ALLSTATE CORP
Form 10-Q
October 31, 2011

UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-Q

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

THE SECURITIES EXCHANGE ACT OF 1934

For the quarterly period ended September 30, 2011

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 X No ___

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

Yes X No ___

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

Large accelerated filer	X	Accelerated filer	____
Non-accelerated filer	____ (Do not check if a smaller reporting company)	Smaller reporting company	____

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

Yes ___ No X

As of October 18, 2011, the registrant had 505,352,126 common shares, $.01 par value, outstanding.

THE ALLSTATE CORPORATION

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September 30, 2011

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PART I. FINANCIAL INFORMATION

ITEM 1. FINANCIAL STATEMENTS

THE ALLSTATE CORPORATION AND SUBSIDIARIES

CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS

($ in millions, except per share data)	Three Months Ended September 30, 2011	Three Months Ended September 30, 2010	Nine Months Ended September 30, 2011	Nine Months Ended September 30, 2010
	(unaudited)		(unaudited)	
Revenues				
Property-liability insurance premiums	$ 6,432	$ 6,499	$ 19,337	$ 19,515
Life and annuity premiums and contract charges	552	548	1,668	1,637
Net investment income	994	1,005	2,996	3,104
Realized capital gains and losses:				
Total other-than-temporary impairment losses	(197)	(99)	(435)	(637)
Portion of loss recognized in other comprehensive income	(6)	(68)	(37)	(91)
Net other-than-temporary impairment losses recognized in earnings	(203)	(167)	(472)	(728)
Sales and other realized capital gains and losses	467	23	889	(215)
Total realized capital gains and losses	264	(144)	417	(943)
	8,242	7,908	24,418	23,313
Costs and expenses				
Property-liability insurance claims and claims expense	5,132	4,603	15,963	14,109
Life and annuity contract benefits	455	445	1,331	1,372
Interest credited to contractholder funds	405	445	1,240	1,358
Amortization of deferred policy acquisition costs	1,122	1,006	3,191	2,969
Operating costs and expenses	825	828	2,465	2,446
Restructuring and related charges	8	9	28	33
Interest expense	92	91	275	275
	8,039	7,427	24,493	22,562
Gain (loss) on disposition of operations	--	9	(17)	12
Income (loss) from operations before income tax expense (benefit)	203	490	(92)	763
Income tax expense (benefit)	38	123	(156)	131
Net income	$ 165	$ 367	$ 64	$ 632
Earnings per share:				
Net income per share - Basic	$ 0.32	$ 0.68	$ 0.12	$ 1.17
Weighted average shares - Basic	512.0	540.9	520.4	540.6
Net income per share - Diluted	$ 0.32	$ 0.68	$ 0.12	$ 1.16
Weighted average shares - Diluted	514.2	543.0	522.9	542.7
Cash dividends declared per share	$ 0.21	$ 0.20	$ 0.63	$ 0.60

See notes to condensed consolidated financial statements.

THE ALLSTATE CORPORATION AND SUBSIDIARIES

CONDENSED CONSOLIDATED STATEMENTS OF FINANCIAL POSITION

($ in millions, except par value data)	**September 30, 2011** (unaudited)	**December 31, 2010**
Assets		
Investments		
Fixed income securities, at fair value (amortized cost $73,935 and $78,786)	$ 76,394	$ 79,612
Equity securities, at fair value (cost $4,252 and $4,228)	4,157	4,811
Mortgage loans	6,956	6,679
Limited partnership interests	4,407	3,816
Short-term, at fair value (amortized cost $3,517 and $3,279)	3,517	3,279
Other	2,094	2,286
Total investments	97,525	100,483
Cash	1,026	562
Premium installment receivables, net	4,988	4,839
Deferred policy acquisition costs	4,444	4,769
Reinsurance recoverables, net	6,720	6,552
Accrued investment income	854	809
Deferred income taxes	792	784
Property and equipment, net	908	921
Goodwill	874	874
Other assets	2,037	1,605
Separate Accounts	6,791	8,676
Total assets	$ 126,959	$ 130,874
Liabilities		
Reserve for property-liability insurance claims and claims expense	$ 20,395	$ 19,468
Reserve for life-contingent contract benefits	14,308	13,482
Contractholder funds	43,776	48,195
Unearned premiums	10,002	9,800
Claim payments outstanding	960	737
Other liabilities and accrued expenses	6,691	5,564
Long-term debt	5,907	5,908
Separate Accounts	6,791	8,676
Total liabilities	108,830	111,830
Commitments and Contingent Liabilities (Note 10)		
Equity		
Preferred stock, $1 par value, 25 million shares authorized, none issued	--	--
Common stock, $.01 par value, 2.0 billion shares authorized and 900 million issued, 505 million and 533 million shares outstanding	9	9
Additional capital paid-in	3,177	3,176
Retained income	31,704	31,969
Deferred ESOP expense	(43)	(44)
Treasury stock, at cost (395 million and 367 million shares)	(16,693)	(15,910)
Accumulated other comprehensive income:		
Unrealized net capital gains and losses:		
Unrealized net capital losses on fixed income securities with OTTI	(155)	(190)
Other unrealized net capital gains and losses	1,683	1,089
Unrealized adjustment to DAC, DSI and insurance reserves	(496)	36
Total unrealized net capital gains and losses	1,032	935
Unrealized foreign currency translation adjustments	49	69
Unrecognized pension and other postretirement benefit cost	(1,135)	(1,188)
Total accumulated other comprehensive loss	(54)	(184)
Total shareholders equity	18,100	19,016
Noncontrolling interest	29	28
Total equity	18,129	19,044

Total liabilities and equity	$	126,959	$	130,874

See notes to condensed consolidated financial statements.

THE ALLSTATE CORPORATION AND SUBSIDIARIES

CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS

($ in millions)	**Nine Months Ended September 30,**	
	2011	**2010**
Cash flows from operating activities	(unaudited)	
Net income	$ 64	$ 632
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation, amortization and other non-cash items	149	55
Realized capital gains and losses	(417)	943
Loss (gain) on disposition of operations	17	(12)
Interest credited to contractholder funds	1,240	1,358
Changes in:		
Policy benefits and other insurance reserves	546	143
Unearned premiums	220	172
Deferred policy acquisition costs	138	(138)
Premium installment receivables, net	(158)	(137)
Reinsurance recoverables, net	(275)	(229)
Income taxes	(188)	178
Other operating assets and liabilities	335	58
Net cash provided by operating activities	1,671	3,023
Cash flows from investing activities		
Proceeds from sales		
Fixed income securities	23,916	17,345
Equity securities	1,116	4,262
Limited partnership interests	762	387
Mortgage loans	74	121
Other investments	149	98
Investment collections		
Fixed income securities	3,864	3,672
Mortgage loans	491	784
Other investments	105	96
Investment purchases		
Fixed income securities	(21,900)	(20,712)
Equity securities	(1,066)	(2,721)
Limited partnership interests	(1,159)	(1,040)
Mortgage loans	(896)	(55)
Other investments	(199)	(99)
Change in short-term investments, net	64	104
Change in other investments, net	(357)	(464)
Purchases of property and equipment, net	(160)	(114)
Disposition of operations	1	7
Net cash provided by investing activities	4,805	1,671
Cash flows from financing activities		
Repayment of long-term debt	(1)	(1)
Contractholder fund deposits	1,606	2,297
Contractholder fund withdrawals	(6,439)	(6,779)
Dividends paid	(327)	(322)
Treasury stock purchases	(858)	(5)
Shares reissued under equity incentive plans, net	18	26
Excess tax benefits on share-based payment arrangements	(4)	(7)
Other	(7)	(15)
Net cash used in financing activities	(6,012)	(4,806)
Net increase (decrease) in cash	464	(112)
Cash at beginning of period	562	612
Cash at end of period	$ 1,026	$ 500

See notes to condensed consolidated financial statements.

