to sustain a level of earnings that would justify the carrying amount of the investment. As of September 30, 2015 and December 31, 2014, the carrying value for cost method limited partnerships was \$1.15 billion and \$1.12 billion, respectively. To determine if an other-than-temporary impairment has occurred, the Company evaluates whether an impairment indicator has occurred in the period that may have a significant adverse effect on the carrying value of the investment. Impairment indicators may include: significantly reduced valuations of the investments held by the limited partnerships; actual recent cash flows received being significantly less than expected cash flows; reduced valuations based on financing completed at a lower value; completed sale of a material underlying investment at a price significantly lower than expected; or any other adverse events since the last financial statements received that might affect the fair value of the investee's capital. Additionally, the Company's portfolio monitoring process includes a quarterly review of all cost method limited partnerships to identify instances where the net asset value is below established thresholds for certain periods of time, as well as investments that are performing below expectations, for further impairment consideration. If a cost method limited partnership is other-than-temporarily impaired, the carrying value is written down to fair value, generally estimated to be equivalent to the reported net asset value of the fund.

#### Mortgage loans

Mortgage loans are evaluated for impairment on a specific loan basis through a quarterly credit monitoring process and review of key credit quality indicators. Mortgage loans are considered impaired when it is probable that the Company will not collect the contractual principal and interest. Valuation allowances are established for impaired loans to reduce the carrying value to the fair value of the collateral less costs to sell or the present value of the loan's expected future repayment cash flows discounted at the loan's original effective interest rate. Impaired mortgage loans may not have a valuation allowance when the fair value of the collateral less costs to sell is higher than the carrying value. Valuation allowances are adjusted for subsequent changes in the fair value of the collateral less costs to sell. Mortgage loans are charged off against their corresponding valuation allowances when there is no reasonable expectation of recovery. The impairment evaluation is non-statistical in respect to the aggregate portfolio but considers facts and circumstances attributable to each loan. It is not considered probable that additional impairment losses, beyond those identified on a specific loan basis, have been incurred as of September 30, 2015. Accrual of income is suspended for mortgage loans that are in default or when full and timely collection of principal and interest payments is not probable. Cash receipts on mortgage loans on nonaccrual status are generally recorded as

a reduction of carrying value.

Debt service coverage ratio is considered a key credit quality indicator when mortgage loans are evaluated for impairment. Debt service coverage ratio represents the amount of estimated cash flows from the property available to the borrower to meet principal and interest payment obligations. Debt service coverage ratio estimates are updated annually or more frequently if conditions are warranted based on the Company's credit monitoring process.



The following table reflects the carrying value of non-impaired fixed rate and variable rate mortgage loans summarized by debt service coverage ratio distribution.

(\$ in millions)	September 30, 2015			December 31, 2014		
	Fixed rate mortgage loans	Variable rate mortgage loans	Total	Fixed rate mortgage loans	Variable rate mortgage loans	Total
Below 1.0	\$106	\$—	\$106	\$110	\$—	\$110
1.0 - 1.25	433	—	433	424	—	424
1.26 - 1.50	1,271	—	1,271	1,167	1	1,168
Above 1.50	2,565	18	2,583	2,450	20	2,470
Total non-impaired mortgage loans	\$4,375	\$18	\$4,393	\$4,151	\$21	\$4,172

Mortgage loans with a debt service coverage ratio below 1.0 that are not considered impaired primarily relate to instances where the borrower has the financial capacity to fund the revenue shortfalls from the properties for the foreseeable term, the decrease in cash flows from the properties is considered temporary, or there are other risk mitigating circumstances such as additional collateral, escrow balances or borrower guarantees.

The net carrying value of impaired mortgage loans is as follows:

(\$ in millions)	September 30, 2015	December 31, 2014
Impaired mortgage loans with a valuation allowance	\$9	\$16
Impaired mortgage loans without a valuation allowance	—	—
Total impaired mortgage loans	\$9	\$16
Valuation allowance on impaired mortgage loans	\$7	\$8

The average balance of impaired loans was \$12 million and \$30 million for the nine months ended September 30, 2015 and 2014, respectively.

The rollforward of the valuation allowance on impaired mortgage loans is as follows:

(\$ in millions)	Three months ended September 30,		Nine months ended September 30,	
	2015	2014	2015	2014
Beginning balance	\$7	\$9	\$8	\$21
Net decrease in valuation allowance	—	(2)	—	(6)
Charge offs	—	—	(1)	(8)
Ending balance	\$7	\$7	\$7	\$7

Payments on all loans were current as of September 30, 2015 and December 31, 2014.

