



NATIONAL ASSOCIATION OF INSURANCE COMMISSIONERS

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Date: October 9, 2006

To: Members of the NAIC

From: Gail M. Sciacchetano, Deputy General Counsel
Kara Binderup, Staff Attorney

Re: DeHoyos v. Allstate Corporation

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Executive Summary

This is a class action lawsuit alleging the redlining and credit scoring practices of Allstate violated the Civil Rights Act and the Fair Housing Act. Specifically, plaintiffs allege that All State has used credit information in its underwriting in a manner that has resulted in minorities paying higher premiums for automobile and homeowner's insurance. The case was originally filed in the U.S. District Court for the Western District of Texas. In September, 2003, the U.S. Court of Appeals for the Fifth Circuit affirmed the district court's denial of Allstate's Motion to Dismiss Plaintiff's claim as reverse preempted under the McCarran-Ferguson Act. The Court of Appeals held the Federal Civil Rights statute, "as invoked by non-Caucasian insureds to challenge credit scoring systems utilized by their insurers did not interfere with any identified state insurance statute or regulatory goal, and were not reverse preempted." DeHoyos v. Allstate, 345 F.3d 290 (2003).

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In May, 2006, after eighteen months of settlement negotiations, Plaintiffs moved for preliminary approval of the settlement. On June 2, 2006, the district court ruled that the terms of the Settlement Agreement were "sufficiently fair, reasonable and adequate to warrant: a) preliminary approval; b) conditional certification of the settlement class; c) scheduling of the fairness hearing (December 18, 2006); d) distribution of notice to the class; e) preliminary barring and enjoinder of plaintiffs in the class from commencing further actions during the settlement approval process." DeHoyos v. Allstate, No. 2329417, 2006 U.S. Dist, Westlaw (W.D. Tex., June 2, 2006)

**WORLD
WIDE WEB**

www.naic.org

The settlement provides injunctive and equitable relief as follows:

1. Allstate will roll-out a new insurance scoring algorithm (ISM7)

2. In states where Allstate uses credit reports to rate policies, Allstate will provide its customers with the opportunity to have an insurance policy priced using the settlement scoring algorithm.
3. Allstate will make the new insurance scoring algorithm publicly available.
4. Allstate will provide credit education to Class Members about business transactions where credit reports are used and how Class Members can improve their credit scores.
5. Allstate will adopt a premium reduction appeals program for all customers who experience extraordinary events that negatively impact their credit history.
6. Allstate will increase substantially the amount of its national media advertising to target multicultural consumers.
7. Class Members will be entitled to apply for a one-time monetary payment to be determined based on a comparison of their insurance scoring group prior to the settlement and the insurance scoring group that would have been assigned under the new scoring algorithm.

Source: www.allstate.com/Media/Newsheadlines/pr_2006) (last visited October 9, 2006)

Contact Information

Settlement information can be obtained by calling 866-817-6514, by going to the website at www.creditusesettlement.com, by writing to DeHoyos Settlement, P.O. Box 9000, #6428, Merrick, NY 11566-9000, or contacting JoAnne Kron at jkron1@allstate.com

History of the Case

In November 2001, named plaintiffs Jose DeHoyos, Eva DeHoyos, Georgia Harrison, Charles White, Sheryl Franks and Martel Shaw filed a Class Action complaint against Allstate in the U.S. District Court for the Western District of Texas, San Antonio Division. They alleged that Allstate had engaged in racial discrimination through its use of credit scoring in underwriting and pricing of automobile and homeowners insurance policies. They further alleged that Allstate's automated underwriting system, which was used for credit information, had a disparate impact on African-Americans and Hispanics. Allstate denied the allegations, specifically denying the material allegations of liability and wrongdoing, and raised various legal and affirmative defenses to include reverse preemption under McCarran-Ferguson.

On February 1, 2002, Allstate filed a Motion to Dismiss asserting the McCarran-Ferguson Act preempted federal discrimination law. The Court denied the Motion to Dismiss on April 5, 2002 and granted Allstate's Motion for Leave to File Interlocutory Appeal. On September 3, 2003, the Court of Appeals affirmed the denial of Allstate's Motion to Dismiss holding "the Federal Civil Rights Statutes, as invoked by non-Caucasian insurers to challenge credit scoring systems utilized by their insurers, did not interfere with any identified state insurance statute or regulatory goals and were not reverse preempted." *DeHoyos v. Allstate*, 345 F.3d 290 (5th Cir, Sept.2003). The Court went on to say that for Federal law to impair state law so as to be reverse preempted under McCarran-Ferguson, "it must directly conflict with state regulation, frustrate a declared state policy, or interfere with a state administrative regime". "The Defendants did not draw the Court's attention to any specific law, regulation, or decision in Texas or Florida requiring or condoning the credit scoring practice at issue." Appellants argued that the states had approved a pricing scheme; however, the Court ruled this was insufficient to create a McCarran-Ferguson exemption.

Allstate appealed to the Supreme Court for Writ of Certiorari which was denied in April, 2004. Amicus briefs filed in support of Petitioner Allstate included briefs by the Chamber of Commerce of the United States and the AAI with the AIA, NAI, NAMIC and RAA.

