

Excerpts from articles on Berardinelli's book.

State Attorney General Charles Foti filed a lawsuit in Orleans Parish Civil District Court late Wednesday 11/07 alleging collusion, price fixing and antitrust violations by six major insurance companies, including State Farm and Allstate, as well as the firms that manufacture their claims-processing software and companies that offer them advice and collect their data.

"This alleged scheme gave insurers an unjust advantage over policyholders, which they used before, during and after one of the greatest disasters this country has ever suffered, by reaping huge profits from the misfortunes of persons whom they pledged to protect from the risk of loss.

The suit names State Farm Fire and Casualty Co. and Allstate Insurance Co., Louisiana's two largest residential insurers; Farmers Insurance Exchange, the state's fifth-largest homeowners insurance company; Standard Fire Insurance Co., better known as Travelers, the state's seventh-largest home insurer; military insurer USAA Casualty Insurance Co., the eighth-largest homeowners policy company; and tiny Lafayette Insurance Co., a division of United Fire Group.

The suit also names Marshall & Swift/Boeckh LLC and Xactware Solutions Inc., companies that manufacture leading claims-adjusting software; and Xactware's parent company, insurance data collector Insurance Services Office Inc. It also names McKinsey & Co., an international consulting firm that has advised many major insurance companies on practices to adopt in computing claims.

By using the outside vendors to unify "power and control," insurers systematically reduce the percentage of premium dollars that companies return to policyholders in the form of claims payments "under a shroud of secrecy," the suit says. **While the industry has historically paid 70 cents on every premium dollar collected back to policyholders in claims payments, in Katrina, it paid 50 cents for every premium dollar, the suit says.**

Claims adjusters, the suit says, are pressured or required to accept the pricing database information from the Xactware or Marshall & Swift/Boeckh software in the estimates they write if the adjusters want to be able to close claims and get paid for the work.

While the companies purport to be providing an independent and objective benchmark for pricing, the suit says, "they intentionally devalue the market price in order to underpay their policyholders and/or artificially deflate or attempt to deflate construction and repair costs in the affected market."

Meanwhile, the suit says State Farm has testified under oath that it can modify Xactware's price lists before adjusting claims. A pricing specialist conducted surveys of building material suppliers for the latest prices and updated its New Orleans prices several times per quarter between 2005 and 2007. However, the suit says, a **State Farm price list containing 10,000 different items was exactly the same as a Travelers price list on Nov. 15, 2005, something that would be "a statistical impossibility without collusion."**

Allstate adopts a hard-nosed approach to claims. One typical slide picked from the book refers to taking a stricter stance on settlements: "Stand firm on final offer with no real negotiation."

*Another—and the inspiration for the book's title—distinguishes between the treatment to be accorded to customers who hire a lawyer to press for a higher payout and those who don't: The unrepresented get the "good hands" approach (settlements within 200 days or so); the lawyered get "boxing gloves" (resolution that could take three years or longer). Think of it as the Oliver Twist strategy: Accept the company's initial offer (which may seem more fair to Allstate than it seems to you) and you'll get your money quickly. **Ask for more and you may be in for a battle.** And while the slides specifically deal with Allstate's auto division, Berardinelli and others familiar with the project contend the concept was applied to homeowners as well.*

The strategy outlined in the slides sounds much like the marching orders Shannon Brady Kmatz says she got when she was an Allstate claims adjuster. Kmatz, who left Allstate in 2000, says she felt **under constant pressure to "fast-track" claims**—that is, settle quickly for as little as possible. **"We called it throwing them a bone,"** she said. "You offer \$500 and hope they go away." She said she was also evaluated on how successful she was at convincing people to accept the company's offer rather than try to get more money by hiring an attorney. **Adjusters who excelled at these goals, Kmatz says, were rewarded with free dinners and bonuses that could add up to a few thousand dollars a year.** Kmatz provided evidence of such bonuses in a 2003 affidavit that is part of a class-action suit Berardinelli has filed against Allstate, and MONEY has reviewed those documents.

Allstate wasn't the only insurer to ask management consultants to help revamp claims processing, say several former claims adjusters. McKinsey helped **State Farm with the program known as ACE**, or Advancing Claims Excellence, and Accenture advised **Farmers Insurance, which had a claims program called ACME**, short for Achieving Claims Management Excellence.

One thing is not in dispute: All three insurers have made startling progress in lowering their claims payout ratios since they engaged the consultants. At Allstate, claims paid fell from 87.2% of premiums charged in 1992 to 43.5% last year, according to the CFA's Hunter. At State Farm the ratio dropped from 77.5% in 1994 to 66.6% in 2005 (the most recent figure available), while at Farmers it fell from 74.7% in 2001 to 56.9%.

The adjuster might not mention, however, that **it's possible to override the prices in Xactimate**. An insurer might instead insert fees charged by "preferred" vendors who agree to work at discounted rates to get regular referrals from insurers. **Farmers spokesman Jerry Davies confirms that Farmers occasionally does this** in markets where its vendors can beat the going Xactimate rate, but he adds that its vendors do "top-quality work."

Steve Strzelec, a Seattle claims consultant says many policyholders who do pay out of pocket never get the extra money to cover their replacement costs because they don't know they're entitled to it. How much is left on the table? Hard to tell. But an internal study made public during a lawsuit this year estimated that **in 1999 alone State Farm customers failed to claim as much as \$135 million in replacement-cost benefits**. The insurer told MONEY it began paying replacement costs up front in 2000, but saw an "unexpected spike" in claims, so it returned to paying only actual cash value up front in 2003.

"The insurance industry...is purposely misleading customers," California Lieutenant Governor and former Insurance Commissioner John Garamendi tells NOW. "The first commandment of the insurance industry is, 'Thou shalt pay as little, as late, as possible.'... You go to financial heaven if you can carry out that commandment."

The insurance industry is enjoying record-breaking profits, but who's paying the price? Insurance used to be considered a quasi-public trust that's supposed to function as the safety net for the middle class, Berardinelli says in his book. But McKinsey, which worked for other insurance companies before perfecting its strategies with Allstate, orchestrated a radical shift by

transforming that all-important trust into a high-stakes zero-sum game where **the interests of Wall Street are placed above those of policyholders.**

"It's more than just a change in one company. It's more about a replacement of the traditional paradigm of insurance," Berardinelli said in an interview in New Orleans in early May.