## 5. Fair Value of Assets and Liabilities

Fair value is defined as the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. The hierarchy for inputs used in determining fair value maximizes the use of observable inputs and minimizes the use of unobservable inputs by requiring that observable inputs be used when available. Assets and liabilities recorded on the Condensed Consolidated Statements of Financial Position at fair value are categorized in the fair value hierarchy based on the observability of inputs to the valuation techniques as follows:

Level 1: Assets and liabilities whose values are based on unadjusted quoted prices for identical assets or liabilities in an active market that the Company can access.

Level 2: Assets and liabilities whose values are based on the following:

(a) Quoted prices for similar assets or liabilities in active markets;

(b) Quoted prices for identical or similar assets or liabilities in markets that are not active; or

(c) Valuation models whose inputs are observable, directly or indirectly, for substantially the full term of the asset or liability.

Level 3: Assets and liabilities whose values are based on prices or valuation techniques that require inputs that are both unobservable and significant to the overall fair value measurement. Unobservable inputs reflect the Company's

estimates of the assumptions that market participants would use in valuing the assets and liabilities.

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The availability of observable inputs varies by instrument. In situations where fair value is based on internally developed pricing models or inputs that are unobservable in the market, the determination of fair value requires more judgment. The degree of judgment exercised by the Company in determining fair value is typically greatest for instruments categorized in Level 3. In many instances, valuation inputs used to measure fair value fall into different levels of the fair value hierarchy. The category level in the fair value hierarchy is determined based on the lowest level input that is significant to the fair value measurement in its entirety. The Company uses prices and inputs that are current as of the measurement date, including during periods of market disruption. In periods of market disruption, the ability to observe prices and inputs may be reduced for many instruments.

The Company is responsible for the determination of fair value and the supporting assumptions and methodologies. The Company gains assurance that assets and liabilities are appropriately valued through the execution of various processes and controls designed to ensure the overall reasonableness and consistent application of valuation methodologies, including inputs and assumptions, and compliance with accounting standards. For fair values received from third parties or internally estimated, the Company's processes and controls are designed to ensure that the valuation methodologies are appropriate and consistently applied, the inputs and assumptions are reasonable and consistent with the objective of determining fair value, and the fair values are accurately recorded. For example, on a continuing basis, the Company assesses the reasonableness of individual fair values that have stale security prices or that exceed certain thresholds as compared to previous fair values received from valuation service providers or brokers or derived from internal models. The Company performs procedures to understand and assess the methodologies, processes and controls of valuation service providers. In addition, the Company may validate the reasonableness of fair values by comparing information obtained from valuation service providers or brokers to other third party valuation sources for selected securities. The Company performs ongoing price validation procedures such as back-testing of actual sales, which corroborate the various inputs used in internal models to market observable data. When fair value determinations are expected to be more variable, the Company validates them through reviews by members of management who have relevant expertise and who are independent of those charged with executing investment transactions.

The Company has two types of situations where investments are classified as Level 3 in the fair value hierarchy. The first is where specific inputs significant to the fair value estimation models are not market observable. This primarily occurs in the Company's use of broker quotes to value certain securities where the inputs have not been corroborated to be market observable, and the use of valuation models that use significant non-market observable inputs.

The second situation where the Company classifies securities in Level 3 is where quotes continue to be received from independent third-party valuation service providers and all significant inputs are market observable; however, there has been a significant decrease in the volume and level of activity for the asset when compared to normal market activity such that the degree of market observability has declined to a point where categorization as a Level 3 measurement is considered appropriate. The indicators considered in determining whether a significant decrease in the volume and level of activity for a specific asset has occurred include the level of new issuances in the primary market, trading volume in the secondary market, the level of credit spreads over historical levels, applicable bid-ask spreads, and price consensus among market participants and other pricing sources.

Certain assets are not carried at fair value on a recurring basis, including investments such as mortgage loans, limited partnership interests, bank loans and policy loans. Accordingly, such investments are only included in the fair value hierarchy disclosure when the investment is subject to remeasurement at fair value after initial recognition and the resulting remeasurement is reflected in the condensed consolidated financial statements. In addition, derivatives embedded in fixed income securities are not disclosed in the hierarchy as free-standing derivatives since they are presented with the host contracts in fixed income securities.

