

UNITED STATES DISTRICT COURT
NORTHERN DISTRICT OF ILLINOIS
EASTERN DIVISION

CITY OF ST. CLAIR SHORES POLICE AND)	Case No.
FIRE RETIREMENT SYSTEM, Individually)	
and on Behalf of All Others Similarly Situated,)	<u>CLASS ACTION</u>
)	
Plaintiff,)	
)	
vs.)	
)	
THE ALLSTATE CORPORATION,)	
THOMAS J. WILSON, MATTHEW E.)	
WINTER and PATRICK MACELLARO,)	
)	
Defendants.)	
)	
_____)	<u>DEMAND FOR JURY TRIAL</u>

COMPLAINT FOR VIOLATIONS OF THE FEDERAL SECURITIES LAWS

Plaintiff, individually and on behalf of all others similarly situated, alleges the following based upon personal knowledge as to plaintiff's own acts, and upon information and belief as to all other matters based on the investigation conducted by and through plaintiff's attorneys, which included, among other things, a review of The Allstate Corporation's ("Allstate" or the "Company") Securities and Exchange Commission ("SEC") filings, conference call transcripts and releases; media and analyst reports about the Company; and other public information regarding Allstate and the insurance industry. Plaintiff believes that substantial additional evidentiary support will exist for the allegations set forth herein after a reasonable opportunity for discovery.

INTRODUCTION

1. This securities fraud class action is brought on behalf of all persons who purchased the common stock of Allstate between October 30, 2014 and August 3, 2015, inclusive (the "Class Period") and were damaged thereby (the "Class"). The claims asserted herein are alleged against Allstate, its Chairman and Chief Executive Officer ("CEO") Thomas J. Wilson ("Wilson"), its President Matthew E. Winter ("Winter"), and its Vice President of Investor Relations Patrick Macellaro ("Macellaro") (collectively, "Defendants") for violations of §§10(b) and 20(a) of the Securities Exchange Act of 1934 (the "Exchange Act") and Rule 10b-5 promulgated thereunder.

2. Allstate is the largest publicly traded personal lines insurance company in the United States. Personal lines insurance includes homeowner, renter, motorcycle and auto insurance. This case relates primarily to Allstate's auto segment, which was its largest business segment, and its core Allstate brand.

3. Personal lines insurance is a low-margin business. Small variations were very important and closely monitored by Allstate. As Wilson explained, it is "a relatively low margin business . . . it's not like a software business, where you lose 5 points of margin and you don't really care that much. We care a lot, because it's sort of like everything."

4. Allstate reported various metrics used to evaluate its business, including its combined ratio and underlying combined ratio. As explained in greater detail herein, the “combined ratio” is the ratio of claims losses and expenses to revenues from insurance policies. One hundred percent minus the combined ratio is the underwriting margin. Thus, a combined ratio of 95.0 represents a 5% underwriting margin. The underlying combined ratio is the combined ratio excluding certain one-time events, such as losses from catastrophes. The underlying combined ratio is followed closely by management and investors, as it is used to track the performance of the business, absent the impact of unusual events.

5. Another critical, if not the most important, metric used by Defendants in managing Allstate’s auto business was auto claim frequency. Defendants monitored frequency on a daily and at times hourly basis, as a spike in claims required prompt remedial action. For example, if claims frequency spiked, Allstate might tighten underwriting to reduce its risk in a particular segment of its auto business (*e.g.*, particular states or geographies) or it could seek to increase prices. Price increases could take several months to implement, as rates would need to be approved by various states and thereafter Allstate would need to wait until its customers’ six-month policy terms rolled through expiration into renewal to charge the higher prices. Given its importance, Defendants routinely discussed Allstate’s auto claims frequency with investors, reported it in quarterly and annual SEC filings, and were asked about it by analysts.

