ALLSTATE CORP
Form 10-Q
August 05, 2009

UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-Q

/X/ QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF

THE SECURITIES EXCHANGE ACT OF 1934

FOR THE QUARTERLY PERIOD ENDED JUNE 30, 2009

OR

[ ] TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE

SECURITIES EXCHANGE ACT OF 1934

Commission file number 1-11840

THE ALLSTATE CORPORATION

(Exact name of registrant as specified in its charter)

Delaware	**36-3871531**
(State of Incorporation)	(I.R.S. Employer Identification Number)

2775 Sanders Road, Northbrook, Illinois 60062

(Address of principal executive offices) (Zip Code)

Registrant s telephone number, including area code: (847) 402-5000

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

Yes X No

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	Smaller reporting company
X			
		(Do not check if a 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 X

As of July 31, 2009, the registrant had 536,387,353 common shares, $.01 par value, outstanding.

THE ALLSTATE CORPORATION

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June 30, 2009

PART I. FINANCIAL INFORMATION

ITEM I. FINANCIAL STATEMENTS

THE ALLSTATE CORPORATION AND SUBSIDIARIES

CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS

($ in millions, except per share data)	Three Months Ended June 30, 2009 (unaudited)	Three Months Ended June 30, 2008	Six Months Ended June 30, 2009 (unaudited)	Six Months Ended June 30, 2008
Revenues				
Property-liability insurance premiums earned	$ 6,560	$ 6,750	$ 13,142	$ 13,514
Life and annuity premiums and contract charges	494	471	978	923
Net investment income	1,108	1,412	2,284	2,938
Realized capital gains and losses:				
Total other-than-temporary impairment losses	(471)	(1,265)	(1,196)	(1,723)
Portion of loss recognized in other comprehensive income	154	--	154	--
Net other-than-temporary impairment losses recognized in earnings	(317)	(1,265)	(1,042)	(1,723)
Sales and other realized capital gains and losses	645	50	1,011	(147)
Total realized capital gains and losses	328	(1,215)	(31)	(1,870)
	8,490	7,418	16,373	15,505
Costs and expenses				
Property-liability insurance claims and claims expense	5,002	4,776	9,722	9,452
Life and annuity contract benefits	407	395	794	792
Interest credited to contractholder funds	561	563	1,140	1,187
Amortization of deferred policy acquisition costs	1,229	959	2,626	2,034
Operating costs and expenses	702	728	1,503	1,520
Restructuring and related charges	32	(5)	77	(6)
Interest expense	97	88	185	176
	8,030	7,504	16,047	15,155
Gain (loss) on disposition of operations	1	--	4	(9)
Income (loss) from operations before income tax expense (benefit)	461	(86)	330	341
Income tax expense (benefit)	72	(111)	215	(32)
Net income	$ 389	$ 25	$ 115	$ 373
Earnings per share:				
Net income per share - Basic	$ 0.72	$ 0.05	$ 0.21	$ 0.67
Weighted average shares - Basic	539.8	551.8	539.3	556.3
Net income per share - Diluted	$ 0.72	$ 0.05	$ 0.21	$ 0.67
Weighted average shares - Diluted	540.6	553.8	540.1	558.3

Cash dividends declared per share	$ 0.20	$ 0.41	$ 0.40	$ 0.82

See notes to condensed consolidated financial statements.

THE ALLSTATE CORPORATION AND SUBSIDIARIES

CONDENSED CONSOLIDATED STATEMENTS OF FINANCIAL POSITION

($ in millions, except par value data)		June 30, 2009		December 31, 2008
Assets		(unaudited)		
Investments:				
Fixed income securities, at fair value (amortized cost $79,890 and $77,104)	$	72,766	$	68,608
Equity securities, at fair value (cost $3,483 and $3,137)		3,297		2,805
Mortgage loans		9,406		10,229
Limited partnership interests		2,464		2,791
Short-term, at fair value (amortized cost $6,070 and $8,903)		6,070		8,906
Other		2,455		2,659
Total investments		96,458		95,998
Cash		667		415
Premium installment receivables, net		4,794		4,842
Deferred policy acquisition costs		8,228		8,542
Reinsurance recoverables, net		6,621		6,403
Accrued investment income		859		884
Deferred income taxes		2,710		3,794
Property and equipment, net		1,031		1,059
Goodwill		874		874
Other assets		2,656		3,748
Separate Accounts		8,193		8,239
Total assets	$	133,091	$	134,798
Liabilities				
Reserve for property-liability insurance claims and claims expense	$	19,271	$	19,456
Reserve for life-contingent contract benefits		12,835		12,881
Contractholder funds		53,999		58,413
Unearned premiums		9,755		10,024
Claim payments outstanding		813		790
Other liabilities and accrued expenses		6,469		6,663
Long-term debt		6,658		5,659
Separate Accounts		8,193		8,239
Total liabilities		117,993		122,125
Commitments and Contingent Liabilities (Note 11)				
Equity				
Preferred stock, $1 par value, 25 million shares authorized, none issued		--		--
Common stock, $.01 par value, 2.0 billion shares authorized and 900 million issued, 536 million and 536 million shares outstanding		9		9
Additional capital paid-in		3,144		3,130
Retained income		30,969		30,207
Deferred ESOP expense		(47)		(49)
Treasury stock, at cost (364 million and 364 million shares)		(15,835)		(15,855)
Accumulated other comprehensive income:				
Unrealized net capital gains and losses:				
Unrealized net capital losses on fixed income securities with OTTI		(380)		--
Other unrealized net capital gains and losses		(4,374)		(5,767)
Unrealized adjustment to DAC, DSI and insurance reserves		2,642		2,029
Total unrealized net capital gains and losses		(2,112)		(3,738)
Unrealized foreign currency translation adjustments		17		5
Unrecognized pension and other postretirement benefit cost		(1,077)		(1,068)
Total accumulated other comprehensive loss		(3,172)		(4,801)
Total shareholders equity		15,068		12,641
Noncontrolling interest		30		32
Total equity		15,098		12,673
Total liabilities and equity	$	133,091	$	134,798

See notes to condensed consolidated financial statements.

THE ALLSTATE CORPORATION AND SUBSIDIARIES

CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS

($ in millions)	Six Months Ended June 30, 2009	Six Months Ended June 30, 2008
	(unaudited)	
Cash flows from operating activities		
Net income	$ 115	$ 373
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation, amortization and other non-cash items	(86)	(141)
Realized capital gains and losses	31	1,870
(Gain) loss on disposition of operations	(4)	9
Interest credited to contractholder funds	1,140	1,187
Changes in:		
Policy benefits and other insurance reserves	(148)	(146)
Unearned premiums	(283)	(179)
Deferred policy acquisition costs	548	(269)
Premium installment receivables, net	55	(12)
Reinsurance recoverables, net	(133)	51
Income taxes	1,359	(361)
Other operating assets and liabilities	(112)	(83)
Net cash provided by operating activities	2,482	2,299
Cash flows from investing activities		
Proceeds from sales:		
Fixed income securities	8,856	14,113
Equity securities	3,547	5,106
Limited partnership interests	214	214
Mortgage loans	141	204
Other investments	262	163
Investment collections:		
Fixed income securities	2,658	2,144
Mortgage loans	598	399
Other investments	65	69
Investment purchases:		
Fixed income securities	(12,424)	(9,430)
Equity securities	(4,207)	(5,155)
Limited partnership interests	(268)	(599)
Mortgage loans	(14)	(438)
Other investments	(41)	(75)
Change in short-term investments, net	3,167	(6,604)
Change in other investments, net	(80)	(274)
Disposition (acquisition) of operations	12	(120)
Purchases of property and equipment, net	(104)	(98)
Net cash provided by (used in) investing activities	2,382	(381)
Cash flows from financing activities		
Change in short-term debt, net	--	18
Proceeds from issuance of long-term debt	1,000	--
Repayment of long-term debt	(1)	--
Contractholder fund deposits	2,450	7,035
Contractholder fund withdrawals	(7,736)	(7,441)
Dividends paid	(327)	(444)
Treasury stock purchases	(3)	(865)
Shares reissued under equity incentive plans, net	--	13
Excess tax benefits on share-based payment arrangements	(6)	2
Other	11	90
Net cash used in financing activities	(4,612)	(1,592)
Net increase in cash	252	326

Cash at beginning of period		415		422
Cash at end of period	$	667	$	748

See notes to condensed consolidated financial statements.

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THE ALLSTATE CORPORATION AND SUBSIDIARIES

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

(Unaudited)

1. General

Basis of presentation

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

The condensed consolidated financial statements and notes as of June 30, 2009, and for the three-month and six-month periods ended June 30, 2009 and 2008 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, 2008. The results of operations for the interim periods should not be considered indicative of results to be expected for the full year.

To conform to the 2009 presentation, certain amounts in the prior year condensed consolidated financial statements and notes have been reclassified.

Subsequent events were evaluated through August 5, 2009, the date the consolidated financial statements were issued.

Adopted accounting standards

Financial Accounting Standards Board (FASB) Staff Position No. FAS 115-2 and FAS 124-2, Recognition and Presentation of Other-Than-Temporary Impairments (FSP FAS 115-2)

In April 2009, the FASB issued FSP FAS 115-2 which amends Statement of Financial Accounting Standards No. 115, *Accounting for Certain Investments in Debt and Equity Securities* (SFAS No. 115), to provide recognition guidance for debt securities classified as available-for-sale and subject to other-than-temporary impairment (OTTI) guidance. If the fair value of a debt security is less than its amortized cost basis at the reporting date, an entity shall assess whether the impairment is an OTTI. When an entity intends to sell an impaired security or more likely than not will be required to sell an impaired security before recovery of its amortized cost basis, an OTTI is recognized in earnings. If the entity does not expect to recover the entire amortized cost basis of an impaired security, even if it does not intend to sell the security and it is not more likely than not that it would be required to sell the security before recovery of its amortized cost basis, the entity must consider, based upon an estimate of the present value of cash flows expected to be collected on the debt security as compared to its amortized cost basis, whether a credit loss exists. The portion of the total OTTI related to a credit loss shall be recognized in earnings while the portion of the total OTTI related to factors other than credit shall be recognized in other comprehensive income (OCI). The statement of operations is required to present the total OTTI with an offset for the amount of the total OTTI that is recognized in OCI. The statement disclosing accumulated other comprehensive income (AOCI) is required to separately present amounts recognized for debt securities for which a portion of an OTTI has been recognized in earnings.