In determining fair value, the Company principally uses the market approach which generally utilizes market transaction data for the same or similar instruments. To a lesser extent, the Company uses the income approach which involves determining fair values from discounted cash flow methodologies. For the majority of Level 2 and Level 3 valuations, a combination of the market and income approaches is used.

Summary of significant valuation techniques for assets and liabilities measured at fair value on a recurring basis  
Level 1 measurements

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Fixed income securities: Comprise certain U.S. Treasury fixed income securities. Valuation is based on unadjusted quoted prices for identical assets in active markets that the Company can access.

Equity securities: Comprise actively traded, exchange-listed equity securities. Valuation is based on unadjusted quoted prices for identical assets in active markets that the Company can access.

Short-term: Comprise U.S. Treasury bills valued based on unadjusted quoted prices for identical assets in active markets that the Company can access and actively traded money market funds that have daily quoted net asset values for identical assets that the Company can access.

Separate account assets: Comprise actively traded mutual funds that have daily quoted net asset values for identical assets that the Company can access. Net asset values for the actively traded mutual funds in which the separate account assets are invested are obtained daily from the fund managers.

Level 2 measurements

Fixed income securities:

U.S. government and agencies: The primary inputs to the valuation include quoted prices for identical or similar assets in markets that are not active, contractual cash flows, benchmark yields and credit spreads.

Municipal: The primary inputs to the valuation include quoted prices for identical or similar assets in markets that are not active, contractual cash flows, benchmark yields and credit spreads.

Corporate, including privately placed: The primary inputs to the valuation include quoted prices for identical or similar assets in markets that are not active, contractual cash flows, benchmark yields and credit spreads. Also included are privately placed securities valued using a discounted cash flow model that is widely accepted in the financial services industry and uses market observable inputs and inputs derived principally from, or corroborated by, observable market data. The primary inputs to the discounted cash flow model include an interest rate yield curve, as well as published credit spreads for similar assets in markets that are not active that incorporate the credit quality and industry sector of the issuer.

Foreign government: The primary inputs to the valuation include quoted prices for identical or similar assets in markets that are not active, contractual cash flows, benchmark yields and credit spreads.

ABS and RMBS: The primary inputs to the valuation include quoted prices for identical or similar assets in markets that are not active, contractual cash flows, benchmark yields, prepayment speeds, collateral performance and credit spreads. Certain ABS are valued based on non-binding broker quotes whose inputs have been corroborated to be market observable.

CMBS: The primary inputs to the valuation include quoted prices for identical or similar assets in markets that are not active, contractual cash flows, benchmark yields, collateral performance and credit spreads.

Redeemable preferred stock: The primary inputs to the valuation include quoted prices for identical or similar assets in markets that are not active, contractual cash flows, benchmark yields, underlying stock prices and credit spreads.

Equity securities: The primary inputs to the valuation include quoted prices or quoted net asset values for identical or similar assets in markets that are not active.

Short-term: The primary inputs to the valuation include quoted prices for identical or similar assets in markets that are not active, contractual cash flows, benchmark yields and credit spreads. For certain short-term investments, amortized cost is used as the best estimate of fair value.

Other investments: Free-standing exchange listed derivatives that are not actively traded are valued based on quoted prices for identical instruments in markets that are not active.

OTC derivatives, including interest rate swaps, foreign currency swaps, foreign exchange forward contracts, certain options and certain credit default swaps, are valued using models that rely on inputs such as interest rate yield curves, currency rates, and counterparty credit spreads that are observable for substantially the full term of the contract. The valuation techniques underlying the models are widely accepted in the financial services industry and do not involve significant judgment.

Level 3 measurements

Fixed income securities:

Municipal: Comprise municipal bonds that are not rated by third party credit rating agencies but are rated by the National Association of Insurance Commissioners (“NAIC”). The primary inputs to the valuation of these municipal bonds include quoted prices for identical or similar assets in markets that exhibit less liquidity relative to those markets supporting Level 2 fair value measurements, contractual cash flows, benchmark yields and credit spreads. Also included are municipal bonds valued based on non-binding broker quotes where the inputs have not been corroborated to be market observable. Also includes auction rate securities (“ARS”) primarily backed by student loans that have become illiquid due to failures in the auction market and are valued using a discounted cash flow model that is widely accepted in the financial services industry and uses significant non-market observable inputs, including the anticipated date liquidity will return to the market.