6. Prior to the start of the Class Period, Allstate embarked on a plan to grow its policies-in-force and revenues in its auto insurance segment. The auto insurance market is segmented, with some insurers focusing on high quality, lower risk drivers and others targeting higher risk drivers who in turn pay higher premiums. Rather than simply chase an increase in market share at the expense of profitability and margins, Defendants claimed Allstate’s plan was to grow auto policies-in-force and revenues while maintaining profitability. In truth, Allstate’s new business was of lower

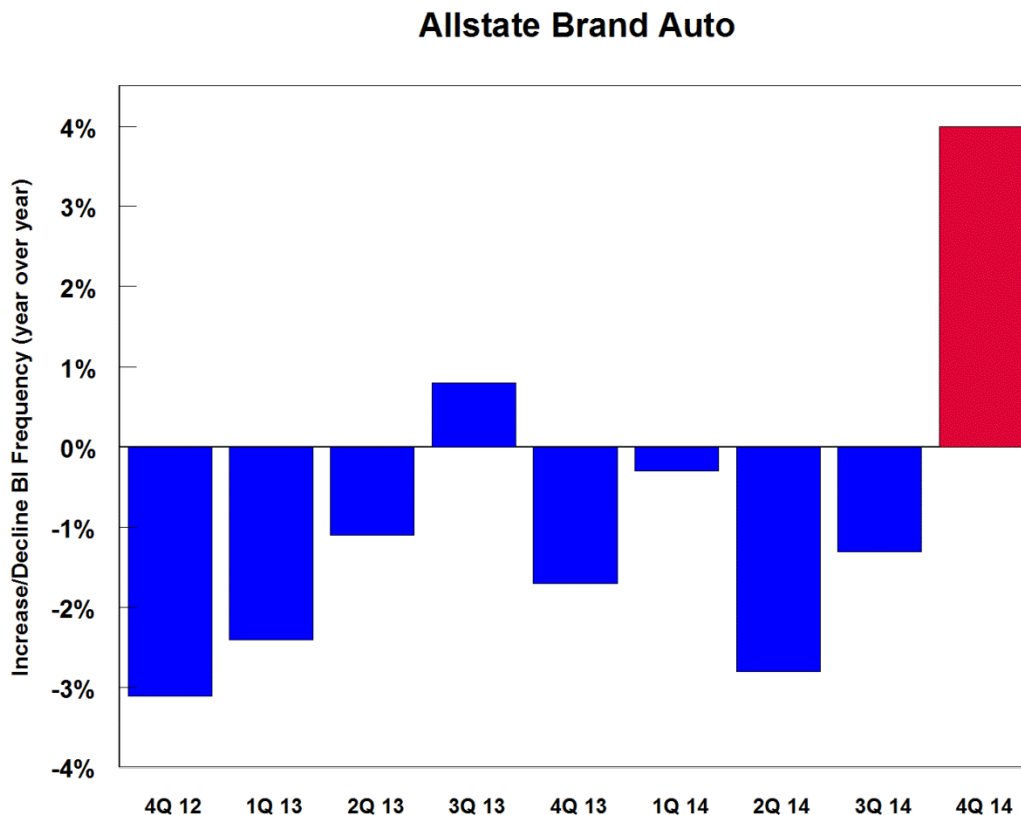
quality and carried increased risk, which caused, in substantial part, Allstate's largest increase in frequency of auto claims in nearly five years.

7. As the frequency of auto claims skyrocketed, Defendants denied there was an increase at all. Then, as the spike continued and could no longer be denied, Defendants made false and misleading statements regarding the cause of the dramatic increase. Rather than admit that Allstate's auto policy growth and increased revenues had caused a spike in auto claims and reduced profit margins, Defendants claimed the spike in claims frequency was caused solely by external events beyond Allstate's control – namely weather and increased miles driven. This was false.

8. For years leading up to the start of the Class Period, Allstate's claim frequency remained flat or declining. As one analyst noted in August of 2013, "[auto] frequency for the last three years has . . . been pretty much nonexistent." Just over a year later, another analyst reported that Allstate's frequency trends "remained relatively benign." Allstate's profitability metrics leading up to the Class Period were also stable, with the underlying combined ratio for Allstate brand auto staying around 91-93 in the first three quarters of 2014.¹

9. However, in October 2014, Allstate experienced a massive spike in auto claim frequency that reversed the long-standing favorable frequency and profitability trends. The Allstate brand auto underlying combined ratio skyrocketed to 98.2 in 4Q 2014, the highest level since 2011. Following several consecutive quarters of year-over-year declines in bodily injury (or "BI") claim frequency, the October spike contributed to a 4% increase for 4Q 2014. This spike in frequency was caused in substantial part by Allstate's new business growth, and the reversal of Allstate's positive trend is illustrated in the graph below:

¹ Allstate reports its financial results on a calendar-year basis. Thus, its first quarter ("1Q") ends on March 31, its second quarter ("2Q") ends on June 30, its third quarter ("3Q") ends on September 30, and its fourth quarter ("4Q") and fiscal year end on December 31. Allstate management typically takes several weeks after the end of a quarter to prepare and file the Company's financial statements and to hold conference calls to discuss its results.



