Consumer Federation of America

THE "GOOD HANDS" COMPANY OR A LEADER IN ANTI-CONSUMER PRACTICES?

EXCESSIVE PRICES AND POOR CLAIMS PRACTICES AT THE ALLSTATE CORPORATION

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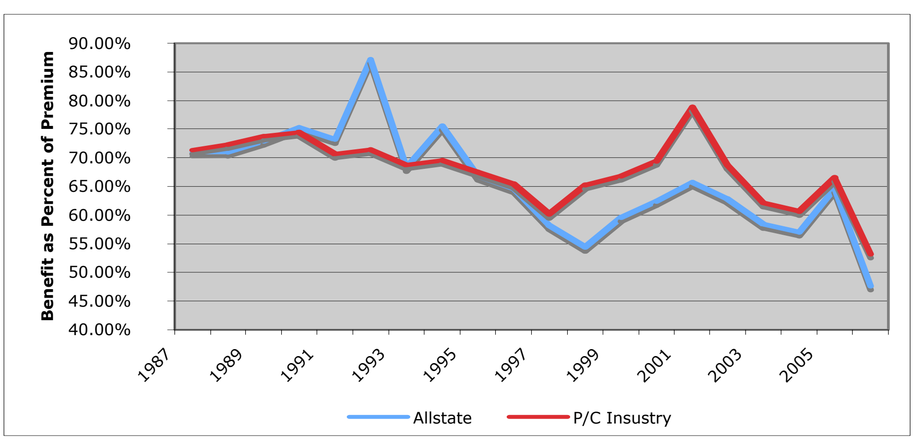
I. EXECUTIVE SUMMARY

In recent years, property-casualty insurers have made a number of significant but not always highly visible changes in the way they assess risk, set rates and manage claims. The aftermath of Hurricane Katrina exposed the harmful effects of many of these changes on policyholders, especially lower income and minority consumers.

These alarming trends have been apparent for more than a decade. Over time, property-casualty insurers overall have paid out less in claims for every dollar spent on premiums by consumers, as profits and overhead costs increased. Many insurers have implemented pricing "innovations" like using credit scores and multiple rate classifications that appear to have a disparate, adverse impact on poorer and minority consumers. They have changed policy language to hollow out the coverage offered, particularly for home insurance, and dramatically increased consumers' out-of-pocket costs. They have deployed ambiguous and harmful coverage restrictions that are beyond the ability of consumers to clearly understand. Some insurers have also refused to renew the policies of consumers in coastal regions, forcing them into high-cost state-supported insurance pools. This practice socializes the cost of high risks while privatizing the profitable risks.

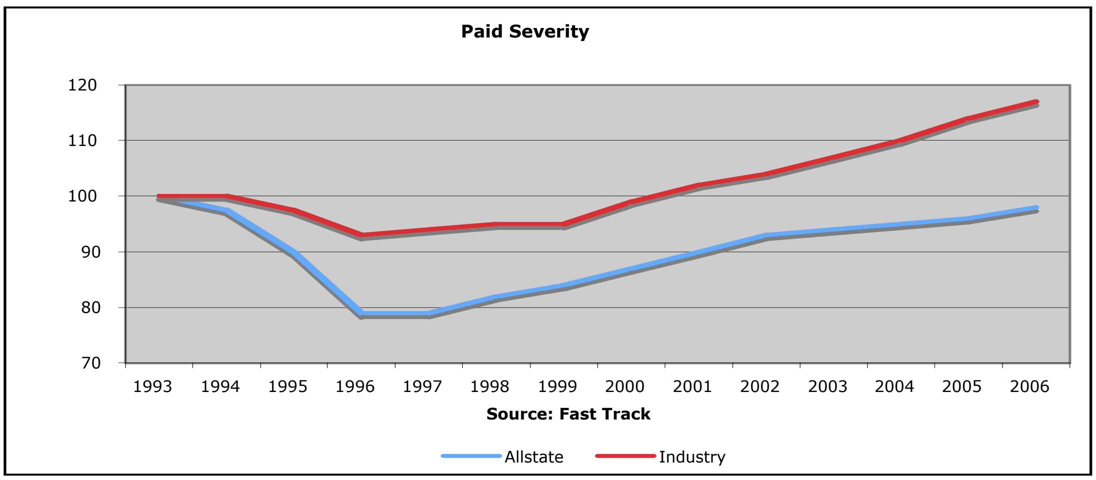
As CFA has tracked these questionable practices, one insurance company stood out as a leader in creating and exploiting many of these trends. That insurer is Allstate. As a result, CFA launched a detailed investigation of Allstate's business practices, which found:

1. **Excessive rates and profits**, compared to the low level of claims that Allstate has paid out to consumers. From 1987 to 1996, property-casualty insurers overall paid out 70 percent of premiums as benefits. From 1997to 2006, the payout was only 65 percent, a decline of 7.1 percent in value to consumers for the typical insurance product. In the late 1980s and early 1990s, Allstate's insurance products were of slightly greater value per premium dollar to consumers than those of other insurers. However, the company's property-casualty products have become less valuable than the industry average in recent years. Allstate paid out 73 percent of premium in benefits from 1987 to 1996 and a startlingly low 59 percent from 1997 to 2006, a decline of 19.2 percent in the value of Allstate's product to consumers (see graph below.)



As the consumer value of Allstate's policies has declined, their profits have increased. Allstate's profits were consistently higher than that of the overall industry during this period, averaging about 6 percent more. Allstate's current return on equity of 25.8 percent is also significantly higher than the returns it earned in the late 1980s.

2. **Questionable claims settlement practices,** resulting in unjustifiably low claims payments. Allstate was one of the first major insurers to adopt claims payment techniques designed to systematically reduce payments to policyholders without adequately examining the validity of each individual claim, such as an automated payment system called Colossus. It adopted these techniques after being told by a consultant that these systems would put them in a "zero-sum game" with claimants, including their policyholders who filed claims, in which Allstate shareholders would benefit financially at the expense of policyholders.

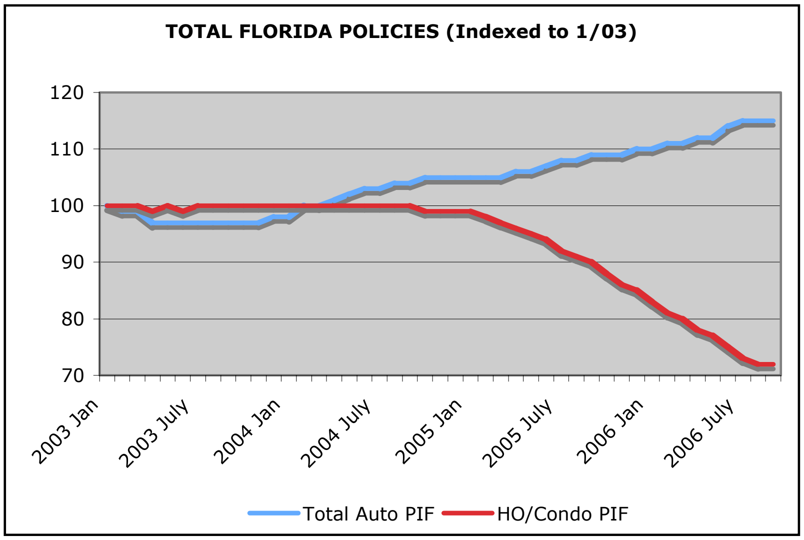


This graph, based on information produced by Allstate,[1] offers significant evidence of a pattern of underpayment. It shows that Allstate has consistently paid out lower claims for bodily injuries relative to the rest of the property-casualty insurance industry over more than a twenty year period. (It is indexed to 1993, which is listed as "100.") From 1993 to 1996, Allstate's paid severity dropped by 21 percent to 79, while industry-wide payments dropped to 94. Since 1996, Allstate's paid severity has slowly increased to about 98, while the industry increased to 117. Overall, Allstate reduced its payouts on these claims by almost 20 percent relative to the industry result.

3. **Mistreatment of consumers throughout the country in the aftermath of Hurricane Katrina.** Allstate has proven to be a fair weather friend for many policyholders. It has dropped coverage for hundreds in many coastal areas around the country. In 2005 and the first half of 2006, Allstate abandoned thousands of Floridians it had insured, dropping about thirty percent of its book of business in that short period of time.[2]

[1] May 16, 2007, Dan Hale, Chief Financial Officer of Allstate, presentation to the UBS 2007 Global Finance Services Conference (At Slide 6).

[2] Allstate's non-renewal effort at this time appears to have been more severe than the actions taken by other leading insurers.



Yet, they actually increased their market share for automobile insurance in Florida during 2006.[3] This chart[4] shows how Allstate cut policies for homes in Florida in 2005 and 2006, while increasing the number of auto policies it sold in the state.

4. **Unfair rating and underwriting practices**. Allstate has been a leader in developing complex and difficult to understand pricing systems, using credit scores and multiple rate "tiers" not clearly related to the risk of their customers. These trends make comparison shopping for consumers more difficult and appear to lead to higher rates for poorer and minority consumers.

5. **High consumer complaints.** Complaints filed against Allstate are greater than almost all of its major competitors. Many of these complaints relate to claims settlement practices consumers have perceived as unfair. According to data collected by the National Association of Insurance Commissioners, Allstate's "complaint ratio" was the second worst of thirteen major automobile insurers in 2005 and 2006 (tying with Farmers Insurance.) Allstate had the second worst complaint ratio among eight major home insurers in 2005, and the lowest ranking in 2006.

6. **Shifting costs to taxpayers**. Allstate is an industry leader in seeking taxpayer subsidies for its riskier insurance coverage, especially in Congress. In the wake of Hurricane Katrina, Allstate and other major insurers have been criticized by state officials and policyholders for underpaying claims for wind damage and shifting these costs to the flood insurance program, which is supported by tax dollars. A newspaper investigation found that Allstate might also have charged the government more for materials used to

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[3] Bear Sterns June 21, 2007 Report on "Meetings with Management" of Allstate, shows that market share in auto insurance rose from 12.8 percent to 13.0 percent from 2005 to 2006. However, Bear Sterns warned that the reason may be linked to clever selection by Allstate of which homeowner policyholders to non-renew to keep their auto insurance portfolio growing: "Our one remaining concern is that the initial non-renewed customers were primarily mono-line homeowners, while the next batch of non-renewals will have both auto and home policies."

[4] Based upon a PowerPoint Presentation of the then Allstate CEO Edward M. Liddy to the Credit Suisse Insurance Conference, November 17, 2006, Slide 16.

repair flood damages paid for by taxpayers than Allstate pays for the same materials to repair wind damages.

Allstate is certainly not the only insurer pursuing these harmful practices, but it has been at the forefront in developing and implementing many of them. Unfortunately, many of these "innovations" have now been adopted across the industry.

These practices do not appear to be justified by any increase in financial risk borne by property-casualty insurers. In fact, a detailed analysis of the investment performance of Allstate and other property-casualty insurers shows that they represent a below-average risk for investors, as measured by standard measures of risk for investment.

Based on our investigation, CFA urges consumers to consider the findings of this report before purchasing or renewing home and auto insurance from Allstate. We also urge action by state insurance departments, the National Association of Insurance Commissioners and the federal government to study and correct Allstate's practices and to consider taking steps regarding other insurance companies that pursue the anti-consumer practices detailed in this report.