FSP FAS 115-2 expands the disclosure requirements of SFAS No. 115 (for both debt and equity securities) and requires a more detailed, risk-oriented breakdown of security types and related information, and requires that the annual disclosures be made for interim periods. In addition, new disclosures are required about significant inputs used in determining credit losses as well as a rollforward of credit losses each period. FSP FAS 115-2 is effective for interim periods ending after June 15, 2009. The disclosures are not required for earlier periods presented for comparative purposes. FSP FAS 115-2 applies to existing and new investments held as of the beginning of the interim period of adoption.

The Company adopted the provisions of FSP FAS 115-2 as of April 1, 2009. The adoption resulted in the reclassification of $1.15 billion of previously recorded OTTI write-downs from retained income to unrealized capital losses. The cumulative effect of adoption, net of related deferred policy acquisition costs (DAC), deferred sales inducements (DSI) and tax adjustments, was an increase in retained income of $863 million and a decrease in unrealized net capital gains and losses of $578 million, with a net benefit to equity of $285 million. The benefit to

THE ALLSTATE CORPORATION AND SUBSIDIARIES

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

(Unaudited)

equity resulted from a decrease in a deferred tax asset valuation allowance. The adoption did not have an impact on the Company s Condensed Consolidated Statement of Operations.

FSP FAS 157-4, Determining Fair Value When the Volume and Level of Activity for the Asset or Liability Have Significantly Decreased and Identifying Transactions That Are Not Orderly (FSP FAS 157-4)

In April 2009, the FASB issued FSP FAS 157-4, which amends SFAS No. 157, *Fair Value Measurements* (SFAS No. 157), to provide additional guidance for estimating fair value when the volume and level of activity for an asset or liability have significantly decreased. Guidance on identifying circumstances that indicate a transaction is not orderly is also provided. If it is concluded that there has been a significant decrease in the volume and level of market activity for an asset or liability in relation to normal market activity, transaction or quoted prices may not be determinative of fair value and further analysis of transaction or quoted prices may be necessary. A significant adjustment to transaction or quoted prices may be necessary to estimate fair value under the current market conditions. Determination of whether a transaction is orderly is based on the weight of relevant evidence.

The disclosure requirements of SFAS No. 157 are expanded to include the inputs and valuation techniques used to measure fair value and a discussion of changes in valuation techniques and related inputs during the quarterly reporting period. Disclosures of assets and liabilities measured at fair value are to be presented by major security type. FSP FAS 157-4 does not require disclosures for earlier periods presented for comparative purposes. FSP FAS 157-4 is effective for interim periods ending after June 15, 2009. Revisions resulting from a change in valuation technique or its application shall be accounted for as a change in accounting estimate and disclosed, along with the total effect of the change in valuation technique and related inputs, if practicable, by major category. The Company adopted the provisions of FSP FAS 157-4 as of April 1, 2009. The adoption of FSP FAS 157-4 had no effect on the Company s results of operations or financial position.

FSP No. FAS 107-1 and APB 28-1, Interim Disclosures about Fair Value of Financial Instruments (FSP FAS 107-1 and APB 28-1)

In April 2009, the FASB issued FSP FAS 107-1 and APB 28-1, which amends FASB Statement No. 107, *Disclosures about Fair Value of Financial Instruments*, to require disclosures about fair value of financial instruments for interim reporting periods as well as in annual financial statements; and amends Accounting Principles Board Opinion No. 28, *Interim Financial Reporting*, to require those disclosures in summarized financial information for interim reporting periods. FSP FAS 107-1 and APB 28-1 is effective for interim periods ending after June 15, 2009. The disclosures are not required for earlier periods presented for comparative purposes. The Company adopted the provisions of FSP FAS 107-1 and APB 28-1 for second quarter 2009 with required disclosures in Note 5. FSP FAS 107-1 and APB 28-1 affects disclosures only and therefore the adoption had no impact on the Company s results of operations or financial position.

SFAS No. 141(R), Business Combinations (SFAS No. 141R)

In December 2007, the FASB issued SFAS No. 141R which replaces SFAS No. 141, *Business Combinations* (SFAS No. 141). In April 2009, the FASB issued FSP No. FAS 141(R)-1, *Accounting for Assets Acquired and Liabilities Assumed in a Business Combination That Arise from Contingencies* (FSP FAS 141(R)-1), which clarifies SFAS No. 141R by addressing application issues raised by preparers, auditors and the legal profession. Among other things, SFAS No. 141R and the related FSP broaden the scope of SFAS No. 141 to include all transactions where an acquirer obtains control of one or more other businesses; retains the guidance to recognize intangible assets separately from goodwill; requires, with limited exceptions, that all assets acquired and liabilities assumed, including certain of those that arise from contingencies, be measured at their acquisition date fair values; requires most acquisition and restructuring-related costs to be expensed as incurred; requires that step acquisitions, once control is acquired, be recorded at the full amounts of the fair values of the identifiable assets, liabilities and the noncontrolling interest in the acquiree; and replaces the reduction of asset values and recognition of negative goodwill with a requirement to recognize a gain in earnings. The provisions of SFAS No. 141R and FSP FAS 141(R)-1 are effective for fiscal years beginning after December 15, 2008 and are to be applied prospectively only. Early adoption is not permitted. The Company will apply the provisions of SFAS No. 141R to any business combinations effective subsequent to January 1, 2009.

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SFAS No. 160, Noncontrolling Interests in Consolidated Financial Statements - an amendment of ARB No. 51 (SFAS No. 160)

In December 2007, the FASB issued SFAS No. 160 which clarifies that a noncontrolling interest in a subsidiary is that portion of the subsidiary s equity that is attributable to owners of the subsidiary other than its parent or parent s affiliates. Noncontrolling interests are required to be reported as equity in the consolidated financial statements and as such, net income will include amounts attributable to both the parent and the noncontrolling interest with disclosure of the amounts attributable to each on the face of the consolidated statements of operations, if material. SFAS No. 160 requires that all changes in a parent s ownership interest in a subsidiary when control of the subsidiary is retained, be accounted for as equity transactions. In contrast, when control over a subsidiary is relinquished and the subsidiary is deconsolidated, SFAS No. 160 requires a parent to recognize a gain or loss in net income as well as provide certain associated expanded disclosures. SFAS No. 160 is effective as of the beginning of a reporting entity s first fiscal year beginning after December 15, 2008. SFAS No. 160 requires prospective application as of the beginning of the fiscal year in which the standard is initially applied, except for the presentation and disclosure requirements which are to be applied retrospectively for all periods presented. The adoption of SFAS No. 160 resulted in $32 million of noncontrolling interest being reclassified from total liabilities to total equity on the December 31, 2008 Condensed Consolidated Statement of Financial Position presented. The adoption did not have a material effect on the Company s results of operations.

SFAS No. 161, Disclosures about Derivative Instruments and Hedging Activities - an amendment of FASB Statement No. 133 (SFAS No. 161)

In March 2008, the FASB issued SFAS No. 161, which amends and expands the disclosure requirements for derivatives currently accounted for in accordance with SFAS No. 133, *Accounting for Derivative Instruments and Hedging Activitie*s (SFAS No. 133). The new disclosures are designed to enhance the understanding of how and why an entity uses derivative instruments and how derivative instruments affect an entity s financial position, results of operations, and cash flows. The standard requires, on a quarterly basis, quantitative disclosures about the potential cash outflows associated with the triggering of credit-risk-contingent features, if any; tabular disclosures about the classification and fair value amounts of derivative instruments reported in the statement of financial position; disclosure of the location and amount of gains and losses on derivative instruments reported in the statement of operations; and qualitative information about how and why an entity uses derivative instruments and how derivative instruments and related hedged items affect the entity s financial statements. SFAS No. 161 is effective for fiscal periods beginning after November 15, 2008, and is to be applied on a prospective basis only. SFAS No. 161 affects disclosures only and therefore the adoption had no impact on the Company s results of operations or financial position (see Note 6).

FSP No. EITF 03-6-1, Determining Whether Instruments Granted in Share-Based Payment Transactions Are Participating Securities (FSP EITF 03-6-1)

In June 2008, the FASB issued FSP EITF 03-6-1, clarifying that non-forfeitable instruments granted in share-based payment transactions are participating securities prior to vesting and, therefore, need to be included in the earnings allocation in computing earnings per share under the two-class method described in FASB Statement No. 128, *Earnings Per Share.* The two-class method is an earnings allocation formula that treats participating securities as having the same rights to earnings as available to common shareholders. The provisions of this FASB staff position are effective for reporting periods ending after December 15, 2008. The adoption of FSP EITF 03-6-1 impacted previously reported basic and diluted earnings per share amounts as follows: changed from $(1.71) to $(1.70) for the three months ended September 30, 2008, changed from $(2.11) to $(2.10) for the three months ended December 31, 2008, and changed from $(3.07) to $(3.06) for the year ended December 31, 2008. The basic and diluted earnings per share amounts for other 2008 periods were unchanged.

