

ALLSTATE CORP

Form 10-Q

May 01, 2018

UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-Q

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

For the quarterly period ended March 31, 2018

OR

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

For the transition period from _____ to _____

Commission file number 1-11840

THE ALLSTATE CORPORATION

(Exact name of registrant as specified in its charter)

Delaware

36-3871531

(State or other jurisdiction of incorporation or organization) (I.R.S. Employer Identification No.)

2775 Sanders Road, Northbrook, Illinois 60062

(Address of principal executive offices) (Zip Code)

(847) 402-5000

(Registrant's telephone number, including area code)

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

Yes No

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

Yes No

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

Large accelerated filer Accelerated filer

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

Emerging growth company

If an emerging growth company, indicate by check mark if the registrant has elected not to use the extended transition period for complying with any new or revised financial accounting standards provided pursuant to Section 13(a) of the Exchange Act.

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

Yes No

As of April 17, 2018, the registrant had 351,488,825 common shares, \$.01 par value, outstanding.

The Allstate Corporation
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Condensed Consolidated Financial Statements

Part I. Financial Information

Item 1. Financial Statements

The Allstate Corporation and Subsidiaries

Condensed Consolidated Statements of Operations

(\$ in millions, except per share data)	Three months ended March 31,	
	2018	2017
	(unaudited)	
Revenues		
Property and casualty insurance premiums	\$8,286	\$7,959
Life premiums and contract charges	616	593
Other revenue	216	210
Net investment income	786	748
Realized capital gains and losses:		
Total other-than-temporary impairment (“OTTI”) losses	—	(62)
OTTI losses reclassified (from) to other comprehensive income	(1)	3
Net OTTI losses recognized in earnings	(1)	(59)
Sales and valuation changes on equity investments and derivatives	(133)	193
Total realized capital gains and losses	(134)	134
Total Revenues	9,770	9,644
Costs and expenses		
Property and casualty insurance claims and claims expense	5,149	5,416
Life contract benefits	504	474
Interest credited to contractholder funds	161	173
Amortization of deferred policy acquisition costs	1,273	1,169
Operating costs and expenses	1,355	1,307
Restructuring and related charges	22	10
Interest expense	83	85
Total costs and expenses	8,547	8,634
Gain on disposition of operations	1	2
Income from operations before income tax expense	1,224	1,012
Income tax expense	249	317
Net income	975	695
Preferred stock dividends	29	29
Net income applicable to common shareholders	\$946	\$666
Earnings per common share:		
Net income applicable to common shareholders per common share - Basic	\$2.67	\$1.82
Weighted average common shares - Basic	354.1	365.7
Net income applicable to common shareholders per common share - Diluted	\$2.63	\$1.79
Weighted average common shares - Diluted	359.9	371.3
Cash dividends declared per common share	\$0.46	\$0.37

See notes to condensed consolidated financial statements.

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Condensed Consolidated Financial Statements

The Allstate Corporation and Subsidiaries

Condensed Consolidated Statements of Comprehensive Income

(\$ in millions)	Three months ended March	
	2018	2017
	(unaudited)	
Net income	\$975	\$695
Other comprehensive (loss) income, after-tax		
Changes in:		
Unrealized net capital gains and losses	(565)	203
Unrealized foreign currency translation adjustments	(4)	(3)
Unrecognized pension and other postretirement benefit cost	23	19
Other comprehensive (loss) income, after-tax	(546)	219
Comprehensive income	\$429	\$914

See notes to condensed consolidated financial statements.

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Condensed Consolidated Financial Statements

The Allstate Corporation and Subsidiaries
Condensed Consolidated Statements of Financial Position

(\$ in millions, except par value data)	March 31, 2018	December 31, 2017
Assets		(unaudited)
Investments		
Fixed income securities, at fair value (amortized cost \$56,209 and \$57,525)	\$ 56,674	\$ 58,992
Equity securities, at fair value (cost \$5,928 and \$5,461)	6,986	6,621
Mortgage loans	4,679	4,534
Limited partnership interests	7,434	6,740
Short-term, at fair value (amortized cost \$3,424 and \$1,944)	3,424	1,944
Other	4,092	3,972
Total investments	83,289	82,803
Cash	450	617
Premium installment receivables, net	5,856	5,786
Deferred policy acquisition costs	4,409	4,191
Reinsurance recoverables, net	8,916	8,921
Accrued investment income	576	569
Property and equipment, net	1,060	1,072
Goodwill	2,189	2,181
Other assets	3,230	2,838
Separate Accounts	3,314	3,444
Total assets	\$ 113,289	\$ 112,422
Liabilities		
Reserve for property and casualty insurance claims and claims expense	\$ 26,115	\$ 26,325
Reserve for life-contingent contract benefits	12,333	12,549
Contractholder funds	19,139	19,434
Unearned premiums	13,448	13,473
Claim payments outstanding	865	875
Deferred income taxes	725	782
Other liabilities and accrued expenses	7,226	6,639
Long-term debt	6,847	6,350
Separate Accounts	3,314	3,444
Total liabilities	90,012	89,871
Commitments and Contingent Liabilities (Note 12)		
Shareholders' equity		
Preferred stock and additional capital paid-in, \$1 par value, 25 million shares authorized, 95.2 thousand and 72.2 thousand shares issued and outstanding, \$2,380 and \$1,805 aggregate liquidation preference	2,303	1,746
Common stock, \$.01 par value, 2.0 billion shares authorized and 900 million issued, 352 million and 355 million shares outstanding	9	9
Additional capital paid-in	3,367	3,313
Retained income	45,031	43,162
Deferred ESOP expense	(3) (3
Treasury stock, at cost (548 million and 545 million shares)	(26,280) (25,982
Accumulated other comprehensive income:		
Unrealized net capital gains and losses:		
Unrealized net capital gains and losses on fixed income securities with OTTI	84	85
Other unrealized net capital gains and losses	283	1,981

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Unrealized adjustment to DAC, DSI and insurance reserves	(180)	(404)
Total unrealized net capital gains and losses	187		1,662	
Unrealized foreign currency translation adjustments	(13)	(9)
Unrecognized pension and other postretirement benefit cost	(1,324)	(1,347)
Total accumulated other comprehensive income ("AOCI")	(1,150)	306	
Total shareholders' equity	23,277		22,551	
Total liabilities and shareholders' equity	\$ 113,289		\$ 112,422	

See notes to condensed consolidated financial statements.

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Condensed Consolidated Financial Statements

The Allstate Corporate and Subsidiaries
Condensed Consolidated Statements of Shareholders' Equity

(\$ in millions)	Three months ended March 31,	
	2018	2017
	(unaudited)	
Preferred stock par value	\$—	\$—
Preferred stock additional capital paid-in		
Balance, beginning of period	1,746	1,746
Preferred stock issuance	557	—
Preferred stock additional capital paid-in	2,303	1,746
Common stock	9	9
Additional capital paid-in		
Balance, beginning of period	3,313	3,303
Forward contract on accelerated share repurchase agreement	45	—
Equity incentive plans activity	9	(18)
Balance, end of period	3,367	3,285
Retained income		
Balance, beginning of period	43,162	40,678
Cumulative effect of change in accounting principle	1,088	—
Net income	975	695
Dividends on common stock	(165)	(136)
Dividends on preferred stock	(29)	(29)
Balance, end of period	45,031	41,208
Deferred ESOP expense	(3)	(6)
Treasury stock		
Balance, beginning of period	(25,982)	(24,741)
Shares acquired	(333)	(249)
Shares reissued under equity incentive plans, net	35	103
Balance, end of period	(26,280)	(24,887)
Accumulated other comprehensive income		
Balance, beginning of period	306	(416)
Cumulative effect of change in accounting principle	(910)	—
Change in unrealized net capital gains and losses	(565)	203
Change in unrealized foreign currency translation adjustments	(4)	(3)
Change in unrecognized pension and other postretirement benefit cost	23	19
Balance, end of period	(1,150)	(197)
Total shareholders' equity	\$23,277	\$21,158

See notes to condensed consolidated financial statements.