II. INTRODUCTION

CFA has observed several adverse trends in the property-casualty insurance industry, some of which began decades ago and some of which are new. For instance, an increase in the use of "classifications" to evaluate customer risk and set rates began many years ago, but it has accelerated in recent years through the use of credit scoring to rate policies. Claims practices have grown less consumer-friendly over the years, as the problems that many consumers encountered after Hurricane Katrina revealed. The use of computer programs such as Colossus has made it less likely that consumers will receive a settlement offer that is based on a fair and individualized assessment of their true losses. Significant coverage restrictions began after Hurricane Andrew but have become worse in recent years with the development of extreme policy restrictions like the "anti-concurrent causation clause."

In the aftermath of Hurricane Katrina, reports of consumer dissatisfaction with the insurance industry filled the newspapers in Florida and along the Gulf Coast. These reports highlighted severe claims adjustment problems, policies with unexpected coverage gaps, denials of continued coverage, limits on new underwriting of business and huge price increases. This adverse conduct toward consumers occurred despite the fact that insurers had already been through a learning curve in responding to a major weather catastrophe more than a decade earlier: Hurricane Andrew. In the wake of the mid-1990s price spikes and coverage cutbacks that occurred, as well as major policy changes that were made by states (such as the creation of state catastrophe insurance pools), insurers promised that they would not in the future cause further coverage upheavals, regardless of the frequency or severity of storms. The fact that the current wave of anti-consumer practices has occurred at a time of record insurance industry profits makes the severe and precipitous actions of some insurers even less justifiable.

The one large insurance company that has been frequently cited for a broad range of anti-consumer practices in recent years is Allstate. This might be because Allstate is a very large company that insures many people. (Only State Farm writes more homeowners insurance policies.) However, Allstate often implements anti-consumer practices earlier or in a harsher manner than its largest competitors. For example, it appears to have withdrawn coverage in coastal areas for more current or potential customers than other insurers. This may explain why Allstate is the subject of a higher degree of consumer complaints filed with regulators than virtually all of its large insurance company peers.

Even before Hurricane Katrina, Allstate was a leader in the insurance industry in implementing a number of anti-consumer practices, such as a claims' payment programs designed to systematically reduce payments to policyholders and other claimants without adequately examining the validity of individual claims. Allstate has also been an "innovator" in the very questionable practice of using credit scores to set insurance rates and in using of hundreds of rate "tiers," which make comparison shopping difficult for consumers and undermine the basic insurance principle of risk spreading. Allstate has also been at the forefront in delivering insurance products that pay out less in claims relative to the cost that consumers pay for premiums and in advocating for state and federal policy changes that shift risk (and costs) from insurers to customers and taxpayers.

III. A BRIEF HISTORY OF ALLSTATE

Allstate was established in 1931 by Sears, Roebuck and Company and became publicly traded in 1993. Allstate's current web site says that the company:

- Is the country's largest publicly held insurance company that offers personal lines of coverage;
- Has $157.5 billion in assets and is in the Fortune index of the 100 largest publicly held companies;
- Offers thirteen major lines of insurance, including property, auto, life and commercial, as well as retirement and investment products and banking services.
- Insures every eighth home and every ninth auto in the country.
- Is known for its, "You're In Good Hands With Allstate" advertising slogan.[5]

Allstate's web site also provides a timeline of key events in the company's history, among which are:

1931 Allstate Insurance Company begins on April 17, 1931.

1939 Allstate begins charging auto rates by age, mileage and use of car and other insurers follow suit.

1994 Allstate redesigns it claims processing procedures.

1995 Sears sells its remaining ownership interest in Allstate to Sears shareholders, making Allstate an independent company that is 100 percent publicly held.[6]

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[5] From www.allstate.com, visited on May 24, 2007.

According to the publication "Best's Rating and Report," Allstate has become the country's second largest property and casualty insurer, after State Farm, and is one of the nation's top 25 life and health insurance companies.

> Private passenger automobile and homeowners products represent Allstate's primary business. The group maintains significant national market shares and is second in the industry for each line. The group's relatively small amount of commercial lines business, representing approximately 5% of property and casualty net writings, is sold largely to small and medium sized establishments. . .Allstate Life Insurance Company and its life insurance subsidiaries and affiliates primarily market personal financial products including life insurance and annuities. Allstate Financial intends to expand its cross-selling of personal financial products through the property and casualty agency force. . .The group's mix of business is split approximately 95% personal lines and 5% commercial lines. Primary lines of business are private passenger automobile and homeowners insurance, which respectively represent approximately 70% and 25% of Allstate's total book of property and casualty business. With personal automobile lines serving as an entree, agents are capable of cross-selling other products to policyholders, including homeowners insurance, commercial lines (generally to small and medium sized accounts) and personal financial products. Having multiple products for agents to sell has historically been instrumental in Allstate achieving high agent and customer retention.[7]

Best's breaks down Allstate's major lines of property-casualty insurance as follows:

Private Passenger car insurance	69%
Homeowners Insurance	25%
Commercial Multi Peril	2%
All other	4%[8]

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6 Ibid. Allstate's web site also noted the following major natural catastrophes in its timeline, "**1989** Hurricane Hugo - the largest catastrophe to date - sets the standard for CAT losses, costing the insurance industry $4.2 billion. **1992** Hurricane Andrew hits Florida, causing $16 billion in industry wide insured losses. At the time, it is the costliest natural disaster in U.S. history. This single event causes the industry to rethink the way it writes business in risk-prone areas. **1994** The Northridge, Calif., earthquake rocks the insurance industry with a $10 billion loss. **2005** Hurricane Katrina strikes the Gulf Coast, becoming the costliest natural disaster in U.S. history with estimated industry wide, insured losses of nearly $40 billion."

7 *Best's Rating and Report Updates* for Allstate Insurance Group, March 23, 2007.

8 According to Allstate's web site, it provides coverage in the following areas: Auto, Homeowners, Condominium, Renters, Scheduled Personal Property, Business Umbrella, Commercial Auto, Commercial Inland Marine, Small Business Owners, Landlord Package, Manufactured Home, Mobile Home, Motor Home, Motorcycle, Boat, Personal Umbrella, Comprehensive Personal Liability, Off-road Vehicle, Motor Club, Loan Protection and, for the federal government, flood. They also do wealth transfer (such as estate planning), life insurance, long-term care, supplemental health, annuities, IRAs, 401(k)s and banking.

IV. ASSESSING ALLSTATE'S CONSUMER PRACTICES

There are several ways to test how well an insurance company's practices work to the benefit of consumers. The factors that we have assessed to evaluate Allstate's consumer record are the consumer value of the rates that are charged, coverage availability and stability, coverage quality, consumer satisfaction and claims handling.[9]

MEASURE #1: RATES
ALLSTATE PROVIDES POOR CONSUMER VALUE FOR THE MONEY

a) Allstate's Complex Pricing Makes Price Comparisons Difficult

It is almost impossible to compare prices in insurance today because even within a single insurer group there are multiple insurers,[10] and these insurers use many rate tiers. Allstate uses up to 384 tiers of rates[11] and has been a leader, with Progressive, in expanding the use of a wide variety of classification categories.[12]

The use of hundreds of rate tiers obviously means that Allstate will offer consumers with certain characteristics lower rates, while people with other characteristics will receive higher quotes. Allstate has been a leader in moving to this high degree of segmentation and individual customer profiling, particularly in the use of credit scores.[13]

Some of the extensive segmentation that has resulted from these practices may have a disparate and harmful effect on the lower and moderate income Americans and, to the extent that it moves in the direction of individualized pricing, which Allstate's Chief Financial Officer says

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[9] Based on the author's more than 45-years of experience in evaluating the impact of the insurance marketplace on consumers, these factors are factors that CFA has determined that many consumers consider when making insurance purchasing decisions. We did not include an analysis of solvency, since much of our review involved large, financially stable insurers.

[10] Allstate Group includes sixteen property-casualty companies: Allstate County Mutual Insurance Company, Allstate Fire & Casualty Insurance Company, Allstate Indemnity Company, Allstate Insurance Company, Allstate North American Insurance Company, Allstate Property & Casualty Insurance Company, Allstate Texas Lloyd's Company, Deerbrook Insurance Company, Encompass Home and Automobile Insurance Company, Encompass Indemnity Company, Encompass Independent Insurance Company, Encompass Insurance Company of America, Encompass Insurance Company of Massachusetts., Encompass Insurance Company, Encompass Property & Casualty Company and Northbrook Indemnity Company.

[11] A "tier" is a separate base rate to which certain rating factors are applied, such as driving record, driver factors (age, marital status), use of car, area where the car is garaged, amount of insurance bought and make of car. In home insurance the rating factors include amount of insurance, type of home (frame, brick), construction quality and territory. Tiers are based significantly on credit score. Two consumers in the same rating tier may get a different premium because they seek different amounts of insurance and/ or have different rating factors. Two consumers with identical rating factors may be charged a different premium because of placement in different rating tiers.

[12] We compared the rates of major personal lines insurers in the "old-fashioned way," by using the online price guides that most state insurance departments put on their web sites. Besides being only a snapshot of the vast array of rates insurers charge to consumers, the state guides, unfortunately, tend to be out-of-date. Our limited sample indicated that Allstate appeared to be in the mid-range in price compared to their leading insurer competition, sometimes high and sometimes low, depending on the area.

[13] Allstate was one of the first insurers to begin using credit scoring in the early to mid-1990s. It is estimated by Conning & Company that about 90 percent of the industry has followed Allstate's lead in using credit scores, in part out of fear of being adversely selected against by Allstate. Also, see "Credit Scoring and the End of Insurance," Center for Economic Justice, at http://www.cej-online.org/birnbaum%20cfp%20talk%20040421.pdf

is Allstate's goal,[14] undermines the very point of insurance – to spread risk. Insurance is a type of social contract, involving a simple subsidy. Everyone buying insurance contributes to a common fund from which those with claims will be paid. The Allstate-led rush to ultra-segmentation of the insurance marketplace is threatening the very fabric of insurance.[15]

Worse, this segmentation appears to lead in the direction of charging lower income people more and affluent customers less, in order to attract these more desirable customers and sell them multiple products. For instance, using credit scores to segment customers means that lower income households are more likely to see higher prices at Allstate while more affluent households receive lower prices,[16] even though insurance companies cannot use wealth as a rating factor.[17]

In a 2005 presentation to investment analysts, then-Allstate Chief Executive Officer (CEO) Ed Liddy stated:

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[14] Statement of Dan Hale, Allstate Chief Financial Officer (CFO), at UBS 2007 Global Finance Services Conference, May 16, 2007. To Allstate's credit, it has not been an industry leader in using information about the educational attainment and occupation of its customers, as GEICO has. It appears that Allstate has only tested this approach in a few states. Education and occupation data is a very clear proxy for customer race and income, which most states do not allow to be used for the purposes of offering insurance or setting rates.

[15] For a discussion of this disturbing trend, see "Insurers Learn to Pinpoint Risks – and Avoid Them," *Los Angeles Times*, November 28, 2006. ("Some veteran observers wonder whether the intense focus on individual policyholders and properties is a recipe for insurance disaster. 'Insurers who look at each risk individually at the expense of broadly diversified pools are going to end up in the soup,' predicted author Peter L. Bernstein, whose book, 'Against the Gods: The Remarkable Story of Risk' traces the mathematical origins of the insurance industry. 'Diversification, not flyspecking one risk at a time, is insurer's optimal form of risk management.'…the new techniques appear to be dismantling much of what insurance traditionally has been about.") Allstate appears to use more pricing tiers -- 384 -- than most other insurers. Moreover, other major insurers do not appear to have made the development of individualized prices a major goal, as has Allstate.