Pending accounting standards

FSP No. FAS 132(R)-1, Employers Disclosures about Postretirement Benefit Plan Assets (FSP FAS 132(R)-1)

In January 2009, the FASB issued FSP FAS 132(R)-1 which amends SFAS No. 132(R), *Employers Disclosures about Pensions and Other Postretirement Benefit*s, to provide guidance on an employer s disclosures about plan assets of a defined benefit pension or other postretirement plan. Since plan assets measured at fair value are reported net of benefit obligations in an employer s statements of financial position, the disclosures are intended to increase transparency surrounding the types of assets and associated risks in the benefit plans. FSP FAS 132(R)-1 requires companies to disclose information about how investment allocation decisions are made in the plans, the fair value of

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(Unaudited)

each major category of plan assets at each annual reporting date for each plan separately, information that would enable users to assess the assumptions and valuation techniques used in the development of the fair value measurements at the reporting date, and information that provides an understanding of significant concentrations of risk in plan assets. FSP FAS 132(R)-1 is effective for fiscal years ending after December 15, 2009. The disclosures are not required for earlier periods that are presented for comparative purposes and earlier application is permitted. FSP FAS 132(R)-1 affects disclosures and therefore implementation will not impact the Company s results of operations or financial position.

SFAS No. FAS 167, Amendments to FASB Interpretation No. 46(R) (SFAS No. 167)

In June 2009, the FASB issued SFAS No. 167 which amends FASB Interpretation No. 46(R), *Consolidation of Variable Interest Entitie*s (FIN 46R), to require an entity to perform a qualitative analysis to determine whether the entity holds a controlling financial interest (i.e., primary beneficiary (PB)) in a variable interest entity (VIE). The analysis identifies the PB of a VIE as the entity that has both the power to direct the activities of the VIE that most significantly impact the economic performance of the VIE and the obligation to absorb losses or the right to receive benefits that could potentially be significant to the VIE. Additional amendments include the requirement to perform ongoing reassessments of FIN 46R to determine whether the entity is the PB of a VIE and the elimination of the quantitative approach for determining the PB of a VIE. SFAS No. 167 is effective for fiscal years ending after December 15, 2009 with early application prohibited. The Company is in the process of evaluating the impact of adoption on the Company s results of operations or financial position.

2. Earnings per share

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

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

($ in millions, except per share data)	**Three months ended June 30, 2009**	**Three months ended June 30, 2008**	**Six months ended June 30, 2009**	**Six months ended June 30, 2008**
Numerator:				
Net income	$ 389	$ 25	$ 115	$ 373
Denominator:				
Weighted average common shares outstanding	539.8	551.8	539.3	556.3

Effect of dilutive potential common shares:								
Stock options		0.8		2.0		0.8		2.0
Weighted average common and dilutive potential common shares outstanding		540.6		553.8		540.1		558.3
Earnings per share - Basic:	$	0.72	$	0.05	$	0.21	$	0.67
Earnings per share - Diluted:	$	0.72	$	0.05	$	0.21	$	0.67

The effect of dilutive potential common shares does not include the effect of options with an anti-dilutive effect on earnings per 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 26.4 million and 17.6 million Allstate common shares, with exercise prices ranging from $26.69 to $64.53 and $48.01 to $65.38, were outstanding at June 30, 2009 and 2008, respectively, but were not included in the computation of diluted earnings per share for the three-month periods. Options to purchase 26.8 million and 17.6 million Allstate common shares, with exercise prices ranging from $26.69 to $64.53 and $48.01 to $65.38, were outstanding at June 30, 2009 and 2008, respectively, but were not included in the computation of diluted earnings per share for the six-month periods.

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NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

(Unaudited)

3. Supplemental Cash Flow Information

Non-cash investment exchanges, including modifications of certain fixed income securities, mortgage loans and other investments, as well as mergers completed with equity securities and limited partnerships, totaled $156 million and $20 million for the six-month periods ended June 30, 2009 and 2008, respectively.

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

($ in millions)	Six months ended June 30,			
		2009		**2008**
Net change in proceeds managed				
Net change in fixed income securities	$	--	$	399
Net change in short-term investments		(530)		82
Operating cash flow (used) provided	$	(530)	$	481
Net change in liabilities				
Liabilities for collateral and security repurchase, beginning of year	$	(340)	$	(3,461)
Liabilities for collateral and security repurchase, end of period		(870)		(2,980)
Operating cash flow provided (used)	$	530	$	(481)

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(Unaudited)

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	Gross unrealized Losses	Fair value
At June 30, 2009				
U.S. government and agencies	$ 3,932	$ 261	$ (8)	$ 4,185
Municipal	24,122	481	(1,506)	23,097
Corporate	31,488	649	(2,199)	29,938
Foreign government	2,479	271	(27)	2,723
Residential mortgage-backed securities (RMBS)	9,663	102	(2,262)	7,503
Commercial mortgage-backed securities (CMBS)	4,983	19	(1,765)	3,237
Asset-backed securities (ABS)	3,185	17	(1,151)	2,051
Redeemable preferred stock	38	1	(7)	32
Total fixed income securities	$ 79,890	$ 1,801	$ (8,925)	$ 72,766
At December 31, 2008				
U.S. government and agencies	$ 3,272	$ 963	$ (1)	$ 4,234
Municipal	23,565	467	(2,184)	21,848
Corporate	31,040	463	(3,876)	27,627
Foreign government	2,206	544	(75)	2,675
RMBS	8,010	93	(1,538)	6,565
CMBS	5,840	10	(2,004)	3,846
ABS	3,135	5	(1,353)	1,787
Redeemable preferred stock	36	--	(10)	26
Total fixed income securities	$ 77,104	$ 2,545	$ (11,041)	$ 68,608

Scheduled maturities

The scheduled maturities for fixed income securities are as follows at June 30, 2009:

($ in millions)	**Amortized cost**	**Fair value**
Due in one year or less	$ 2,777	$ 2,786
Due after one year through five years	18,607	18,604
Due after five years through ten years	14,457	14,300
Due after ten years	31,201	27,522
	67,042	63,212
Residential mortgage- and asset-backed securities	12,848	9,554
Total	$ 79,890	$ 72,766

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

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Net investment income

Net investment income is as follows:

($ in millions)	Three months ended June 30, 2009	Three months ended June 30, 2008	Six months ended June 30, 2009	Six months ended June 30, 2008
Fixed income securities	$ 993	$ 1,197	$ 2,035	$ 2,476
Equity securities	19	31	35	63
Mortgage loans	131	156	268	316
Limited partnership interests	4	30	7	90
Other	2	56	16	122
Investment income, before expense	1,149	1,470	2,361	3,067
Investment expense	(41)	(58)	(77)	(129)
Net investment income	$ 1,108	$ 1,412	$ 2,284	$ 2,938

Realized capital gains and losses

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

($ in millions)	Three months ended June 30, 2009	Three months ended June 30, 2008	Six months ended June 30, 2009	Six months ended June 30, 2008
Fixed income securities	$ 15	$ (1,137)	$ 122	$ (1,495)
Equity securities	27	(151)	(136)	(109)
Mortgage loans	(16)	(38)	(48)	(37)
Limited partnership interests	(84)	(6)	(423)	(5)
Derivatives	420	125	515	(206)
Other	(34)	(8)	(61)	(18)
Realized capital gains and losses	$ 328	$ (1,215)	$ (31)	$ (1,870)

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

($ in millions)	**Three months ended June 30, 2009**	**2008**	**Six months ended June 30, 2009**	**2008**
Impairment write-downs (1)	$ (291)	$ (250)	$ (911)	$ (665)
Change in intent write-downs (2)	(26)	(1,015)	(131)	(1,058)
Net OTTI losses recognized in earnings	(317)	(1,265)	(1,042)	(1,723)
Sales	263	(73)	681	30
Valuation of derivative instruments	367	40	470	(285)
Settlements of derivative instruments	52	83	40	108
EMA LP income (3)	(37)	--	(180)	--
Realized capital gains and losses	$ 328	$ (1,215)	$ (31)	$ (1,870)

(1) Beginning April 1, 2009 for fixed income securities, impairment write-downs reflect the credit loss component of issue specific other-than-temporary declines in fair value where the amortized cost basis is not expected to be entirely recovered. For periods prior to April 1, 2009 for fixed income securities and all periods for equity securities, impairment write-downs reflect issue specific other-than-temporary declines in fair value, including instances where the Company could not reasonably assert that the recovery period would be temporary.

(2) Beginning April 1, 2009 for fixed income securities, change in intent write-downs reflect instances where the Company has made a decision to sell the security or it is more likely than not the Company will be required to sell the security before recovery of its amortized cost basis. For periods prior to April 1, 2009 for fixed income securities and all periods for equity securities, change in intent write-downs reflect instances where the Company could not assert a positive intent to hold until recovery.

(3) Beginning in the fourth quarter of 2008, income from limited partnership interests accounted for utilizing the equity method of accounting (EMA LP) is reported in realized capital gains and losses. EMA LP income for periods prior to the fourth quarter of 2008 is reported in net investment income.

Gross gains of $298 million and $114 million and gross losses of $78 million and $152 million were realized on sales of fixed income securities during the three months ended June 30, 2009 and 2008, respectively. Gross gains of $948 million and $269 million and gross losses of $330 million and $288 million were realized on sales of fixed income securities during the six months ended June 30, 2009 and 2008, respectively.

Other-than-temporary impairment losses by asset type are as follows:

($ in millions)	**Three months ended June 30, 2009**			**Six months ended June 30, 2009**		
	Gross	**Included in OCI**	**Net**	**Gross**	**Included in OCI**	**Net**
Fixed income securities:						
Municipal	$ (36)	$ 4	$ (32)	$ (86)	$ 4	(82)
Corporate	(37)	(9)	(46)	(92)	(9)	(101)

Foreign government	--	--	--	(17)	--	(17)
RMBS	(213)	151	(62)	(259)	151	(108)
CMBS	(43)	(1)	(44)	(52)	(1)	(53)
ABS	(37)	9	(28)	(175)	9	(166)
Total fixed income securities	(366)	154	(212)	(681)	154	(527)
Equity securities	(32)	--	(32)	(186)	--	(186)
Mortgage loans	(15)	--	(15)	(49)	--	(49)
Limited partnership interests	(46)	--	(46)	(243)	--	(243)
Other	(12)	--	(12)	(37)	--	(37)
Other-than-temporary impairment losses	$ (471)	$ 154	$ (317)	$ (1,196)	$ 154	$ (1,042)

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The total amount of other-than-temporary impairment losses included in accumulated other comprehensive income for fixed income securities at June 30, 2009, which were not included in earnings, are presented in the following table. The amount excludes $101 million of net unrealized gains related to changes in valuation of the fixed income securities subsequent to the impairment measurement date.

