Securities Regulation Daily Wrap Up, FRAUD AND MANIPULATION—N.D. Ill.: Failure to disclose reduced insurance underwriting standards creates securities fraud claim against Allstate, (Feb. 28, 2018)

Securities Regulation Daily Wrap Up

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By Joseph Arshawsky, J.D.

Allstate Corporation's, its CEO, chairman, and president from 2005 to 2015, Thomas Wilson's, and the CEO and president of Allstate Financial (who also took over for Wilson as president in 2015), Matthew Winter's motions to dismiss a shareholder class action under Exchange Act Sections 10(b) and 20(a) and Rule 10b-5 were denied by a federal court in Illinois. The court found that the shareholders adequately pleaded misrepresentations when Allstate blamed higher auto claims on external factors instead of its own loosened underwriting standards. The court also found that scienter and loss causation were adequately alleged (*Carpenters Pension Trust Fund for Northern California v. The Allstate Corporation*, February 27, 2018, Gettleman, R.).

Underwriting standards. The complaint was filed on behalf of a class of investors that purchased Allstate common stock between October 29, 2014 and August 3, 2015. The issue is whether Allstate, Wilson, and Winter made material false statements and omissions regarding the cause of an alleged spike in auto insurance claims frequency. According to the shareholders, starting in 2013, Allstate implemented a plan to attract more auto insurance customers. Allstate greatly reduced its underwriting standards to attract customers who had previously been considered too risky. The plan worked, but the chickens came home to roost in the form of a spike in claims not occurring among competitors. Allstate issued statements blaming external factors. Allstate's stock price remained inflated until August 13, 2015 when it issued a press release reporting its financial results for the second quarter of 2015, fully disclosing the negative impact of its reduced underwriting standards. Allstate's stock fell more than 10 percent on that day, and this suit followed. The defendants moved to dismiss the case, which was denied.

False or misleading statements. Allstate, Wilson, and Winter argued that their statements regarding the reasons for an increase in auto claims frequency were opinions, not determinable facts. The court disagreed. For example, on an October 30, 2014 earnings call, Wilson and Winter "saw nothing to indicate that the increase in claims frequency was driven by growth," and instead attributed the increase to "miles driven and precipitation," assuring investors that Wilson and Winter were not "concerned that it was a quality issue" and was not particular to Allstate. Their "failure to mention Allstate's reduction in underwriting standards makes these statements misleading."

Even if a reasonable investor understood Wilson's and Winter's conclusions to be uncertain, the defendants did not disclose that Allstate decreased its underwriting standards while simultaneously asserting that the increase in claims frequency was attributable to external factors. In any event, the statements were not uncertain. Wilson's and Winter's assurances that they had considered all possible reasons for the increase would not have been understood by reasonable investors as uncertain.

Scienter. First, regarding Wilson, his stock sales may very well be indicative of normal estate planning and investment diversification but the shareholders' claim that they are indicative of insider selling is both cogent and equally compelling, particularly in light of the other allegations in the complaint. The shareholders allege that two substantial stock sales took place two months and just over eight months before Allstate's negative disclosures. The fact that Wilson failed to maximize his profits by perfectly timing his stock sales does nothing to undercut the claim of insider selling. The shareholders' complaint read in its entirety gives rise to a strong inference of scienter as to Wilson, that is, one that is "at least as compelling as any opposing inference one could draw from the facts alleged."

Winter did not sell stock. Still, the shareholders have adequately alleged that Winter, who served as Allstate's CEO and president of Allstate Financial, then took over for Wilson as president in 2015, had direct involvement in and knowledge of Allstate's undisclosed plan to reduce its underwriting standards. Winter admitted in August 4, 2015 that the reduced underwriting standards contributed to the increased claims frequency, and that such an impact was expected. "Given these admissions, plaintiffs' claim that Winter's statements attributing the increase in claims frequency to external factors were made with an intent to deceive investors is 'cogent and at least as compelling as any opposing inference one could draw from the facts alleged." Accordingly, the investors have adequately pleaded scienter as to both Wilson and Winter.

Loss causation. The shareholders alleged that Allstate failed to attribute any of its increase in claims frequency to its reduced underwriting standards until it reported its 2015 second quarter financial results. Allstate's stock price dropped 10 percent the next day while the S & P 500 remained flat. Accordingly, loss causation was adequately pleaded.

Control person liability under Section 20(a) was also adequately alleged.

The case is No. 1:16-cv-10510.

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Companies: City of St. Clair Shores Police and Fire Retirement System; The Allstate Corp.

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