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Condensed Consolidated Financial Statements

The Allstate Corporation and Subsidiaries
Condensed Consolidated Statements of Cash Flows

(\$ in millions)	Three months ended March 31,	
	2018	2017
Cash flows from operating activities	(unaudited)	
Net income	\$975	\$695
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation, amortization and other non-cash items	122	119
Realized capital gains and losses	134	(134)
Gain on disposition of operations	(1)	(2)
Interest credited to contractholder funds	161	173
Changes in:		
Policy benefits and other insurance reserves	(364)	183
Unearned premiums	(204)	(248)
Deferred policy acquisition costs	10	14
Premium installment receivables, net	(58)	(19)
Reinsurance recoverables, net	(12)	11
Income taxes	181	284
Other operating assets and liabilities	(318)	(219)
Net cash provided by operating activities	626	857
Cash flows from investing activities		
Proceeds from sales		
Fixed income securities	10,619	7,083
Equity securities	1,138	2,601
Limited partnership interests	53	210
Other investments	76	24
Investment collections		
Fixed income securities	583	1,029
Mortgage loans	46	223
Other investments	122	174
Investment purchases		
Fixed income securities	(9,789)	(8,800)
Equity securities	(1,535)	(2,383)
Limited partnership interests	(415)	(268)
Mortgage loans	(192)	(86)
Other investments	(330)	(219)
Change in short-term investments, net	(1,533)	1,572
Change in other investments, net	(27)	(10)
Purchases of property and equipment, net	(62)	(74)
Acquisition of operations	(5)	(1,356)
Net cash used in investing activities	(1,251)	(280)
Cash flows from financing activities		
Proceeds from issuance of long-term debt	498	—
Proceeds from issuance of preferred stock	558	—
Contractholder fund deposits	253	257
Contractholder fund withdrawals	(492)	(483)
Dividends paid on common stock	(132)	(122)

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Dividends paid on preferred stock	(29)	(29)
Treasury stock purchases	(270)	(264)
Shares reissued under equity incentive plans, net	10	67
Other	62	3
Net cash provided by (used in) financing activities	458	(571)
Net (decrease) increase in cash	(167)	6
Cash at beginning of period	617	436
Cash at end of period	\$450	\$442

See notes to condensed consolidated financial statements.

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Notes to Condensed Consolidated Financial Statements

The Allstate Corporation and Subsidiaries

Notes to Condensed Consolidated Financial Statements

(Unaudited)

Note 1 General

Basis of presentation

The accompanying condensed consolidated financial statements include the accounts of The Allstate Corporation (the "Corporation") and its wholly owned subsidiaries, primarily Allstate Insurance Company ("AIC"), a property and casualty insurance company with various property and casualty and life and investment subsidiaries, including Allstate Life Insurance Company ("ALIC") (collectively referred to as the "Company" or "Allstate"). These condensed consolidated financial statements have been prepared in conformity with accounting principles generally accepted in the United States of America ("GAAP").

The condensed consolidated financial statements and notes as of March 31, 2018 and for the three month periods ended March 31, 2018 and 2017 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, 2017. The results of operations for the interim periods should not be considered indicative of results to be expected for the full year. All significant intercompany accounts and transactions have been eliminated.

Adopted accounting standards

Recognition and Measurement of Financial Assets and Financial Liabilities

Effective January 1, 2018, the Company adopted new Financial Accounting Standards Board ("FASB") guidance requiring equity investments, including equity securities and limited partnership interests not accounted for under the equity method of accounting or that do not result in consolidation to be measured at fair value with changes in fair value recognized in net income. The guidance clarifies that an entity should evaluate the realizability of deferred tax assets related to available-for-sale fixed income securities in combination with the entity's other deferred tax assets. The Company's adoption of the new FASB guidance included adoption of the relevant elements of Technical Corrections and Improvements to Financial Instruments, issued in February 2018.

Upon adoption of the new guidance on January 1, 2018, \$1.16 billion of pre-tax unrealized net capital gains for equity securities were reclassified from AOCI to retained income. The after-tax change in accounting for equity securities did not affect the Company's total shareholders' equity and the unrealized net capital

gains reclassified to retained income will never be recognized in net income.

Upon adoption of the new guidance on January 1, 2018, the carrying value of cost method limited partnership interests increased \$224 million, pre-tax to fair value. The after-tax cumulative-effect increase in retained income of \$177 million increased the Company's shareholders' equity but will never be recognized in net income thereby negatively impacting calculations of returns on equity.

Revenue from Contracts with Customers

Effective January 1, 2018, the Company adopted new FASB guidance which revises the criteria for revenue recognition. Insurance contracts are excluded from the scope of the new guidance. The Company's principal activities impacted by the new guidance are those related to the issuance of protection plans for consumer products and automobiles and service contracts that provide roadside assistance. Under the guidance, the transaction price is attributed to underlying performance obligations in the contract and revenue is recognized as the entity satisfies performance obligations and transfers control of a good or service to the customer. Incremental costs of obtaining a contract may be capitalized to the extent the entity expects to recover those costs.

Adoption of the guidance on January 1, 2018 under the modified retrospective approach resulted in the recognition of an immaterial after-tax net cumulative effect increase to the beginning balance of retained income. In addition to the net cumulative effect, the Company also recorded in the statement of financial position an increase of approximately

\$160 million pre-tax in unearned premiums with a corresponding \$160 million pre-tax increase in DAC for protection plans sold directly to retailers for which SquareTrade is deemed to be the principal in the transaction. These impacts offset fully and did not impact retained income at the date of adoption.

Presentation of Net Periodic Pension and Postretirement Benefits Costs

Effective January 1, 2018, the Company adopted new FASB guidance requiring identification, on the statement of operations or in disclosures, the line items in which the components of net periodic pension and postretirement benefits costs are presented. The new guidance permits only the service cost component to be eligible for capitalization where applicable. The adoption had no impact on the Company's results of operations or financial position.

Goodwill Impairment

In January 2017, the FASB issued guidance to simplify the accounting for goodwill impairment which removes the second step of the goodwill impairment

Notes to Condensed Consolidated Financial Statements

test that requires a hypothetical purchase price allocation. Under the new guidance, goodwill impairment will be measured and recognized as the amount by which a reporting unit's carrying value, including goodwill, exceeds its fair value, not to exceed the carrying amount of goodwill allocated to the reporting unit. The revised guidance does not affect a reporting entity's ability to first assess qualitative factors by reporting unit to determine whether to perform the quantitative goodwill impairment test. The guidance is to be applied on a prospective basis, with the effects, if any, recognized in net income in the period of adoption. The Company elected to early adopt the new guidance as of January 1, 2018. The adoption had no impact on the Company's results of operations or financial position.

Changes to significant accounting policies

Investments

Changes were made to the Company's Significant Accounting Policies upon adoption of new FASB guidance related to the recognition and measurement of financial assets. Equity securities primarily include common stocks, exchange traded and mutual funds, non-redeemable preferred stocks and real estate investment trust equity investments. Equity securities are carried at fair value. Equity securities without readily determinable or estimable fair values are measured using the measurement alternative which is cost less impairment, if any, and adjustments resulting from observable price changes in orderly transactions for the identical or similar investment of the same issuer. The periodic change in fair value of equity securities is recognized within realized capital gains and losses on the Condensed Consolidated Statements of Operations effective January 1, 2018.

Investments in limited partnership interests include interests in private equity funds, real estate funds and other funds. Where the Company's interest is so minor that it exercises virtually no influence over operating and financial policies, investments in limited partnership interests purchased prior to January 1, 2018 are accounted for at fair value primarily utilizing the net asset value as a practical expedient ("NAV") to determine fair value. All other investments in limited partnership interests, including those purchased subsequent to January 1, 2018, are accounted for in accordance with the equity method of accounting ("EMA").

Investment income from limited partnership interests carried at fair value is recognized based upon the changes in fair value of the investee's equity primarily determined using NAV. Income from EMA limited partnership interests is recognized based on the Company's share of the partnerships' earnings. Income from EMA limited partnership interests is generally recognized on a three month delay due to the availability of the related financial statements.

Recognition of Revenue

Revenues related to protection plans, other contracts (primarily finance and insurance products) and roadside assistance are deferred and earned over

the term of the contract in a manner that recognizes revenue as obligations under the contracts are performed. Revenues from these products are classified as premiums as the products are backed by insurance. Protection plans and finance and insurance premiums are recognized using a cost-based incurrence method. Roadside assistance premiums are recognized evenly over the term of the contract as performance obligations are fulfilled.

Tax Reform

On December 22, 2017, Public Law 115-97, known as the Tax Cuts and Jobs Act of 2017 ("Tax Legislation") became effective, permanently reducing the U.S. corporate income tax rate from 35% to 21% beginning January 1, 2018. As a result, the corporate tax rate is not comparable between periods.

Pending accounting standards

Accounting for Leases

In February 2016, the FASB issued guidance revising the accounting for leases. Under the new guidance, lessees will be required to recognize a right-of-use asset and lease liability for all leases other than those that meet the definition of a short-term lease. The lease liability will be equal to the present value of lease payments. A right-of-use asset will be based on the lease liability adjusted for qualifying initial direct costs. Recognition of the lease liability and right-of-use asset will result in an increase in total assets and liabilities in the Condensed Consolidated Statement of Financial Position. The expense of operating leases under the new guidance will be recognized in the income statement on a straight-line basis by adjusting the amortization of the right-of-use asset to produce a straight-line

expense when combined with the interest expense on the lease liability. For finance leases, the expense components are computed separately and produce greater up-front expense compared to operating leases as interest expense on the lease liability is higher in early years and the right-of-use asset is amortized on a straight-line basis. Lease classification will be based on criteria similar to those currently applied. The accounting model for lessors will be similar to the current model with modifications to reflect definition changes for components such as initial direct costs. Lessors will continue to classify leases as operating, direct financing, or sales-type. The guidance is effective for reporting periods beginning after December 15, 2018, using a modified retrospective approach applied at the beginning of the earliest period presented. The FASB has exposed for comment an optional simplified transition approach that would allow application of the transition provisions at the effective date instead of the earliest date presented. The Company is in the process of evaluating the impact of adoption, which is not expected to be material to the Company's results of operations or financial position.