($ in millions)		
Municipal	$	(4)
Corporate		(94)
RMBS		(399)
CMBS		(63)
ABS		(125)
Total	$	(685)

A rollforward of the amount related to credit losses for fixed income securities recognized in earnings is presented in the following table.

($ in millions)		
Beginning balance of cumulative credit loss for securities held at April 1, 2009	$	(1,357)
Additional credit loss for securities previously other-than-temporarily impaired		(44)
Additional credit loss for securities not previously other-than-temporarily impaired		(148)
Reduction in credit loss for securities disposed or collected		43
Reduction in credit loss for securities other-than-temporarily impaired to fair value		--
Change in credit loss due to accretion of increase in cash flows and time value of cash flows for securities previously other-than-temporarily impaired		--
Ending balance at June 30, 2009	$	(1,506)

The Company uses its best estimate of future cash flows expected to be collected from the fixed income security discounted at the security s effective rate prior to impairment 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 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 may not be limited to, the remaining payment terms of the security, prepayment speeds, foreign exchange rates, the financial condition of the issuer(s), expected defaults, expected recoveries, the value of the underlying collateral and current subordination levels, vintage, geographic concentration, available reserves or escrows, third party guarantees and other credit enhancements. Additionally, 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 collectability of the security may also be considered. The estimated fair value of collateral may be used to estimate recovery value if the Company determines that the security is dependent on the liquidation of collateral for recovery. 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. If the Company determines that the fixed income security does not have sufficient cash flow or other information to determine a recovery value for the security, the Company may conclude that the entire decline in fair value is deemed to be credit related and is recorded in earnings. The unrealized loss deemed to be related to factors other than credit remains classified in OCI.

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Unrealized net capital gains and losses

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

($ in millions) At June 30, 2009	Fair value	Gross unrealized Gains	Gross unrealized Losses	Unrealized net gains (losses)
Fixed income securities (1)	$ 72,766	$ 1,801	$ (8,925)	$ (7,124)
Equity securities	3,297	162	(348)	(186)
Short-term investments	6,070	--	--	--
Derivative instruments(2)	(13)	5	(20)	(15)
Unrealized net capital gains and losses, pre-tax				(7,325)
Amounts recognized for:				
Insurance reserves (3)				--
DAC and DSI (4)				4,064
Amounts recognized				4,064
Deferred income taxes				1,149
Unrealized net capital gains and losses, after-tax				$ (2,112)

(1) Unrealized net capital gains and losses for fixed income securities comprise $(584) million related to unrealized net capital losses on fixed income securities with OTTI and $(6,540) million related to other unrealized net capital gains and losses.

(2) Included in the fair value of derivative securities are $(5) million classified as assets and $8 million classified as liabilities.

(3) 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, resulting in a premium deficiency. Although the Company evaluates premium deficiencies on the combined performance of our 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 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.

At December 31, 2008	Fair value	Gross unrealized Gains	Gross unrealized Losses	Unrealized net gains (losses)
Fixed income securities	$ 68,608	$ 2,545	$ (11,041)	$ (8,496)
Equity securities	2,805	112	(444)	(332)
Short-term investments	8,906	4	(1)	3
Derivative instruments (1)	15	25	(14)	11
Unrealized net capital gains and losses, pre-tax				(8,814)
Amounts recognized for:				
Insurance reserves				(378)
DAC and DSI				3,500
Amounts recognized				3,122

Deferred income taxes		1,954
Unrealized net capital gains and losses, after-tax	$	(3,738)

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(1) Included in the fair value of derivative securities are $4 million classified as assets and $(11) million classified as liabilities.

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Change in unrealized net capital gains and losses

The change in unrealized net capital gains and losses for the six months ended June 30, 2009 is as follows:

($ in millions)		
Fixed income securities	$	1,372
Equity securities		146
Short-term investments		(3)
Derivative instruments		(26)
Total		1,489
Amounts recognized for:		
Insurance reserves		378
DAC and DSI		564
Increase in amounts recognized		942
Deferred income taxes		(805)
Increase in unrealized net capital gains and losses	$	1,626

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 a decision to sell or whether it is more likely than not the Company will be required to sell for reasons such as liquidity, contractual or regulatory purposes before recovery of the amortized cost basis. If a security meets either of these criteria, the security s decline in fair value is deemed 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 if it expects to receive cash flows sufficient to recover the entire amortized cost basis of the security by comparing the estimated recovery value calculated by discounting the best estimate of future cash flows at the security s effective rate prior to impairment with 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 attributed to other factors recognized in OCI.

For equity securities, the Company considers various factors, including whether the Company 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.

Our portfolio monitoring process includes a quarterly review of all securities using a screening process to identify situations where the fair value, compared to amortized cost for fixed income securities and cost for equity securities, is below established thresholds for certain time periods, or which are identified through other monitoring criteria such as ratings, ratings downgrades or payment defaults. The securities identified, as well as others 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 of the issue or issuer and its future earnings potential. Some of the factors considered in evaluating whether a decline in fair value is other than temporary are: 1) the length of time and extent to which the fair value has been less than amortized cost for fixed income securities, or cost for equity securities; 2) the financial condition, near-term and long-term prospects of the issue or issuer, including relevant industry conditions and trends, geographic location and implications of rating agency actions and offering prices; and 3) the specific reasons that a security is in a significant unrealized loss position, including market conditions which could affect liquidity.

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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 (1)			12 months or more (1)			Total
	Number of issues	Fair value	Unrealized losses	Number of issues	Fair value	Unrealized losses	Total unrealized losses
At June 30, 2009							
Fixed income securities							
U.S. government and agencies	11	$ 619	$ (8)	--	$ --	$ --	$ (8)
Municipal	1,677	7,923	(701)	760	3,322	(805)	(1,506)
Corporate	638	6,413	(619)	776	8,050	(1,580)	(2,199)
Foreign government	47	517	(21)	14	59	(6)	(27)
RMBS	615	1,373	(112)	465	2,587	(2,150)	(2,262)
CMBS	106	935	(309)	329	2,089	(1,456)	(1,765)
ABS	31	237	(54)	214	1,403	(1,097)	(1,151)
Redeemable preferred stock	1	3	(2)	2	17	(5)	(7)
Total fixed income securities (2)	3,126	18,020	(1,826)	2,560	17,527	(7,099)	(8,925)
Equity securities	209	1,247	(313)	20	110	(35)	(348)
Total fixed income and equity securities	3,335	$ 19,267	$ (2,139)	2,580	$ 17,637	$ (7,134)	$ (9,273)
Investment grade fixed income securities	2,826	$ 16,587	$ (1,442)	2,063	$ 14,923	$ (4,918)	$ (6,360)
Below investment grade fixed income securities	300	1,433	(384)	497	2,604	(2,181)	(2,565)
Total fixed income securities	3,126	$ 18,020	$ (1,826)	2,560	$ 17,527	$ (7,099)	$ (8,925)
At December 31, 2008							
Fixed income securities							
U.S. government and agencies	5	$ 230	$ (1)	--	$ --	$ --	$ (1)
Municipal	2,648	11,981	(1,983)	117	598	(201)	(2,184)
Corporate	1,632	14,827	(2,050)	448	4,504	(1,826)	(3,876)
Foreign government	58	349	(63)	3	13	(12)	(75)
RMBS	465	1,875	(457)	317	1,685	(1,081)	(1,538)
CMBS	295	2,729	(797)	179	899	(1,207)	(2,004)
ABS	81	551	(124)	181	1,092	(1,229)	(1,353)
Redeemable preferred stock	3	17	(10)	1	1	--	(10)
Total fixed income securities	5,187	32,559	(5,485)	1,246	8,792	(5,556)	(11,041)
Equity securities	325	1,897	(398)	10	53	(46)	(444)
Total fixed income and equity securities	5,512	$ 34,456	$ (5,883)	1,256	$ 8,845	$ (5,602)	$ (11,485)
Investment grade fixed income securities	4,687	$ 30,484	$ (4,813)	1,081	$ 7,988	$ (4,961)	$ (9,774)
Below investment grade fixed income securities	500	2,075	(672)	165	804	(595)	(1,267)
Total fixed income securities	5,187	$ 32,559	$ (5,485)	1,246	$ 8,792	$ (5,556)	$ (11,041)

(1) The aging of unrealized losses, and therefore the time period category of aging, as of June 30, 2009 was reset to the historical point of impairment for securities impacted by the adoption of FSP FAS 115-2. December 31, 2008 balances have not been restated.

(2) Unrealized losses resulting from factors other than credit on fixed income securities with other-than-temporary impairments for which the Company has recorded a credit loss in earnings total $99 million for the less than 12 month category and $511 million for the 12 months or greater category.

As of June 30, 2009, $2.20 billion of unrealized losses are related to securities with an unrealized loss position less than 20% of cost or amortized cost, the degree of which suggests that these securities do not pose a high risk of being other-than-temporarily impaired. Of the $2.20 billion, $1.86 billion are related to unrealized losses on investment grade fixed income securities. Investment grade is defined as a security having a rating from the NAIC of 1 or 2; a rating of Aaa, Aa, A or Baa from Moody s, a rating of AAA, AA, A or BBB from Standard & Poor s (S&P), Fitch or Dominion, or aaa, aa, a or bbb from A.M. Best; or a comparable internal rating if an externally provided rating is not available. Unrealized losses on investment grade securities are principally related to rising interest rates or changes in credit spreads since the securities were acquired.