[16] Detailed studies by the states of Missouri and Texas found a disparate, adverse effect on lower income and minority consumers in the use of credit scores for insurance purposes. "Insurance-Based Credit Scores: Impact on Minority and Low Income Populations in Missouri," State of Missouri Department of Insurance, January 2004. "Use of Credit Information by Insurers in Texas," Texas Department of Insurance, December 20, 2004. See also testimony of Birny Birnbaum of the Center for Economic Justice before the Ohio Civil Rights Commission at: http://www.cej-online.org/report_to_ohio_civil_rights_commission.pdf and the report of the Center for Economic Justice at http://www.cej-online.org/bb%20co%20test%20040218.pdf.

[17] In an August 2006 story on insurance scoring, *Consumer Reports* reported that:

- Almost all insurers now use insurance scores derived from credit report data to set premiums and accept or reject customers. Insurers say that people who engage in certain credit activities, such as carrying high balances, are likely to file more claims than others.
- Scoring systems can penalize consumers for reasonable credit usage. Opening three new accounts in the last year, including one credit card in the last four months, and then making two or more loan inquiries can increase your score and boost your premium.
- Scores have no consistent effect on premiums. Because scoring methods vary from company to company, consumers can't predict whether certain credit behavior will raise or lower their premium.
- State studies raise concerns that insurance scores may discriminate. Studies in Missouri, Texas, and Washington show that insurance scores have an adverse disparate effect on blacks, Hispanics, and the poor. The Federal Trade Commission is undertaking a nationwide study.
- Consumers have no legal right to insurance score information. Most insurers do not divulge scores to them, so consumers have no way of knowing what they can do to lower their premiums.

> Tiered pricing helps us attract higher lifetime value customers who buy more products and stay with us for a longer period of time. That's Nirvana for an insurance company. That drives growth on both the top and bottom line.
>
> This year, we've expanded from seven basic price levels to 384 potential price levels in our auto business.
>
> Tiered pricing has several very good, very positive effects on our business. It enables us to attract really high quality customers to our book of business.
>
> Make no mistake about it; the economics of insurance are driven largely by retention levels. It is a huge advantage. And our retentions are as high as they have ever been.
>
> The key, of course, is if 23% or 20% of the American public shops, some will shop every six months in order to save a buck on a six-month auto policy. That's not exactly the kind of customer that we want. So, the key is to use our drawing mechanisms and our tiered pricing to find out of that 20% or 23%, to find those that are unhappy with their current carrier, are likely to stay with us longer, likely to buy multiple products and that's where tiered pricing and a good advertising campaign comes in.
>
> It (tiered pricing) has raised the profitability of the industry.[18]

Given Mr. Liddy's comments, it should come as no surprise that recent studies have shown that insurance credit scoring has a disproportionate impact on lower income and minority consumers because the credit scoring models penalize consumers with certain characteristics disproportionately found with lower income and minority consumers and penalize consumers for the absence of credit information. Fair Isaac, in introducing a new "non-traditional" credit scores stated that over 20 percent of consumers could not be scored using traditional credit information. These consumers – euphemistically called "urban markets" – receive higher insurance rates because of insurance credit scoring. Allstate has a special company dedicated to the so-called non-standard or high-risk consumers and that company, Allstate Indemnity, charges higher rates than Allstate Insurance Company.

According to Mr. Liddy, Allstate's strategic building blocks include:

1. Investing in marketing.
2. Improving customer loyalty.
3. Effective distribution, including leadership in pricing sophistication, innovation in products and services and "next generation claims systems."[19]

b) **<u>Allstate's Rates are Rising as Others Insurers Lower Prices</u>**

There are some indications that Allstate is increasing prices in many regions. (Allstate's CFO said there were 350 price increases in 2006 and 300 more were expected in 2007.[20])

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18 Partial Transcript of Presentation to Edward M. Liddy, Chairman and CEO, The Allstate Corporation Twenty-First Annual Strategic Decisions Conference, Sanford C. Bernstein & Co., June 2, 2005.

19 Ibid, at Slide 5.

Meanwhile most insurers are lowering prices.[21] The investment community expects remarkable results from Allstate's apparent decision to not take indicated rate reductions.[22] In California, Allstate has announced its decision to stop writing new home insurance policies and Allstate is alone among major insurers in seeking home insurance price increases.[23] The California Department of Insurance has responded to Allstate's request for a 12 percent increase in homeowners' insurance prices for current policyholders with an order to show cause as to why Allstate's home insurance prices shouldn't, instead, be reduced.[24] The Foundation for Taxpayer and Consumer Rights ("FTCR") states that Allstate's loss ratios in California over recent years have been unjustifiably low, at 33.4 percent in 2005 and only 24.4 percent[25] in 2004 compared to an average of 34.2 percent in 2005 and 31.0 percent in 2004 for all California insurers combined.[26] FTCR is seeking an average refund of $326 a year for each of Allstate's California policyholders.[27] FTCR has also criticized loss ratios in California for the rest of the property-casualty industry but there are reductions coming into place in some of these companies.[28]

Significant price increases have been sought by Allstate in areas where losses were high due to Hurricane Katrina. Most remarkable were increases of 70 to 90 percent in the Mississippi Coastal counties, especially because new policies written in these places will <u>exclude</u> wind and hail coverage.[29] Since flood coverage is also excluded, it is hard to understand what remaining risks Allstate believes justify such a rate increase.

c) <u>Allstate's Prices are Excessive[30] as Reflected in Low Payouts to Consumers</u>

While Allstate's rates may appear at first glance to be reasonable relative to other market leaders, they are not. The benefits that Allstate pays out to policyholders in return for these premiums are very low by industry standards, indicative of bad value. When assessing the value

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20 Statement of Dan Hale, Allstate Chief Financial Officer (CFO), at UBS 2007 Global Finance Services Conference, May 16, 2007.

21 For example, see *Auto Insurance Premiums Expected to Drop in 2007 for First Time Since 1999*, Insurance Information Institute, December 5, 2006. According to Bear Sterns' June 21, 2007 Report on "Meetings with Management" of Allstate, "ALL (Allstate's Stock Symbol) has not taken nor do they plan to take cuts to chase PIF (Policy in Force) growth. . .while we suspect rates declined mid single digits for PGR (Progressive's Stock Symbol), last quarter's average rate change for ALL was +1%. . .ALL is not matching price decreases as they have figured out that the price differential has to be fairly substantial for customers to switch…motivated shopping remains rather benign…"

22 Bear Sterns expects "ALL will post continued stable earnings driven by the auto book, as the company maintains its pricing discipline" with a "Combined ratio excluding CATs for Property-Liability . . . expected to be between 84.0 and 86.0 in 2007." (Q2'07 Earnings Preview, July 5, 2007)

23 "California remains a tough regulatory environment for Allstate. Investors should expect continued hearings regarding Allstate's recent rate filings…" Bear Sterns June 21, 2007 Report on "Meetings with Management" of Allstate.

24 Press release of the California Department of Insurance, May 23, 2007.

25 In the next section, "Value of Coverage Relative to Price," we point out that low loss ratios are an indication of overpricing and poor value for consumers.

26 Allstate's loss ratios in California in private passenger auto were also low, 52.5 percent in 2005 and 52.1 percent in 2004, compared to 55.6 percent and 55.4 percent for the industry in the same years. Automobile insurance rate reductions are justified in California as well. Consumers Union has asked for such relief for consumers.

27 Press release, May, 23, 2007.

28 For example, State Farm recently agreed to a 20 percent reduction in homeowners' insurance in California.

29 "Allstate Hiking Rates in Six Southern Mississippi Counties Between 70% and 90%," *BestWire*, April 24, 2007. According to the article, the Mississippi Insurance Department has agreed to these increases in principle.

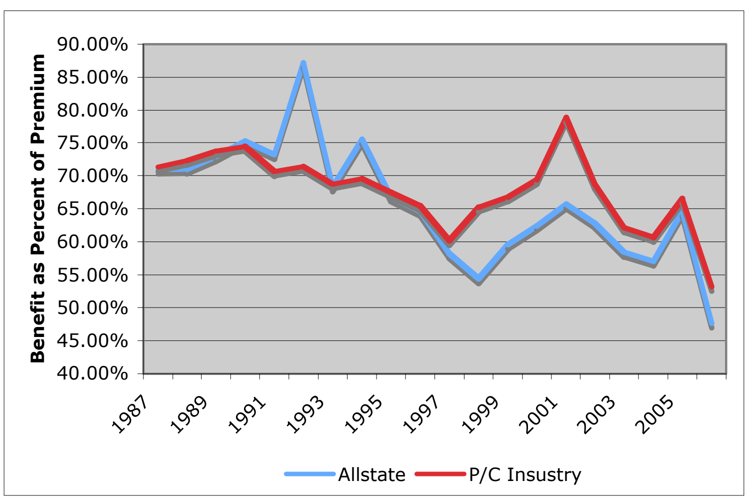
30 The premium charged for coverage is too high relative to the financial benefit provided (claims payouts.)

of coverage offered by Allstate, it is important to ask, for every dollar a consumer pays to Allstate, what is it used for and how does that compare to industry leaders? The key test determining the value of insurance coverage is the benefit-to-cost ratio; incurred losses divided by premiums earned, also known in the insurance industry as the "loss ratio."

YEAR	Allstate Pure Loss Ratio	Industry Pure Loss Ratio
1987	70.9%	71.3%
1988	71.0%	72.3%
1989	72.9%	73.7%
1990	75.2%	74.4%
1991	73.2%	70.6%
1992	87.2%	71.4%
1993	68.3%	68.7%
1994	75.5%	69.5%
1995	66.8%	67.5%
1996	64.6%	65.4%
1997	58.2%	60.2%
1998	54.4%	65.2%
1999	59.6%	66.8%
2000	62.4%	69.4%
2001	65.7%	78.9%
2002	62.8%	68.7%
2003	58.4%	62.1%
2004	57.0%	60.7%
2005	64.6%	66.5%
2006	47.6%	53.2%

Source: *Bests Aggregates and Averages*, 2006 from Best's Allstate Company Report.

These data, also shown in the chart below, clearly demonstrate for the entire property-casualty book of business the decline in benefits (claims payments paid out) that Allstate and the industry generally provides to customers relative to costs (premiums paid) over time:



Using the loss ratio as a measure, property-casualty insurance is less valuable than it used to be for insurance consumers overall, but especially for Allstate customers. In the first decade of this series, property-casualty insurers paid out 70 percent of premiums as benefits. In the second decade, the payout was only 65 percent, a decline of 5.0 points (7.1 percent) in value to consumers for the typical insurance product.

In the late 1980s and early 1990s, Allstate's insurance products were of slightly greater value per premium dollar to consumers than those of other insurers. However, the company's property-casualty products have become less valuable than the industry average in recent years. Allstate paid out 73 percent in the first decade and a startlingly low 59 percent in the second decade, a decline of 14 points (19.2 percent) in the value of Allstate's product to consumers. In other words, claims payouts have declined from 73 cents on the dollar to 59 cents on the dollar (a 19.2 percent reduction in benefits to consumers per dollar of premium.) The most significant decline in policy value occurred after Allstate became a fully public company in 1995.

What caused this drop in efficiency by Allstate and the insurance industry overall? There are three possible reasons: a reduction in investment income requiring Allstate to charge higher rates relative to benefits to make up for lost income; an increase in overhead expenses, or an increase in profits.