Measurement of Credit Losses on Financial Instruments

In June 2016, the FASB issued guidance which revises the credit loss recognition criteria for certain

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Notes to Condensed Consolidated Financial Statements

financial assets measured at amortized cost, including reinsurance recoverables. The new guidance replaces the existing incurred loss recognition model with an expected loss recognition model. The objective of the expected credit loss model is for the reporting entity to recognize its estimate of expected credit losses for affected financial assets in a valuation allowance deducted from the amortized cost basis of the related financial assets that results in presenting the net carrying value of the financial assets at the amount expected to be collected. The reporting entity must consider all relevant information available when estimating expected credit losses, including details about past events, current conditions, and reasonable and supportable forecasts over the life of an asset. Financial assets may be evaluated individually or on a pooled basis when they share similar risk characteristics. The measurement of credit losses for available-for-sale debt securities measured at fair value is not affected except that credit losses recognized are limited to the amount by which fair value is below amortized cost and the carrying value adjustment is recognized through a valuation allowance and not as a direct write-down. The guidance is effective for reporting periods beginning after December 15, 2019, and for most affected instruments must be adopted using a modified retrospective approach, with a cumulative effect adjustment recorded to beginning retained income. The Company is in the process of evaluating the impact of adoption.

Accounting for Hedging Activities

In August 2017, the FASB issued amendments intended to better align hedge accounting with an organization's risk management activities. The

amendments expand hedge accounting for nonfinancial and financial risk components and revise the measurement methodologies to better align with an organization's risk management activities. Separate presentation of hedge ineffectiveness is eliminated to provide greater transparency of the full impact of hedging by requiring presentation of the results of the hedged item and hedging instrument in a single financial statement line item. In addition, the amendments reduce complexity by simplifying the manner in which assessments of hedge effectiveness may be performed. The guidance is effective for reporting periods beginning after December 15, 2018. The presentation and disclosure guidance is effective on a prospective basis. The impact of adoption is not expected to be material to the Company's results of operations or financial position.

Other revenue presentation

Concurrent with the adoption of new FASB guidance on revenue from contracts with customers and the Company's objective of providing more information related to revenues for our Services Businesses, the Company revised the presentation of total revenue to include other revenue. Previously, components of other revenue were presented within operating costs and expenses and primarily represent fees collected from policyholders relating to premium installment payments, commissions on sales of non-proprietary products, fee-based services and other revenue transactions. Other revenue is recognized when performance obligations are fulfilled. Prior periods have been reclassified to conform to current separate presentation of other revenue.

Note 2 Earnings per Common Share

Basic earnings per common share is computed using the weighted average number of common shares outstanding, including vested unissued participating restricted stock units. Diluted earnings per common share is computed using the weighted average number

of common and dilutive potential common shares outstanding. For the Company, dilutive potential common shares consist of outstanding stock options and unvested non-participating restricted stock units and contingently issuable performance stock awards.

Computation of basic and diluted earnings per common share

(\$ in millions, except per share data)

Three
months
ended
March 31,
2018 2017

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Numerator:		
Net income	\$975	\$695
Less: Preferred stock dividends	29	29
Net income applicable to common shareholders ⁽¹⁾	\$946	\$666
Denominator:		
Weighted average common shares outstanding	354.1	365.7
Effect of dilutive potential common shares:		
Stock options	4.1	4.2
Restricted stock units (non-participating) and performance stock awards	1.7	1.4
Weighted average common and dilutive potential common shares outstanding	359.9	371.3
Earnings per common share - Basic	\$2.67	\$1.82
Earnings per common share - Diluted	\$2.63	\$1.79

⁽¹⁾ Net income applicable to common shareholders is net income less preferred stock dividends.

Notes to Condensed Consolidated Financial Statements

The effect of dilutive potential common shares does not include the effect of options with an anti-dilutive effect on earnings per common share because their exercise prices exceed the average market price of Allstate common shares during the period or for which the unrecognized compensation cost would have an anti-dilutive effect.

Options to purchase 1.0 million and 2.8 million Allstate common shares, with exercise prices ranging from \$86.61 to \$102.84 and \$67.81 to \$81.86, were outstanding for the three-month periods ended March 31, 2018 and 2017, respectively, but were not included in the computation of diluted earnings per common share in those periods.

Note 3 Acquisition

On January 3, 2017, the Company acquired SquareTrade Holding Company, Inc. (“SquareTrade”), a consumer product protection plan provider that distributes through many of America’s major retailers and Europe’s mobile operators, for \$1.4 billion in cash. SquareTrade is a provider of consumer electronics and appliance protection plans covering products including TVs, smartphones and computers. This acquisition broadens Allstate’s unique product offerings to better meet consumers’ needs.

In connection with the acquisition, the Company recorded goodwill of \$1.10 billion, commissions paid to retailers (reported in deferred policy acquisition costs) of \$66 million, other intangible assets (reported in other assets) of \$555 million, contractual liability

insurance policy premium expenses (reported in other assets) of \$205 million, unearned premiums of \$389 million and net deferred income tax liability of \$138 million. These amounts reflect re-measurement adjustments to the fair value of the opening balance sheet assets and liabilities.

Of the \$555 million assigned to other intangible assets, \$465 million is attributable to acquired customer relationships. The \$555 million assigned to other intangible assets also included \$69 million assigned to the SquareTrade trade name which is considered to have an indefinite useful life. The amortization expense of intangible assets for the three months ended March 31, 2018 and 2017 was \$21 million and \$23 million, respectively.

Notes to Condensed Consolidated Financial Statements

Note 4 Reportable Segments

Reportable segments revenue information

(\$ in millions)	Three months ended March 31,	
	2018	2017
Property-Liability		
Insurance premiums		
Auto	\$5,591	\$5,388
Homeowners	1,848	1,815
Other personal lines	444	431
Commercial lines	136	125
Allstate Protection	8,019	7,759
Discontinued Lines and Coverages	—	—
Total property-liability insurance premiums	8,019	7,759
Other revenue	174	167
Net investment income	337	308
Realized capital gains and losses	(95) 135
Total Property-Liability	8,435	8,369
Service Businesses		
Consumer product protection plans	123	59
Roadside assistance	64	68
Finance and insurance products	80	73
Intersegment premiums and service fees ⁽¹⁾	29	28
Other revenue	16	16
Net investment income	5	3
Realized capital gains and losses	(4) —
Total Service Businesses	313	247
Allstate Life		
Traditional life insurance premiums	146	140
Interest-sensitive life insurance contract charges	181	181
Other revenue	26	27
Net investment income	122	120
Realized capital gains and losses	(3) 1
Total Allstate Life	472	469
Allstate Benefits		
Traditional life insurance premiums	9	9
Accident and health insurance premiums	248	232
Interest-sensitive life insurance contract charges	29	28
Net investment income	19	17
Realized capital gains and losses	(2) —
Total Allstate Benefits	303	286
Allstate Annuities		
Fixed annuities contract charges	3	3
Net investment income	290	289

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Realized capital gains and losses	(29)	(2)
Total Allstate Annuities	264	290

Corporate and Other		
Net investment income	13	11
Realized capital gains and losses	(1)	—

Total Corporate and Other	12	11
Intersegment eliminations ⁽¹⁾	(29)	(28)
Consolidated revenues	\$9,770	\$9,644

⁽¹⁾ Intersegment insurance premiums and service fees are primarily related to Arity and Allstate Roadside Services and are eliminated in the condensed consolidated financial statements.