10. Despite the spike in claim frequency in October 2014, during an earnings call on October 30, 2014, in response to an analyst’s question about frequency, Winter claimed “***our frequency so far has been extremely favorable to prior year,***” adding, “***frequency trends have been good.***”²

11. Allstate experienced a second consecutive month with a massive, undisclosed spike in claims frequency in November 2014. Since the negative trends were unknown to investors, Allstate’s stock continued to trade at artificially inflated prices. On November 25-26, 2014, when Allstate’s stock was trading at then all-time highs of more than \$67 per share, Wilson took advantage of his access to and knowledge of insider information. Wilson exercised stock options that were not due to expire until 2019 and cashed out the shares for over \$33 million, significantly reducing his

² The particular statements alleged herein to be false and misleading are emphasized with bold and italics. Any emphasis is added unless otherwise noted.

stake in Allstate. Although Wilson had not sold stock in nearly 10 years, he sold stock valued at more than 28 times his annual base salary just after Allstate had reversed favorable trends and was experiencing a second consecutive month of massive, undisclosed increases in auto claims frequency. After disposing of approximately 675,000 of his directly owned shares, Wilson was left with approximately 113,000 shares.

12. Wilson's unusual stock sale did not go unnoticed. *Crain's Chicago Business* published an article on December 3, 2014 reporting that Wilson's options "weren't set to expire until 2019," which "raises questions as to why Wilson cashed them out now." Allstate representatives "didn't respond to [*Crain's*] request for comment." The article noted the run up in Allstate's stock: "So far in 2014, Allstate's stock has increased 24.9 percent in 2014, easily outpacing the 11.6 percent return of the Standard & Poor's 500 Financial Index."

13. Allstate hosted its next earnings call on February 5, 2015 to discuss its 4Q and fiscal year ("FY") 2014 results. During the call, Macellaro disclosed that Allstate brand auto "did experience a spike in the underlying combined ratio in the fourth quarter" as a result of "higher levels of accident frequency experienced in the first two months [October and November] of the quarter." While Macellaro admitted the spike in frequency that Winter had previously denied, Macellaro falsely and misleadingly attributed the cause of the spike to external factors, stating it was "***driven by a combination of increased economic activity and non-catastrophe weather.***"

14. When pressed, Winter was even more direct about the cause of the spike in frequency, falsely and misleadingly stating: "***Let me start with what is not driving it. Number one, we saw nothing to indicate that it's a quality of business issue or that it's being driven by growth, which is a natural question that you would have . . .***" Winter reaffirmed that the spike in frequency was caused by "***two factors . . . miles driven and precipitation.***" Since the negative trends were purportedly externally driven (rather than reflective of a deterioration in the quality of new

business), analysts from Wells Fargo Securities (“Wells Fargo”) described the increased claims as a “[f]requency blip” and reported that “Allstate does not think the frequency increase is associated with the quality of business being written or the greater pace of business growth.” This was significant, because rather than being interpreted as impacting Allstate’s financial outlook, the increased frequency was perceived to be, as Morningstar Equity Research (“Morningstar”) analysts reported, “a one-time event.”

15. In truth, it was not a one-time event because the spike in frequency was being driven in substantial part by the new business growth in auto policies. This was well known by Defendants based on decades of Allstate and industry experience in evaluating such trends.