As of June 30, 2009, the remaining $7.07 billion of unrealized losses are related to securities in unrealized loss positions greater than or equal to 20% of cost or amortized cost. Of the $7.07 billion, $2.32 billion are related to

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below investment grade fixed income securities and $246 million are related to equity securities. Of these amounts, $1.22 billion of the below investment grade fixed income securities had been in an unrealized loss position for a period of twelve or more consecutive months as of June 30, 2009. Unrealized losses on below investment grade securities are principally related to rising interest rates or changes in credit spreads. Unrealized losses on equity securities are primarily related to equity market fluctuations. The other securities comprising the $4.50 billion of unrealized losses were evaluated based on factors such as the financial condition and near-term and long-term prospects of the issuer and were determined to have adequate resources to fulfill contractual obligations, such as recent financings or bank loans, cash flows from operations, collateral or the position of a subsidiary with respect to its parent s bankruptcy.

Unrealized losses on residential mortgage-backed, asset-backed and commercial mortgage-backed holdings were evaluated based on credit ratings, as well as the performance of the underlying collateral relative to the securities positions in the securities respective capital structure. The unrealized losses on residential mortgage-backed and asset-backed securities were evaluated with credit enhancements from bond insurers where applicable. The unrealized losses on municipal bonds that had credit enhancements from bond insurers were evaluated on the quality of the underlying security. These investments were determined to have adequate resources to fulfill contractual obligations.

As of June 30, 2009, the Company did not have the intent 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 June 30, 2009, the Company had the intent and ability to hold the equity securities with unrealized losses for a period of time sufficient for them to recover.

Limited partnership impairment

As of June 30, 2009 and December 31, 2008, equity-method limited partnership interests totaled $1.40 billion and $1.56 billion, respectively. The Company recognizes a loss in value for equity-method investments when evidence demonstrates that it is other-than-temporarily impaired. 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 an earnings capacity that would justify the carrying amount of the investment. The Company did not have any write-downs for the three months ended June 30, 2009 and 2008 related to equity-method limited partnership interests. The Company had write-downs of $10 million and $8 million for the six months ended June 30, 2009 and 2008, respectively, related to equity-method limited partnership interests.

As of June 30, 2009 and December 31, 2008, the carrying value for cost-method limited partnership interests was $1.07 billion and $1.23 billion, respectively, which primarily included limited partnership interests in fund investments. The fair value for cost-method investments is estimated to be equivalent to the reported net asset value of the underlying funds. 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: 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; significantly reduced valuations of the investments held by limited partnerships; or any other recent adverse events since the last financial statements received that might affect the fair value of the investee s capital. Additionally, the Company uses a screening process to identify those investments whose net asset value is below established thresholds for certain periods of time, and investments that are performing below expectations for consideration for inclusion on its watch-list. The Company had write-downs of $46 million and $7 million for the three months ended June 30, 2009 and 2008, respectively, and write-downs of $233 million and $12 million for the six months ended June 30, 2009 and 2008, respectively, related to cost method investments that were other-than-temporarily impaired.

5. Fair Value of Assets and Liabilities

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.

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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 non-active markets; 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. These inputs reflect the Company s estimates of the assumptions that market participants would use in valuing the assets and liabilities.

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. This condition could cause an instrument to be reclassified from Level 1 to Level 2, or from Level 2 to Level 3.

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, equity options embedded in fixed income securities are not disclosed in the hierarchy with free-standing derivatives as the embedded derivatives are presented with the host contract in fixed income securities. As of June 30, 2009, 68.4% of total assets are measured at fair value and 0.5% of total liabilities are measured at fair value.

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

Level 1 measurements

- Fixed income securities: Comprise U.S. Treasuries. 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 U.S. and international equity securities. Valuation is based on unadjusted quoted prices for identical assets in active markets that the Company can access.

- Short-term: Comprise 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:

Corporate, including privately placed: Valued based on inputs including quoted prices for identical or similar assets in markets that are not active. Also includes privately placed securities which have market-observable external ratings from independent third party rating agencies.

Municipal: Externally rated municipals are valued based on inputs including quoted prices for identical or similar assets in markets that are not active. Included in municipals are auction rate securities (ARS) other than those backed by student loans. ARS backed by student loans are included in Level 3.

U.S. government and agencies: Valued based on inputs including quoted prices for identical or similar assets in markets that are not active.

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CMBS: Valuation is principally based on inputs including quoted prices for identical or similar assets in markets that are not active.

Redeemable preferred stock; U.S. government sponsored entities (U.S. Agency); Prime residential mortgage-backed securities (Prime); Foreign government; ABS - credit card, auto and student loans: Valued based on inputs including quoted prices for identical or similar assets in markets that are not active.

- Equity securities: Valued based on inputs including quoted prices for identical or similar assets in markets that are not active.

- Short-term: Commercial paper and other short-term investments are valued based on quoted prices for identical or similar assets in markets that are not active or amortized cost.

- 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 credit default swaps, and commodity swaps, are valued using models that rely on inputs such as interest rate yield curves, currency rates, adjustment for counterparty credit risks, and commodity prices 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.

- Contractholder funds: Derivatives embedded in certain annuity contracts are valued based on internal models that rely on inputs such as interest rate yield curves and equity index volatility assumptions that are market observable for substantially the full term of the contract. The valuation techniques are widely accepted in the financial services industry and do not include significant judgment.

Level 3 measurements

- Fixed income securities:

Corporate: Valued based on non-binding broker quotes.

Corporate privately placed: Valued based on non-binding broker quotes and models that are widely accepted in the financial services industry and use internally assigned credit ratings as inputs and instrument specific inputs. Instrument specific inputs used in internal fair value determinations include coupon rate, coupon type, weighted average life, sector of the issuer and call provisions. Privately placed securities are categorized as Level 3 as a result of the significance of non-market observable inputs. The internally modeled securities are valued based on internal ratings, which are not observable in the market. Multiple internal ratings comprise a National Association of Insurance Commissioners (NAIC) rating category and when used in the internal model provide a more refined determination of fair value. The Company s internal ratings are primarily consistent with the NAIC ratings which are generally updated annually.

Municipal: ARS primarily backed by student loans that have become illiquid due to failures in the auction market and municipal bonds that are not rated by third party credit rating agencies but are generally rated by the NAIC are included in Level 3. ARS backed by student loans are valued based on a discounted cash flow model with certain inputs to the valuation model that are significant to the valuation, but are not market observable, including estimates of future coupon rates if auction failures continue, maturity assumptions, and illiquidity premium. Non-rated municipal bonds are valued based on valuation models that are widely accepted in the financial services industry and are categorized as Level 3 as a result of the significance of non-market observable inputs, which may include projections of future cash flows.

Subprime residential mortgage-backed securities (Subprime); Alt-A residential mortgage-backed securities (Alt-A): Subprime and Alt-A are principally valued based on inputs including quoted prices for identical or similar assets in markets that exhibit less liquidity relative to those markets supporting Level 2 fair value measurements. Certain Subprime and Alt-A are valued based on non-binding broker quotes. Due to the reduced availability of actual market prices or relevant observable inputs as a result of

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the decrease in liquidity that has been experienced in the market for these securities, all Subprime and Alt-A are categorized as Level 3.

Other collateralized debt obligations (CDO): Valued based on non-binding broker quotes received from brokers who are familiar with the investments. Due to the reduced availability of actual market prices or relevant observable inputs as a result of the decrease in liquidity that has been experienced in the market for these securities, all collateralized loan obligations (CLO), including synthetic collateralized debt obligations, are categorized as Level 3.

CMBS; Commercial real estate collateralized debt obligations (CRE CDO): CRE CDO, which are reported as CMBS, and other CMBS, are either valued based on non-binding broker quotes or based on inputs including quoted prices for identical or similar assets in markets that exhibit less liquidity relative to those markets supporting Level 2 fair value measurements. Due to the reduced availability of actual market prices or relevant observable inputs as a result of the decrease in liquidity that has been experienced in the market for these securities, certain CMBS are categorized as Level 3.

ABS - credit card, auto, student loans and other: Valued based on inputs including quoted prices for identical or similar assets in markets that are not active. Due to the reduced availability of actual market prices or relevant observable inputs as a result of the decrease in liquidity that has been experienced in the market for these securities, certain ABS are categorized as Level 3.

- Other investments: Certain free-standing OTC derivatives, such as interest rate caps and floors, certain credit default swaps and OTC options (including swaptions), are valued using valuation models that are widely accepted in the financial services industry. Non-market observable inputs such as volatility assumptions may be significant to the valuation of the instruments.

- Contractholder funds: Derivatives embedded in 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 use stochastically determined cash flows based on the contractual elements of embedded derivatives and other applicable market data. 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 and other investments written-down to fair value in connection with recognizing other-than-temporary impairments are valued using valuation models that are widely accepted in the financial services industry. Inputs to the valuation models include non-market observable inputs such as credit spreads. Limited partnership interests written-down to fair value in connection with recognizing other-than-temporary impairments are valued using net asset values and other sources.

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The following table summarizes the Company s assets and liabilities measured at fair value on a recurring and non-recurring basis as of June 30, 2009:

($ 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 (1)	Balance as of June 30, 2009
Assets					
Fixed income securities:					
U.S. government and agencies	$ 973	$ 3,212	$ --		$ 4,185
Municipal	--	20,584	2,513		23,097
Corporate	--	20,101	9,837		29,938
Foreign government	--	2,723	--		2,723
RMBS	--	5,126	2,377		7,503
CMBS	--	2,293	944		3,237
ABS	--	323	1,728		2,051
Redeemable preferred stock	--	30	2		32
Total fixed income securities	973	54,392	17,401		72,766
Equity securities	3,004	223	70		3,297
Short-term investments	442	5,628	--		6,070
Other investments:					
Free-standing derivatives	--	779	296	$ (627)	448
Separate account assets	8,193	--	--		8,193
Other assets	1	--	2		3
Total recurring basis assets	12,613	61,022	17,769	(627)	90,777
Non-recurring basis (2)	--	--	273		273
Total assets at fair value	$ 12,613	$ 61,022	$ 18,042	$ (627)	$ 91,050
% of total assets at fair value	13.9 %	67.0 %	19.8 %	(0.7)%	100.0 %
Liabilities					
Contractholder funds:					
Derivatives embedded in annuity contracts	$ --	$ (120)	$ (155)		$ (275)
Other liabilities:					
Free-standing derivatives	(4)	(611)	(137)	$ 383	(369)
Total liabilities at fair value	**$** (4)	$ (731)	$ (292)	$ 383	$ (644)
% of total liabilities at fair value	0.6 %	113.5 %	45.3 %	(59.4)%	100.0 %

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(1) The Company nets all fair value amounts recognized for derivative instruments and fair value amounts recognized for the right to reclaim cash collateral or the obligation to return cash collateral executed with the same counterparty under a master netting agreement. At June 30, 2009, the right to reclaim cash collateral was offset by securities held, and the obligation to return collateral was $244 million.