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Notes to Condensed Consolidated Financial Statements

Reportable segments financial performance

(\$ in millions)	Three months ended March 31,	
	2018	2017
Property-Liability		
Allstate Protection	\$962	\$550
Discontinued Lines and Coverages	(3)	(2)
Total underwriting income	959	548
Net investment income	337	308
Income tax expense on operations	(268)	(268)
Realized capital gains and losses, after-tax	(75)	89
Property-Liability net income applicable to common shareholders	953	677
Service Businesses		
Adjusted net loss	(5)	(10)
Realized capital gains and losses, after-tax	(3)	—
Amortization of purchased intangible assets, after-tax	(16)	(15)
Service Businesses net loss applicable to common shareholders	(24)	(25)
Allstate Life		
Adjusted net income	69	59
Realized capital gains and losses, after-tax	(2)	1
DAC and DSI amortization related to realized capital gains and losses, after-tax	(2)	(3)
Allstate Life net income applicable to common shareholders	65	57
Allstate Benefits		
Adjusted net income	28	22
Realized capital gains and losses, after-tax	(2)	—
Allstate Benefits net income applicable to common shareholders	26	22
Allstate Annuities		
Adjusted net income	35	29
Realized capital gains and losses, after-tax	(23)	(2)
Valuation changes on embedded derivatives not hedged, after-tax	4	—
Gain on disposition of operations, after-tax	1	2
Allstate Annuities net income applicable to common shareholders	17	29
Corporate and Other		
Adjusted net loss	(90)	(81)
Realized capital gains and losses, after-tax	(1)	—
Business combination expenses, after-tax	—	(13)
Corporate and Other net loss applicable to common shareholders	(91)	(94)
Consolidated net income applicable to common shareholders	\$946	\$666

Notes to Condensed Consolidated Financial Statements

Note 5 Investments

Amortized cost, gross unrealized gains and losses and fair value for fixed income securities

(\$ in millions)	Amortized cost	Gross unrealized		Fair value
		Gains	Losses	
March 31, 2018				
U.S. government and agencies	\$ 3,373	\$50	\$(17)	\$3,406
Municipal	8,404	257	(92)	8,569
Corporate	41,699	763	(611)	41,851
Foreign government	968	21	(10)	979
Asset-backed securities ("ABS")	1,196	11	(10)	1,197
Residential mortgage-backed securities ("RMBS")	453	100	(3)	550
Commercial mortgage-backed securities ("CMBS")	95	6	(2)	99
Redeemable preferred stock	21	2	—	23
Total fixed income securities	\$ 56,209	\$ 1,210	\$(745)	\$56,674

December 31, 2017

U.S. government and agencies	\$ 3,580	\$56	\$(20)	\$3,616
Municipal	8,053	311	(36)	8,328
Corporate	42,996	1,234	(204)	44,026
Foreign government	1,005	27	(11)	1,021
ABS	1,266	13	(7)	1,272
RMBS	480	101	(3)	578
CMBS	124	6	(2)	128
Redeemable preferred stock	21	2	—	23
Total fixed income securities	\$ 57,525	\$ 1,750	\$(283)	\$58,992

Scheduled maturities for fixed income securities

(\$ in millions)	As of March 31, 2018	
	Amortized cost	Fair value
Due in one year or less	\$4,629	\$4,627
Due after one year through five years	28,201	28,199
Due after five years through ten years	16,363	16,220
Due after ten years	5,272	5,782
	54,465	54,828
ABS, RMBS and CMBS	1,744	1,846
Total	\$56,209	\$56,674

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

Net investment income

(\$ in millions)	Three months ended March 31,	
	2018	2017
Fixed income securities	\$508	\$518

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Equity securities	34	44
Mortgage loans	51	55
Limited partnership interests ⁽¹⁾⁽²⁾	180	120
Short-term investments	12	6
Other	66	56
Investment income, before expense	851	799
Investment expense	(65)	(51)
Net investment income	\$786	\$748

Due to the adoption of the recognition and measurement accounting standard, limited partnerships previously ⁽¹⁾ reported using the cost method are now reported at fair value with changes in fair value recognized in net investment income.

⁽²⁾ Includes net investment income of \$103 million for EMA limited partnership interests and \$77 million for limited partnership interests carried at fair value for the three months ended March 31, 2018.

Notes to Condensed Consolidated Financial Statements

Realized capital gains and losses by asset type

(\$ in millions)	Three months ended March 31,	
	2018	2017
Fixed income securities	\$(43)	\$5
Equity securities	(93)	106
Limited partnership interests	10	40
Derivatives	(8)	(15)
Other	—	(2)
Realized capital gains and losses	\$(134)	\$134

Realized capital gains and losses by transaction type

(\$ in millions)	Three months ended March 31,	
	2018	2017
Impairment write-downs ⁽¹⁾	\$(1)	\$(43)
Change in intent write-downs ⁽¹⁾	—	(16)
Net OTTI losses recognized in earnings	(1)	(59)
Sales ⁽¹⁾	(42)	208
Valuation of equity investments ⁽¹⁾	(83)	—
Valuation and settlements of derivative instruments	(8)	(15)
Realized capital gains and losses	\$(134)	\$134

Due to the adoption of the recognition and measurement accounting standard, equity securities are reported at fair value with changes in fair value recognized in valuation of equity investments and are no longer included in impairment write-downs, change in intent write-downs and sales.

Gross gains of \$45 million and gross losses of \$87 million were realized on sales of fixed income securities during the three months ended March 31, 2018. Gross gains of \$235 million and gross losses of \$75 million were realized on sales of fixed income and equity securities during the three months ended March 31, 2017.

Valuation changes included in net income for investments still held as of March 31, 2018

(\$ in millions)	Three months ended March 31, 2018
Equity securities	\$ (49)
Limited partnership interests carried at fair value	78
Total valuation changes	\$ 29

(\$ in millions)	Three months ended March 31, 2018		Three months ended March 31, 2017	
	Included Gross in OCI	Net	Gross	Included in OCI Net
Fixed income securities:				
Corporate	\$ —	\$ —	\$(9)	\$ 3
				\$(6)

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RMBS	—	—	(1)	(3)	(4)
CMBS	—	(1)	(1)	(6)	3 (3)
Total fixed income securities	—	(1)	(1)	(16)	3 (13)
Equity securities ⁽¹⁾	—	—	(36)	—	(36)
Limited partnership interests ⁽¹⁾ (2)	—	—	(7)	—	(7)
Other	—	—	(3)	—	(3)
OTTI losses	\$—	\$ (1)	\$(1)	\$(62)	\$ 3 \$(59)

Due to the adoption of the recognition and measurement accounting standard, equity securities and limited ⁽¹⁾ partnerships previously reported using the cost method are now reported at fair value with changes in fair value recognized in net income and are no longer included in the table above.

The total amount of OTTI losses included in AOCI at the time of impairment for fixed income securities, which were not included in earnings, are presented in the following table. The amounts exclude \$202 million and \$208 million as of March 31, 2018 and

December 31, 2017, respectively, of net unrealized gains related to changes in valuation of the fixed income securities subsequent to the impairment measurement date.

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Notes to Condensed Consolidated Financial Statements

OTTI losses included in AOCI at the time of impairment for fixed income securities

(\$ in millions)	March 31, 2018	December 31, 2017
Municipal	\$ (5)	\$ (5)
ABS	(12)	(15)
RMBS	(74)	(77)
CMBS	(4)	(4)
Total	\$ (95)	\$ (101)

Rollforward of the cumulative credit losses recognized in earnings for fixed income securities held as of

(\$ in millions)	March 31,	
	2018	2017
Beginning balance	\$ (226)	\$ (318)
Additional credit loss for securities previously other-than-temporarily impaired	(1)	(8)
Additional credit loss for securities not previously other-than-temporarily impaired	—	(5)
Reduction in credit loss for securities disposed or collected	15	37
Ending balance	\$ (212)	\$ (294)

The Company uses its best estimate of future cash flows expected to be collected from the fixed income security, discounted at the security's original or current effective rate, as appropriate, to calculate a recovery value and determine whether a credit loss exists. The determination of cash flow estimates is inherently subjective and methodologies may vary depending on facts and circumstances specific to the security. All reasonably available information relevant to the collectability of the security, including past events, current conditions, and reasonable and supportable assumptions and forecasts, are considered when developing the estimate of cash flows expected to be collected. That information generally includes, but is not limited to, the remaining payment terms of the security, prepayment speeds, foreign exchange rates, the financial condition and future earnings potential of the issue or issuer, expected defaults, expected recoveries, the value of underlying collateral, vintage, geographic concentration of underlying collateral, available reserves or escrows, current subordination levels, third party guarantees and other credit

enhancements. Other information, such as industry analyst reports and forecasts, sector credit ratings, financial condition of the bond insurer for insured fixed income securities, and other market data relevant to the realizability of contractual cash flows, may also be considered. The estimated fair value of collateral will be used to estimate recovery value if the Company determines that the security is dependent on the liquidation of collateral for ultimate settlement. If the estimated recovery value is less than the amortized cost of the security, a credit loss exists and an OTTI for the difference between the estimated recovery value and amortized cost is recorded in earnings. The portion of the unrealized loss related to factors other than credit remains classified in AOCI. If the Company determines that the fixed income security does not have sufficient cash flow or other information to estimate a recovery value for the security, the Company may conclude that the entire decline in fair value is deemed to be credit related and the loss is recorded in earnings.