1. General

Basis of presentation

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

The condensed consolidated financial statements and notes as of September 30, 2011 and for the three-month and nine-month periods ended September 30, 2011 and 2010 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, 2010. The results of operations for the interim periods should not be considered indicative of results to be expected for the full year.

Adopted accounting standards

Consolidation Analysis Considering Investments Held through Separate Accounts

In April 2010, the Financial Accounting Standards Board (FASB) issued guidance clarifying that an insurer is not required to combine interests in investments held in a qualifying separate account with its interests in the same investments held in the general account when performing a consolidation evaluation. The adoption of this guidance as of January 1, 2011 had no impact on the Company s results of operations or financial position.

Disclosure of Supplementary Pro Forma Information for Business Combinations

In December 2010, the FASB issued disclosure guidance for entities that enter into business combinations that are material. The guidance specifies that if an entity presents comparative financial statements, the entity should disclose pro forma revenue and earnings of the combined entity as though the business combination that occurred during the current year had occurred as of the beginning of the comparable prior annual reporting period only. The guidance expands the supplemental pro forma disclosures to include a description of the nature and amount of material, nonrecurring pro forma adjustments directly attributable to the business combination. The Company will apply the guidance to any business combinations entered into on or after January 1, 2011.

Criteria for Classification as a Troubled Debt Restructuring (TDR)

In April 2011, the FASB issued clarifying guidance related to determining whether a loan modification or restructuring should be classified as a TDR. The additional guidance provided pertains to the two criteria used to determine whether a TDR exists, specifically whether the creditor has granted a concession and whether the debtor is experiencing financial difficulties. The guidance related to the identification of a TDR is to be applied retrospectively to the beginning of the annual period of adoption. The measurement of impairment on a TDR identified under this guidance is effective prospectively. Disclosures about the credit quality of financing receivables and the allowance for credit losses previously deferred for TDRs, is also effective for reporting periods beginning on or after June 15, 2011. The adoption of this guidance as of July 1, 2011 did not have a material effect on the Company s results of operations or financial position.

Pending accounting standards

Accounting for Costs Associated with Acquiring or Renewing Insurance Contracts

In October 2010, the FASB issued guidance modifying the definition of the types of costs incurred by insurance entities that can be capitalized in the acquisition of new and renewal contracts. The guidance specifies that the costs must be based on successful efforts. The guidance also specifies that advertising costs should be included as deferred acquisition costs only when the direct-response advertising accounting criteria are met. If application of the guidance would result in the capitalization of acquisition costs that had not been capitalized prior to adoption, the entity may elect not to capitalize those additional costs. The new guidance is effective for reporting periods beginning after December 15, 2011 and should be applied prospectively, with retrospective application permitted. The Company plans to adopt the new guidance retrospectively. Upon adoption on January 1, 2012, the deferred policy acquisition costs (DAC) balance will be reduced with a corresponding decrease to retained income, net of taxes. In periods subsequent to January 1, 2012, a lower amount of acquisition costs will be capitalized which will increase operating costs and expenses and the smaller DAC balance will result in decreased amortization of DAC. The Company is in the process of completing the retrospective adoption calculations and measuring the impact of adoption on the Company s results of operations and financial position.

Criteria for Determining Effective Control for Repurchase Agreements

In April 2011, the FASB issued guidance modifying the assessment criteria of effective control for repurchase agreements. The new guidance removes the criterion requiring an entity to have the ability to repurchase or redeem financial assets on substantially the agreed terms and the collateral maintenance implementation guidance related to that criterion. The guidance is to be applied prospectively to transactions or modifications of existing transactions that occur during reporting periods beginning on or after December 15, 2011. Early adoption is not permitted. The impact of adoption is not expected to be material to the Company s results of operations and financial position.

Amendments to Fair Value Measurement and Disclosure Requirements

In May 2011, the FASB issued guidance that clarifies the application of existing fair value measurement and disclosure requirements and amends certain fair value measurement principles, requirements and disclosures. To improve consistency in global application, changes in wording were made. The guidance is to be applied prospectively for reporting periods beginning after December 15, 2011. Early adoption is not permitted. The impact of adoption is not expected to be material to the Company s results of operations and financial position.

Presentation of Comprehensive Income

In June 2011, the FASB issued guidance amending the presentation of comprehensive income and its components. Under the new guidance, an entity has the option to present comprehensive income in a single continuous statement or in two separate but consecutive statements. Both options require an entity to present reclassification adjustments for items reclassified from other comprehensive income to net income in the statement(s) where the components of net income and the components of comprehensive income are presented. The guidance is effective for reporting periods beginning after December 15, 2011 and is to be applied retrospectively. Early adoption is permitted. The impact of adoption is related to presentation only and will have no impact on the Company s results of operations and financial position. In October 2011, the FASB announced that they will discuss at a future meeting whether to delay the effective date of certain provisions in the new guidance related to the presentation of reclassification adjustments.

Intangibles Goodwill and Other

In September 2011, the FASB issued guidance providing the option to first assess qualitative factors, such as macroeconomic conditions and industry and market considerations, to determine whether it is more likely than not that the fair value of a reporting unit is less than its carrying amount. If indicated by the qualitative assessment, then it is necessary to perform the two-step goodwill impairment test. If the option is not elected, the guidance requiring the two-step goodwill impairment test is unchanged. The new guidance is effective for annual and interim goodwill impairment tests performed for fiscal years beginning after December 15, 2011, with early adoption permitted. The impact of adoption is not expected to be material to the Company s results of operations and financial position.

2. Earnings per share

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

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

($ in millions, except per share data)	Three months ended September 30, 2011	Three months ended September 30, 2010	Nine months ended September 30, 2011	Nine months ended September 30, 2010
Numerator:				
Net income	$ 165	$ 367	$ 64	$ 632
Denominator:				
Weighted average common shares outstanding	512.0	540.9	520.4	540.6
Effect of dilutive potential common shares:				
Stock options	1.6	1.9	2.0	2.0
Restricted stock units (non-participating)	0.6	0.2	0.5	0.1
Weighted average common and dilutive potential common shares outstanding	514.2	543.0	522.9	542.7
Earnings per share - Basic	$ 0.32	$ 0.68	$ 0.12	$ 1.17
Earnings per share - Diluted	$ 0.32	$ 0.68	$ 0.12	$ 1.16

The effect of dilutive potential common shares does not include the effect of options with an anti-dilutive effect on earnings per share because their exercise prices exceed the average market price of Allstate common shares during the period or for which the unrecognized compensation cost would have an anti-dilutive effect. Options to purchase 27.6 million and 27.6 million Allstate common shares, with exercise prices ranging from $24.70 to $62.84 and $27.36 to $62.84, were outstanding for the three-month periods ended September 30, 2011 and 2010, respectively, but were not included in the computation of diluted earnings per share in those periods. Options to purchase 27.6 million and 26.6 million Allstate common shares, with exercise prices ranging from $25.91 to $62.84 and $27.36 to $64.53, were outstanding for the nine-month periods ended September 30, 2011 and 2010, respectively, but were not included in the computation of diluted earnings per share in those periods.

3. Supplemental Cash Flow Information

Non-cash investment exchanges, including modifications of certain mortgage loans (primarily refinances at maturity with no concessions granted to the borrower), fixed income securities, limited partnerships and other investments, as well as mergers completed with equity securities, totaled $564 million and $544 million for the nine months ended September 30, 2011 and 2010, respectively.