(2) Includes $144 million of mortgage loans, $85 million of limited partnership interests and $44 million of other investments written-down to fair value in connection with recognizing other-than-temporary impairments.

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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, 2008:

($ 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 (1)	Balance as of December 31, 2008
Assets					
Fixed income securities:					
U.S. government and agencies	$ 662	$ 3,572	$ --		$ 4,234
Municipal	--	19,385	2,463		21,848
Corporate	--	17,432	10,195		27,627
Foreign government	--	2,675	--		2,675
RMBS	--	3,577	2,988		6,565
CMBS	--	3,389	457		3,846
ABS	--	73	1,714		1,787
Redeemable preferred stock	--	24	2		26
Total fixed income securities	662	50,127	17,819		68,608
Equity securities	2,477	254	74		2,805
Short-term investments	563	8,343	--		8,906
Other investments:					
Free-standing derivatives	--	812	13	$ (525)	300
Separate account assets	8,239	--	--		8,239
Other assets	--	--	1		1
Total recurring basis assets	11,941	59,536	17,907	(525)	88,859
Non-recurring basis (2)	--	--	301		301
Total assets at fair value	$ 11,941	$ 59,536	$ 18,208	$ (525)	$ 89,160
% of total assets at fair value	13.4 %	66.8 %	20.4 %	(0.6)%	100.0 %
Liabilities					
Contractholder funds:					
Derivatives embedded in annuity contracts	$ --	$ (37)	$ (265)		$ (302)
Other liabilities:					
Free-standing derivatives	--	(1,177)	(114)	$ 505	(786)
Total liabilities at fair value	**$** --	$ (1,214)	$ (379)	$ 505	$ (1,088)
% of total liabilities at fair value	-- %	111.6 %	34.8 %	(46.4)%	100.0 %

(1) The Company nets all fair value amounts recognized for derivative instruments and fair value amounts recognized for the right to reclaim cash collateral or the obligation to return cash collateral executed with the same counterparty under a master netting agreement. At December 31, 2008, the right to reclaim cash collateral was offset by securities held, and the obligation to return collateral was $20 million.

(2) Includes $165 million of mortgage loans, $121 million of limited partnership interests and $15 million of other investments written-down to fair value in connection with recognizing other-than-temporary impairments.

When the inputs used to measure fair value fall within different levels of the hierarchy, the level within which the fair value measurement is categorized is based on the lowest level input that is significant to the fair value measurement in its entirety. Thus, a Level 3 fair value measurement may include inputs that are observable (Level 1 or Level 2) and unobservable (Level 3).

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The following table provides a summary of changes in fair value during the three-month period ended June 30, 2009 of Level 3 assets and liabilities held at fair value on a recurring basis. Net transfers in and/or out of Level 3 are reported as having occurred at the beginning of the quarter the transfer occurred; therefore, for all transfers into Level 3, all realized and changes in unrealized gains and losses in the quarter of transfer are reflected in the table below.

($ in millions)	Balance as of March 31, 2009	Total realized and unrealized gains (losses) included in: Net income (1)	OCI on Statement of Financial Position	Purchases, sales, issuances and settlements, net	Net transfers in and/or (out) of Level 3	Balance as of June 30, 2009	Total gains (losses) included in net income for financial instruments still held at June 30, 2009 (3)
Assets							
Fixed income securities:							
Municipal	$ 2,395	$ (4)	$ 95	$ (44)	$ 71	$ 2,513	$ (4)
Corporate	9,818	(2)	586	(554)	(11)	9,837	(15)
RMBS	2,506	(55)	115	--	(189)	2,377	(57)
CMBS	775	(72)	253	1	(13)	944	(72)
ABS	1,379	(26)	270	145	(40)	1,728	(27)
Redeemable preferred stock	2	--	--	--	--	2	--
Total fixed income securities	16,875	(159)	1,319	(452)	(182)	17,401	(175)
Equity securities	73	--	--	--	(3)	70	--
Other investments:							
Free-standing derivatives, net	(103)	213	--	49	--	159 (2)	246
Other assets	3	(1)	--	--	--	2	(1)
Total recurring Level 3 assets	$ 16,848	$ 53	$ 1,319	$ (403)	$ (185)	$ 17,632	$ 70
Liabilities							
Contractholder funds:							
Derivatives embedded in annuity contracts	$ (291)	$ 131	$ --	$ 5	$ --	$ (155)	$ 131
Total recurring Level 3 liabilities	$ (291)	$ 131	$ --	$ 5	$ --	$ (155)	$ 131

(1) The effect to net income totals $184 million and is reported in the Condensed Consolidated Statements of Operations as follows: $38 million in realized capital gains and losses, $15 million in net investment income and $(131) million in life and annuity contract benefits.

(2) Comprises $296 million of assets and $(137) million of liabilities.

(3) The amounts represent gains and losses included in net income for the period of time that the asset or liability was determined to be in Level 3. These gains and losses total $201 million and are reported in the Condensed Consolidated Statements of Operations as follows: $52 million in realized capital gains and losses, $17 million in net investment income, $(1) million in interest credited to contractholder funds, and $(131) million in life and annuity contract benefits.

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The following table provides a summary of changes in fair value during the six-month period ended June 30, 2009 of Level 3 assets and liabilities held at fair value on a recurring basis.

($ in millions)		Total realized and unrealized gains (losses) included in:					
	Balance as of December 31, 2008	Net income (1)	OCI on Statement of Financial Position	Purchases, sales, issuances and settlements, net	Net transfers in and/or (out) of Level 3	Balance as of June 30, 2009	Total gains (losses) included in net income for financial instruments still held at June 30, 2009 (3)
Assets							
Fixed income securities:							
Municipal	$ 2,463	$ (3)	$ 61	$ (35)	$ 27	$ 2,513	$ (3)
Corporate	10,195	(52)	638	(880)	(64)	9,837	(65)
RMBS	2,988	(59)	(209)	(143)	(200)	2,377	(73)
CMBS	457	(106)	172	(4)	425	944	(94)
ABS	1,714	(166)	288	9	(117)	1,728	(153)
Redeemable preferred stock	2	--	--	--	--	2	--
Total fixed income securities	17,819	(386)	950	(1,053)	71	17,401	(388)
Equity securities	74	--	(4)	3	(3)	70	--
Other investments:							
Free-standing derivatives, net	(101)	219	--	41	--	159 (2)	254
Other assets	1	1	--	--	--	2	1
Total recurring Level 3 assets	$ 17,793	$ (166)	$ 946	$ (1,009)	$ (68)	$ 17,632	$ (133)
Liabilities							
Contractholder funds:							
Derivatives embedded in annuity contracts	$ (265)	$ 105	$ --	$ 5	$ --	$ (155)	$ 105
Total recurring Level 3 liabilities	$ (265)	$ 105	$ --	$ 5	$ --	$ (155)	$ 105

(1) The effect to net income totals $(61) million and is reported in the Condensed Consolidated Statements of Operations as follows: $(230) million in realized capital gains and losses, $65 million in net investment income, $1 million in interest credited to contractholder funds, and $(105) million in life and annuity contract benefits.

(2) Comprises $296 million of assets and $(137) million of liabilities.

(3) The amounts represent gains and losses included in net income for the period of time that the asset or liability was determined to be in Level 3. These gains and losses total $(28) million and are reported in the Condensed Consolidated Statements of Operations as follows: $(196) million in realized capital gains and losses, $62 million in net investment income, $(1) million in interest credited to contractholder funds, and $(105) million in life and annuity contract benefits.

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The following table provides a summary of changes in fair value during the three-month period ended June 30, 2008 of Level 3 assets and liabilities held at fair value on a recurring basis.

($ in millions)	Balance as of March 31, 2008	Total realized and unrealized gains (losses) included in: Net income (1)	OCI on Statement of Financial Position	Purchases, sales, issuances and settlements, net	Net transfers in and/or (out) of Level 3	Balance as of June 30, 2008	Total gains (losses) included in net income for financial instruments still held at June 30, 2008 (3)
Assets							
Fixed income securities:							
Municipal	$ 1,477	$ (2)	$ (62)	$ (26)	$ 1,502	$ 2,889	$ (2)
Corporate	12,804	(40)	(187)	(479)	(75)	12,023	(64)
Foreign government	14	--	--	5	(14)	5	--
RMBS	4,434	(427)	267	(312)	--	3,962	(410)
CMBS	670	(349)	307	(48)	4	584	(323)
ABS	3,166	(8)	(67)	(363)	95	2,823	(2)
Redeemable preferred stock	1	--	--	--	--	1	--
Total fixed income securities	22,566	(826)	258	(1,223)	1,512	22,287	(801)
Equity securities	128	(4)	(3)	36	(82)	75	(2)
Other investments:							
Free-standing derivatives, net	(39)	10	--	10	--	(19) (2)	41
Other assets	2	--	--	--	--	2	--
Total recurring Level 3 assets	$ 22,657	$ (820)	$ 255	$ (1,177)	$ 1,430	$ 22,345	$ (762)
Liabilities							
Contractholder funds:							
Derivatives embedded in annuity contracts	$ (10)	$ (11)	$ --	$ 1	$ --	$ (20)	$ (11)
Total recurring Level 3 liabilities	$ (10)	$ (11)	$ --	$ 1	$ --	$ (20)	$ (11)

(1) The effect to net income totals $(831) million and is reported in the Condensed Consolidated Statements of Operations as follows: $(834) million in realized capital gains and losses, $15 million in net investment income, $(1) million in interest credited to contractholder funds, and $(11) million in life and annuity contract benefits.