Corporate, including privately placed: Primarily valued based on non-binding broker quotes where the inputs have not been corroborated to be market observable. Also included are equity-indexed notes which are valued using a discounted cash flow model that is widely accepted in the financial services industry and uses significant non-market observable inputs, such as volatility. Other inputs include an interest rate yield curve, as well as published credit spreads for similar assets that incorporate the credit quality and industry sector of the issuer.

ABS, RMBS and CMBS: Valued based on non-binding broker quotes received from brokers who are familiar with the investments and where the inputs have not been corroborated to be market observable.

Equity securities: The primary inputs to the valuation include quoted prices or quoted net asset values for identical or similar assets in markets that exhibit less liquidity relative to those markets supporting Level 2 fair value measurements.

Other investments: Certain OTC derivatives, such as interest rate caps, certain credit default swaps and certain options (including swaptions), are valued using models that are widely accepted in the financial services industry. These are categorized as Level 3 as a result of the significance of non-market observable inputs such as volatility. Other primary inputs include interest rate yield curves and credit spreads.

Contractholder funds: Derivatives embedded in certain life and annuity contracts are valued internally using models widely accepted in the financial services industry that determine a single best estimate of fair value for the embedded derivatives within a block of contractholder liabilities. The models primarily use stochastically determined cash flows based on the contractual elements of embedded derivatives, projected option cost and applicable market data, such as interest rate yield curves and equity index volatility assumptions. These are categorized as Level 3 as a result of the significance of non-market observable inputs.

Assets and liabilities measured at fair value on a non-recurring basis

Mortgage loans written-down to fair value in connection with recognizing impairments are valued based on the fair value of the underlying collateral less costs to sell. Limited partnership interests written-down to fair value in connection with recognizing other-than-temporary impairments are valued using net asset values.

The following table summarizes the Company's assets and liabilities measured at fair value on a recurring and non-recurring basis as of September 30, 2015.

(\$ in millions)	Quoted prices in active markets for identical assets (Level 1)	Significant other observable inputs (Level 2)	Significant unobservable inputs (Level 3)	Counterparty and cash collateral netting	Balance as of September 30, 2015
<b>Assets</b>					
<b>Fixed income securities:</b>					
U.S. government and agencies	\$2,851	\$904	\$5		\$3,760
Municipal	—	7,305	189		7,494
Corporate	—	41,029	600		41,629
Foreign government	—	1,085	—		1,085
ABS	—	2,529	182		2,711
RMBS	—	1,010	1		1,011
CMBS	—	523	19		542
Redeemable preferred stock	—	25	—		25
Total fixed income securities	2,851	54,410	996		58,257
Equity securities	3,925	170	141		4,236
Short-term investments	351	2,645	40		3,036
Other investments: Free-standing derivatives	—	42	1	\$(14)	29
Separate account assets	3,677	—	—		3,677
Other assets	2	—	1		3
Total recurring basis assets	10,806	57,267	1,179	(14)	69,238
Non-recurring basis <sup>(1)</sup>	—	—	25		25
Total assets at fair value	\$10,806	\$57,267	\$1,204	\$(14)	\$69,263
% of total assets at fair value	15.6	% 82.7	% 1.7	% —	% 100
<b>Liabilities</b>					

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Contractholder funds: Derivatives embedded in life and annuity contracts	\$—	\$—	\$ (295 )	\$ (295 )
Other liabilities: Free-standing derivatives	(5 )	(14 )	(9 ) \$5	(23 )
Total liabilities at fair value	\$(5 )	\$(14 )	\$(304 ) \$5	\$(318 )
% of total liabilities at fair value	1.6	% 4.4	% 95.6	% (1.6 )% 100 %

(1) Includes \$8 million of limited partnership interests and \$17 million of other investments written-down to fair value in connection with recognizing other-than-temporary impairments.



The following table summarizes the Company's assets and liabilities measured at fair value on a recurring and non-recurring basis as of December 31, 2014.