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

($ in millions)	Nine months ended September 30, 2011	Nine months ended September 30, 2010
Net change in proceeds managed		
Net change in short-term investments	$ (301)	$ 187
Operating cash flow (used) provided	(301)	187
Net change in cash	1	2
Net change in proceeds managed	$ (300)	$ 189

Net change in liabilities		
Liabilities for collateral, beginning of year	$ (484)	$ (658)
Liabilities for collateral, end of period	(784)	(469)
Operating cash flow provided (used)	$ 300	$ (189)

4. Investments

Fair values

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

($ in millions)	Amortized cost	Gross unrealized Gains	Gross unrealized Losses	Fair value
September 30, 2011				
U.S. government and agencies	$ 4,009	$ 337	$ --	$ 4,346
Municipal	14,445	816	(262)	14,999
Corporate	42,335	2,644	(450)	44,529
Foreign government	1,941	197	(5)	2,133
Residential mortgage-backed securities (RMBS)	5,027	146	(541)	4,632
Commercial mortgage-backed securities (CMBS)	2,045	37	(258)	1,824
Asset-backed securities (ABS)	4,110	87	(291)	3,906
Redeemable preferred stock	23	2	--	25
Total fixed income securities	$ 73,935	$ 4,266	$ (1,807)	$ 76,394
December 31, 2010				
U.S. government and agencies	$ 8,320	$ 327	$ (51)	$ 8,596
Municipal	16,201	379	(646)	15,934
Corporate	36,260	1,816	(421)	37,655
Foreign government	2,821	347	(10)	3,158
RMBS	8,509	216	(732)	7,993
CMBS	2,213	58	(277)	1,994
ABS	4,425	113	(294)	4,244
Redeemable preferred stock	37	1	--	38
Total fixed income securities	$ 78,786	$ 3,257	$ (2,431)	$ 79,612

Scheduled maturities

The scheduled maturities for fixed income securities are as follows as of September 30, 2011:

($ in millions)	Amortized cost	Fair value
Due in one year or less	$ 3,441	$ 3,507
Due after one year through five years	20,985	21,764
Due after five years through ten years	20,860	22,097
Due after ten years	19,512	20,488
	64,798	67,856
RMBS and ABS	9,137	8,538
Total	$ 73,935	$ 76,394

Actual maturities may differ from those scheduled as a result of prepayments by the issuers. Because of the potential for prepayment on RMBS and ABS, they are not categorized by contractual maturity. CMBS are categorized by contractual maturity because they generally are not subject to prepayment risk.

Net investment income

Net investment income is as follows:

($ in millions)	Three months ended September 30, 2011	Three months ended September 30, 2010	Nine months ended September 30, 2011	Nine months ended September 30, 2010
Fixed income securities	$ 862	$ 926	$ 2,661	$ 2,840
Equity securities	23	17	76	63
Mortgage loans	91	92	267	295
Limited partnership interests	33	6	61	19
Short-term investments	2	2	5	6
Other	27	5	64	12
Investment income, before expense	1,038	1,048	3,134	3,235
Investment expense	(44)	(43)	(138)	(131)
Net investment income	$ 994	$ 1,005	$ 2,996	$ 3,104

Realized capital gains and losses

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

($ in millions)	Three months ended September 30, 2011	Three months ended September 30, 2010	Nine months ended September 30, 2011	Nine months ended September 30, 2010
Fixed income securities	$ 603	$ 84	$ 615	$ (240)
Equity securities	(77)	83	60	142
Mortgage loans	(28)	(1)	(37)	(54)
Limited partnership interests	8	(20)	129	(15)
Derivatives	(234)	(286)	(354)	(779)
Other	(8)	(4)	4	3
Realized capital gains and losses	$ 264	$ (144)	$ 417	$ (943)

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

($ in millions)	Three months ended September 30, 2011	Three months ended September 30, 2010	Nine months ended September 30, 2011	Nine months ended September 30, 2010
Impairment write-downs	$ (190)	$ (137)	$ (374)	$ (599)
Change in intent write-downs	(13)	(30)	(98)	(129)
Net other-than-temporary impairment losses recognized in earnings	(203)	(167)	(472)	(728)
Sales	692	319	1,116	552
Valuation of derivative instruments	(254)	(133)	(282)	(571)
Settlements of derivative instruments	20	(152)	(72)	(209)

Equity method of accounting (EMA) limited partnership income		9		(11)		127		13
Realized capital gains and losses	$	264	$	(144)	$	417	$	(943)

Gross gains of $709 million and $387 million and gross losses of $32 million and $173 million were realized on sales of fixed income securities during the three months ended September 30, 2011 and 2010, respectively. Gross gains of $1.10 billion and $673 million and gross losses of $218 million and $360 million were realized on sales of fixed income securities during the nine months ended September 30, 2011 and 2010, respectively.

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

($ in millions)	Three months ended September 30, 2011			Nine months ended September 30, 2011		
	Gross	Included in OCI	Net	Gross	Included in OCI	Net
Fixed income securities:						
Municipal	$ (8)	$ --	$ (8)	$ (50)	$ (3)	$ (53)
Corporate	(14)	--	(14)	(19)	1	(18)
Foreign government	--	--	--	(1)	--	(1)
RMBS	(57)	(3)	(60)	(164)	(28)	(192)
CMBS	(1)	(3)	(4)	(27)	(10)	(37)
ABS	--	--	--	(7)	3	(4)
Total fixed income securities	(80)	(6)	(86)	(268)	(37)	(305)
Equity securities	(81)	--	(81)	(114)	--	(114)
Mortgage loans	(29)	--	(29)	(42)	--	(42)
Limited partnership interests	(2)	--	(2)	(4)	--	(4)
Other	(5)	--	(5)	(7)	--	(7)
Other-than-temporary impairment losses	$ (197)	$ (6)	$ (203)	$ (435)	$ (37)	$ (472)

	Three months ended September 30, 2010			Nine months ended September 30, 2010		
	Gross	Included in OCI	Net	Gross	Included in OCI	Net
Fixed income securities:						
Municipal	$ (1)	$ --	$ (1)	$ (106)	$ 4	$ (102)
Corporate	(14)	(1)	(15)	(67)	1	(66)
RMBS	(56)	(41)	(97)	(268)	(43)	(311)
CMBS	(1)	(26)	(27)	(44)	(37)	(81)
ABS	--	--	--	(9)	(16)	(25)
Total fixed income securities	(72)	(68)	(140)	(494)	(91)	(585)
Equity securities	(14)	--	(14)	(51)	--	(51)
Mortgage loans	(3)	--	(3)	(50)	--	(50)
Limited partnership interests	(10)	--	(10)	(42)	--	(42)
Other-than-temporary impairment losses	$ (99)	$ (68)	$ (167)	$ (637)	$ (91)	$ (728)

The total amount of other-than-temporary impairment losses included in accumulated other comprehensive income at the time of impairment for fixed income securities, which were not included in earnings, are presented in the following table. The amount excludes $211 million and $322 million as of September 30, 2011 and December 31, 2010, respectively, of net unrealized gains related to changes in valuation of the fixed income securities subsequent to the impairment measurement date.