(2) Comprises $59 million of assets and $(78) million of liabilities.

(3) The amounts represent gains and losses included in net income for the period of time that the asset or liability was determined to be in Level 3. These gains and losses total $(773) million and are reported in the Condensed Consolidated Statements of Operations as follows: $(777) million in realized capital gains and losses, $15 million in net investment income, and $(11) million in life and annuity contract benefits.

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The following table provides a summary of changes in fair value during the six-month period ended June 30, 2008 of Level 3 assets and liabilities held at fair value on a recurring basis.

($ in millions)		Total realized and unrealized gains (losses) included in:					
	Balance as of January 1, 2008	Net income (1)	OCI on Statement of Financial Position	Purchases, sales, issuances and settlements, net	Net transfers in and/or (out) of Level 3	Balance as of June 30, 2008	Total gains (losses) included in net income for financial instruments still held at June 30, 2008 (3)
Assets							
Fixed income securities:							
Municipal	$ 1,477	$ 3	$ (78)	$ (35)	$ 1,522	$ 2,889	$ (2)
Corporate	12,868	(167)	(189)	(594)	105	12,023	(206)
Foreign government	19	1	--	(1)	(14)	5	1
RMBS	5,405	(629)	(226)	(567)	(21)	3,962	(593)
CMBS	833	(347)	155	(62)	5	584	(320)
ABS	3,769	(20)	(381)	(640)	95	2,823	(20)
Redeemable preferred stock	1	--	--	--	--	1	4
Total fixed income securities	24,372	(1,159)	(719)	(1,899)	1,692	22,287	(1,136)
Equity securities	129	(5)	(9)	49	(89)	75	(3)
Other investments:							
Free-standing derivatives, net	10	(42)	--	13	--	(19) (2)	3
Other assets	2	--	--	--	--	2	--
Total recurring Level 3 assets	$ 24,513	$ (1,206)	$ (728)	$ (1,837)	$ 1,603	$ 22,345	$ (1,136)
Liabilities							
Contractholder funds:							
Derivatives embedded in annuity contracts	$ 4	$ (25)	$ --	$ 1	$ --	$ (20)	$ (25)
Total recurring Level 3 liabilities	$ 4	$ (25)	$ --	$ 1	$ --	$ (20)	$ (25)

(1) The effect to net income totals $(1.23) billion and is reported in the Condensed Consolidated Statements of Operations as follows: $(1.23) billion in realized capital gains and losses, $28 million in net investment income, $(4) million in interest credited to contractholder funds, and $(25) million in life and annuity contract benefits.

(2) Comprises $59 million of assets and $(78) million of liabilities.

(3) The amounts represent gains and losses included in net income for the period of time that the asset or liability was determined to be in Level 3. These gains and losses total $(1.16) billion and are reported in the Condensed Consolidated Statements of Operations as follows: $(1.16) billion in realized capital gains and losses, $28 million in net investment income, $(1) million in interest credited to contractholder funds, and $(25) million in life and annuity contract benefits.

Presented below are the carrying values and fair value estimates of financial instruments not carried at fair value as of June 30, 2009.

Financial assets

($ in millions)	June 30, 2009		December 31, 2008	
	Carrying value	Fair value	Carrying value	Fair value
Mortgage loans	$ 9,406	$ 7,736	$ 10,229	$ 8,903
Limited partnership interests cost basis	1,065	971	1,228	1,217
Bank loans	695	600	1,038	713

The fair value of mortgage loans is based on discounted contractual cash flows or if the loans are impaired due to credit reasons, the lower of discounted contractual cash flows or fair value of collateral less costs to sell. Risk adjusted discount rates are selected using current rates at which similar loans would be made to borrowers with similar characteristics, using similar types of properties as collateral. The fair value of limited partnership interests accounted for on the cost basis is determined using reported net asset values of the underlying funds. The fair value of bank loans, which are reported in other investments on the Condensed Consolidated Statements of Financial Position, are valued based on broker quotes from brokers familiar with the loans and current market conditions.

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Financial liabilities

($ in millions)	June 30, 2009		December 31, 2008	
	Carrying value	Fair value	Carrying value	Fair value
Contractholder funds on investment contracts	$ 42,334	$ 39,749	$ 46,972	$ 43,479
Long-term debt	6,658	6,199	5,659	4,944
Liability for collateral	870	870	340	340

The fair value of contractholder funds on investment contracts is based on the terms of the underlying contracts utilizing prevailing market rates for similar contracts adjusted for credit risk. Deferred annuities included in contractholder funds are valued using discounted cash flow models which incorporate market value margins, which are based on the cost of holding economic capital, and the Company s own credit risk. Immediate annuities without life contingencies and fixed rate funding agreements are valued at the present value of future benefits using market implied interest rates which include the Company s own credit risk.

The fair value of long-term debt is based on market observable data (such as the fair value of the debt when traded as an asset) or, in certain cases, is determined using discounted cash flow calculations based on current interest rates for instruments with comparable terms and considers the Company s own credit risk. The liability for collateral is valued at carrying value due to its short-term nature.

6. Derivative Financial Instruments

The Company primarily uses derivatives for risk management and asset replication. In addition, the Company has derivatives embedded in non-derivative host contracts, which are required to be separated from the host contracts and accounted for at fair value as derivative instruments. With the exception of non-hedge derivatives used for asset replication and non-hedge embedded derivatives, all of the Company s derivatives are evaluated for their ongoing effectiveness as either accounting hedge or non-hedge derivative financial instruments on at least a quarterly basis. The Company does not use derivatives for trading purposes. Non-hedge accounting is generally used for portfolio level hedging strategies where the terms of the individual hedged items do not meet the strict homogeneity requirements prescribed in SFAS No. 133 to permit the application of SFAS No. 133 s hedge accounting model.

The Company uses derivatives to partially mitigate potential adverse impacts from changes in risk-free interest rates, negative equity market valuations and increases in credit spreads. Property-Liability uses interest rate swaption contracts and exchange traded options on Treasury futures to offset potential declining fixed income market values resulting from potential rising interest rates. Property-Liability also uses interest rate swaps to mitigate municipal bond interest rate risk within the municipal bond portfolio. Exchange traded equity put options are utilized by Property-Liability for overall equity portfolio protection from significant declines in equity market values below a targeted level. Equity index futures are used by Property-Liability to offset valuation losses in our equity portfolio during periods of declining equity market values. Credit default swaps are typically used to mitigate the credit risk within the Property-Liability and Allstate Financial fixed income portfolios.

Portfolio duration management is a risk management strategy that is principally employed by Property-Liability wherein, depending on the current portfolio duration relative to a designated target and the expectations of future interest rate movements, the Company uses financial futures and interest rate swaps to change the duration of the portfolio in order to mitigate the economic effect that interest rates would otherwise have on the fair value of its fixed income securities.

Property-Liability also uses futures to hedge the market risk related to deferred compensation liability contracts and forward contracts to hedge foreign currency risk. Allstate Financial uses foreign currency swaps primarily to reduce the foreign currency risk associated with issuing foreign currency denominated funding agreements and holding foreign currency denominated investments.

Asset-liability management is a risk management strategy that is principally employed by Allstate Financial to balance the respective interest-rate sensitivities of its assets and liabilities. Depending upon the attributes of the assets acquired and liabilities issued, derivative instruments such as interest rate swaps, caps, floors and futures are acquired to change the interest rate characteristics of existing assets and liabilities to ensure the relationship is maintained within specified ranges and to reduce exposure to rising or falling interest rates. Allstate Financial uses financial futures and interest rate swaps to hedge anticipated asset purchases and liability issuances and financial futures and options for

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hedging the Company s equity exposure contained in equity indexed annuity product contracts that offer equity returns to contractholders. In addition, Allstate Financial uses interest rate swaps to hedge interest rate risk inherent in funding agreements.

When derivatives meet specific criteria, they may be designated as accounting hedges and accounted for as fair value, cash flow, foreign currency fair value or foreign currency cash flow hedges. Allstate Financial designates certain of its interest rate and foreign currency swap contracts and certain investment risk transfer reinsurance agreements as fair value hedges when the hedging instrument is highly effective in offsetting the risk of changes in the fair value of the hedged item. Allstate Financial designates certain of its foreign currency swap contracts as cash flow hedges when the hedging instrument is highly effective in offsetting the exposure of variations in cash flows for the hedged risk that could affect net income. Amounts are reclassified to net investment income or realized capital gains and losses as the hedged item affects net income.

Asset replication refers to the synthetic creation of assets through the use of derivatives and primarily investment grade host bonds to replicate securities that are either unavailable in the cash markets or more economical to acquire in synthetic form. The Company replicates fixed income securities using a combination of a credit default swap and one or more highly rated fixed income securities to synthetically replicate the economic characteristics of one or more cash market securities. The Company also creates synthetic exposure to equity markets through the use of exchange traded equity index future contracts and an investment grade host bond.

The Company s primary embedded derivatives are conversion options in fixed income securities, which provide the Company with the right to convert the instrument into a predetermined number of shares of common stock; equity options in Allstate Financial annuity product contracts, which provide equity returns to contractholders; and equity-indexed notes containing equity call options, which provide a coupon payout that is determined using one or more equity-based indices.

The notional amounts specified in the contracts are used to calculate the exchange of contractual payments under the agreements and are generally not representative of the potential for gain or loss on these agreements. However, the notional amounts specified in selling protection credit default swaps represent the maximum amount of potential loss, assuming no recoveries.