Upon remand, the parties then began to engage in discovery, with Allstate producing "a significant amount of documents to Plaintiffs including rate books and policy manuals." (*DeHoyos v. Allstate*, Civ. Act. SA-01-CA-1010-FB "Plaintiff's Memorandum in Support of Preliminary Approval of Settlement Agreement and Certification of the Class for Settlement Purposes Only," p. 3 (May 24, 2006).

In August of 2004, the parties began formal settlement discussions, which lasted eighteen months, where they held more than 50 negotiating sessions, both in person and via telephone conference calls. A significant amount of electronic data was produced including the design data Allstate had utilized to develop credit score formulas. Allstate produced information regarding how it developed and implemented credit scoring. Plaintiffs retained statistical experts engaged in an extensive disparate impact analysis of policyholder data and Allstate's credit scoring formulas. Detailed discussion of the terms of the settlement will follow below.

NAIC Consideration of Amicus Brief Requests

In September 2002, the Illinois Director of Insurance, Nathaniel Shapo, submitted a formal request for consideration by the NAIC Executive Committee to submit an amicus brief on behalf of Allstate to support its appeal to the U. S.

Court of Appeals for the Fifth Circuit. The request was to brief “whether or not the McCarran-Ferguson Act preempts the federal judiciary from determining, in the context of a nationwide class action, whether facially neutral underwriting characteristics, in this case the development of rates by the use of credit information or credit scoring, is unfair discrimination under Federal Civil Rights legislation.” The NAIC Executive Committee declined to take action on the request.

Again in March, 2005 the NAIC was asked to file a brief in support of Allstate’s petition for certiorari before the U.S. Supreme Court. Again, the NAIC declined stating that the NAIC had been very active in opposing race-based premium underwriting, and in doing so had taken the position that the McCarran-Ferguson Act did not preempt Federal civil rights laws.

Terms of the Settlement Proposed in May, 2006

Briefly, the proposed settlement requires Allstate to provide:

- A new credit scoring formula which underwent extensive testing by Plaintiff’s experts;
- An appeals process for people whose credit score had been impacted by an extraordinary circumstance;
- A credit education program designed to increase minority understanding of the use of credit and the management of their credit scoring;
- An increase in minority marketing; and
- A one-time monetary relief.

Allstate denies that any discrimination occurred contending that information from credit reports is nondiscriminatory and a “valid and sound predictor of insurance losses.” Nevertheless, Allstate has agreed to modify its practices by instituting a new automated credit scoring algorithm that is known as ISM7. This settlement algorithm will be rolled out on a scheduled state-by-state, company-by-company and line-by-line basis as explained in Schedule 1 of the Settlement Agreement. The proposed roll-out is contingent on receiving state regulatory approval and subject to any state-specific modifications resulting from state law, regulation or any modification made at the request or direction of insurance regulators.

This algorithm will remain in effect for a period of at least three years for the companies identified in Schedule 1. Allstate agrees it will not materially modify the algorithm unless it is required to by regulatory changes in a specific state, because of other changes in credit agencies recordings or pursuant to a request, direction or order of an insurance regulator. Allstate has reserved the right to make nonmaterial changes, meaning a change that maintains substantially the same variables in associated weights comprising the settlement algorithm.

Allstate is required to file documentation with the appropriate state regulatory agency and will engage in best efforts to comply with state laws and regulations. Allstate will provide Class Members who are active policyholders an opportunity to obtain a policy with their premium determined using the settlement algorithm.

The roll-out of this settlement algorithm for all the companies identified in Schedule 2 of the Settlement Agreement will commence no later than December 31, 2008.

Communication to policyholders will occur by posting of the settlement algorithm on the Settlement Administrators' website (www.creditusesttlement.com) and on Allstate's website on the effective date of the settlement.

In addition, a Class member may be entitled to a one-time settlement payment. To potentially qualify for this the Class Member must submit a request form identifying them as African-American or of Hispanic or Latino origin. Allstate will then identify the individual, the policy, and perform a calculation with the new settlement algorithm to determine if they had been paying more in premiums. Exhibit 10 of the Settlement Agreement specifies the formulas for the settlement payment payout.

Subject to regulatory approval, Allstate will implement an appeals process in all states, lines and companies where credit information is used to rate policies. Allstate will use its best efforts to obtain regulatory approval of this appeals process with consideration given to any reasonable addition, modification or other changes required by a regulator. This appeals process will be in place for a minimum of two years commencing on the effective date of the settlement.

Allstate will pay for consumer education materials prepared by the Consumer Credit Counseling Services consisting of 200,000 hard copy brochures and 20,000 DVDs distributed through minority advocacy organizations. A total of \$250,000 allocated among the advocacy organizations will assist each one in distributing the consumer education material within a one-year period.

Finally, Allstate agrees that it will increase its minority marketing expenditures by 15% for four years.

As noted above, the Fairness Hearing is December 18, 2006. Notice of intention to appear must be received by November 6, 2006.

Final Note

The NAIC has been unable to obtain discovery in this proceeding as it has been conducted under protective orders which remain in place. We have provided for you a copy of the settlement agreement, Westlaw sites and a link to the

settlement site. Further information is available on the settlement website to include settlement exhibits, frequently asked questions, copies of the settlement algorithms, and request forms.

Should you need further information, please do not hesitate to contact Gail Sciacchetano at 816-783-8019, or Kara Binderup at 816-783-8023.