($ in millions)	September 30, 2011	December 31, 2010
Municipal	$ (12)	$ (27)
Corporate	(36)	(31)

RMBS	(372)	(467)
CMBS	(8)	(49)
ABS	(22)	(41)
Total	$ (450)	$ (615)

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

($ in millions)	**Three months ended September 30,**		**Nine months ended September 30,**	
	2011	**2010**	**2011**	**2010**
Beginning balance	$ (912)	$ (1,309)	$ (1,046)	$ (1,187)
Cumulative effect of change in accounting principle	--	81	--	81
Additional credit loss for securities previously other-than-temporarily impaired	(56)	(101)	(133)	(265)
Additional credit loss for securities not previously other-than-temporarily impaired	(25)	(9)	(82)	(197)
Reduction in credit loss for securities disposed or collected	66	104	313	330
Reduction in credit loss for securities the Company has made the decision to sell or more likely than not will be required to sell	--	42	15	43
Change in credit loss due to accretion of increase in cash flows	4	1	10	4
Ending balance	$ (923)	$ (1,191)	$ (923)	$ (1,191)

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

Unrealized net capital gains and losses

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

($ in millions) September 30, 2011	Fair value	Gross unrealized Gains	Gross unrealized Losses	Unrealized net gains (losses)
Fixed income securities	$ 76,394	$ 4,266	$ (1,807)	$ 2,459
Equity securities	4,157	250	(345)	(95)
Short-term investments	3,517	--	--	--
Derivative instruments (1)	(10)	2	(17)	(15)
EMA limited partnership interests (2)				7
Unrealized net capital gains and losses, pre-tax				2,356
Amounts recognized for:				
Insurance reserves (3)				(641)
DAC and DSI (4)				(122)
Amounts recognized				(763)
Deferred income taxes				(561)
Unrealized net capital gains and losses, after-tax				$ 1,032

(1) Included in the fair value of derivative instruments are $(6) million classified as assets and $4 million classified as liabilities.

(2) Unrealized net capital gains and losses for limited partnership interests represent the Company s share of EMA limited partnerships other comprehensive income. Fair value and gross gains and losses are not applicable.

(3) The insurance reserves adjustment represents the amount by which the reserve balance would increase if the net unrealized gains in the applicable product portfolios were realized and reinvested at current lower interest rates, resulting in a premium deficiency. Although the Company evaluates premium deficiencies on the combined performance of life insurance and immediate annuities with life contingencies, the adjustment primarily relates to structured settlement annuities with life contingencies, in addition to annuity buy-outs and certain payout annuities with life contingencies.

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

December 31, 2010	Fair value	Gross unrealized Gains	Gross unrealized Losses	Unrealized net gains (losses)
Fixed income securities	$ 79,612	$ 3,257	$ (2,431)	$ 826
Equity securities	4,811	646	(63)	583
Short-term investments	3,279	--	--	--
Derivative instruments (1)	(17)	2	(24)	(22)
Unrealized net capital gains and losses, pre-tax				1,387
Amounts recognized for:				
Insurance reserves				(41)
DAC and DSI				97
Amounts recognized				56
Deferred income taxes				(508)
Unrealized net capital gains and losses, after-tax				$ 935

(1) Included in the fair value of derivative instruments are $2 million classified as assets and $19 million classified as liabilities.

Change in unrealized net capital gains and losses

The change in unrealized net capital gains and losses for the nine months ended September 30, 2011 is as follows:

($ in millions)		
Fixed income securities	$	1,633
Equity securities		(678)
Derivative instruments		7
EMA limited partnership interests		7
Total		969
Amounts recognized for:		
Insurance reserves		(600)
DAC and DSI		(219)
Amounts recognized		(819)
Deferred income taxes		(53)
Increase in unrealized net capital gains and losses	$	97

Portfolio monitoring

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

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

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

For equity securities, the Company considers various factors, including whether it has the intent and ability to hold the equity security for a period of time sufficient to recover its cost basis. Where the Company lacks the intent and ability to hold to recovery, or believes the recovery period is extended, the equity security s decline in fair value is considered other than temporary and is recorded in earnings. For equity securities managed by a third party, the Company has contractually retained its decision making authority as it pertains to selling equity securities that are in an unrealized loss position.

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

The following table summarizes the gross unrealized losses and fair value of fixed income and equity securities by the length of time that individual securities have been in a continuous unrealized loss position.

($ in millions)	Less than 12 months			12 months or more			Total
	Number of issues	Fair value	Unrealized losses	Number of issues	Fair value	Unrealized losses	Total unrealized losses
September 30, 2011							
Fixed income securities							
U.S. government and agencies	6	$ 151	$ --	--	$ --	$ --	$ --
Municipal	173	1,243	(26)	303	1,958	(236)	(262)
Corporate	509	6,073	(219)	104	1,327	(231)	(450)
Foreign government	18	346	(5)	--	--	--	(5)
RMBS	110	284	(13)	289	1,193	(528)	(541)
CMBS	69	566	(58)	74	530	(200)	(258)
ABS	49	683	(8)	114	1,062	(283)	(291)
Total fixed income securities	934	9,346	(329)	884	6,070	(1,478)	(1,807)
Equity securities	2,453	2,067	(339)	49	20	(6)	(345)
Total fixed income and equity securities	3,387	$ 11,413	$ (668)	933	$ 6,090	$ (1,484)	$ (2,152)
Investment grade fixed income securities	633	$ 6,733	$ (182)	567	$ 4,147	$ (728)	$ (910)
Below investment grade fixed income securities	301	2,613	(147)	317	1,923	(750)	(897)
Total fixed income securities	934	$ 9,346	$ (329)	884	$ 6,070	$ (1,478)	$ (1,807)
December 31, 2010							
Fixed income securities							
U.S. government and agencies	32	$ 2,081	$ (51)	--	$ --	$ --	$ (51)
Municipal	847	4,130	(175)	411	2,715	(471)	(646)
Corporate	438	5,994	(186)	150	1,992	(235)	(421)
Foreign government	33	277	(9)	1	10	(1)	(10)
RMBS	280	583	(12)	422	1,939	(720)	(732)
CMBS	14	158	(3)	114	835	(274)	(277)
ABS	68	762	(8)	133	1,313	(286)	(294)
Total fixed income securities	1,712	13,985	(444)	1,231	8,804	(1,987)	(2,431)
Equity securities	773	610	(48)	44	91	(15)	(63)
Total fixed income and equity securities	2,485	$ 14,595	$ (492)	1,275	$ 8,895	$ (2,002)	$ (2,494)
Investment grade fixed income securities	1,607	$ 13,280	$ (408)	857	$ 6,217	$ (943)	$ (1,351)
Below investment grade fixed income securities	105	705	(36)	374	2,587	(1,044)	(1,080)
Total fixed income securities	1,712	$ 13,985	$ (444)	1,231	$ 8,804	$ (1,987)	$ (2,431)

As of September 30, 2011, $837 million of unrealized losses are related to securities with an unrealized loss position less than 20% of amortized cost or cost, the degree of which suggests that these securities do not pose a high risk of being other-than-temporarily impaired. Of the $837 million, $422 million are related to unrealized losses on investment grade fixed income securities. Investment grade is defined as a security having a rating of Aaa, Aa, A or Baa from Moody s, a rating of AAA, AA, A or BBB from Standard & Poor s (S&P), Fitch, Dominion or Realpoint, a rating of aaa, aa, a or bbb from A.M. Best, or a comparable internal rating if an externally provided rating is not available. Unrealized losses on investment grade securities are principally related to widening credit spreads or rising interest rates since the time of initial purchase.

As of September 30, 2011, the remaining $1.31 billion of unrealized losses are related to securities in unrealized loss positions greater than or equal to 20% of amortized cost or cost. Investment grade fixed income securities comprising $488 million of these unrealized losses were evaluated based on factors such as expected 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 $1.31 billion, $668 million are related to below investment grade fixed income securities and $159 million are related to equity securities. Of these amounts, $512 million of the below investment grade fixed income securities had been in an unrealized loss position greater than or equal to 20% of amortized cost for a period of twelve or more consecutive months as of September 30, 2011. Unrealized losses on below investment grade securities are principally related to RMBS, CMBS and ABS and were the result of wider credit spreads resulting from higher risk premiums since the time of initial purchase, largely due to macroeconomic conditions and credit market deterioration, including the impact of lower real estate valuations.