16. On May 6, 2015, Defendants hosted their next conference call to discuss Allstate’s 1Q 2015 results. Defendants reported that frequency was still elevated “across our book of business.” However, Defendants continued to downplay the significance of the spike in claims frequency by again placing the blame entirely on external factors, with Winter stating that “*the frequency pressure is a combination of miles driven and weather.*” Winter assured investors “*we did a very intense deep dive into our business . . . to make sure in effect that these aren’t our problems but are in fact external.*” He continued, stating that “*all of that review showed that this trend is externally driven primarily by miles driven*” and “*we validated it with external data . . . and then we look[ed] at other sources to ensure that that in fact is true.*”

17. When an analyst asked why the purported external factors were not having the same impact on competitors, Wilson claimed that while “we can’t answer the question as it relates to other people . . . *we don’t see anything in the way we have done our business.*”

18. Thereafter, an analyst from Credit Suisse Securities Research & Analytics (“Credit Suisse”) reported “we are more confident that this is not an [Allstate] specific issue.” Analysts remained optimistic that, since the increased frequency was purportedly the result of external factors

rather than the new business, it would not recur. For example, MKM Partners reported “we would expect better auto results are ahead.”

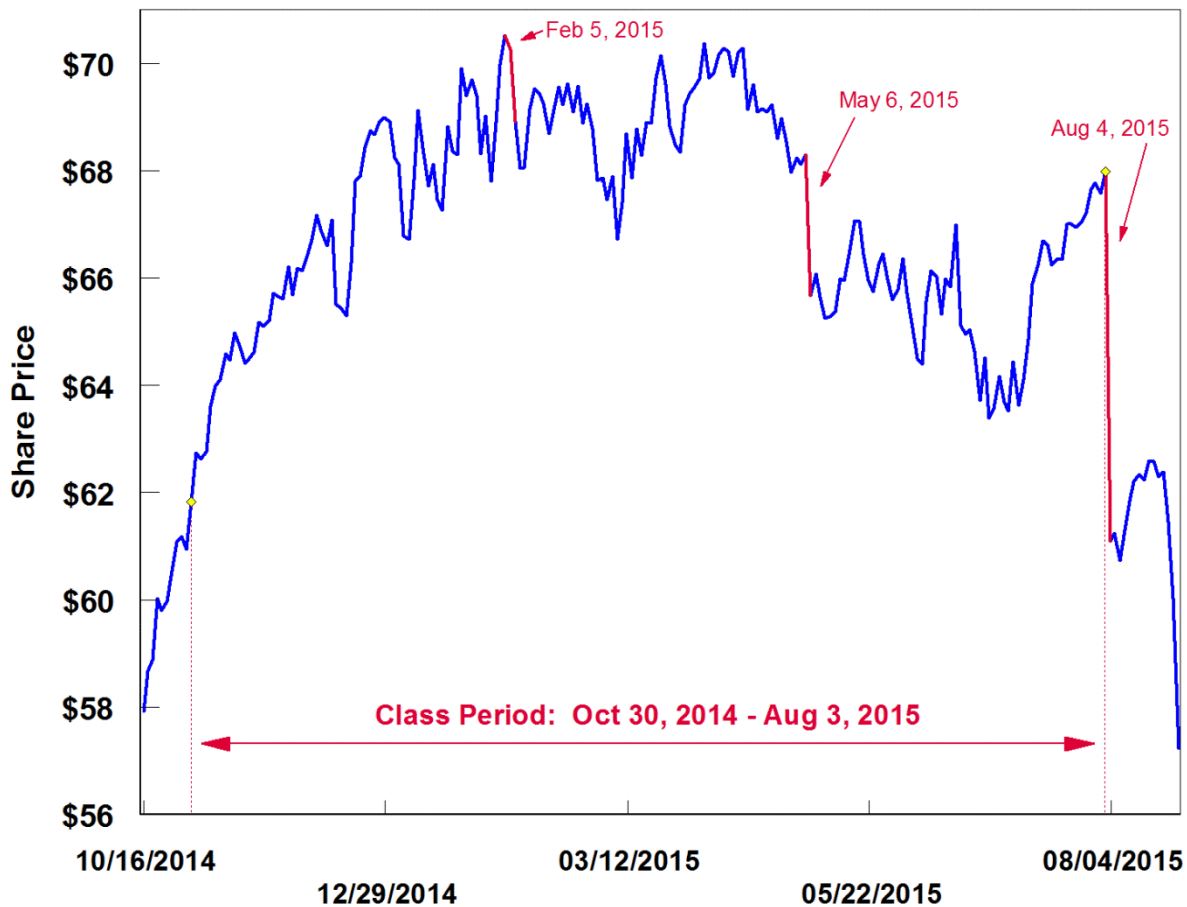
19. However, since the negative frequency trends were being driven by new business, the problem was not going away. At and after the end of the Class Period, Defendants finally admitted that the increased frequency trends were not solely attributable to external factors, but were in fact caused in substantial part by the new business growth, which Defendants described as a “new business penalty.” Defendants acknowledged it would take several quarters to remedy and fix the problem. Defendants also admitted that they needed to tighten underwriting to reduce claim frequency.