Notes to Condensed Consolidated Financial Statements

Unrealized net capital gains and losses included in AOCI

(\$ in millions)	Fair value	Gross unrealized Gains	Losses	Unrealized net gains (losses)
March 31, 2018				
Fixed income securities	\$56,674	\$ 1,210	\$ (745)	\$ 465
Short-term investments	3,424	—	—	—
Derivative instruments ⁽¹⁾	2	2	(3)	(1)
EMA limited partnerships ⁽²⁾				1
Unrealized net capital gains and losses, pre-tax				465
Amounts recognized for:				
Insurance reserves ⁽³⁾				(119)
DAC and DSI ⁽⁴⁾				(109)
Amounts recognized				(228)
Deferred income taxes				(50)
Unrealized net capital gains and losses, after-tax				\$ 187

⁽¹⁾ Included in the fair value of derivative instruments is \$2 million classified as liabilities.

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

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

The insurance reserves adjustment represents the amount by which the reserve balance would increase if the net unrealized gains in the applicable product portfolios were realized and reinvested at current lower interest rates, resulting in a premium deficiency. This adjustment primarily relates to structured settlement annuities with life contingencies (a type of immediate fixed annuities).

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

Unrealized net capital gains and losses included in AOCI

(\$ in millions)	Fair value	Gross unrealized Gains	Losses	Unrealized net gains (losses)
December 31, 2017				
Fixed income securities	\$58,992	\$ 1,750	\$ (283)	\$ 1,467
Equity securities	6,621	1,172	(12)	1,160
Short-term investments	1,944	—	—	—
Derivative instruments ⁽¹⁾	2	2	(3)	(1)
EMA limited partnerships				1
Unrealized net capital gains and losses, pre-tax				2,627
Amounts recognized for:				
Insurance reserves				(315)
DAC and DSI				(196)
Amounts recognized				(511)
Deferred income taxes				(454)
Unrealized net capital gains and losses, after-tax				\$ 1,662

⁽¹⁾ Included in the fair value of derivative instruments is \$2 million classified as liabilities.

Change in unrealized net capital gains and losses

(\$ in millions)	Three months ended March 31, 2018
Fixed income securities	\$ (1,002)
Equity securities ⁽¹⁾	—

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Total	(1,002)
Amounts recognized for:	
Insurance reserves	196
DAC and DSI	87
Amounts recognized	283
Deferred income taxes	154
Decrease in unrealized net capital gains and losses, after-tax	\$(565)

⁽¹⁾ Upon adoption of the recognition and measurement accounting standard on January 1, 2018, \$1.16 billion of pre-tax unrealized net capital gains for equity securities were reclassified from AOCI to retained income. See Note 1 of the condensed consolidated financial statements.

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Notes to Condensed Consolidated Financial Statements

Portfolio monitoring

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

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

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

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

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

Notes to Condensed Consolidated Financial Statements

Gross unrealized losses and fair value by type and length of time held in a continuous unrealized loss position

(\$ in millions)	Less than 12 months			12 months or more			Total unrealized losses
	Number of issues	Fair value	Unrealized losses	Number of issues	Fair value	Unrealized losses	
March 31, 2018							
Fixed income securities							
U.S. government and agencies	57	\$1,514	\$ (16)	13	\$74	\$ (1)	\$ (17)
Municipal	2,535	4,626	(74)	160	323	(18)	(92)
Corporate	1,656	22,720	(458)	199	3,006	(153)	(611)
Foreign government	43	531	(9)	4	39	(1)	(10)
ABS	80	541	(6)	7	11	(4)	(10)
RMBS	139	36	(1)	181	43	(2)	(3)
CMBS	—	—	—	6	24	(2)	(2)
Total fixed income securities	4,510	29,968	(564)	570	3,520	(181)	(745)
Investment grade fixed income securities	4,161	\$27,020	\$ (470)	516	\$3,284	\$ (153)	\$ (623)
Below investment grade fixed income securities	349	2,948	(94)	54	236	(28)	(122)
Total fixed income securities	4,510	\$29,968	\$ (564)	570	\$3,520	\$ (181)	\$ (745)

December 31, 2017

Fixed income securities							
U.S. government and agencies	66	\$2,829	\$ (18)	18	\$182	\$ (2)	\$ (20)
Municipal	1,756	3,143	(24)	165	349	(12)	(36)
Corporate	781	11,616	(102)	208	3,289	(102)	(204)
Foreign government	45	580	(10)	5	44	(1)	(11)
ABS	57	476	(3)	9	34	(4)	(7)
RMBS	118	35	(1)	181	50	(2)	(3)
CMBS	2	1	—	6	23	(2)	(2)
Redeemable preferred stock	1	—	—	—	—	—	—
Total fixed income securities	2,826	18,680	(158)	592	3,971	(125)	(283)
Equity securities	127	369	(12)	2	—	—	(12)
Total fixed income and equity securities	2,953	\$19,049	\$ (170)	594	\$3,971	\$ (125)	\$ (295)
Investment grade fixed income securities	2,706	\$17,668	\$ (134)	535	\$3,751	\$ (98)	\$ (232)
Below investment grade fixed income securities	120	1,012	(24)	57	220	(27)	(51)
Total fixed income securities	2,826	\$18,680	\$ (158)	592	\$3,971	\$ (125)	\$ (283)

As of March 31, 2018, \$721 million of the \$745 million unrealized losses are related to securities with an unrealized loss position less than 20% of amortized cost, the degree of which suggests that these securities do not pose a high risk of being other-than-temporarily impaired. Of the \$721 million, \$611 million are related to unrealized losses on investment grade fixed income securities. Of the remaining \$110 million, \$92 million have been in an unrealized loss position for less than 12 months. Investment grade is defined as a security having a rating of Aaa, Aa, A or Baa from Moody's, a rating of AAA, AA, A or BBB from S&P Global Ratings ("S&P"), a comparable rating from another nationally recognized rating agency, or a comparable internal rating if an externally provided rating is not available. Market prices for certain securities may have credit spreads which imply higher or lower credit quality than the current third party rating. Unrealized losses on investment grade securities are principally related to an increase in market yields which may include increased risk-free interest rates and/or wider credit spreads since the time of initial purchase.

As of March 31, 2018, the remaining \$24 million of unrealized losses are related to securities in unrealized loss positions greater than or equal to 20% of amortized cost. Investment grade fixed income

securities comprising \$12 million of these unrealized losses were evaluated based on factors such as discounted cash flows and the financial condition and near-term and long-term prospects of the issue or issuer and were determined to have adequate resources to fulfill contractual obligations. Of the \$24 million, \$12 million are related to below investment grade fixed income securities. Of these amounts, \$4 million are related to below investment grade fixed income securities that had been in an unrealized loss position greater than or equal to 20% of amortized cost for a period of twelve or more consecutive months as of March 31, 2018.

ABS, RMBS and CMBS in an unrealized loss position were evaluated based on actual and projected collateral losses relative to the securities' positions in the respective securitization trusts, security specific expectations of cash flows, and credit ratings. This evaluation also takes into consideration credit enhancement, measured in terms of (i) subordination from other classes of securities in the trust that are contractually obligated to absorb losses before the class of security the Company owns, and (ii) the expected impact of other structural features embedded in the securitization trust beneficial to the class of securities the Company owns, such as

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Notes to Condensed Consolidated Financial Statements

overcollateralization and excess spread. Municipal bonds in an unrealized loss position were evaluated based on the underlying credit quality of the primary obligor, obligation type and quality of the underlying assets.

As of March 31, 2018, the Company has not made the decision to sell and it is not more likely than not the Company will be required to sell fixed income securities with unrealized losses before recovery of the amortized cost basis.

Limited partnerships

Investments in limited partnership interests include interests in private equity funds, real estate funds and other funds. As of March 31, 2018 and December 31, 2017, the carrying value of EMA limited partnerships totaled \$5.77 billion and \$5.41 billion, respectively, and limited partnerships carried at fair value as of March 31, 2018, while at cost method as of December 31, 2017, totaled \$1.66 billion and \$1.33 billion, respectively.

Mortgage loans

Mortgage loans are evaluated for impairment on a specific loan basis through a quarterly credit monitoring process and review of key credit quality indicators. Mortgage loans are considered impaired when it is probable that the Company will not collect the contractual principal and interest. Valuation allowances are established for impaired loans to reduce the carrying value to the fair value of the collateral less costs to sell or the present value of the loan's expected future repayment cash flows

discounted at the loan's original effective interest rate. Impaired mortgage loans may not have a valuation allowance when the fair value of the collateral less costs to sell is higher than the carrying value. Valuation allowances are adjusted for subsequent changes in the fair value of the collateral less costs to sell or present value of the loan's expected future repayment cash flows. Mortgage loans are charged off against their corresponding valuation allowances when there is no reasonable expectation of recovery. The impairment evaluation is non-statistical in respect to the aggregate portfolio but considers facts and circumstances attributable to each loan. It is not considered probable that additional impairment losses, beyond those identified on a specific loan basis, have been incurred as of March 31, 2018.

Accrual of income is suspended for mortgage loans that are in default or when full and timely collection of principal and interest payments is not probable. Cash receipts on mortgage loans on nonaccrual status are generally recorded as a reduction of carrying value.