RMBS, CMBS and ABS in an unrealized loss position were evaluated based on actual and projected collateral losses relative to the securities positions in the respective securitization trusts, security specific expectations of cash flows, and credit ratings. This evaluation also takes into consideration credit enhancement, measured in terms of (i) subordination from other classes of securities in the trust that are contractually obligated to absorb losses before the class of security the Company owns, (ii) the expected impact of other structural features embedded in the securitization trust beneficial to the class of securities the Company owns, such as overcollateralization and excess spread, and (iii) for RMBS and ABS in an unrealized loss position, credit enhancements from reliable bond insurers, where applicable. Municipal bonds in an unrealized loss position were evaluated based on the quality of the underlying securities, taking into consideration credit enhancements from reliable bond insurers, where applicable. Unrealized losses on equity securities are primarily related to temporary equity market fluctuations of securities that are expected to recover.

As of September 30, 2011, the Company has not made the decision to sell and it is not more likely than not the Company will be required to sell fixed income securities with unrealized losses before recovery of the amortized cost basis. As of September 30, 2011, the Company had the intent and ability to hold equity securities with unrealized losses for a period of time sufficient for them to recover.

Limited partnerships

As of September 30, 2011 and December 31, 2010, the carrying value of equity method limited partnership interests totaled $2.96 billion and $2.47 billion, respectively. The Company recognizes an impairment loss for equity method investments when evidence demonstrates that the loss is other than temporary. Evidence of a loss in value that is other than temporary may include the absence of an ability to recover the carrying amount of the investment or the inability of the investee to sustain a level of earnings that would justify the carrying amount of the investment. The Company had no write-downs related to equity method limited partnership interests for the three months and nine months ended September 30, 2011 and the three months ended September 30, 2010, and write-downs of $1 million for the nine months ended September 30, 2010.

As of September 30, 2011 and December 31, 2010, the carrying value for cost method limited partnership interests was $1.45 billion and $1.35 billion, respectively. To determine if an other-than-temporary impairment has occurred, the Company evaluates whether an impairment indicator has occurred in the period that may have a significant adverse effect on the carrying value of the investment. Impairment indicators may include: significantly reduced valuations of the investments held by the limited partnerships; actual recent cash flows received being significantly less than expected cash flows; reduced valuations based on financing completed at a lower value; completed sale of a material underlying investment at a price significantly lower than expected; or any other adverse events since the last financial statements received that might affect the fair value of the investee s capital. Additionally, the Company s portfolio monitoring process includes a quarterly review of all cost method limited partnerships to identify instances where the net asset value is below established thresholds for certain periods of time, as well as investments that are performing below expectations, for further impairment consideration. If a cost method limited partnership is other-than-temporarily impaired, the carrying value is written down to fair value, generally estimated to be equivalent to the reported net asset value of the underlying funds. The Company had write-downs related to cost method investments of $2 million and $10 million for the three months ended September 30, 2011 and 2010, respectively, and $4 million and $41 million for the nine months ended September 30, 2011 and 2010, 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. Mortgage loan valuation allowances are charged off when there is no reasonable expectation of recovery. The impairment evaluation is non-statistical in respect to the aggregate portfolio but considers facts and circumstances attributable to each loan. It is not considered probable that additional impairment losses, beyond those identified on a specific loan basis, have been incurred as of September 30, 2011.

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

Debt service coverage ratio is considered a key credit quality indicator when mortgage loans are evaluated for impairment. Debt service coverage ratio represents the amount of estimated cash flows from the property available to the borrower to meet principal and interest payment obligations. Debt service coverage ratio estimates are updated annually or more frequently if conditions are warranted based on the Company s credit monitoring process. The following table reflects the carrying value of non-impaired fixed rate and variable rate mortgage loans summarized by debt service coverage ratio distribution:

($ in millions)	**September 30, 2011**			**December 31, 2010**		
Debt service coverage ratio distribution	**Fixed rate mortgage loans**	**Variable rate mortgage loans**	**Total**	**Fixed rate mortgage loans**	**Variable rate mortgage loans**	**Total**
Below 1.0	$ 277	$ --	$ 277	$ 280	$ --	$ 280
1.0 - 1.25	1,699	--	1,699	1,583	16	1,599
1.26 - 1.50	1,584	69	1,653	1,520	5	1,525
Above 1.50	2,888	168	3,056	2,540	546	3,086
Total non-impaired mortgage loans	$ 6,448	$ 237	$ 6,685	$ 5,923	$ 567	$ 6,490

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

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

($ in millions)	**September 30, 2011**	**December 31, 2010**
Impaired mortgage loans with a valuation allowance	$ 257	$ 168
Impaired mortgage loans without a valuation allowance	14	21
Total impaired mortgage loans	$ 271	$ 189
Valuation allowance on impaired mortgage loans	$ 70	$ 84

The average balance of impaired loans was $201 million during the nine months ended September 30, 2011.

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

($ in millions)	**Three months ended September 30, 2011**	**Nine months ended September 30, 2011**
Beginning balance	$ 68	$ 84
Net increase in valuation allowance	29	42

Charge offs	(27)	(56)
Ending balance	$ 70	$ 70

The carrying value of past due mortgage loans is as follows:

($ in millions)	**September 30, 2011**	**December 31, 2010**
Less than 90 days past due	$ --	$ 12
90 days or greater past due	64	78
Total past due	64	90
Current loans	6,892	6,589
Total mortgage loans	$ 6,956	$ 6,679

5. Fair Value of Assets and Liabilities

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

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

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

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

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

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

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

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 has two types of situations where investments are classified as Level 3 in the fair value hierarchy. The first 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.

The second situation where the Company classifies securities in Level 3 is where specific inputs significant to the fair value estimation models are not market observable. This occurs in two primary instances. The first relates to the Company s use of broker quotes. The second relates to auction rate securities (ARS) backed by student loans for which a key input, the anticipated date liquidity will return to this market, is not market observable.

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

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

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

Level 1 measurements

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

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

- Short-term: Comprise actively traded money market funds that have daily quoted net asset values for identical assets that the Company can access.

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

Level 2 measurements

- Fixed income securities:

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

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

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

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

RMBS and ABS: 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.

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

Level 3 measurements

- Fixed income securities:

Municipal: ARS primarily backed by student loans that have become illiquid due to failures in the auction market are valued using a discounted cash flow model that is widely accepted in the financial services industry and uses significant non-market observable inputs, including estimates of future coupon rates if auction failures continue, the anticipated date liquidity will return to the market and illiquidity premium. Also included are municipal bonds that are not rated by third party credit rating agencies but are rated by the National Association of Insurance Commissioners (NAIC), and other high-yield municipal bonds. 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.

Corporate, including privately placed: Primarily valued based on non-binding broker quotes. Also included are equity-indexed notes which are valued using a discounted cash flow model that is widely accepted in the financial services industry and uses significant non-market observable inputs, such as volatility. Other inputs include an interest rate yield curve, as well as published credit spreads for similar assets that incorporate the credit quality and industry sector of the issuer.

RMBS, CMBS and ABS: Valued based on non-binding broker quotes received from brokers who are familiar with the investments.

