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How a get-tough policy lifted Allstate's profits

For more than a decade, Allstate Insurance Co. kept a secret from its auto policyholders -- a national strategy to force customers to accept reduced cash payouts or face years in court.

Thousands of pages of Allstate documents reviewed by the Herald-Tribune detail how the nation's second-largest insurer systematically cut payments to customers as a way to boost profits.

The documents describe a two-pronged strategy.

First, the company evaluates claims with a computer program designed to reduce payouts by as much as 20 percent of what the company once paid for the same injuries.

Second, Allstate pushes policyholders to accept quick settlements without the help of lawyers. Policyholders who try to fight for more money face Allstate attorneys coached to refuse to negotiate and to drag out litigation.

The approach often forces car accident victims to take what Allstate offers right away or spend years in court while their bills go unpaid -- a strategy Allstate spelled out in guidelines for claims adjusters that "forces the claimant and attorney to think about the obstacles they must overcome ..."

The Herald-Tribune examined summaries and transcripts meticulously re-created from more than 12,000 pages of what were then secret Allstate records describing the system, as well as ex-employees' depositions and company documents from suits across the nation.

Allstate has since made those documents public, unexpectedly posting some 150,000 pages of its internal business files to its Web site.

An Allstate spokesman said Friday the company decided to release the full documents to "dispel inaccurate portrayal" of its claims practices by lawyers, regulators and others around the nation. Taken as a whole, he said, the documents show Allstate's aggressive efforts to fight fraud.

The release came on the heels of a Florida appeals court ruling that state regulators have the right to ban Allstate from writing new policies because of its refusal to turn over those and other documents to state investigators.

The files reviewed by the Herald-Tribune, and those now revealed by Allstate, tell how the company succeeded in its effort to "redefine the game" of insurance as architects of the strategy had coached in the mid-1990s.

It was a "Zero Sum Economic Game. Allstate gains ... others must lose," declared a consultant's PowerPoint slide from a 1994 presentation to executives.

During the next five years of Allstate's claims overhaul, the same consultant, New York-based McKinsey & Co., chose confrontational words to describe the new system. In PowerPoint presentations and discussion papers drawn up for Allstate executives, McKinsey used "boxing gloves" to characterize how Allstate should treat policyholders who balk at settlements. For customers who hired lawyers, McKinsey urged, "align alligators," adding these instructions: "sit and wait."

The documents also show:

Allstate removed much of the discretion of local claims agents to set payouts, requiring them to base their recommendations on a computer program called Colossus. Under that program, average payouts for bodily injuries dropped more than 20 percent in the first few years, internal documents show, a big step toward reaching McKinsey's goal of "establishing a new fair market value" of such injuries.

Allstate recognized that when an injured driver hired a lawyer, the insurer lost money. In repeated presentations to Allstate executives, McKinsey coached tougher and increased legal action. By 1996, Allstate had doubled its legal force, hiring 225 more lawyers. "The bottom line is that Allstate is trying more cases than ever before," a corporate newsletter said.

Policyholders claiming injuries from minor-impact accidents and who hired lawyers were suspected of fraud, and therefore often targeted for reduced payments. In 1998, Virginia insurance regulators cited evidence: corporate guidelines that called for agents in such cases to "make a nominal offer, if warranted; or deny claim." The purpose, Allstate stated, was "to send a message to attorneys ... It forces the claimant and attorney to think about the obstacles they must overcome to recover a significant settlement or the benefits of a smaller 'walkaway' settlement."

Allstate set goals to contact policyholders who filed claims within three days, to speed settlements and increase customer satisfaction. But documents show the insurer also tracked how speedy contact reduced the number of lawyers hired by accident victims -- by as much as 20 percent in some markets.

The insurance company saw reduced payouts as a way to increase profits. Early on, consultants promised that driving down the "fair market value" of soft-tissue injuries, such as a fractured spine, chronic pain or limited mobility, would generate profits "shareholders will notice." Combined with similar changes to Allstate's home insurance and collision programs, they predicted, the yearly gain could reach $1.1 billion.

Allstate rewrote its claims policies at a time when the entire industry was grappling with legal cases it felt were out of control. Accident victims were hiring lawyers to push for more money for hard-to-prove injuries such as whiplash and back pain. An Allstate memo shows that accident victim lawyers were involved in two-thirds of the company's bodily injury claims.