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

Carrying value of non-impaired mortgage loans summarized by debt service coverage ratio distribution

(\$ in millions)	March 31, 2018			December 31, 2017		
	Fixed rate mortgage loans	Variable rate mortgage loans	Total	Fixed rate mortgage loans	Variable rate mortgage loans	Total
Debt service coverage ratio distribution						
Below 1.0	\$27	\$ —	\$27	\$3	\$ —	\$3
1.0 - 1.25	355	—	355	345	—	345
1.26 - 1.50	1,165	30	1,195	1,141	30	1,171
Above 1.50	2,998	100	3,098	2,949	62	3,011
Total non-impaired mortgage loans	\$4,545	\$ 130	\$4,675	\$4,438	\$ 92	\$4,530

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

Net carrying value of impaired mortgage loans

(\$ in millions)

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	March 31, 2018	December 31, 2017
Impaired mortgage loans with a valuation allowance	\$ 4	\$ 4
Impaired mortgage loans without a valuation allowance	—	—
Total impaired mortgage loans	\$ 4	\$ 4
Valuation allowance on impaired mortgage loans	\$ 3	\$ 3

The valuation allowance on impaired loans had no activity for the three months ended March 31, 2018 and 2017. The average balance of impaired loans was \$4 million and \$5 million for the three months ended March 31, 2018 and 2017, respectively.

Payments on all mortgage loans were current as of March 31, 2018 and December 31, 2017.

Notes to Condensed Consolidated Financial Statements

Short-term investments

Short-term investments, including commercial paper, U.S. Treasury bills, money market funds and other short-term investments, are carried at fair value. As of March 31, 2018 and December 31, 2017, the fair value of short-term investments totaled \$3.42 billion and \$1.94 billion, respectively.

Other investments

Other investments primarily consist of bank loans, policy loans, agent loans, real estate and derivatives.

Bank loans are primarily senior secured corporate loans and are carried at amortized cost. Policy loans are carried at unpaid principal balances. Agent loans are loans issued to exclusive Allstate agents and are carried at unpaid principal balances, net of valuation allowances and unamortized deferred fees or costs. Real estate is carried at cost less accumulated depreciation. Derivatives are carried at fair value.

Other investments by asset type

(\$ in millions)	March 31, 2018	December 31, 2017
Bank loans	\$1,681	\$ 1,702
Policy loans	900	905
Real estate	763	632
Agent loans	562	538
Other	186	195
Total	\$4,092	\$ 3,972

Note 6 Fair Value of Assets and Liabilities

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

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

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

- (a) Quoted prices for similar assets or liabilities in active markets;
- (b) Quoted prices for identical or similar assets or liabilities in markets that are not active; or
- (c) Valuation models whose inputs are observable, directly or indirectly, for substantially the full term of the asset or liability.

Level 3: Assets and liabilities whose values are based on prices or valuation techniques that require inputs that are both unobservable and significant to the overall fair value measurement. Unobservable inputs reflect the Company's estimates of the assumptions that market participants would use in valuing the assets and liabilities.

The availability of observable inputs varies by instrument. In situations where fair value is based on internally developed pricing models or inputs that are

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

The Company is responsible for the determination of fair value and the supporting assumptions and methodologies. The Company gains assurance that assets and liabilities are appropriately valued through the execution of various processes and controls designed to ensure the overall reasonableness and consistent application of valuation methodologies, including inputs and assumptions, and compliance with accounting standards. For fair values received from third parties or internally estimated, the Company's processes and controls are designed to ensure that the valuation methodologies are appropriate and consistently applied, the inputs and assumptions are reasonable and consistent with the objective of determining fair value, and the fair values are accurately recorded. For example, on a continuing basis, the Company assesses the reasonableness of individual fair values that have stale security prices or that exceed certain thresholds as compared to previous fair values received from valuation service providers or brokers or derived from internal models. The Company performs procedures to understand and assess the methodologies, processes and controls of valuation service providers. In addition, the Company

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may validate the reasonableness of fair values by comparing information obtained from valuation service providers or brokers to other third party valuation sources for selected securities. The Company performs ongoing price validation procedures such as back-testing of actual sales, which corroborate the various inputs used in internal models to market observable data. When fair value determinations are expected to be more variable, the Company validates them through reviews by members of management who have relevant expertise and who are independent of those charged with executing investment transactions.

The Company has two types of situations where investments are classified as Level 3 in the fair value hierarchy. The first is where specific inputs significant to the fair value estimation models are not market observable. This primarily occurs in the Company's use of broker quotes to value certain securities where the inputs have not been corroborated to be market observable, and the use of valuation models that use significant non-market observable inputs. The second situation where the Company classifies securities in Level 3 is where quotes continue to be received from independent third-party valuation service providers and all significant inputs are market observable; however, there has been a significant decrease in the volume and level of activity for the asset when compared to normal market activity such that the degree of market observability has declined to a point where categorization as a Level 3 measurement is considered appropriate. The indicators considered in determining whether a significant decrease in the volume and level of activity for a specific asset has occurred include the level of new issuances in the primary market, trading volume in the secondary market, the level of credit spreads over historical levels, applicable bid-ask spreads, and price consensus among market participants and other pricing sources.

Certain assets are not carried at fair value on a recurring basis, including investments such as mortgage loans, bank loans, agent 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 determining fair value, the Company principally uses the market approach which generally utilizes market transaction data for the same or similar instruments. To a lesser extent, the Company uses the income approach which involves determining fair values from discounted cash flow methodologies. For the majority of Level 2 and Level 3 valuations, a combination of the market and income approaches is used.

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

Level 1 measurements

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

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

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

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

Level 2 measurements

• Fixed income securities:

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

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

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

Corporate - privately placed: Valued using a discounted cash flow model that is widely accepted in the financial services industry and uses market observable inputs and inputs derived principally from, or corroborated by, observable market data. The primary inputs to the discounted cash flow model include an interest rate yield curve, as well as published credit spreads for similar assets in markets that are not active that incorporate the credit quality and industry sector of the issuer.

Foreign government: The primary inputs to the valuation include quoted prices for identical or similar assets in markets that are not active,

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contractual cash flows, benchmark yields and credit spreads.

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

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

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

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

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

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

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

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

Level 3 measurements

Fixed income securities:

Municipal: Comprise municipal bonds that are not rated by third party credit rating agencies. The primary inputs to the valuation of these municipal bonds include quoted prices for identical or similar

assets in markets that exhibit less liquidity relative to those markets supporting Level 2 fair value measurements, contractual cash flows, benchmark yields and credit spreads. Also included are municipal bonds valued based on non-binding broker quotes where the inputs have not been corroborated to be market observable and municipal bonds in default valued based on the present value of expected cash flows.

Corporate - public and Corporate - privately placed: Primarily valued based on non-binding broker quotes where the inputs have not been corroborated to be market observable. Other inputs include an interest rate yield curve, as well as published credit spreads for similar assets that incorporate the credit quality and industry sector of the issuer.

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

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

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

Other primary inputs include interest rate yield curves and credit spreads.

Contractholder funds: Derivatives embedded in certain life and annuity contracts are valued internally using models widely accepted in the financial services industry that determine a single best estimate of fair value for the embedded derivatives within a block of contractholder liabilities. The models primarily use stochastically determined cash flows

based on the contractual elements of embedded derivatives, projected option cost and applicable market data, such as interest rate yield curves and equity index volatility assumptions. These are categorized as Level 3 as a result of the significance of non-market observable inputs.

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

Mortgage loans written-down to fair value in connection with recognizing impairments are valued based on the fair value of the underlying collateral less costs to sell. EMA limited partnership interests written-down to fair value in connection with recognizing OTTI losses are generally valued using net asset values.

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Notes to Condensed Consolidated Financial Statements

Investments excluded from the fair value hierarchy

Limited partnerships carried at fair value, which do not have readily determinable fair values, use NAV provided by the investees and are excluded from the fair value hierarchy. These investments are generally not redeemable by the investees and generally cannot be sold without approval of the general partner. We

receive distributions of income and from liquidation of the underlying assets of the investees over the life of these investments, typically 10-12 years. As of March 31, 2018, the Company has commitments to invest \$943 million in limited partnership interests valued using NAV.