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

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

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

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

The following table summarizes the Company s assets and liabilities measured at fair value on a recurring and non-recurring basis as of September 30, 2011:

($ in millions)	Quoted prices in active markets for identical assets (Level 1)	Significant other observable inputs (Level 2)	Significant unobservable inputs (Level 3)	Counterparty and cash collateral netting	Balance as of September 30, 2011
Assets					
Fixed income securities:					
U.S. government and agencies	$ 2,934	$ 1,412	$ --		$ 4,346
Municipal	--	13,546	1,453		14,999
Corporate	--	42,799	1,730		44,529
Foreign government	--	2,133	--		2,133
RMBS	--	4,540	92		4,632
CMBS	--	1,748	76		1,824
ABS	--	2,105	1,801		3,906
Redeemable preferred stock	--	24	1		25
Total fixed income securities	2,934	68,307	5,153		76,394
Equity securities	3,488	627	42		4,157
Short-term investments	200	3,317	--		3,517
Other investments:					
Free-standing derivatives	--	383	1	$ (140)	244
Separate account assets	6,791	--	--		6,791
Other assets	3	--	1		4
Total recurring basis assets	13,416	72,634	5,197	(140)	91,107
Non-recurring basis (1)	--	--	158		158
Total assets at fair value	$ 13,416	$ 72,634	$ 5,355	$ (140)	$ 91,265
% of total assets at fair value	14.7 %	79.6 %	5.9 %	(0.2) %	100.0 %
Liabilities					
Contractholder funds:					
Derivatives embedded in life and annuity contracts	$ --	$ --	$ (597)		$ (597)
Other liabilities:					
Free-standing derivatives	(3)	(225)	(111)	$ 138	(201)
Total liabilities at fair value	$ (3)	$ (225)	$ (708)	$ 138	$ (798)
% of total liabilities at fair value	0.4 %	28.2 %	88.7 %	(17.3) %	100.0 %

(1) Includes $141 million of mortgage loans, $3 million of limited partnership interests and $14 million of other investments written-down to fair value in connection with recognizing other-than-temporary impairments.

The following table summarizes the Company s assets and liabilities measured at fair value on a recurring and non-recurring basis as of December 31, 2010:

($ in millions)	Quoted prices in active markets for identical assets (Level 1)	Significant other observable inputs (Level 2)	Significant unobservable inputs (Level 3)	Counterparty and cash collateral netting	Balance as of December 31, 2010
Assets					
Fixed income securities:					
U.S. government and agencies	$ 4,976	$ 3,620	$ --		$ 8,596
Municipal	--	13,918	2,016		15,934
Corporate	--	35,747	1,908		37,655
Foreign government	--	3,158	--		3,158
RMBS	--	6,199	1,794		7,993
CMBS	--	1,071	923		1,994
ABS	--	1,827	2,417		4,244
Redeemable preferred stock	--	37	1		38
Total fixed income securities	4,976	65,577	9,059		79,612
Equity securities	4,316	432	63		4,811
Short-term investments	174	3,105	--		3,279
Other investments:					
Free-standing derivatives	--	651	74	$ (286)	439
Separate account assets	8,676	--	--		8,676
Other assets	--	--	1		1
Total recurring basis assets	18,142	69,765	9,197	(286)	96,818
Non-recurring basis (1)	--	--	120		120
Total assets at fair value	$ 18,142	$ 69,765	$ 9,317	$ (286)	$ 96,938
% of total assets at fair value	18.7 %	72.0 %	9.6 %	(0.3) %	100.0 %
Liabilities					
Contractholder funds:					
Derivatives embedded in life and annuity contracts	$ --	$ --	$ (653)		$ (653)
Other liabilities:					
Free-standing derivatives	(2)	(529)	(95)	$ 263	(363)
Total liabilities at fair value	$ (2)	$ (529)	$ (748)	$ 263	$ (1,016)
% of total liabilities at fair value	0.2 %	52.1 %	73.6 %	(25.9) %	100.0 %

(1) Includes $111 million of mortgage loans and $9 million of limited partnership interests written-down to fair value in connection with recognizing other-than-temporary impairments.

The following table presents the rollforward of Level 3 assets and liabilities held at fair value on a recurring basis during the three months ended September 30, 2011.

($ in millions)	Balance as of June 30, 2011	Total realized and unrealized gains (losses) included in: Net income (1)	Total realized and unrealized gains (losses) included in: OCI on Statement of Financial Position	Transfers into Level 3	Transfers out of Level 3
Assets					
Fixed income securities:					
Municipal	$ 1,554	$ (10)	$ 1	$ --	$ (22)
Corporate	1,720	(4)	(23)	3	(107)
RMBS	1,194	--	2	--	(1,100)
CMBS	938	(1)	(5)	20	(877)
ABS	2,167	(36)	(75)	--	(329)
Redeemable preferred stock	1	--	--	--	--
Total fixed income securities	7,574	(51)	(100)	23	(2,435)
Equity securities	42	--	--	--	--
Other investments:					
Free-standing derivatives, net	(56)	(57)	--	--	--
Other assets	1	--	--	--	--
Total recurring Level 3 assets	$ 7,561	$ (108)	$ (100)	$ 23	$ (2,435)
Liabilities					
Contractholder funds:					
Derivatives embedded in life and annuity contracts	$ (629)	$ 2	$ --	$ --	$ --
Total recurring Level 3 liabilities	$ (629)	$ 2	$ --	$ --	$ --

	Purchases	Sales	Issuances	Settlements	Balance as of September 30, 2011
Assets					
Fixed income securities:					
Municipal	$ --	$ (70)	$ --	$ --	$ 1,453
Corporate	245	(59)	--	(45)	1,730
RMBS	--	--	--	(4)	92
CMBS	2	--	--	(1)	76
ABS	165	(1)	--	(90)	1,801
Redeemable preferred stock	--	--	--	--	1
Total fixed income securities	412	(130)	--	(140)	5,153
Equity securities	--	--	--	--	42
Other investments:					
Free-standing derivatives, net	5	--	--	(2)	(110)(2)
Other assets	--	--	--	--	1
Total recurring Level 3 assets	$ 417	$ (130)	$ --	$ (142)	$ 5,086
Liabilities					
Contractholder funds:					
Derivatives embedded in life and annuity contracts	$ --	$ --	$ (15)	$ 45	$ (597)
Total recurring Level 3 liabilities	$ --	$ --	$ (15)	$ 45	$ (597)

(1) The effect to net income totals $(106) million and is reported in the Condensed Consolidated Statements of Operations as follows: $(119) million in realized capital gains and losses, $14 million in net investment income, $54 million in interest credited to contractholder funds and $(55) million in life and annuity contract benefits.

(2) Comprises $1 million of assets and $111 million of liabilities.

The following table presents the rollforward of Level 3 assets and liabilities held at fair value on a recurring basis during the nine months ended September 30, 2011.

($ in millions)		Total realized and unrealized gains (losses) included in:			
	Balance as of December 31, 2010	Net income (1)	OCI on Statement of Financial Position	Transfers into Level 3	Transfers out of Level 3
Assets					
Fixed income securities:					
Municipal	$ 2,016	$ (34)	$ 67	$ --	$ (81)
Corporate	1,908	31	(5)	185	(271)
RMBS	1,794	(87)	108	--	(1,213)
CMBS	923	(43)	113	86	(946)
ABS	2,417	19	(47)	--	(642)
Redeemable preferred stock	1	--	--	--	--
Total fixed income securities	9,059	(114)	236	271	(3,153)
Equity securities	63	(10)	--	--	(10)
Other investments:					
Free-standing derivatives, net	(21)	(91)	--	--	--
Other assets	1	--	--	--	--
Total recurring Level 3 assets	$ 9,102	$ (215)	$ 236	$ 271	$ (3,163)
Liabilities					
Contractholder funds:					
Derivatives embedded in life and annuity contracts	$ (653)	$ (24)	$ --	$ --	$ --
Total recurring Level 3 liabilities	$ (653)	$ (24)	$ --	$ --	$ --

	Purchases	Sales	Issuances	Settlements	Balance as of September 30, 2011
Assets					
Fixed income securities:					
Municipal	$ 13	$ (525)	$ --	$ (3)	$ 1,453
Corporate	376	(437)	--	(57)	1,730
RMBS	--	(378)	--	(132)	92
CMBS	12	(66)	--	(3)	76
ABS	468	(164)	--	(250)	1,801
Redeemable preferred stock	--	--	--	--	1
Total fixed income securities	869	(1,570)	--	(445)	5,153
Equity securities	--	(1)	--	--	42
Other investments:					
Free-standing derivatives, net	72	--	--	(70)	(110)(2)
Other assets	--	--	--	--	1
Total recurring Level 3 assets	$ 941	$ (1,571)	$ --	$ (515)	$ 5,086
Liabilities					
Contractholder funds:					
Derivatives embedded in life and annuity contracts	$ --	$ --	$ (42)	$ 122	$ (597)
Total recurring Level 3 liabilities	$ --	$ --	$ (42)	$ 122	$ (597)

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(1) The effect to net income totals $(239) million and is reported in the Condensed Consolidated Statements of Operations as follows: $(242) million in realized capital gains and losses, $30 million in net investment income, $(9) million in interest credited to contractholder funds and $(18) million in life and annuity contract benefits.