An Allstate spokesman in Northbrook, Ill., said that the company's claims policies are legal and fair to its customers, and that its push to reduce payouts is aimed at rooting out fraud and overpayments for questionable injuries.

Allstate says it never crossed the line between what it called "holding the line" on claims and

underpaying them. The insurer also says it did not adopt everything its management consultants recommended, including the phrases "boxing gloves" or "alligators."

But Allstate acknowledges it does embrace a tough legal strategy designed to curb insurance fraud, "abusive medical testing" and "unnecessary plaintiff attorney payments."

"We will offer to settle the claim for a fair and reasonable amount," said corporate affairs spokesman Mike Siemienas.

When victims hire a lawyer and sue, he said, "just because we are being threatened doesn't mean we will negotiate. We will go to trial."

Throughout the redesign, McKinsey said the changes were key for increasing profits and the value of Allstate's stock. The consultant described Allstate's "customers" as shareholders, not policyholders.

The result a decade later closely resembles what Allstate and McKinsey said they were aiming for -- an insurer so notorious for sticking to its settlement offers that lawyers are reluctant to take cases involving Allstate.

"There are many lawyers who won't take an Allstate case," said Sarasota trial attorney David Shapiro. Even when they do, he said, clients give up as they realize they will have to wait years while Allstate forces their case to trial.

"It's that boxing thing," he said. "They just get tired. They lose their resolve more often than they get stronger."

Redefining the game

Allstate's attempt to redefine the claims game for the more than 2 million households it insures in Florida and 16 million it covers nationwide dates back to 1992.

The insurer hired consultants from McKinsey & Co. -- one of the world's largest management consulting firms -- to guide an overhaul of its claims practices, and hopefully, improve flat profits.

McKinsey drafted an often adversarial relationship between Allstate and its customers.

Paying policyholders more than needed was "leakage" and later "opportunity."

"Win by exploiting the economics of the practice of law," a slide encouraged.

McKinsey's "claims organization of the future" revolved around two axes -- standardizing claims awards across the board; and stopping policyholders from hiring lawyers.

The first was accomplished with Allstate's adoption of Colossus, replacing subjective claims agents who the redesign plan labeled as prone to giving policyholders too much.

The program, created by Computer Sciences Corp. and now a mainstay in the insurance industry, calculates injury awards based on factors such as severity of injury and policyholder age. Individual insurers can then "tune" the unregulated software to change payout amounts, making adjustments based on hundreds of factors.

Allstate concedes that it has tuned Colossus numerous times, but says that it has never done so unfairly.

A 15-year-old memo -- not included in the files Allstate has made public -- shows Colossus was set to produce claim awards that were, across the board, 20 percent below the prior average. Further, it instructs that claims agents and their managers "will want to stay within the Colossus range or below it in most cases."

Allstate said the memo was created by one regional office only, and "does not represent Allstate's official position or views," Siemienas said. "Colossus was not uniformly tuned to recommend 20 percent less than average claims settlements."

Current records are not available to show how Allstate uses the computer program to set cash payouts nationwide. Insurers are not required to provide details of the computer programs they use to drive claim settlements, and they fight fiercely to keep those records private. Allstate, court affidavits show, has even sought criminal prosecution of those trying to publish details of its claims system.

Though details are not available, Allstate's own records show the insurer's average payment for bodily injury cases dropped 20 percent as it adopted Colossus nationwide. Automation put Allstate at the forefront of a change in the insurance industry -- most major insurers now use the software to evaluate claims. At a business conference in 2006, Allstate announced it was spending another $95 million to add to the technology.

The movement caused some discomfort within Allstate. A 1996 presentation by the McKinsey team noted resistance from some of Allstate's claims agents, saying there was a "lack of buy-in in some markets due to belief that tuning is not proper."

Colossus is just one of many tools used to determine fair payouts, spokesman Siemienas said. Allstate also uses programs to evaluate the medical care claimants receive and the bills their doctors submit.

"Using Colossus assists claim personnel to more consistently and objectively evaluate casualty claims," Siemienas said.