Assets and liabilities measured at fair value

(\$ in millions)	As of March 31, 2018				Counterparty and cash collateral netting	Total
	Quoted prices in active markets for identical (Level 1)	Significant other observable inputs (Level 2)	Significant unobservable inputs (Level 3)			
Assets						
Fixed income securities:						
U.S. government and agencies	\$2,845	\$561	\$ —			\$3,406
Municipal	—	8,473	96			8,569
Corporate - public	—	30,535	77			30,612
Corporate - privately placed	—	11,024	215			11,239
Foreign government	—	979	—			979
ABS - CDO	—	450	10			460
ABS - consumer and other	—	675	62			737
RMBS	—	550	—			550
CMBS	—	72	27			99
Redeemable preferred stock	—	23	—			23
Total fixed income securities	2,845	53,342	487			56,674
Equity securities	6,374	370	242			6,986
Short-term investments	402	3,022	—			3,424
Other investments: Free-standing derivatives	—	117	1		\$ (15)	103
Separate account assets	3,314	—	—			3,314
Total assets at fair value	\$12,935	\$56,851	\$ 730		\$ (15)	\$70,501
% of total assets at fair value	18.4	% 80.6	% 1.0	%	—	% 100
Investments reported at NAV						
Total						1,663
						\$72,164
Liabilities						
Contractholder funds: Derivatives embedded in life and annuity contracts	\$—	\$—	\$ (262)			\$(262)
Other liabilities: Free-standing derivatives	—	(75)	—		\$ 26	(49)
Total liabilities at fair value	\$—	\$(75)	\$ (262)		\$ 26	\$(311)
% of total liabilities at fair value	—	% 24.1	% 84.3	%	(8.4)	% 100

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Assets and liabilities measured at fair value

(\$ in millions)	As of December 31, 2017					Total
	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		
Assets						
Fixed income securities:						
U.S. government and agencies	\$3,079	\$537	\$ —			\$3,616
Municipal	—	8,227	101			8,328
Corporate - public	—	31,963	108			32,071
Corporate - privately placed	—	11,731	224			11,955
Foreign government	—	1,021	—			1,021
ABS - CDO	—	480	99			579
ABS - consumer and other	—	645	48			693
RMBS	—	578	—			578
CMBS	—	102	26			128
Redeemable preferred stock	—	23	—			23
Total fixed income securities	3,079	55,307	606			58,992
Equity securities	6,032	379	210			6,621
Short-term investments	264	1,660	20			1,944
Other investments: Free-standing derivatives	—	132	1	\$ (6)		127
Separate account assets	3,444	—	—			3,444
Other assets	—	—	—			—
Total recurring basis assets	12,819	57,478	837	(6)		71,128
Non-recurring basis ⁽¹⁾	—	—	3			3
Total assets at fair value	\$12,819	\$57,478	\$ 840	\$ (6)		\$71,131
% of total assets at fair value	18.0	% 80.8	% 1.2	% —	%	100 %
Liabilities						
Contractholder funds: Derivatives embedded in life and annuity contracts	\$—	\$—	\$ (286)			\$(286)
Other liabilities: Free-standing derivatives	(1)	(83)	—	\$ 14		(70)
Total liabilities at fair value	\$(1)	\$(83)	\$ (286)	\$ 14		\$(356)
% of total liabilities at fair value	0.3	% 23.3	% 80.3	% (3.9)	%	100 %

(1) Includes \$3 million of limited partnership interests written-down to fair value in connection with recognizing OTTI losses.

Quantitative information about the significant unobservable inputs used in level 3 fair value measurements

(\$ in millions)	Fair value	Valuation technique	Unobservable input	Range	Weighted average
March 31, 2018					
Derivatives embedded in life and annuity contracts – Equity-indexed and forward starting options	\$(232)	Stochastic cash flow model	Projected option cost	1.0 - 2.2%	1.74%
December 31, 2017					
Derivatives embedded in life and annuity contracts – Equity-indexed and forward starting options	\$(252)	Stochastic cash flow model	Projected option cost	1.0 - 2.2%	1.74%

The embedded derivatives are equity-indexed and forward starting options in certain life and annuity products that provide customers with interest crediting rates based on the performance of the S&P 500. If the projected option cost increased (decreased), it would result in a higher (lower) liability fair value.

As of March 31, 2018 and December 31, 2017, Level 3 fair value measurements of fixed income securities total \$487 million and \$606 million, respectively, and include \$278 million and \$271 million, respectively, of securities valued based on non-binding broker quotes where the inputs have not been corroborated to be

market observable and \$54 million and \$58 million, respectively, of municipal fixed income securities that are not rated by third party credit rating agencies. The Company does not develop the unobservable inputs used in measuring fair value; therefore, these are not included in the table above. However, an increase (decrease) in credit spreads for fixed income securities valued based on non-binding broker quotes would result in a lower (higher) fair value, and an increase (decrease) in the credit rating of municipal bonds that are not rated by third party credit rating agencies would result in a higher (lower) fair value.

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Rollforward of level 3 assets and liabilities held at fair value on a recurring basis during the period

(\$ in millions)	Balance as of December 31, 2017	March 31, 2018			
		Total gains (losses) included in: Net income ⁽¹⁾	OCI	Transfers into Level 3	Transfers out of Level 3
Assets					
Fixed income securities:					
Municipal	\$ 101	\$1	\$ (1)	\$ —	\$ (2)
Corporate - public	108	—	(1)	4	(5)
Corporate - privately placed	224	—	(1)	—	(19)
ABS - CDO	99	—	—	—	(89)
ABS - consumer and other	48	—	1	5	—
CMBS	26	—	—	—	—
Total fixed income securities	606	1	(2)	9	(115)
Equity securities	210	3	—	—	—
Short-term investments	20	—	—	—	—
Free-standing derivatives, net	1	—	—	—	—
Total recurring Level 3 assets	\$ 837	\$4	\$ (2)	\$ 9	\$ (115)
Liabilities					
Contractholder funds: Derivatives embedded in life and annuity contracts	\$ (286)	\$23	\$ —	\$ —	\$ —
Total recurring Level 3 liabilities	\$ (286)	\$23	\$ —	\$ —	\$ —
					Balance as of March 31, 2018
Assets					
Fixed income securities:					
Municipal	\$ —	\$ (2)	\$ —	\$ (1)	\$ 96
Corporate - public	—	(26)	—	(3)	77
Corporate - privately placed	13	—	—	(2)	215
ABS - CDO	—	—	—	—	10
ABS - consumer and other	45	(35)	—	(2)	62
CMBS	1	—	—	—	27
Total fixed income securities	59	(63)	—	(8)	487
Equity securities	30	(1)	—	—	242
Short-term investments	25	(45)	—	—	—
Free-standing derivatives, net	—	—	—	—	1 ⁽²⁾
Total recurring Level 3 assets	\$ 114	\$ (109)	\$ —	\$ (8)	\$ 730
Liabilities					
Contractholder funds: Derivatives embedded in life and annuity contracts	\$ —	\$ —	\$ (1)	\$ 2	\$ (262)
Total recurring Level 3 liabilities	\$ —	\$ —	\$ (1)	\$ 2	\$ (262)

⁽¹⁾ The effect to net income totals \$27 million and is reported in the Condensed Consolidated Statements of Operations as follows: \$4 million in realized capital gains and losses, \$19 million in interest credited to

contractholder funds and \$4 million in life contract benefits.

(2) Comprises \$1 million of assets.

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Notes to Condensed Consolidated Financial Statements

Rollforward of level 3 assets and liabilities held at fair value on a recurring basis during the period

(\$ in millions)	Balance as of December 31, 2016	March 31, 2017			Transfers out of Level 3
		Total gains (losses) included in: Net income ⁽¹⁾	OCI	Transfers into Level 3	
Assets					
Fixed income securities:					
Municipal	\$ 125	\$ 1	\$ 1	\$ —	\$ (1)
Corporate - public	78	—	—	—	(16)
Corporate - privately placed	263	—	5	—	—
ABS - CDO	27	—	2	27	—
ABS - consumer and other	42	—	—	—	(2)
RMBS	1	—	—	—	—
CMBS	22	—	—	—	—
Total fixed income securities	558	1	8	27	(19)
Equity securities	163	10	—	—	(3)
Short-term investments	15	—	—	—	—
Free-standing derivatives, net	(2)	1	—	—	—
Other assets	1	(1)	—	—	—
Total recurring Level 3 assets	\$ 735	\$ 11	\$ 8	\$ 27	\$ (22)
Liabilities					
Contractholder funds: Derivatives embedded in life and annuity contracts	\$ (290)	\$ 3	\$ —	\$ —	\$ —
Total recurring Level 3 liabilities	\$ (290)	\$ 3	\$ —	\$ —	\$ —
					Balance as of March 31, 2017
	Purchases	Sales	Issues	Settlements	
Assets					
Fixed income securities:					
Municipal	\$ —	\$(2)	\$ —	\$ —	\$ 124
Corporate - public	—	—	—	(2)	60
Corporate - privately placed	—	—	—	(5)	263
ABS - CDO	95	—	—	(4)	147
ABS - consumer and other	41	—	—	(1)	80
RMBS	—	—	—	(1)	—
CMBS	3	—	—	—	25
Total fixed income securities	139	(2)	—	(13)	699
Equity securities	1	(1)	—	—	170
Short-term investments	20	—	—	—	35
Free-standing derivatives, net	—	—	—	—	(1) ⁽²⁾
Other assets	—	—	—	—	—
Total recurring Level 3 assets	\$ 160	\$(3)	\$ —	\$ (13)	\$ 903
Liabilities					
Contractholder funds: Derivatives embedded in life and annuity contracts	\$ —	\$ —	\$(1)	\$ 2	\$ (286)

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Total recurring Level 3 liabilities \$ — \$ — \$ (1) \$ 2 \$ (286)

The effect to net income totals \$14 million and is reported in the Condensed Consolidated Statements of

- (1) Operations as follows: \$2 million in realized capital gains and losses, \$10 million in net investment income, \$(5) million in interest credited to contractholder funds and \$7 million in life contract benefits.
- (2) Comprises \$1 million of assets and \$2 million of liabilities.