(2) Comprises $1 million of assets and 111 million of liabilities.

The following table presents the rollforward of Level 3 assets and liabilities held at fair value on a recurring basis during the three months ended September 30, 2010.

($ in millions)		Total realized and unrealized gains (losses) included in:					
	Balance as of June 30, 2010	Net income (1)	OCI on Statement of Financial Position	Purchases, sales, issuances and settlements, net	Transfers into Level 3	Transfers out of Level 3	Balance as of September 30, 2010
Assets							
Fixed income securities:							
Municipal	$ 2,197	$ 13	$ 18	$ (87)	$ 5	$ (2)	$ 2,144
Corporate	2,225	8	77	(96)	192	(229)	2,177
RMBS	2,010	(102)	206	(230)	--	--	1,884
CMBS	880	(66)	134	(120)	38	--	866
ABS	2,430	18	73	64	--	(233)	2,352
Redeemable preferred stock	1	--	--	--	--	--	1
Total fixed income securities	9,743	(129)	508	(469)	235	(464)	9,424
Equity securities	66	14	--	(15)	--	--	65
Other investments:							
Free-standing derivatives, net	(99)	(10)	--	14	--	--	(95)(2)
Other assets	2	--	--	--	--	--	2
Total recurring Level 3 assets	$ 9,712	$ (125)	$ 508	$ (470)	$ 235	$ (464)	$ 9,396
Liabilities							
Contractholder funds:							
Derivatives embedded in life and annuity contracts	$ (119)	$ (23)	$ --	$ --	$ --	$ --	$ (142)
Total recurring Level 3 liabilities	$ (119)	$ (23)	$ --	$ --	$ --	$ --	$ (142)

(1) The effect to net income totals $(148) million and is reported in the Condensed Consolidated Statements of Operations as follows: $(136) million in realized capital gains and losses, $11 million in net investment income and $(23) million in life and annuity contract benefits.

(2) Comprises $11 million of assets and $106 million of liabilities.

The following table presents the rollforward of Level 3 assets and liabilities held at fair value on a recurring basis during the nine months ended September 30, 2010.

($ in millions)		Total realized and unrealized gains (losses) included in:					
	Balance as of December 31, 2009	Net income (1)	OCI on Statement of Financial Position	Purchases, sales, issuances and settlements, net	Transfers into Level 3	Transfers out of Level 3	Balance as of September 30, 2010
Assets							
Fixed income securities:							
Municipal	$ 2,706	$ (34)	$ 76	$ (539)	$ 21	$ (86)	$ 2,144
Corporate	2,241	(29)	178	(62)	355	(506)	2,177
Foreign government	20	--	--	(20)	--	--	--
RMBS	1,671	(271)	549	(51)	--	(14)	1,884
CMBS	1,404	(173)	434	(448)	62	(413)	866
ABS	2,001	36	172	536	--	(393)	2,352
Redeemable preferred stock	2	--	--	(1)	--	--	1
Total fixed income securities	10,045	(471)	1,409	(585)	438	(1,412)	9,424
Equity securities	69	8	4	(12)	--	(4)	65
Other investments:							
Free-standing derivatives, net	55	(242)	--	92	--	--	(95)(2)
Other assets	2	--	--	--	--	--	2
Total recurring Level 3 assets	$ 10,171	$ (705)	$ 1,413	$ (505)	$ 438	$ (1,416)	$ 9,396
Liabilities							
Contractholder funds:							
Derivatives embedded in life and annuity contracts	$ (110)	$ (35)	$ --	$ 3	$ --	$ --	$ (142)
Total recurring Level 3 liabilities	$ (110)	$ (35)	$ --	$ 3	$ --	$ --	$ (142)

(1) The effect to net income totals $(740) million and is reported in the Condensed Consolidated Statements of Operations as follows: $(767) million in realized capital gains and losses, $65 million in net investment income, $(3) million in interest credited to contractholder funds and $(35) million in life and annuity contract benefits.

(2) Comprises $11 million of assets and $106 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. For example, in situations where a fair value quote is not provided by the Company s independent third-party valuation service provider and as a result the price is stale or has been replaced with a broker quote, the security is transferred into Level 3. 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 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 and nine months ended September 30, 2011 or 2010.

During the three and nine months ended September 30, 2011, certain RMBS, CMBS and ABS were transferred into Level 2 from Level 3 as a result of increased liquidity in the market and a sustained increase in market activity for these assets. During the three and nine months ended September 30, 2010, certain CMBS and ABS were transferred into Level 2 from Level 3 as a result of increased liquidity in the market and a sustained increase in market activity for these assets. When transferring these securities into Level 2, the Company did not change the source of fair value estimates or modify the estimates received from independent third-party valuation service providers or the internal valuation approach. Accordingly, for securities included within this group, there was no change in fair value in conjunction with the transfer resulting in a realized or unrealized gain or loss.

Transfers into Level 3 during the three and nine months ended September 30, 2011 and 2010 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 resulting in the security being classified as Level 3. Transfers out of Level 3 during the three and nine months ended September 30, 2011 and 2010 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.

The following table provides the total gains and (losses) included in net income for Level 3 assets and liabilities still held as of September 30.

($ in millions)	**Three months ended September 30,**		**Nine months ended September 30,**	
	2011	**2010**	**2011**	**2010**
Assets				
Fixed income securities:				
Municipal	$ (7)	$ 1	$ (17)	$ (24)
Corporate	(12)	(1)	3	(42)
RMBS	--	(83)	--	(214)
CMBS	(1)	(22)	(10)	(42)
ABS	(38)	28	(26)	53
Total fixed income securities	(58)	(77)	(50)	(269)
Equity securities	--	(1)	--	(8)
Other investments:				
Free-standing derivatives, net	(57)	28	(54)	(113)
Total recurring Level 3 assets	$ (115)	$ (50)	$ (104)	$ (390)
Liabilities				
Contractholder funds:				
Derivatives embedded in life and annuity contracts	$ 2	$ (23)	$ (24)	$ (35)
Total recurring Level 3 liabilities	$ 2	$ (23)	$ (24)	$ (35)

The amounts in the table above represent gains and losses included in net income for the period of time that the asset or liability was determined to be in Level 3. These gains and losses total $(113) million for the three months ended September 30, 2011 and are reported as follows: $(128) million in realized capital gains and losses, $13 million in net investment income, $57 million in interest credited to contractholder funds and $(55) million in life and annuity contract benefits. These gains and losses total $(73) million for the three months ended September 30, 2010 and are reported as follows: $(57) million in realized capital gains and losses, $6 million in net investment income, $1 million in interest credited to contractholder funds and $(23) million in life and annuity contract benefits. These gains and losses total $(128) million for the nine months ended September 30, 2011 and are reported as follows: $(145) million in realized capital gains and losses, $41 million in net investment income, $(6) million in interest credited to contractholder funds and $(18) million in life and annuity contract benefits. These gains and losses total $(425) million for the nine months ended September 30, 2010 and are reported as follows: $(426) million in realized capital gains and losses, $41 million in net investment income, $(5) million in interest credited to contractholder funds and $(35) million in life and annuity contract benefits.