CFA evaluated the drop in benefits relative to premiums to see how much of it could be attributed to a decline in investment income. Over the time frame studied, there was a three-percentage point drop in investment income that insurers earned on property-casualty insurance products. Since insurers typically reflect only about half of the investment income they earn in the rates that are charged, we believe that the drop in investment income accounts for only 1.5 points of the decline in the benefit-to-cost ratio from 1987 to 2006[31]. That is, a reduction in investment income explains less than one-tenth of the drop in benefit payouts to consumers per dollar of insurance premium during this period. For Allstate, a reduction in investment income accounted for less than five percent of the drop in benefits per premium dollar paid by Allstate consumers.

In 1987, the expenses of property-casualty insurers were 33.5 percent (13.3 percent for claims adjustment and 20.2 percent for underwriting.)[32] In 2006, expenses had risen to 39.0 percent (12.1 percent adjustment, 26.8 percent underwriting.)[33]

In 1987, Allstate's expenses represented 34.1 percent of premiums (10.5 percent for loss adjustment and 23.6 percent for underwriting overhead.)[34] In 2006, these costs were 37.5 percent (11.7 percent for loss adjustment and 25.8 percent for underwriting.)[35]

The less efficient expense results, which are somewhat surprising as technology has led to the replacement of some workers and should have lowered costs, accounted for about 3 percent of the drop in benefit to cost efficiency for Allstate and about 5 percent for the property-casualty industry generally.

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31 For a fuller discussion of this factor see: http://www.consumerfed.org/pdfs/2007Insurance_White_Paper.pdf
32 Aggregates and Averages, A. M. Best and Co., 1996 edition.
33 *P/C Industry Reports Record-Setting Underwriting Profit for 2006*, A. M. Best and Co., April 23, 2007.
34 Aggregates and Averages, A. M. Best and Co., 1988 edition.
35 *Best Rating and Report Updates* for Allstate Insurance Group, A. M. Best and Co., 3/23/07.

Allstate's profit was consistently higher than that of the overall industry during this period, averaging about 6 percent more.[36] Allstate's current return on equity (ROE) of 25.8 percent is also significantly higher than its returns in the late 1980s.

An estimate of the impact of profits on consumer value is made in the following table, which shows results for all property-casualty lines combined:

YEAR(S)	ALLSTATE'S LOSS RATIO	P/C INDUSTRY'S LOSS RATIO
1987	71%	71%
2006	48%	53%
CHANGE	-23%	-18%
1987-1996	73%	70%
1997-2006	59%	65%
CHANGE	-14%	-5%
CONTRIBUTIONS TO CHANGE		
IN. INCOME	1.5%	1.5%
EXPENSES	3.4%	5.5%
PROFIT IMPACT ESTIMATE (Change less investment income and expense contributions)		
Endpoint (1987 to 2006)	18.1%	11.0%
Decade to decade (87-96 to 97-06)	9%	-2%

This table indicates that, comparing long-term trends, the impact of profits on the declining consumer value of insurance policies was insignificant for the property-casualty industry as a whole, although it was significant at the end points of 1987 and 2006. For Allstate, however, the impact of profits on declining consumer value was very significant in both cases.

The conclusion we draw from this data is that Allstate charges too much relative to the claims it pays to consumers. Moreover, it is important to note that Allstate's insurance products have become much less valuable to consumers (in relation to costs) at the same time as Allstate's

[36] Allstate ROE data from 1999 through 2006, "Compustat Company Research" Standard and Poor's, May 21, 2007. Industry ROE data from 1999 to 2006 from "Property/Casualty Insurance in a Post-Katrina World," Insurance Information Institute, May 9, 2007.

value to shareholders has increased markedly, as we demonstrate in the section on shareholder results below.

An obvious question that arises from this analysis is that, if personal auto insurance and homeowners' insurance markets are competitive, as insurers often claim, how can a major national insurer charge excessive rates and reap unjustifiably high profits over an extended period of time? In a truly competitive market, insurers would compete at least in part on the basis of price. A company that charges excessive prices and realizes unreasonably high profits should find itself losing business to companies willing to charge less.[37]

The reason for this illogical market behavior is that competition for personal lines of insurance is not sufficiently robust to force insurers to eliminate excessive pricing. The failure of competition to discipline insurance prices and profitability arises from a few factors. First, insurers are legally allowed to collude to coordinate pricing. Insurers are exempt from antitrust laws and are permitted to participate in "advisory organizations," which calculate industry-wide loss costs (estimates of future losses) that member insurers can use to set rates.[38] Since loss costs are the major component of the premiums that insurers charge, collective decision-making through advisory organizations discourages price competition.

The use of credit scoring to set premiums has also impeded competition because it has increased the complexity of pricing and limited the ability of consumers to compare rates. Insurers claim that credit scoring is revenue neutral, meaning that it is simply a tool for more accurately charging premiums to classes of consumers based on their risk. However, as the use of insurance scoring has become almost universal for auto and homeowners policies, insurer loss ratios have declined, indicating greater profitability instead of revenue neutrality as tiers and other complexities makes shopping for price more difficult.

Another reason for the lack of true competition in this market is the very small percentage of consumers who change their insurance companies each year: less than 10 percent for virtually all insurers and less than 5 percent for many. Few consumers enjoy shopping for auto and homeowners' insurance. As insurers raised prices and cutback coverage in many regions in recent years, many policyholders have been advised not to file any but the most serious claims to avoid rate hikes and policy cancellation and have come to fear giving up existing coverage because they might not be able to obtain new coverage. These factors mean that a key characteristic of competitive markets, the ability of consumers to select among different sellers and products, has become more limited. (See Appendix 1 for a detailed list of reasons why consumer difficulty in buying insurance causes inertia in the insurance market and sharply impedes competition.)

Consumers are most aware of the amount of money they spend on insurance at two points in time: when they pay their premiums and when (and if) they have a claim. Since a small

[37] Another example of this disturbing effect is the experience of Progressive, another insurer that has been gaining market share despite offering low payouts as a percentage of premium over a long period of time.

[38] For a more complete discussion of the antitrust exemption that insurers enjoy, see "The McCarran-Ferguson Act: Implications of Repealing the Insurers' Antitrust Exemption," Testimony of J. Robert Hunter before the Committee on the Judiciary of the United States Senate, June 2006. (See http://www.consumerfed.org/pdfs/Antitrust_Senate_McCarran_Repeal_Testimony_2007_030707.pdf)

percentage of consumers file claims, the vast majority of consumers are most aware of their insurance costs if there is a major premium increase. This was the case when credit scoring was being introduced at the turn of the century, because many consumers received sharp premium increases and insurance departments received thousands of complaints about rate increases and credit scoring. Absent a big rate increase for many consumers, which is not likely to occur in the personal auto insurance market because claim costs have consistently declined in recent years, it is unlikely that enough consumers will be motivated to shop for insurance to discipline insurers on price. This inertia in the market is what Allstate appears to be relying upon when it tells investors that it need not lower prices as other insurers are currently doing to maintain market share.[39]

Excessive rates, unjustifiable profits and excess capital (see section below for explanation of Allstate's remarkable stock buybacks of $13.7 billion in recent years) provide strong evidence of the absence of competition in this market. Companies like Allstate and Progressive, which have had among the lowest loss ratios and the highest profitability in the industry have been able to use excess capital, created through excess retained earnings, to increase their market share <u>and</u> have enough left over to buy back huge amounts of company stock with their excessive capital accumulations. This strategy uses capital to give back to shareholders instead of being used to support the insurance business and benefit consumers through lower premium charges.

MEASURE #2: AVAILABILITY
ALLSTATE IS A FAIR WEATHER FRIEND FOR MANY POLICYHOLDERS

In twenty-first century America, insurance is a necessity, not a luxury. Lenders require that their collateral (homes and autos) be covered by insurance. States require drivers to purchase auto insurance. Thus, it is important to the nation that insurance is broadly and affordably available in the same way as other utilities must be available. However, insurance has become scarce in America's higher risk areas, necessitating the creation of state insurance pools to fill the void.[40]

Allstate has been the leader in the property-casualty insurance industry in seeking extremely low-risk insurance underwriting. This has been harmful to consumers generally and to Allstate's policyholders in particular. As the comparative data on shareholder results provided below indicates, neither Allstate nor any property-casualty insurance company has a business model that is financially risky. Yet Allstate is now engaged in a major program to further reduce even this low risk, at the expense of its customers and taxpayers. The *Insurance Journal* reported in May that, "Allstate Corp. CEO Thomas Wilson said at the insurer's annual meeting this week that the company's shift away from catastrophe-prone areas and into products other than homeowners insurance will take years to complete. The first-year chief executive said the number of homeowners policies the company writes will continue to shrink. . ."[41]

The "Allstate Property Catastrophe Management Strategy"[42] (APCMS) includes "limitations on new business writings, rate increases, changes to deductibles and coverage,

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[39] Bear Sterns Q2'07 Earnings Preview, May 23, 2007.
[40] Such as California's Earthquake Authority, Florida's Citizens Insurance company and pools in all of the hurricane-prone states. In some sates, the state pool has become the largest writer of the high-risk insurance.
[41] Allstate CEO: Shift to Less Risky Business Will Take Years to do," *Insurance Journal*, May 17, 2007.
[42] See http://media.allstate.com/categories/6/releases/4079.

changes to underwriting requirements and no longer offering policy renewals in certain markets." Allstate explains that it has to take these steps because ". . .we cannot effectively insure what we cannot predict." Allstate does not explain why they were able to insure these people (while earning very high profits) before they were dropped but it does state, ". . .as a publicly traded company, we are responsible to our shareholders."[43]

The lack of responsibility toward policyholders is evident in recent actions by Allstate. Allstate's APMCS has already led to the non-renewal of hundreds of thousands of homeowners that Allstate voluntarily insured in years past:

- 30,000 homes on Long Island and New York City;
- 40,000 Washington State earthquake policies;
- 120,000 Florida homes;
- Up to 100,000 homes in Texas, and
- Over 400,000 earthquake policies nationally. [44]

At 2.6 people per household,[45] these figures represent almost 2 million Americans who have been told by the insurer they trusted and paid well to take care of them that they would no longer be insured. Some of these homeowners had to deal with two serious blows. First, their homes were damaged by a storm and then Allstate informed them that they would no longer have coverage.[46] This abandonment of policyholders who trusted Allstate occurred at the very worst time, when other insurance companies were reluctant to take new business because of the recent hurricane experiences. CFA has heard many horror stories from Allstate customers that have been dropped in Florida only to have to go the state insurer-of-last-resort, Citizens Insurance Company, at prices thousands of dollars higher than they were previously paying.

Allstate's new coverage plans involve much more than non-renewing policies in some coastal areas. It has also stopped writing home insurance in entire states that Allstate believes are hurricane or earthquake-prone, including Delaware, Connecticut,[47] and California,[48] as well as along the coasts of many states, including Maryland and Virginia.

According to the *New Orleans Times Picayune,* in Louisiana, Allstate is using "…an apparent loophole in the state consumer protection laws" that limits protection from non-renewal for "new" customers. The law forbids non-renewing a policy after three years. Allstate apparently tried to get around this protection by offering its policyholders a coverage enhancement. Allstate "ended the wind and hail coverage of a decades-long policyholder after

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43 Ibid.