Cracking down on lawyers

PowerPoint slides show the McKinsey consultants also advised Allstate to convince policyholders they did not need lawyers, and then to target those who disregarded that advice for denials, delays and litigation.

Other claims were to be marked early on for trial "to send a message to the market."

In this new game, the consultants said, 90 percent of Allstate's claimants would get a settlement check within weeks -- "good hands" treatment.

But the remaining 10 percent of accident victims would wait and wait -- three years or more according to a chart drawn by McKinsey and labeled "boxing gloves."

Tampa trial lawyer Robert Healy says the reality today of doing business with Allstate reflects

McKinsey's tactics.

"They pay less than every single insurance company, and they certainly will spend more on litigation," said Healy, a former Allstate lawyer who was with the company after it implemented its current claims strategy.

"They put pressure on people by establishing that they are a bully in the market."

Allstate contends it operates within the strictures of state insurance regulations, and points to a New Mexico review that found no fault with the company's claims practices.

However, regulators in Virginia and South Carolina reviewing hundreds of claims files found that some policyholders, those who suffered contestable injuries in minor accidents and hired attorneys, were unfairly targeted for outright denials or "nominal" offers of $1,000.

"Allstate's goal of paying only what is owed on any given claim is commendable," Virginia regulators wrote in 1999. "However, the method the company chose to reduce overpayments has led to violations of the Unfair Claims Settlement Practices Act."

A $36 billion insurer has the advantage in such games, contends David Berardinelli, a Santa Fe lawyer who has spent much of the past five years trying to force Allstate to make its claims handling practices public. The author of a trial guide on the subject, Berardinelli plans a consumer book this spring under the title: "From Good Hands to Boxing Gloves."

"When you look at it from the policyholders' point of view, here you are, your home is flattened. They come to you and offer (a low settlement) to you within the first 180 days. McKinsey knew that financial pressure in that first 180 days would be at its greatest," Berardinelli said.

"They won't walk away happy. They'll just walk away. A lot of them won't understand how badly they've been abused."

National rollout

According to status reports given to Allstate executives, the McKinsey approach was tested in the mid-1990s with auto accident victims in markets such as West Palm Beach, Horsham, Penn., and Tustin, Calif., then rolled out nationally. By 1997, it was expanded to include claims on collision, home fire, water and roof damage.

With the first target of reform, the promised initial return was a 15 percent reduction in third-party bodily injury payouts -- reimbursements for non-Allstate customers injured in by Allstate policyholders.

The reality was better.

A 1995 Allstate survey showed the "Colossus tuning process" lowered payments for subjective injuries such as back pain by 10 percent in Los Angeles, 14 percent in New Jersey, and 22 percent in Washington, D.C.

The biggest drop was in the Florida Atlantic region. Payouts fell 23 percent below the national average.

"Florida East and Florida West are getting phenomenal, never-seen-before results in terms of loss/cost management," a 1997 Allstate newsletter declared.

Allstate today pays less than most other auto insurers in Florida for accident injuries, averaging $16,884 per claim in early 2007 compared with an $18,105 average for the industry. The insurer said it was not fair to compare the numbers because of potential differences in the policyholders Allstate recruits.

Beyond reduced payouts, McKinsey's analysis showed Allstate's biggest savings would come from removing policyholders' lawyers from the equation.

Eliminating the lawyer in just half of cases involving soft-tissue injuries such as whiplash would boost Allstate's profit by $240 a share, McKinsey calculated.

Allstate Chairman Ed Liddy touted the results at an international business conference in New York two years ago, showing Allstate had reduced its average check to a car accident victim by 20 percent, and held growth in other auto and home claims below industry averages.

"We obviously pay what we owe, that is a given," Liddy told attendees, according to a transcript of his remarks. "But we do it more efficiently, and we avoid overpayments ..."

Allstate has been sanctioned by regulators in at least two states, Virginia and South Carolina, and sued by policyholders claiming bad faith, forcing it into confidential settlements and large jury verdicts, including a $20 million award in 2006 (later reduced to $8 million) to an Indiana man hurt in a car accident 11 years earlier.

But Allstate's incentives to keep the system have proven larger.

Since changing the way it regards claims, Allstate has reported the largest profits of its 77-year history. It had a record profit of $4.9 billion in 2006. In 2007, it reported a $4.6 billion profit.
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