Presented below are the carrying values and fair value estimates of financial instruments not carried at fair value.

Financial assets

($ in millions)	**September 30, 2011**		**December 31, 2010**	
	Carrying value	**Fair value**	**Carrying value**	**Fair value**
Mortgage loans	$ 6,956	$ 6,989	$ 6,679	$ 6,439
Limited partnership interests - cost basis	1,445	1,768	1,348	1,481
Bank loans	362	345	363	355

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

Financial liabilities

($ in millions)	**September 30, 2011**		**December 31, 2010**	
	Carrying value	**Fair value**	**Carrying value**	**Fair value**
Contractholder funds on investment contracts	$ 31,737	$ 31,999	$ 36,163	$ 35,194
Long-term debt	5,907	6,284	5,908	6,325
Liability for collateral	784	784	484	484

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

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

6. Derivative Financial Instruments

The Company primarily uses derivatives for risk management, to partially mitigate potential adverse impacts from changes in risk-free interest rates, negative equity market valuations and increases in credit spreads, and asset replication. In addition, the Company 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 the exception of non-hedge derivatives used for asset replication and non-hedge embedded derivatives, all of the Company s derivatives are evaluated for their ongoing effectiveness as either accounting hedge or non-hedge derivative financial instruments on at least a quarterly basis. The Company does not use derivatives for trading purposes. Non-hedge accounting is generally used for portfolio level hedging strategies where the terms of the individual hedged items do not meet the strict homogeneity requirements to permit the application of hedge accounting.

Property-liability uses interest rate swaps, swaptions and futures to maintain the interest rate characteristics of existing investments within specified ranges and to reduce exposure to rising or falling interest rates. Portfolio duration management is a risk management strategy that is principally employed by Property-Liability wherein financial futures and interest rate swaps 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. Prior to March 31, 2011, Property-Liability used interest rate swaption contracts and exchange traded options on interest rate futures to offset potential declining fixed income market values resulting from significant increases in interest rates. Prior to March 31, 2011, exchange traded equity put options were utilized by Property-Liability for overall equity portfolio protection from significant declines in equity market values below a targeted level.

Property-Liability uses interest rate swaps to mitigate municipal bond interest rate risk within the municipal bond portfolio. Equity index futures are used by Property-Liability to offset valuation losses in the equity portfolio during periods of declining equity market values. Credit default swaps are typically used to mitigate the credit risk within the Property-Liability fixed income portfolio. Property-Liability uses futures to hedge the market risk related to deferred compensation liability contracts and forward contracts to hedge foreign currency risk associated with holding foreign currency denominated investments and foreign operations.

Asset-liability management is a risk management strategy that is principally employed by Allstate Financial to balance the respective interest-rate sensitivities of its assets and liabilities. Depending upon the attributes of the assets acquired and liabilities issued, derivative instruments such as interest rate swaps, caps, floors, 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. Allstate Financial uses financial futures and interest rate swaps to hedge anticipated asset purchases and liability issuances and futures and options for hedging the equity exposure contained in its equity indexed life and annuity product contracts that offer equity returns to contractholders. In addition, Allstate Financial uses interest rate swaps to hedge interest rate risk inherent in funding agreements.

Allstate Financial uses foreign currency swaps primarily to reduce the foreign currency risk associated with issuing foreign currency denominated funding agreements and holding foreign currency denominated investments. Credit default swaps are also typically used to mitigate the credit risk within the Allstate Financial fixed income portfolio.

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

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

The Company s primary embedded derivatives are equity options in Allstate Financial life and annuity product contracts, which provide equity returns to contractholders; equity-indexed notes containing equity call options, which provide a coupon payout that is determined using one or more equity-based indices; credit default swaps in synthetic collateralized debt obligations, which provide enhanced coupon rates as a result of selling credit protection; and conversion options in fixed income securities, which provide the Company with the right to convert the instrument into a predetermined number of shares of common stock. Substantially all of the fixed income securities with conversion options were sold in March 2011.

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 legally enforceable master netting agreements and are presented on a net basis, by counterparty agreement, in the Condensed Consolidated Statements of Financial Position. For certain exchange traded derivatives, the exchange requires margin deposits as well as daily cash settlements of margin accounts. As of September 30, 2011, the Company pledged $22 million of cash and securities in the form of margin deposits.

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 accumulated other comprehensive income and are reported in net income in the same period the forecasted transactions being hedged impact net income. For embedded derivatives in fixed income securities, net income includes the change in fair value of the embedded derivative and accretion income related to the host instrument. For non-hedge derivatives, net income includes changes in fair value and accrued periodic settlements, when applicable.

The following table provides a summary of the volume and fair value positions of derivative instruments as well as their reporting location in the Condensed Consolidated Statement of Financial Position as of September 30, 2011.

($ in millions, except number of contracts)		**Asset derivatives**				
		Volume (1)				
	Balance sheet location	**Notional amount**	**Number of contracts**	**Fair value, net**	**Gross asset**	**Gross liability**
Derivatives designated as accounting hedging instruments						
Interest rate swap agreements	Other investments	$ 101	n/a	$ (6)	$ --	$ (6)
Foreign currency swap agreements	Other investments	152	n/a	(7)	3	(10)
Total		$ 253	n/a	$ (13)	$ 3	$ (16)
Derivatives not designated as accounting hedging instruments						
Interest rate contracts						
Interest rate swap agreements	Other investments	$ 4,404	n/a	$ 114	$ 114	$ --
Interest rate swaption agreements	Other investments	3,000	n/a	1	1	--
Interest rate cap and floor agreements	Other investments	1,726	n/a	(16)	--	(16)
Equity and index contracts						
Options, futures and warrants (2)	Other investments	170	20,166	127	129	(2)
Options, futures and warrants	Other assets	n/a	1,014	3	3	--
Foreign currency contracts						
Foreign currency swap agreements	Other investments	50	n/a	4	4	--
Foreign currency forwards and options	Other investments	136	n/a	2	2	--
Embedded derivative financial instruments						
Conversion options	Fixed income securities	5	n/a	--	--	--
Equity-indexed call options	Fixed income securities	150	n/a	7	7	--
Credit default swaps	Fixed income securities	172	n/a	(119)	--	(119)
Other embedded derivative financial instruments	Other investments	1,000	n/a	--	--	--
Credit default contracts						
Credit default swaps - buying protection	Other investments	1,312	n/a	43	47	(4)
Credit default swaps - selling protection	Other investments	255	n/a	(12)	--	(12)
Other contracts						
Other contracts	Other investments	5	n/a	--	--	--
Other contracts	Other assets	4	n/a	1	1	--
Total		$ 12,389	21,180	$ 155	$ 308	$ (153)
Total asset derivatives		$ 12,642	21,180	$ 142	$ 311	$ (169)

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

(2) In addition to the number of contracts presented in the table, the Company held 2,860 stock rights and 4,389,707 stock warrants. Stock rights and warrants can be converted to cash upon sale of those instruments or exercised for shares of common stock.

		Liability derivatives									
		Volume (1)									
	Balance sheet location	Notional amount		Number of contracts	Fair value, net		Gross asset		Gross liability		
Derivatives designated as accounting hedging instruments											
Interest rate swap agreements	Other liabilities & accrued expenses	$	84	n/a	$	(9)	$	--	$	(9)	
Foreign currency swap agreements	Other liabilities & accrued expenses		50	n/a		(4)		--		(4)	
Total		$	134	n/a	$	(13)	$	--	$	(13)	
Derivatives not designated as accounting hedging instruments											