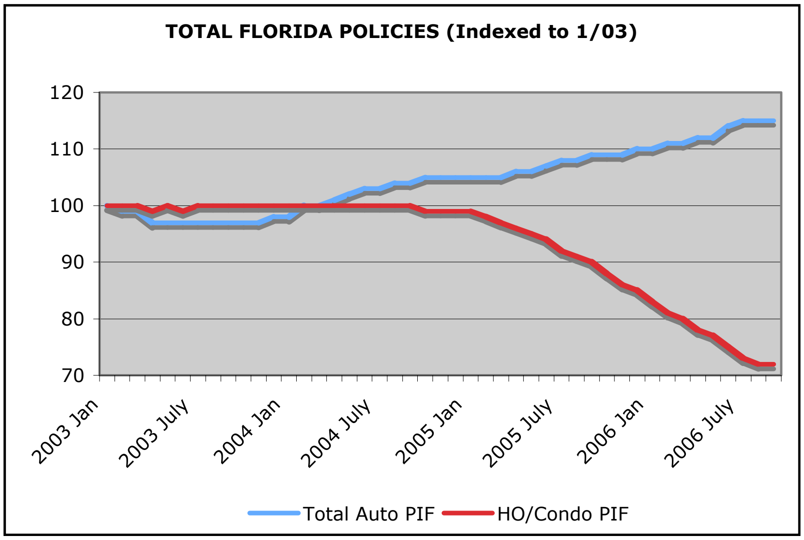
44 *Los Angeles Times*, "Insurers Learn to Pinpoint Risks – and Avoid Them," November 28, 2006.

45 *State and County Quick Facts*, U. S. Census Bureau at http://quickfacts.census.gov.

46 Allstate seems concerned that their agents keep some market for people being dropped or without ability to buy Allstate property insurance policies. So they have provided to their former customers a document called, "Alternate Carrier Options for Allstate Customers." Allstate says in this document that it is "actively working to make additional third-party insurers available through Allstate agents. . ."

47 *Los Angeles Times*, "Insurers Learn to Pinpoint Risks – and Avoid Them," November 28, 2006.

48 California Department of Insurance Press Release, May 23, 2007. One of Allstate's affiliates, Deerbrook Auto Insurance has announced it is pulling out of the California market. (See http://www.insurancejournal.com/news.west/2007/06/28/81199.htm.)



the man expanded his coverage at the company's urging. Allstate argued that the change had in fact produced a new policy that wasn't covered by the consumer protection law."[49]

On November 17, 2006, Allstate's then CEO, Edward M. Liddy, presented statistics to investors revealing the result of their strategy to shed policyholder risk. In a chart showing policy growth indexed to January 2003, Liddy gave investors the good news that the number of Florida automobile policies in force had grown by 15 percent through September 2006, while the number of homeowners' and condominium owners' policies in force had dropped to just over 70 percent of the January 2003 total. The chart reveals that the big drop in homeowners' insurance policies took place starting in 2005.[50]

In 2005 and the first half of 2006, Allstate abandoned thousands of Floridians it had insured, dropping about thirty percent of its book of business in that short period of time.[51] Yet, they actually increased their market share for automobile insurance in Florida during 2006.[52] This occurred despite the fact that Allstate had acted in similar fashion after Hurricane Andrew over a decade earlier. Repeating these unjustified actions toward its own customers is proof that Allstate either mismanaged the transition after the earlier storm or is dropping customers in order to frighten politicians and regulators around the country into granting Allstate the price increases, coverage cutbacks and taxpayer subsidies that Allstate is demanding.

Other insurance companies have taken steps to limit new policies that are written in some coastal areas, but few, if any, have non-renewed longstanding policyholders in anywhere near the large numbers that Allstate has and no insurer has stopped writing new home insurance business in entire states as Allstate has in such states as California, Connecticut and Delaware.

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[49] "Editorial: Be Prudent on Insurance," *Times Picayune*, May 20, 2007. Also see articles "Allstate Defies La. Insurance Chief," *Times Picayune*, March 9, 2007 and "Allstate Finds Way Around State Rule," *Times Picayune*, April 25, 2007.

[50] PowerPoint Presentation of Edward M. Liddy to the Credit Suisse Insurance Conference, November 17, 2006, Slide 16.

[51] Allstate's non-renewal effort at this time appears to have been more severe than the actions taken by other leading insurers.

[52] Bear Sterns June 21, 2007 Report on "Meetings with Management" of Allstate, shows that market share in auto insurance rose from 12.8 percent to 13.0 percent from 2005 to 2006. However, Bear Sterns warned that the reason may be linked to clever selection by Allstate of which homeowner policyholders to non-renew to keep auto growing: "Our one remaining concern is that the initial non-renewed customers were primarily mono-line homeowners, while the next batch of non-renewals will have both auto and home policies." Consumers are not used to being looked at as a batch, but that apparently is how Allstate and the investment community view them.

These actions cause prices to rise as consumers are less likely to shop for insurance when they know that insurers are dropping customers. It also limits supply to an insurance market with inelastic demand (the demand is inelastic because lenders require homeowners insurance). It also causes growth in state residual markets, such as Citizens Insurance Company in Florida and the California Earthquake Authority, making it more likely in the future that taxpayers will be called on to subsidize these entities as the government created mechanisms gain market share.

MEASURE #3: QUALITY OF COVERAGE
INSURERS HAVE SHARPLY REDUCED COVERAGE OFFERED TO CONSUMERS

Allstate has not only cut back on the number of consumers receiving coverage in coastal areas. Like most other insurance companies, Allstate has also sharply reduced the amount of coverage offered to homeowners in high-risk areas in recent years. The introduction of higher two to five percent of home value deductibles and other coverage limits, such as caps on replacement costs, the exclusion or limitation of coverage for mold-related losses, the introduction of limits on payments for hail damage to roofs and the removal of automatic coverage for bringing a severely damaged home up to code has transferred a significant amount of the risk back to policyholders. Allstate's coverage cutbacks do not appear to be demonstrably different than those imposed by most property-casualty insurers.[53]

Allstate, like several other insurers, has included a provision in some homeowners' policies that appears to have deceived some policyholders into thinking they had coverage for wind damage when that might not have been the case. This "anti-concurrent-causation" (ACC) clause stated that wind and rain damage that the policy was supposed to cover would be excluded if significant flood damage occurred, even if flooding occurred well after hurricane winds caused damage. This provision is intellectually ambiguous and is blatantly anti-consumer even if written clearly. Fortunately for consumers everywhere, a Federal District Court Judge in Mississippi ruled that the use of the clause was not legal.

> …these two exclusions are ambiguous in light of the other policy provisions granting coverage for wind and rain damage and in light of the inclusion of a 'hurricane deductible' as part of the policy. To the extent that plaintiffs can prove their allegations that the hurricane winds (or objects driven by those winds) and rains entering the insured premises through openings caused by the hurricane winds proximately caused damage to their insured property, those losses will be covered under the policy, and this will be the case even if flood damage, which is not covered, subsequently occurred. [54]

MEASURE #4: CONSUMER SATISFACTION
COMPLAINTS ABOUT ALLSTATE ARE AMONG THE HIGHEST OF INDUSTRY LEADERS

One measure that is useful in evaluating consumer satisfaction with their insurer is complaint ratios. Consumers sometimes become so upset with an insurer that they complain to a

[53] Allstate is imposing a statewide mandatory five percent deductible on homes in all of Louisiana. See "Allstate Requires 5% Deductible*, Times Picayune*, June 15, 2007.

[54] Memorandum Opinion of L. T. Senter, Jr., Senior Judge, United States District Court, Southern District of Mississippi, Southern Division, in the Case of Buente v. Allstate, March 24, 2006.

state insurance department about the problem. The National Association of Insurance Commissioners compiles complaint information from all the states in the "Consumer Information Source" section of its website (www.naic.org).[55] In order to determine how Allstate compares to other insurers in providing consumer satisfaction, we compared complaint ratio rankings for insurers that sold more than $1 billion in premiums in 2005, which includes thirteen companies that offer personal auto coverage and eight companies that sold homeowners' insurance. The complaints were on a wide variety of topics, including claims settlement practices, pricing, and discrimination. The results are below. The lower the number listed for a particular company, the fewer the complaints NAIC received relative to complaints received for other companies.

AUTO INSURERS WITH PREMIUM WRITINGS OF OVER $1 BILLION

INSURER	COMPLAINT RATIO 2OO5	2006
Allstate	1.16	1.00
American Family	0.86	0.88
Erie Ins Exchange	0.75	0.81
Farmers	1.01	1.00
GEICO Ind.	0.84	0.89
Gov't Employees	0.89	0.75
Inter Ins Exchange	0.52	0.35
Liberty Mutual	3.98	2.38
Metropolitan	1.14	0.91
Nationwide	0.91	0.96
Progressive	0.5	0.34
State Farm	0.4	0.38
USAA	0.74	0.64

HOME INSURERS WITH PREMIUM WRITINGS OF OVER $1 BILLION

INSURER	COMPLAINT RATIO 2OO5	2006
Allstate	0.91	0.86
American Family	0.55	0.51
Farmers	1.05	0.76
Federal	0.10	0.11
Nationwide	0.53	0.54
State Farm F&C	0.31	0.31

55 Site visited on May 24, 2007. The consumer complaint information is compared to the volume of business written by the insurer to adjust for the size of the insurer so that mere size is removed from the ratios. Unfortunately, the NAIC compares these ratios to a median level of complaints rather than the average, which produces a distorted sort of grade inflation where most large insurers look better than the median. For this reason, we opted to compare Allstate Insurance Company's complaint ratios to those of leading competitors.

State Farm General	0.38	0.24
United Services	0.17	0.14

In auto insurance in 2005, the best ranking insurer of the 13 insurers with premiums over $1 billion was State Farm, the nation's largest insurer for auto and home. Allstate's complaint ratio ranked next-to-last, ahead of Liberty Mutual. In 2006, Progressive was the top-ranked insurer on complaints, with Liberty Mutual again the worst. Allstate was tied with Farmers for the next-to-worst complaint ratio.

In homeowners insurance in 2005, Federal Insurance had the best complaint ratio of the eight insurers with premiums over $1 billion and Farmers the worst. Allstate was next-to-worst. In 2006, Federal Insurance again was the best and Allstate had the worst result among the eight leading writers with premiums greater than $1 billion.

The latest annual consumer satisfaction rankings of major insurers by the research firm J.D. Powers found Allstate to be only average in both auto and homeowners insurance rankings. For auto insurance, Powers found "Amica ranks highest in consumer satisfaction for a seventh consecutive year. Erie, State Farm, and GEICO follow Amica in the rankings, respectively. American Family and the Automobile Club of Southern California rank fifth in a tie. USAA receives a higher overall score than Amica, but is not included in the rankings because it is only open to U.S. military personnel and their families."[56]

For homeowners insurance, Powers found "Amica ranks highest in consumer satisfaction for a fifth consecutive year. Amica leads the industry in all five factors contributing to overall consumer satisfaction: policy offerings, price, billing and payment, interaction and claims. . . Erie, State Farm, Automobile Club of Southern California and American Family follow Amica in the ranking, respectively. USAA achieves a higher overall score than Amica, but is not included in the rankings because it is only open to the U.S. military community, and their families."[57]

These complaint and consumer satisfaction comparisons show that Allstate's business practices generate more consumer complaints than other large insurance companies in its size class and fail to satisfy its customers as well as most other leading insurance companies in America.[58]

MEASURE #5: CLAIMS HANDLING
ALLSTATE HAS BEEN AN INDUSTRY "LEADER" IN DEVELOPING ANTI-CONSUMER CLAIMS PRACTICES

In 1992, Allstate adopted the "Claims Core Process Redesign" (CCPR) system recommended by McKinsey & Company. As explained in the book "From 'Good Hands' to

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[56] "Amica Mutual Ranks Highest in Auto Insurance consumer Satisfaction for a Seventh Consecutive Year," press release from J. D. Powers and Associates, August 29, 2006.