Transfers between level categorizations may occur due to changes in the availability of market observable inputs, which generally are caused by changes in market conditions such as liquidity, trading volume or bid-ask spreads. Transfers between level categorizations may also occur due to changes in the

valuation source. Transfers in and out of level categorizations are reported as having occurred at the beginning of the quarter in which the transfer occurred. Therefore, for all transfers into Level 3, all realized and changes in unrealized gains and losses in

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the quarter of transfer are reflected in the Level 3 rollforward table.

There were no transfers between Level 1 and Level 2 during the three months ended March 31, 2018 or 2017.

Transfers into Level 3 during the three months ended March 31, 2018 and 2017 included situations where a fair value quote was not provided by the Company's independent third-party valuation service provider and as a result the price was stale or had been replaced with a broker quote where the inputs

had not been corroborated to be market observable resulting in the security being classified as Level 3. Transfers out of Level 3 during the three months ended March 31, 2018 and 2017 included situations where a broker quote was used in the prior period and a fair value quote became available from the Company's independent third-party valuation service provider in the current period. A quote utilizing the new pricing source was not available as of the prior period, and any gains or losses related to the change in valuation source for individual securities were not significant. Valuation changes included in net income for level 3 assets and liabilities held as of

(\$ in millions)	March 31, 20182017	
Assets		
Equity securities	\$2	\$10
Free-standing derivatives, net	—	1
Other assets	—	(1)
Total recurring Level 3 assets	\$2	\$10
Liabilities		
Contractholder funds: Derivatives embedded in life and annuity contracts	\$23	\$3
Total recurring Level 3 liabilities	\$23	\$3

The amounts in the table above represent gains and losses related to valuation changes included in net income for the period of time that the asset or liability was held and determined to be in Level 3. These gains and losses total \$25 million for the three months ended March 31, 2018 and are reported as follows: \$2 million in realized capital gains and losses, \$19 million in interest credited to contractholder funds and \$4

million in life contract benefits. These gains and losses total \$13 million for the three months ended March 31, 2017 and are reported as follows: \$1 million in realized capital gains and losses, \$10 million in net investment income, \$(5) million in interest credited to contractholder funds and \$7 million in life contract benefits.

Financial assets

Carrying values and fair value estimates of financial instruments not carried at fair value as of

(\$ in millions)	March 31, 2018		December 31, 2017	
	Carrying value	Fair value	Carrying value	Fair value
Mortgage loans	\$4,679	\$4,784	\$4,534	\$4,732
Bank loans	1,681	1,688	1,702	1,704
Agent loans	562	553	538	536

The fair value measurements for mortgage loans, bank loans and agent loans are categorized as Level 3.

Financial liabilities

Carrying values and fair value estimates of financial instruments not carried at fair value as of

(\$ in millions)	March 31, 2018	December 31, 2017
	Carrying Fair	Carrying Fair

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	value	value	value	value
Contractholder funds on investment contracts	\$10,088	\$10,597	\$10,367	\$11,071
Long-term debt	6,847	7,425	6,350	7,199
Liability for collateral	1,037	1,037	1,124	1,124

The fair value measurement is Level 3 for contractholder funds on investment contracts and Level 2 for long-term debt and liability for collateral.

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Note 7 Derivative Financial Instruments

The Company uses derivatives for risk reduction and to increase investment portfolio returns through asset replication. Risk reduction activity is focused on managing the risks with certain assets and liabilities arising from the potential adverse impacts from changes in risk-free interest rates, changes in equity market valuations, increases in credit spreads and foreign currency fluctuations.

Asset replication refers to the “synthetic” creation of assets through the use of derivatives. The Company replicates fixed income securities using a combination of a credit default swap or a foreign currency forward contract and one or more highly rated fixed income securities, primarily investment grade host bonds, to synthetically replicate the economic characteristics of one or more cash market securities. The Company replicates equity securities using futures and options to increase equity exposure.

Property-Liability may use interest rate swaps, swaptions, futures and options to manage the interest rate risks of existing investments. These instruments are utilized to change the duration of the portfolio in order to offset the economic effect that interest rates would otherwise have on the fair value of its fixed income securities. Credit default swaps are typically used to mitigate the credit risk within the Property-Liability fixed income portfolio. Equity index futures and options are used by Property-Liability to offset valuation losses in the equity portfolio during periods of declining equity market values. In addition, equity futures are used to hedge the market risk related to deferred compensation liability contracts. Forward contracts are primarily used by Property-Liability to hedge foreign currency risk associated with holding foreign currency denominated investments and foreign operations.

The Company utilizes several derivative strategies to manage risk in Allstate Life and Allstate Annuities.

Asset-liability management is a risk management strategy that is principally employed by Allstate Life and Allstate Annuities 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, swaptions and futures are utilized 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. Credit default swaps are typically used to mitigate the credit risk within the Allstate Life and Allstate Annuities fixed income portfolios.

Futures and options are used for hedging the equity exposure contained in equity indexed life and annuity product contracts that offer equity returns to contractholders. In addition, the Company uses equity index futures to offset valuation losses in the equity portfolio during periods of declining equity market values. Foreign currency swaps and forwards are primarily used to reduce the foreign currency risk associated with holding foreign currency denominated investments.

The Company also has derivatives embedded in non-derivative host contracts that are required to be separated from the host contracts and accounted for at fair value with changes in fair value of embedded derivatives reported in net income. The Company’s primary embedded derivatives are equity options in life and annuity product contracts, which provide equity returns to contractholders.

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

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 credit default swaps where the Company has sold credit protection 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 or pay to terminate the derivative contracts at the reporting date. The carrying value amounts for OTC derivatives are further

adjusted for the effects, if any, of enforceable master netting agreements and are presented on a net basis, by counterparty agreement, in the Condensed Consolidated Statements of Financial Position.

For those derivatives which qualify for fair value hedge accounting, net income includes the changes in the fair value of both the derivative instrument and the hedged risk, and therefore reflects any hedging ineffectiveness. For cash flow hedges, gains and losses are amortized from AOCI and are reported in net income in the same period the forecasted transactions being hedged impact net income.

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 to permit the application of hedge accounting. For non-hedge derivatives, net income includes changes in fair value and accrued periodic settlements, when applicable. 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

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non-hedge derivative financial instruments on at least a quarterly basis.

Summary of the volume and fair value positions of derivative instruments as of March 31, 2018

(\$ in millions, except number of contracts)	Balance sheet location	Volume ⁽¹⁾		Fair value, net	Gross asset	Gross liability
		Notional amount	Number of contracts			
Asset derivatives						
Derivatives not designated as accounting hedging instruments						
Interest rate contracts						
Interest rate cap agreements	Other investments	\$16	n/a	\$—	\$—	\$—
Equity and index contracts						
Options	Other investments	—	5,991	102	102	—
Financial futures contracts	Other assets	—	1,655	—	—	—
Foreign currency contracts						
Foreign currency forwards	Other investments	253	n/a	(5)	2	(7)
Credit default contracts						
Credit default swaps – buying protection	Other investments	149	n/a	(3)	—	(3)
Credit default swaps – selling protection	Other investments	90	n/a	—	—	—
Other contracts						
Other contracts	Other assets	3	n/a	—	—	—
Total asset derivatives		\$511	7,646	\$94	\$104	\$(10)
Liability derivatives						
Derivatives designated as accounting hedging instruments						
Foreign currency swap agreements	Other liabilities & accrued expenses	\$19	n/a	\$2	\$2	\$—
Derivatives not designated as accounting hedging instruments						
Interest rate contracts						
Interest rate cap agreements	Other liabilities & accrued expenses	26	n/a	1	1	—
Equity and index contracts						
Options and futures	Other liabilities & accrued expenses	540	5,990	(36)	10	(46)
Foreign currency contracts						
Foreign currency forwards	Other liabilities & accrued expenses	316	n/a	(13)	1	(14)
Embedded derivative financial instruments						
Guaranteed accumulation benefits	Contractholder funds	215	n/a	(20)	—	(20)
Guaranteed withdrawal benefits	Contractholder funds	266	n/a	(10)	—	(10)
Equity-indexed and forward starting options in life and annuity product contracts	Contractholder funds	1,770	n/a	(232)	—	(232)
Credit default contracts						
Credit default swaps – buying protection	Other liabilities & accrued expenses	275	n/a	(5)	—	(5)
Credit default swaps – selling protection	Other liabilities & accrued expenses	5				