(\$ in millions)	Quoted prices in active markets for identical assets (Level 1)	Significant other observable inputs (Level 2)	Significant unobservable inputs (Level 3)	Counterparty and cash collateral netting	Balance as of December 31, 2014
<b>Assets</b>					
<b>Fixed income securities:</b>					
U.S. government and agencies	\$3,240	\$1,082	\$6		\$4,328
Municipal	—	8,227	270		8,497
Corporate	—	41,253	891		42,144
Foreign government	—	1,645	—		1,645
ABS	—	3,782	196		3,978
RMBS	—	1,206	1		1,207
CMBS	—	592	23		615
Redeemable preferred stock	—	26	—		26
Total fixed income securities	3,240	57,813	1,387		62,440
Equity securities	3,787	234	83		4,104
Short-term investments	692	1,843	5		2,540
Other investments: Free-standing derivatives	—	95	2	\$(5)	92
Separate account assets	4,396	—	—		4,396
Other assets	2	—	1		3
Total recurring basis assets	12,117	59,985	1,478	(5)	73,575
Non-recurring basis <sup>(1)</sup>	—	—	9		9
Total assets at fair value	\$12,117	\$59,985	\$1,487	\$(5)	\$73,584
% of total assets at fair value	16.5	% 81.5	% 2.0	% —	% 100
<b>Liabilities</b>					
Contractholder funds: Derivatives embedded in life and annuity contracts	\$—	\$—	\$(323)	)	\$(323)
Other liabilities: Free-standing derivatives	(1)	) (50)	) (9)	) \$22	(38)
Total liabilities at fair value	\$(1)	) \$(50)	) \$(332)	) \$22	\$(361)
% of total liabilities at fair value	0.3	% 13.8	% 92.0	% (6.1)	)% 100

(1) Includes \$6 million of mortgage loans and \$3 million of limited partnership interests written-down to fair value in connection with recognizing other-than-temporary impairments.

The following table summarizes quantitative information about the significant unobservable inputs used in Level 3 fair value measurements.

(\$ in millions)	Fair value	Valuation technique	Unobservable input	Range	Weighted average
September 30, 2015					
Derivatives embedded in life and annuity contracts – Equity-indexed and forward starting options	\$(242)	) Stochastic cash flow model	Projected option cost	1.0 - 2.2%	1.76%
December 31, 2014					

Derivatives embedded in life and annuity contracts – Equity-indexed and forward starting options	\$(278 )	Stochastic cash flow model	Projected option cost	1.0 - 2.0%	1.76%
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The embedded derivatives are equity-indexed and forward starting options in certain life and annuity products that provide customers with interest crediting rates based on the performance of the S&P 500. If the projected option cost increased (decreased), it would result in a higher (lower) liability fair value.

As of September 30, 2015 and December 31, 2014, Level 3 fair value measurements of fixed income securities total \$996 million and \$1.39 billion, respectively, and include \$676 million and \$1.03 billion, respectively, of securities valued based on non-binding broker quotes where the inputs have not been corroborated to be market observable and \$114 million and \$169 million, respectively, of municipal securities that are not rated by third party credit rating agencies. The Company does not develop the

unobservable inputs used in measuring fair value; therefore, these are not included in the table above. However, an increase (decrease) in credit spreads for fixed income securities valued based on non-binding broker quotes would result in a lower (higher) fair value, and an increase (decrease) in the credit rating of municipal bonds that are not rated by third party credit rating agencies would result in a higher (lower) fair value.

The following table presents the rollforward of Level 3 assets and liabilities held at fair value on a recurring basis during the three months ended September 30, 2015.

(\$ in millions)	Total gains (losses) included in:				
	Balance as of June 30, 2015	Net income <sup>(1)</sup>	OCI	Transfers into Level 3	Transfers out of Level 3
<b>Assets</b>					
Fixed income securities:					
U.S. government and agencies	\$5	\$—	\$—	\$—	\$—
Municipal	215	3	—	3	—
Corporate	626	11	(10	) —	(24
ABS	120	—	(1	) 31	—
RMBS	1	—	—	—	—
CMBS	28	—	—	—	—
Total fixed income securities	995	14	(11	) 34	(24
Equity securities	108	(2	) (3	) —	—
Short-term investments	35	—	—	—	—
Free-standing derivatives, net	(7	) (1	) —	—	—
Other assets	1	—	—	—	—
Total recurring Level 3 assets	\$1,132	\$11	\$(14	) \$34	\$(24
<b>Liabilities</b>					
Contractholder funds:					
Derivatives embedded in life and annuity contracts	\$(315	) \$19	\$—	\$—	\$—
Total recurring Level 3 liabilities	\$(315	) \$19	\$—	\$—	\$—
	Purchases	Sales	Issues	Settlements	Balance as of September 30, 2015
<b>Assets</b>					
Fixed income securities:					
U.S. government and agencies	\$—	\$—	\$—	\$—	\$5
Municipal	—	(32	) —	—	189
Corporate	10	(11	) —	(2	) 600
ABS	60	—	—	(28	) 182
RMBS	—	—	—	—	1
CMBS	4	—	—	(13	) 19
Total fixed income securities	74	(43	) —	(43	) 996
Equity securities	38	—	—	—	141
Short-term investments	5	—	—	—	40
Free-standing derivatives, net	—	—	—	—	(8
Other assets	—	—	—	—	1