[57] "Amica Mutual Ranks Highest in Home Insurance Consumer Satisfaction for a Fifth Consecutive Year," press release from J. D. Powers and Associates, October 30, 2006.

[58] Allstate's claims practices led the NAIC complaint list of complaints against the insurer, with "unsatisfactory settlement/offer" leading the list of most frequent complaint, followed by "delay" in claim processing, "denial of claim" and "other" claim problem.

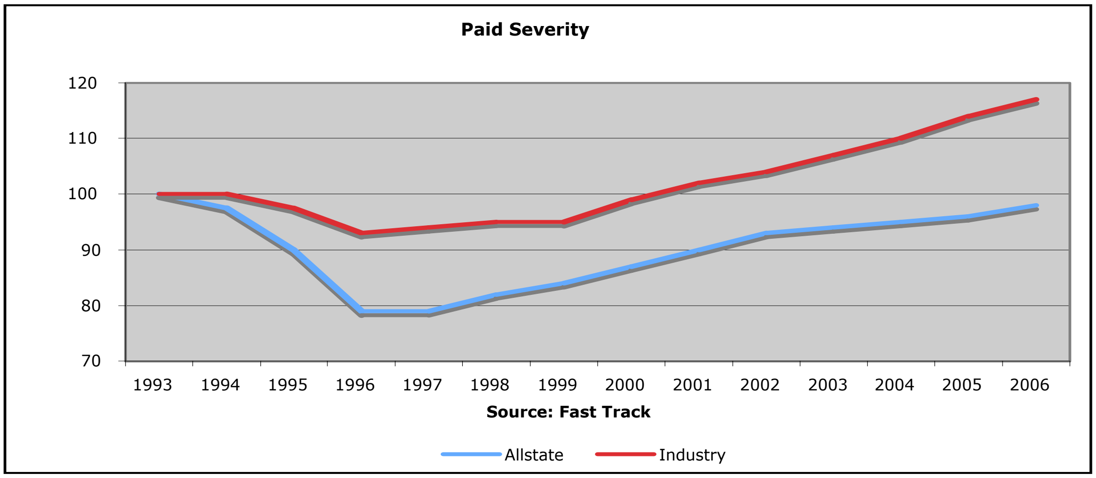
Boxing Gloves,"[59] the CCPR was intended to "radically alter our whole approach to the business of claims.[60]" McKinsey saw the CCPR as a "Zero Sum Game." "Using Zero Sum Game theory, McKinsey converted Allstate's claim processes into an institutionalized competition called a "Zero Sum Economic Game," which pitted Allstate and its shareholders against its policyholders for a share of the claim fund."[61] A McKinsey slide introducing CCPR to Allstate identifies the winners and losers starkly, "Improving Allstate's casualty economics will have a negative economic impact on some medical providers, plaintiff attorneys, and claimants…Allstate gains, others must lose."[62]

As the key element of CCPR, Allstate uses a program known as "Colossus," sold by Computer Sciences Corporation (CSC.) CSC sales literature touted Colossus[63] as "the most powerful cost savings tool" and also suggested that, "the program will immediately reduce the size of bodily injury claims by up to 20 percent." As reported in the book *From 'Good Hands' to Boxing Gloves,* "…any insurer who buys a license to use Colossus is able to calibrate the amount of 'savings' it wants Colossus to generate. . .If Colossus does not generate sufficient 'savings' to meet the insurer's needs or goals, the insurer simply goes back and 'adjusts' the benchmark values until Colossus produces the desired results."[64]

Programs like Colossus are designed to systematically reduce payments to policyholders without adequately examining the validity of each individual claim. The use of these programs appears to sever the promise of good faith that insurers owe to their policyholders. Any increase in profits that results from arbitrarily selected reductions in claims payments cannot be considered to be legitimate. The introduction of these systems could explain part of the decline in benefits that policyholders have been receiving as a percentage of premiums paid in recent years by Allstate and later, to a lesser degree, by the insurance industry. Most, but not all, major insurance companies are now using Colossus. In most cases the purchase of the system was made by insurers following the marketing efforts of CSC, which promise significant savings in claims costs.

In an amazingly revealing slide[65] in Allstate CFO Hale's PowerPoint presentation, Mr. Hale shows bodily injury severity claims (the sort of claims Colossus is designed to reduce) indexed to 1993, the year in which CCPR began, so 1993 is listed as 100:

59 *From Good Hands to Boxing Gloves – How Allstate Changed Casualty Insurance in America*, Trial Guides, 2006, Berardinelli, Freeman and DeShaw.
60 Ibid. Slide 5166 of McKinsey as reported in the book.
61 Ibid, page 99.
62 Ibid, page 101.
63 Allstate is not the only large insurer to use Colossus. Computer Sciences Corporation claims that the majority of leading insurers use the product. However, several large insurers, apparently including State Farm, do not use Colossus.
64 *From Good Hands to Boxing Gloves – How Allstate Changed Casualty Insurance in America*, Trial Guides, 2006, Berardinelli, Freeman and DeShaw, pages 131, 133, 135.
65 May 16, 2007, Dan Hale, Chief Financial Officer of Allstate, presentation to the UBS 2007 Global Finance Services Conference (At Slide 6).



By 1996, Allstate's paid severity had dropped by 21 percent to 79. Since 1996, it has slowly gone back up to about 98. The rest of the industry also was indexed to 1993. The comparable figures for the industry were 94 in 1996 and 117 in 2006. In other words, CPPR apparently worked to drop Allstate's paid bodily injury severity by about 20 percent, as McKinsey/Colossus suggested it might, CCPR maintained Allstate's paid severity until 2006 at 16 points below the industry severity (98 versus 117.) Thus, Allstate appears to continue to exceed the industry in the use of this claims' reduction method.

It is very likely that Allstate is succeeding in keeping the consumer value of its policies lower than the industry generally, measured by loss ratio, because of this ability to underpay the industry. On average, Allstate's book of business is at least average (probably worse than average with its sub standard market share – that is its large share of higher risk auto insurance business) and, consequently, should be near the industry average for frequency and severity. How is it possible for Allstate to outperform the industry by 20 percent when they should be presented with industry average claims?

The same slide shows that, during the same 1993 to 2006 period, Allstate kept its homeowners insurance severity to an index of 240 compared with the industry's figure of 350, a 31 percent lower increase in payouts per claim than the industry achieved. We do not know if this is the result of the use of computerized or other CCPR-type systems.

Since Hurricane Katrina, Allstate has been involved in many claim disputes that have led to a significant number of lawsuits against Allstate in several states.[66] In one case, a jury found that Allstate improperly delayed a wind claim, contending that flooding caused it. A large award was granted. Allstate recently filed a Form 8-K with the Securities and Exchange Commission

[66] State Farm is also facing many lawsuits regarding claims practices in the wake of Hurricane Katrina, as is much of the insurance industry, particularly relating to wind/water issues and the use of anti-concurrent-causation clauses. A case could be made that State Farm's record after Katrina is even worse than Allstate's. In fact, both insurers have had demonstrably poor claims outcomes for their Katrina policyholders as evidenced by the number of lawsuits (See "Allstate. Scruggs Group Settle Mississippi Claims," National Underwriter, June 25, 2007 – mentions "hundreds" of Katrina homeowners effected by the settlement; "State Farm Strikes Deal to Settle Thousands of Mississippi Claims," National Underwriter, March 26, 2007 – the Judge later disapproved the settlement and legal battles continue)

indicating that it is the subject of a criminal investigation over its "handling of hurricane claims in Mississippi."[67]

V. AS ALLSTATE'S CONSUMERS LOSE, INVESTORS REAP UNUSUALLY HIGH RETURNS

On May 16, 2007, Dan Hale, Chief Financial Officer of Allstate, gave a presentation to the UBS 2007 Global Finance Services Conference.[68] In his remarks, Mr. Hale told the assembled investors that,

> Allstate went public in 1995 with a market cap of $12 billion. Through the end of last year we had returned $6.6 billion in dividends… repurchased about $13.7 billion in shares. . .and finished 2006 with a market cap of $40 billion. Our total return to shareholders over that time was 481 percent, 62 percent higher than the S&P 500. And… during that decade Allstate's total return beat both the S&P 500 and the S&P property/casualty index in each period measured. That's consistency. That's performance. That's a great investment. Through hurricanes and earthquakes. . .through the ups and downs of the economy and the stock market. . .through short-term changes in frequency figures or competitors' pricing plans. . .Allstate has demonstrated that its policyholders and shareholders are in very good hands. And we intend to keep it that way.

Allstate is very proud indeed of the returns it has provided to shareholders. In 2006, the CFO said, Allstate's "operating income return on equity was 25.8 percent" and in the first quarter of 2007 the return was 24.3 percent. How did they achieve these results? In his remarks, Hale pointed to several methods:

- In the last 11 years, Allstate bought back 372 million shares at a cost of $13.7 billion.[69]
- Allstate raised dividends at an average of 11.7 percent annually."[70]
- Allstate took ". . .necessary actions to reduce our exposure in certain catastrophe prone areas where there is an unfavorable risk-return tradeoff. Wherever possible, we've worked to provide alternative coverage for affected policyholders."
- Allstate filed more that 350 rate increase requests with states in 2006 and plans to file about 300 more this year.
- "More than a decade ago we redesigned our claims processes from top to bottom. The result was a significant gap between Allstate and the industry when it comes to bodily injury, auto property damage and comprehensive severity. That gap continues to this

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[67] *National Underwriter Online News*, May 21, 2007.

[68] The speech and the PowerPoint slides that accompany it are available on Allstate's web site, www.allstate.com, where CFA downloaded in on May 20, 2007.

[69] The buybacks continue. Consider this statement from an e mail from investment firm Bear Sterns to clients on June 27, 2007,"This afternoon Allstate announced a $500 million accelerated share repurchase (ASR) as part of their current $4 billion share repurchase authorization." Bear Sterns pointed out that in analyzing stock performance after announcement of an ASR, ". . .shares outperformed the S&P 500 and Russell 3000 indexes by 8.2% and 7.4%, respectively in the subsequent year."

[70] Ibid.

day." The accompanying slide (number 6, discussed above) showed a drop of 20 percent over the 1993 to 1996 period.[71]

- "…pricing is now integrated with local marketing and distribution strategies – state by state and, in some cases, market by market. . .Our most recent rollout, for example, increased initial rating tiers from seven to as many as 384… better segmentation, going to 384 tiers was a real leap forward. But we believe that pricing may one day be so sophisticated that tiers are eliminated altogether. Instead, we'll be able to input specific customer information and generate an accurate, competitive rate for that customer alone. Truly personal pricing."

Allstate's net income in the last five years is as follows:

Year	Post-tax Net Income (billions)	
2002	$1.1	
2003	$2.7	
2004	$3.2	(2004: four hurricanes in Florida.)
2005	$1.8	(2005: Hurricane Katrina and other hurricanes.)[72]
2006	$5.0	

This translates into handsome rates of return on equity:

Year	Allstate[73]	P/C Industry[74]	Fortune 1000[75]
2002	13.7%	2.2%	10.0%
2003	16.5	8.9	12.6
2004	17.0	9.4	13.9

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[71] A discussion of the consumer implications of this sudden, planned drop in claims payouts is found in the section on claims handling practices above.