Fair value, which is equal to the carrying value, is the estimated amount that the Company would receive (pay) to terminate the derivative contracts at the reporting date. The carrying value amounts for OTC free-standing derivatives have been further adjusted for the effects, if any, of legally enforceable master netting agreements and are presented on a net basis in the Condensed Consolidated Statements of Financial Position. For certain exchange traded derivatives, the exchange requires margin deposits as well as daily cash settlements of margin accounts. As of June 30, 2009, the Company pledged $76 million of securities in the form of margin deposits.

The net impact to pre-tax income for derivatives includes valuation and settlements of derivatives. For those derivatives which qualify for fair value hedge accounting, net income includes the changes in the fair value of the hedged risk, and therefore reflects any hedging ineffectiveness. For cash flow hedges, gains and losses amortized from accumulated other comprehensive income are reported in net income. For embedded derivatives in convertible fixed income securities and equity-indexed notes, net income includes the change in fair value of the embedded derivative and accretion income related to the host instrument.

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The following table provides a summary of the volume and fair value positions of derivative instruments as well as their reporting location in the Condensed Consolidated Statements of Financial Position at June 30, 2009.

($ in millions, except number of contracts)		**Asset derivatives**				
		Volume (1)				
	Balance sheet location	Notional amount	Number of contracts	Fair value, net	Gross asset	Gross liability
Derivatives designated as accounting hedging instruments						
Interest rate swap agreements	Other investments	$ 1,054	n/a	$ (104)	$ --	$ (104)
Foreign currency swap agreements	Other investments	38	n/a	(4)	--	(4)
Foreign currency and interest rate swap agreements	Other investments	723	n/a	212	212	--
Total		$ 1,815	n/a	$ 104	$ 212	$ (108)
Derivatives not designated as accounting hedging instruments						
Interest rate contracts						
Interest rate swap agreements	Other investments	$ 4,116	n/a	$ 163	$ 187	$ (24)
Interest rate swaption agreements	Other investments	14,000	n/a	219	219	--
Interest rate cap and floor agreements	Other investments	2,619	n/a	--	13	(13)
Financial futures contracts and options	Other investments	n/a	29,600	6	6	--
Financial futures contracts and options	Other assets	n/a	2,727	--	--	--
Equity and index contracts						
Options, financial futures and warrants	Other investments	79	137,730	233	233	--
Options, financial futures and warrants	Other assets	n/a	3,007	1	1	--
Foreign currency contracts						
Foreign currency swap agreements	Other investments	75	n/a	2	3	(1)
Foreign currency forwards and options	Other investments	169	n/a	4	8	(4)
Embedded derivative financial instruments						
Conversion options in fixed income securities	Fixed income securities	990	n/a	254	261	(7)
Equity-indexed call options in fixed income securities	Fixed income securities	665	n/a	77	77	--
Other embedded derivative financial instruments	Other investments	1,000	n/a	1	1	--
Credit default contracts						
Credit Default Swaps Buying Protection	Other investments	424	n/a	6	13	(7)
Credit Default Swaps Selling Protection	Other investments	218	n/a	(45)	--	(45)
Other contract						
Other contracts	Other investments	75	n/a	--	--	--

Other contracts	Other assets		6	n/a		2	2	--
Total		$	24,436	173,064	$	923	$ 1,024	$ (101)
Total derivative assets		$	26,251	173,064	$	1,027	$ 1,236	$ (209)

(1) Volume for OTC derivative contracts is represented by their notional amounts. Volume for exchange traded derivatives is represented by the number of contracts which is the basis on which they are traded. (n/a = not applicable)

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THE ALLSTATE CORPORATION AND SUBSIDIARIES

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

(Unaudited)

($ in millions, except number of contracts)	**Liability derivatives**					
		Volume (1)				
	Balance sheet location	Notional amount	Number of contracts	Fair value, net	Gross asset	Gross liability
Derivatives designated as accounting hedging instruments						
Interest rate swap agreements	Other liabilities & accrued expenses	$ 2,099	n/a	$ (205)	$ --	$ (205)
Foreign currency swap agreements	Other liabilities & accrued expenses	189	n/a	(8)	5	(13)
Foreign currency and interest rate swap agreements	Other liabilities & accrued expenses	147	n/a	29	29	--
Foreign currency and interest rate swap agreements	Contractholder funds	n/a	n/a	18	18	--
Total		$ 2,435	n/a	$ (166)	$ 52	$ (218)
Derivatives not designated as accounting hedging instruments						
Interest rate contracts						
Interest rate swap agreements	Other liabilities & accrued expenses	$ 4,465	n/a	$ (64)	$ 53	$ (117)
Interest rate swaption agreements	Other liabilities & accrued expenses	3,000	n/a	46	46	--
Interest rate cap and floor agreements	Other liabilities & accrued expenses	3,091	n/a	(5)	16	(21)
Financial futures contracts and options	Other liabilities & accrued expenses	n/a	500	--	--	--
Equity and index contracts						
Options, financial futures and warrants	Other liabilities & accrued expenses	24	33,086	(91)	--	(91)
Foreign currency contracts						
Foreign currency swap agreements	Other liabilities & accrued expenses	40	n/a	--	--	--
Foreign currency forwards and options	Other liabilities & accrued expenses	n/a	n/a	--	--	--
Embedded derivative financial instruments						
Guaranteed accumulation benefits	Contractholder funds	1,000	n/a	(93)	--	(93)
Guaranteed withdrawal benefits	Contractholder funds	744	n/a	(62)	--	(62)
Other embedded derivative financial instruments	Contractholder funds	4,264	n/a	(121)	--	(121)
Credit default contracts						
Credit Default Swaps Buying Protection	Other liabilities & accrued expenses	816	n/a	(12)	14	(26)
Credit Default Swaps Selling Protection	Other liabilities & accrued expenses	454	n/a	(77)	--	(77)
Total		$ 17,898	33,586	$ (479)	$ 129	$ (608)
Total derivative liabilities		$ 20,333	33,586	$ (645)	$ 181	$ (826)
Total derivatives		$ 46,584	206,650	$ 382		

(1) Volume for OTC derivative contracts is represented by their notional amounts. Volume for exchange traded derivatives is represented by the number of contracts which is the basis on which they are traded. (n/a = not applicable)

The following table provides a summary of the impacts of the Company s foreign currency contracts in cash flow hedging relationships in the Condensed Consolidated Statements of Operations and the Condensed Consolidated Statements of Financial Position. Amortization of net gains from accumulated other comprehensive income related to cash flow hedges is expected to be $1 million during the next twelve months.

($ in millions)

Effective portion	**Three months ended June 30, 2009**	**Six months ended June 30, 2009**
Loss recognized in OCI on derivatives during the period	$ (28)	$ (24)
Loss recognized in OCI on derivatives during the term of the hedging relationship	$ (15)	$ (15)
Gain reclassified from AOCI into income (net investment income)	$ --	$ 1
Gain reclassified from AOCI into income (realized capital gains and losses)	$ 1	$ 1
Ineffective portion and amount excluded from effectiveness testing		
Gain recognized in income on derivatives (realized capital gains and losses)	$ --	$ --

THE ALLSTATE CORPORATION AND SUBSIDIARIES

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

(Unaudited)

The following table presents gains and losses from valuation, settlements and hedge ineffectiveness reported on derivatives used in fair value hedging relationships and derivatives not designated as accounting hedging instruments in the Condensed Consolidated Statements of Operations.

($ in millions)	Three months ended June 30, 2009					
	Net investment income	Realized capital gains and losses	Life and annuity contract benefits	Interest credited to contractholder funds	Operating costs and expenses	Total gain (loss) recognized in net income on derivatives
Derivatives in fair value accounting hedging relationships						
Interest rate contracts	$ 71	$ 6	$ --	$ (1)	$ --	$ 76
Foreign currency and interest rate contracts	--	(2)	--	90	--	88
Subtotal	71	4	--	89	--	164
Derivatives not designated as accounting hedging instruments						
Interest rate contracts	--	540	--	--	--	540
Equity and index contracts	--	(132)	--	32	16	(84)
Embedded derivative financial instruments	--	52	133	(68)	--	117
Foreign currency contracts	--	(7)	--	--	(12)	(19)
Credit default contracts	--	(38)	--	--	--	(38)
Other contracts	(1)	--	--	(4)	--	(5)
Subtotal	(1)	415	133	(40)	4	511
Total	$ 70	$ 419	$ 133	$ 49	$ 4	$ 675

	Six months ended June 30, 2009					
	Net investment income	Realized capital gains and losses	Life and annuity contract benefits	Interest credited to contractholder funds	Operating costs and expenses	Total gain (loss) recognized in net income on derivatives
Derivatives in fair value accounting hedging relationships						
Interest rate contracts	$ 78	$ 10	$ --	$ (13)	$ --	$ 75
Foreign currency and interest rate contracts	--	(3)	--	60	--	57
Subtotal	78	7	--	47	--	132
Derivatives not designated as accounting hedging instruments						
Interest rate contracts	--	579	--	--	--	579
Equity and index contracts	--	(85)	--	9	3	(73)
Embedded derivative financial instruments	--	29	110	(85)	--	54
Foreign currency contracts	--	(6)	--	--	(12)	(18)

Credit default contracts		--		(10)		--		--		--	(10)
Other contracts		(1)		--		--		(1)		--	(2)
Subtotal		(1)		507		110		(77)		(9)	530
Total	$	77	$	514	$	110	$	(30)	$	(9)	$ 662

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NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

(Unaudited)

The following table provides a summary of the changes in fair value of the Company s fair value hedging relationships in the Condensed Consolidated Statements of Operations.

($ in millions)	Three months ended June 30, 2009			
	Gain (loss) on derivatives		Gain (loss) on hedged risk	
Location of gain or (loss) recognized in net income on derivatives	Interest rate contracts	Foreign currency & interest rate contracts	Contractholder funds	Investments
Interest credited to contractholder funds	$ --	$ 79	$ (79)	$ --
Net investment income	105	--		