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Total recurring Level 3 assets	\$117	\$ (43	) \$—	\$ (43	) \$1,170
<b>Liabilities</b>					
<b>Contractholder funds:</b>					
Derivatives embedded in life and annuity contracts	\$—	\$—	\$—	\$1	\$(295 )
Total recurring Level 3 liabilities	\$—	\$—	\$—	\$1	\$(295 )

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The effect to net income totals \$30 million and is reported in the Condensed Consolidated Statements of Operations as follows: \$8 million in realized capital gains and losses, \$3 million in net investment income, \$27 million in interest credited to contractholder funds and \$(8) million in life and annuity contract benefits.

(2) Comprises \$1 million of assets and \$9 million of liabilities.

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The following table presents the rollforward of Level 3 assets and liabilities held at fair value on a recurring basis during the nine months ended September 30, 2015.

(\$ in millions)	Total gains (losses) included in:				
	Balance as of December 31, 2014	Net income <sup>(1)</sup>	OCI	Transfers into Level 3	Transfers out of Level 3
<b>Assets</b>					
<b>Fixed income securities:</b>					
U.S. government and agencies	\$6	\$—	\$—	\$—	\$—
Municipal	270	5	(4	) 3	(2
Corporate	891	11	(16	) 5	(232
ABS	196	(2	) 1	43	(84
RMBS	1	—	—	—	—
CMBS	23	—	—	—	—
Total fixed income securities	1,387	14	(19	) 51	(318
Equity securities	83	(1	) 1	—	—
Short-term investments	5	—	—	—	—
Free-standing derivatives, net	(7	) —	—	—	—
Other assets	1	—	—	—	—
Total recurring Level 3 assets	\$1,469	\$13	\$(18	) \$51	\$(318
<b>Liabilities</b>					
<b>Contractholder funds:</b>					
Derivatives embedded in life and annuity contracts	\$(323	) \$24	\$—	\$—	\$—
Total recurring Level 3 liabilities	\$(323	) \$24	\$—	\$—	\$—
	Purchases	Sales	Issues	Settlements	Balance as of September 30, 2015
<b>Assets</b>					
<b>Fixed income securities:</b>					
U.S. government and agencies	\$—	\$—	\$—	\$(1	) \$5
Municipal	—	(81	) —	(2	) 189
Corporate	70	(57	) —	(72	) 600
ABS	70	(5	) —	(37	) 182
RMBS	—	—	—	—	1
CMBS	9	—	—	(13	) 19
Total fixed income securities	149	(143	) —	(125	) 996
Equity securities	58	—	—	—	141
Short-term investments	35	—	—	—	40
Free-standing derivatives, net	—	—	—	(1	) (8
Other assets	—	—	—	—	1
Total recurring Level 3 assets	\$242	\$(143	) \$—	\$(126	) \$1,170
<b>Liabilities</b>					
	\$—	\$—	\$(1	) \$5	\$(295

Contractholder funds:

Derivatives embedded in life  
and annuity contracts

Total recurring Level 3 liabilities	\$—	\$—	\$(1	) \$5	\$(295	)
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The effect to net income totals \$37 million and is reported in the Condensed Consolidated Statements of

(1) Operations as follows: \$4 million in realized capital gains and losses, \$9 million in net investment income, \$32 million in interest credited to contractholder funds and \$(8) million in life and annuity contract benefits.

(2) Comprises \$1 million of assets and \$9 million of liabilities.

The following table presents the rollforward of Level 3 assets and liabilities held at fair value on a recurring basis during the three months ended September 30, 2014.

(\$ in millions)

	Balance as of June 30, 2014	Total gains (losses) included in:			
		Net income <sup>(1)</sup>	OCI	Transfers into Level 3	Transfers out of Level 3
Assets					
Fixed income securities:					
U.S. government and agencies	\$6	\$—	\$—	\$—	\$—
Municipal	302				