[72] Remarkably, Allstate reported a positive return on equity of 9.0 percent for the third quarter of 2005, the quarter that Katrina hit the Gulf Coast. Its October 19, 2005 press release included this highlight table:

Consolidated Highlights - Three Months Ended September 30, (in millions, except per share amounts and ratios)

	Est. 2005	2004	Change
Consolidated revenues	$8,942	$8,442	$500
Net (loss) income	(1,548)	56	$(1,604)
Net (loss) income per diluted share	(2.36)	0.09	$(2.45)
Operating (loss) income	(1,650)	49	$(1,699)
Operating (loss) income per diluted share	(2.52)	0.08	$(2.60)
Property-Liability combined ratio	149.6	110.5	39.1 pts.
Effect of catastrophes on combined ratio	69.4	26.0	43.4 pts.
Effect of catastrophes on Net (loss) income per diluted share	(4.67)	(1.59)	$3.08
Book value per diluted share	29.66	30.33	$(0.67)
Return on equity	9.2	13.9	(4.7) pts.
Operating income return on equity	9.0	16.5	(7.5) pts.

[73] Allstate earnings press releases 2/4/04, 2/2/05, 1/31/06 and 1/30/07 from Allstate web site.

[74] "Property/Casualty Insurance in a Post-Katrina World," Insurance Information Institute, May 9, 2007.

[75] Ibid.

2005	8.6	10.5	14.9
2006	25.8	14.0	15.0
Average	16.3%	9.0%	13.3%

In its "2007 Notice of Annual Meeting/Proxy Statement/2006 Annual Report," Allstate states that Allstate's stock value rose by 115.66 percent through 2006, whereas the stock value of all property-casualty insurers rose by 60.58 percent.[76] During the same period, the Standard & Poor's 500 index increased by 35.43 percent.

Best's rates Allstate's overall capitalization as "superior," its underwriting leverage as "modestly above average gross and net underwriting leverage," its reserve quality as "modestly favorable" in recent years after being unfavorable historically, its leverage as approximately the same as the industry composite and balance sheet liquidity as "sound."[77]

These data show that Allstate's returns are higher than its insurance industry peers and much higher than that of the broader American economy. The question is, does the financial risk incurred by Allstate, as well as its pricing, claims and service practices, justify these high profits? The following analysis explains why the answer to this key question is "no."

The common wisdom frequently articulated by the insurance industry is that insurers need high profits to cover losses in a very risky sector of the economy. Insurers also claim that their shareholders should receive greater returns given the investment risk they assume. For example, the Insurance Information Institute says that, "considering the tremendous risk assumed by investors who back major insurance and reinsurance companies, the returns in most years are woefully inadequate," complaining that insurers in 2006 will just about match the 15 percent return on equity of the Fortune 500 "for just the second time in many years."[78] In fact, primary insurers have succeeded in eliminating or shifting a great deal of their risk. Allstate has been even more successful at lowering risk than the rest of the property-casualty insurance industry generally.

If one owns property-casualty insurance company stock, one has, with few exceptions, bought into a low-risk business, lower in risk than the market in general. This is shown in ValueLine statistics, which assess the riskiness of particular stocks. One key measure is the stock's Beta, which measures the volatility of a stock's price in relation to overall stock market volatility as measured by a market index, such as the Standard and Poor's 500. A beta between 0 and 1 represents a low-volatility investment, such as most regulated utility stocks. A Beta equal to 1 matches the overall index, such as the S&P 500. A Beta greater than 1 is more volatile than average, such as most "small cap" funds.

Another measure of shareholder risk is the Financial Safety Index, with a range of 1 to 5, 1 being safest and 5 being least safe; 3 is an average risk. A third measure is the Stock Price Stability assessment, reported in five percentile intervals with 5 signifying the lowest stability and 100 the highest stability. 50 is average stability.

[76] Indexed to the beginning of 2002.
[77] *Best's Rating and Report Updates for Allstate Insurance Group*, March 23, 2007 edition.
[78] Earlybird Forecast 2007, Insurance Information Institute, December 21, 2006.

ValueLine posts results for 27 property-casualty insurers.[79] The simple averages for these carriers are: Beta = 0.95, Financial Safety = 2.4, and Stock Price Stability = 83.

By all three measures, property-casualty insurance stocks have below-average risk, safer than buying an S&P 500 stock index fund. Therefore, long-term below-average returns for insurers should be expected given the low-risk nature of this investment. The slightly below average returns of the property-casualty industry has received over time demonstrate that capital markets are performing efficiently by awarding below-average returns to a below-average risk industry.

Now consider Allstate. The Allstate CFO knows what he is talking about when he tells investors about what a great investment Allstate is. Allstate has provided huge returns to investors at very low risk: Beta = 0.90, Financial Safety = 1, and Stock Price Stability = 95.[80] Allstate is a lower risk investment than the property-casualty industry generally and the overall market, but it produces higher returns for shareholders. Moreover, Allstate continues to shed risk as it abandons many policyholders in hurricane and earthquake prone areas of America.

VI. ALLSTATE AND OTHER INSURERS SUCCEED IN SHIFTING SIGNIFICANT RISK TO TAXPAYERS

Insurers have become quite adept at convincing government to use tax dollars or create other mechanisms to help them avoid risk. Prominent examples of this are the federal Terrorism Risk Insurance Act (TRIA), the National Flood Insurance Program (NFIP), the California Earthquake Authority (CEA), the Citizen's Insurance Company in Florida, Citizen's Insurance in Louisiana and wind "pools" in a number of other states. State pools have become the largest writers of insurance in some states. Such an arrangement allows insurers to "cherry-pick" in these states, keeping the safest risks for themselves and shifting the highest risks onto the taxpayers of the state, thereby socializing high-risk, potentially unprofitable policies and privatizing the low risk, profitable business. This adverse result for both policyholders and taxpayers is hardly surprising. It is like trying to "solve" the health insurance crisis by requiring states to cover the sick or terminally ill, while the private sector writes coverage only for young and healthy consumers.

In addition to being one of the prime industry leaders in using coverage exclusions, price increases and non-renewals to shift risk to policyholders over the last decade, Allstate has been the leader in promoting direct federal financial assistance for natural catastrophe insurance for the industry. Allstate created and is a primary funding source for Protecting America, an organization that has advocated the creation of a federal catastrophe reinsurance program, in which taxpayers could directly subsidize insurers for certain losses.[81] Based on its past actions,

[79] ValueLine, March 23, 2007. The stocks are ACE Ltd., Alleghany Corp., Allstate Corp., American Financial Group, W.R. Berkley Corp., Berkshire Hathaway, Inc., CNA Financial, Chubb Corp., Cincinnati Financial, Erie, Everest Re Group, HCC Insurance, Hanover Insurance Group, Markel Corp., Mercury General, Ohio Casualty Corp., Old Republic International Corp., PMI Group, Inc., Partner Re, Ltd., Progressive Corp., RLI Corp., Safeco Corp., St. Paul/Travelers Group, Selective Insurance, Transatlantic Holdings, 21st Century Insurance Group and XL Group, Ltd.

[80] ValueLine, March 23, 2007 edition.

[81] Protecting America seeks "Catastrophe funds, at both the federal and state levels, would provide the backstop necessary for companies to insure against hurricanes and earthquakes in a financially responsible manner that

one might conclude that Allstate is promoting this approach, at least in part, because it will facilitate their reduction of policies in coastal and earthquake markets without generating as much outrage from consumers and lawmakers.

Taxpayers may also have to deal with problems generated by the involvement of Allstate and other insurers in the National Flood Insurance Program (NFIP) in the wake of Hurricane Katrina. The NFIP hires "Write Your Own" (WYO) insurance companies to sell and service flood insurance on its behalf. The federal government bears 100 percent of the financial risk and compensates the insurance companies quite handsomely for their service as WYO flood insurance contractors.

Allstate and other WYO insurers sell wind policies to homeowners in many of the same areas in which they sell flood insurance. However, having the same insurance company adjust both a wind claim and a flood claim is a serious potential conflict-of-interest. Every dollar that is determined to be wind damage comes out of the insurer's pocket but every dollar of flood damage reimbursement comes out of the federal taxpayer's pocket. (The NFIP has a deficit so losses and costs in excess of NFIP premiums are borne by taxpayers.)

Exacerbating the potential conflict is the fact that WYO insurers are paid a fee based on the value of flood claims paid out to policyholders. The fees, effective for claims paid September 1, 2004 and later, rise as the amount paid out for flood claims rises:

Claim Range (Gross claim)	Fee
Erroneous Assignment	$60.00
Closed Without Payment (CWOP)	225.00
.01 - $1,000.00	300.00
1,000.01 – 2,500.00	425.00
2,500.01 – 5,000.00	500.00
5,000.01 – 7,500.00	575.00
7,500.01 – 10,000.00	650.00
10,000.01 – 15,000.00	750.00
15,000.01 – 25,000.00	850.00
25,000.01 – 35,000.00	1,000.00
35,000.01 – 50,000.00	1,250.00
50,000.01 – 100,000.00	3%
100,000.01 – 250,000.00	2.3%, but not less than $3,000
250,000.01 and up	2.1%, but not less than $5,750

doesn't threaten their solvency or their ability to protect their customers from other potential losses. It has the potential to help stabilize markets following a catastrophe, prevent insurance availability problems and reduce insurance costs for consumers." (At http://www.protectingamerica.org/?SecID=5) Allstate's web site puts it this way, "Recent hurricane seasons have caused unprecedented damage and impacted millions of Americans throughout the Gulf Coast and Florida. In addition, earthquakes pose an enormous threat. In the United States about 5,000 quakes can be felt each year. America needs to be better prepared. Preparing and protecting America from catastrophe is larger than Allstate and even larger than the insurance industry. That's why Allstate is supporting a coalition called ProtectingAmerica.org." (See http://www.allstate.com/about/advoc-ad-campaign.aspx)

The temptation for insurers to determine greater flood damage than is justified -- and less wind damage-- is great. A flood claim is not paid by the insurer and the insurer gets a fee for finding that the damage is flood rather than wind-related, a fee that grows as the flood claim grows.

As a consequence, there have been many claims of insurers servicing the flood insurance program attempting to underpay for wind damage and overpay for flood damage. In one Allstate case, Weiss v Allstate[82], the jury found that Allstate had said that a claim was flood when it was wind. There are still many unresolved cases against many insurers regarding the question of wind versus flood coverage.

Further, the *New Orleans Times Picayune* reports that Allstate appears to have shifted costs to the NFIP by charging it more to replace the same materials than it charged itself.

> Allstate seemed to have two different ways of pricing the damage repair costs…If Allstate attributed the damage to wind or rain, for example – putting it (Allstate) on the hook for payment under the customer's homeowner policy – the company priced the cost of removing and replacing the drywall at 76 cents per square foot, but if the damage was blamed on storm surge or flooding, the estimated cost of removing and replacing the drywall more than quadrupled, to $3.31 per square foot. Other similar high charges for water claims and low charges for wind were made for other materials required for the repair.[83]

According to the adjusters interviewed by the *Times Picayune*, Allstate was the only insurer doing this in Louisiana.[84] It is clearly troubling to consider that an insurer might overcharge taxpayers for building materials. This practice is even more troubling because it increases the fee taxpayers will give to Allstate for handling flood claims adjustments.

VII. CONCLUSION

Allstate has increasingly engaged in anti-consumer and anti-taxpayer behavior that has, unfortunately, been emulated by many other insurance companies. These practices include:

- The value of Allstate's insurance policies to consumers has dropped sharply over the last two decades as it has paid out significantly less for each premium dollar it has taken in.

- For the second time in fifteen years, Allstate has dropped insurance coverage that the company had voluntarily offered for hundreds of thousands of Americans through no fault of those policyholders. Either Allstate has repeatedly blundered when initially offering coverage in high-risk areas or it has overreacting to the risk today.

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[82] The verdict was for over $2 million. No. 06-3774, 2007 WL 891869 (E.D. La. Mar. 21, 2007). Other key Allstate cases include *Buente v. Allstate* (Civil Action No.: 1:05CV712, in the United States District Court for the Southern District of Mississippi), in which the court found that Allstate's flood exclusion was valid but that the ACC clause was ambiguous and *Wellmeyer v. Allstate Insurance Co.*, No. 06 CV 01585, 2007 WL 1235042 (E.D. La. Apr. 26, 2007)

[83] "Allstate Unit Pricing Challenged After Katrina," *Times Picayune*, May, 20, 2007.

[84] Ibid

- Allstate has adopted claims payment techniques that appear to routinely underpay claims. It adopted these techniques after being told by a consultant that these systems would put them in a "zero-sum game" with their policyholders, in which Allstate management and shareholders would benefit financially at the expense of policyholders.

- Allstate and other insurers adopted egregious and misleading anti-concurrent-causation policy language, which causes consumers to lose wind coverage if flood losses occur, even if the losses caused by flooding are easily distinguishable from and occur well after wind losses.

- Consumers file more complaints about Allstate than its peers, primarily because of its claims' settlement procedures. Allstate's complaint ratios are higher than almost all major insurance companies.

- Allstate has been an industry leader in attempts to shift wind risks and costs to federal taxpayers. It has also promoted other measures that would shift costs to federal and state taxpayers.

At the same time as Allstate has promoted these anti-consumer practices, it has performed very well for investors, far exceeding overall property-casualty insurers' financial and stock market results and the results of the S&P 500 as well.

These actions are directly and indirectly harmful to Allstate's customers throughout the country. They also represent unwelcome precedents for other insurers to follow. Allstate is applying its unfair claims practices nationally. The movement to high segmentation of risk harms the lower income Americans everywhere. The rush away from risk toward a riskless insurance product, particularly coupled with lower claims payouts per premium dollar received, has diminished the value of all of Allstate's insurance products. The shift of risk away from insurance companies toward state and federal insurance programs exposes all of America's consumers to unnecessary costs as taxpayers that should be borne as part of the private insurance mechanism.

VIII. RECOMMENDATIONS

Advice for Consumers

Consumers should consider the following key findings of this report when buying from or renewing insurance with Allstate.

First, Allstate has a history of precipitously dropping large numbers of customers in areas that it suddenly perceives to be of greater risk, despite the fact that the company is in good financial condition. For example, hundreds of thousands of consumers in coastal areas lost their coverage in 2005-2006 when Allstate was earning record profits.

Second, Allstate's policies are often a poor consumer value**.** Allstate's rates are often too high given the value of the claims that it pays out. Allstate uses an array of consumer "classes" (developed with factors such as credit scoring) to determine rates that frequently appear to be less related to the financial risk represented by its customers than to its marketing strategies. As a result, some consumers, particularly lower income and minority consumers, may be asked to pay rates that are unjustifiably high. Moreover, Allstate, like many insurers, has inserted ambiguous "anti-concurrent causation" clauses in some homeowner's policies that unjustifiably revoke the coverage that Allstate claims to be offering.

Third, Allstate has been a leader in adopting highly questionable claims processing procedures that may result in unjustifiably low payments. The use of automated claims settlement systems like Colossus by Allstate and other insurers means that insurers are more likely to make "lowball" offers are not reflective of the actual losses for which consumers should be compensated under the terms of the policy. Moreover, Allstate receives more consumer complaints than most other insurers of its size, many of which relate to claims settlement practices consumers have perceived as unfair.

CFA advises consumers not to settle any claim that does not seem fair. Advocate strongly for a fair settlement amount. If the insurer resists a fair settlement, consider seeking legal advice.

As many insurers now use automated claims settlement systems that may not fairly evaluate each individual claim, consumers who have filed a claim can help ensure that they receive a fair settlement asking the following questions:

- Has the insurer used Colossus or any other computer programs to help determine the value of your claim?

- If the answer is "yes," how did the insurer calculate the settlement offer that was made? It is important here to find out how the computer program that helped determine the settlement offer was "tuned" or "benchmarked" or otherwise adjusted. Ask specifically if any fine-tuning or other adjustments to the "tuned" settlement amount were made by management. Ask for the program "output" on the settlement that should show a range of settlement "suggestions" from a low to a high amount. In many cases, the high amount may be less than a fair settlement if management has tuned the program to produce "savings" or "consistency" or other "benefit." (In the case of Colossus, the savings promised by the company that created it was of the order of 20 percent.)

- In order to remove a 20 percent bias in the computer program that may unjustifiably lower the settlement amount offered by the insurer, consumers should consider raising the "high" offer made by Colossus high by 25 percent to arrive at a settlement offer that may be fairer. In other words, if the range of offers generated by Colossus was from $8,000 to $10,000, the proper settlement could be of the order of $12,500.

If a consumer receives either a small rate hike or notice of a renewal with no reduction from Allstate, you may want to shop around to see if Allstate's price is competitive. Allstate seems to think that consumers will not shop around unless they see a large rate increase so it may not be following the lead of other insurers in lowering prices.

Actions the States Should Take

CFA urges the National Association of Insurance Commissioners to undertake a market conduct examination of Allstate to look into the anti-consumer actions documented in this report. The exam should focus, at least in part, on how Allstate is able to pay 20 percent less than it used to in claims, as compared to the rest of the property-casualty insurance industry. The NAIC should also undertake a review of underwriting and tier placement factors (such as credit scoring) used by Allstate, including determining the impact of these factors on low income and minority consumers.

After performing this examination of Allstate, commissioners should undertake similar examinations for other major property-casualty insurers, as many of them have adopted similar anti-consumer practices.

States should also determine if the rates charged by Allstate in each state for each line of insurance are too high, given Allstate's unusually high profits and low cost/benefit ratios we documented. Given the fact that Allstate has apparently told investors that it believes that consumers are not likely to move to other insurers if Allstate does not follow their lead in dropping rates in some areas, rate reductions that are necessary may not have been filed with the states. If rates are too high, insurance commissioners should follow the lead of California in convening hearings to require Allstate to demonstrate why the rates should not be reduced.

CFA also recommends that state insurance commissioners review the rates of other companies that appear to be following Allstate's lead in setting excessive prices and using questionable classification systems, such as Progressive.

Actions the Federal Government Should Take

Congress and the Federal Emergency Management Agency (FEMA) should act to ensure that Allstate and other WYO insurance companies are not unjustifiably enriching themselves at the expense of taxpayers who fund the flood insurance program. There are several serious problems that must be sorted out, including:

- Did Write Your Own (WYO) insurers illegally shift costs to taxpayers after Hurricane Katrina by falsely determining that wind losses that should have been paid by insurers were flood losses?

- Is Allstate charging the National Flood Insurance Program more for materials when a flood claim occurs than it pays for the same materials in its wind claims?

- Are fees charged by WYO insurers for claims handling excessive?

- Compared to the costs of the WYO program, would a return to a flood insurance program where claims are paid directly by the government save federal money and remove the claims conflict-of-interest that WYO insurers have?

- Are there ways to make the fee structure of the WYO more competitive, perhaps by requiring competitive bidding to select WYO companies or by returning the entire program to a direct servicing entity that is selected competitively?

- Computer Sciences Corporation (CSC), FEMA's current contractor for the flood insurance program, collects data for and performs audits of the flood insurance program's claims. FEMA should study whether CSC has a conflict-of-interest in its large contractual relationships with many of the WYO insurers, running into tens of millions of dollars. For example, the Colossus program of Allstate (a WYO company) is purchased from CSC. Can CSC properly serve FEMA given these sorts of possible conflicts?

No study is needed to show that the use of anti-concurrent causation (ACC) clauses by WYO insurers could lead to significant shifting of private wind claims to taxpayers who fund the NFIP. Congress should prohibit the use of policy clauses such as the ACC by WYO insurers that might increase taxpayer costs to the benefit of the WYO insurer.

APPENDIX 1

WHY COMPETITION IS WEAK IN INSURANCE

1. ***Complex Legal Document***. Most products are able to be viewed, tested, "tires kicked" and so on. Insurance policies, however, are difficult for consumers to read and understand -- even more difficult than documents for most other financial products. For example, consumers often think they are buying insurance, only to find they bought a list of exclusions.

2. ***Comparison Shopping is Difficult***. Consumers must first understand what is in the policy to compare prices.

3. ***Policy Lag Time***. Consumers pay a significant amount for a piece of paper that contains specific promises regarding actions that might be taken far into the future. The test of an insurance policy's usefulness may not arise for decades, when a claim arises.

4. ***Determining Service Quality is Very Difficult***. Consumers must determine service quality at the time of purchase, but the level of service offered by insurers is usually unknown at the time a policy is bought. Some states have complaint ratio data that help consumers make purchase decisions, and the NAIC has made a national database available that should help, but service is not an easy factor to assess.

5. ***Financial Soundness is Hard to Assess***. Consumers must determine the financial solidity of the insurance company. One can get information from A.M. Best and other rating agencies, but this is also complex information to obtain and decipher.

6. ***Pricing is Dismayingly Complex***. Some insurers have many tiers of prices for similar consumers—as many as 25 tiers in some cases. Consumers also face an array of classifications that can number in the thousands of slots. Online assistance may help consumers understand some of these distinctions, but the final price is determined only when the consumer actually applies and full underwriting is conducted. At that point, the consumer might be quoted a much different rate than he or she expected. Frequently, consumers receive a higher rate, even after accepting a quote from an agent.

7. ***Producer Compensation is unknown***. Since many people are overwhelmed with insurance purchase decisions, they often go to an insurer or an agent and rely on them for the decision-making process. Hidden commission arrangements may tempt agents to place insureds in the higher priced insurance companies. Contingency commissions may also bias an agent or brokers decision making process.

8. ***Underwriting Denial***. After all that, underwriting may result in the consumer being turned away.

9. ***Mandated Purchase***. Government or lending institutions often require insurance. Consumers who must buy insurance do not constitute a “free-market”, but a captive market ripe for arbitrary insurance pricing. The demand is inelastic.

10. ***Incentives for Rampant Adverse Selection***. Insurer profit can be maximized by refusing to insure classes of business (e.g., redlining) or by charging regressive prices.

11. ***Antitrust Exemption***. Insurance is largely exempt from antitrust law under the provisions of the McCarran-Ferguson Act.

Compare shopping for insurance with shopping for a can of peas. When you shop for peas, you see the product and the unit price. All the choices are before you on the same shelf. At the checkout counter, no one asks where you live and then denies you the right to make a purchase. You can taste the quality as soon as you get home and it doesn’t matter if the pea company goes broke or provides poor service. If you don’t like peas at all, you need not buy any. By contrast, the complexity of insurance products and pricing structures makes it difficult for consumers to comparison shop. Unlike peas, which are a discretionary product, consumers absolutely require insurance products, whether as a condition of a mortgage, as a result of mandatory insurance laws, or simply to protect their home or health.