20. More specifically, after the close of trading on August 3, 2015, Defendants issued a release reporting disappointing 2Q 2015 results and a third consecutive quarter of increased claims frequency. The release quoted Wilson as stating that Allstate had suffered ““continued increases in auto losses”” and its ““second quarter operating income of \$262 million was lower than last year, reflecting increased frequency and severity of auto accidents.”” Contrary to Defendants’ Class Period statements that increased frequency was caused solely by external factors, Wilson admitted in the release that ““recent growth in Allstate brand auto policies in force did increase frequency”” and the Company needed ““tighter underwriting standards.”” The next morning, August 4, 2015, Defendants hosted a conference call during which Wilson again admitted that “the new business growth rate” contributed to increased frequency and had negatively impacted margins. Winter even acknowledged that the “impact was expected” by management.

21. Analysts reacted negatively to the new information, as they now understood the spike in frequency was not a “blip” or “one-time event,” but would have a recurring impact on Allstate’s growth and profitability. Analysts understood that it was an Allstate-specific problem, with analysts from UBS Securities (“UBS”) reporting: “Given that new business is less profitable than renewals,

we expect that the growth is contributing to the underlying deterioration and uptick in frequency. Still, given that other major personal auto carriers have not reported the same magnitude of increases in frequency, the persistent increase in frequency is a concern.” Analysts from Deutsche Bank Securities (“Deutsche Bank”) reported: “Strangely, Allstate’s woes did not appear in competitor accident-year loss ratios for 2Q15,” and Allstate’s results “could suggest some operational control problems.” Deutsche Bank noted that the “spike in claims trend is the sharpest in five years.”

22. As a result of the disappointing disclosures, Allstate’s stock price dropped by more than 10% from \$69.38 per share on August 3, 2015 to \$62.34 per share on August 4, 2015, on an unusually high volume of trading, eliminating more than \$2 billion in market capitalization. The following chart reflects the decline in Allstate’s stock price:



JURISDICTION AND VENUE

23. The claims asserted herein arise under and pursuant to §§10(b) and 20(a) of the Exchange Act [15 U.S.C. §§78j(b) and 78t(a)] and Rule 10b-5 promulgated thereunder by the SEC [17 C.F.R. §240.10b-5]. This Court has jurisdiction over the subject matter of this action pursuant to §27 of the Exchange Act [15 U.S.C. §78aa] and 28 U.S.C. §1331.

24. Venue is proper in this District pursuant to §27 of the Exchange Act and 28 U.S.C. §1391(b), as many of the acts and practices complained of herein occurred in substantial part in this District, Allstate maintains its principal place of business in this District, and certain of the acts and conduct complained of herein, including the dissemination of materially false and misleading information to the investing public, occurred in this District.

25. In connection with the acts alleged in this complaint, Defendants, directly or indirectly, used the means and instrumentalities of interstate commerce, including, but not limited to, the mails, interstate telephone communications, and the facilities of the national securities markets.

PARTIES

26. Plaintiff City of St. Clair Shores Police and Fire Retirement System purchased the common stock of Allstate during the Class Period as set forth in the certification attached hereto and was damaged as the result of Defendants' wrongdoing as alleged in this complaint.

27. Defendant Allstate operates as a property-liability insurer in the United States and Canada. Allstate maintains its headquarters at 2775 Sanders Road, Northbrook, Illinois 60062. Incorporated in 1992 as a holding company for Allstate Insurance Company, Allstate has grown to be the third largest personal passenger auto insurer and the largest publicly held personal lines insurer in the United States. Throughout the Class Period Allstate stock traded on the New York Stock Exchange ("NYSE") under the ticker symbol "ALL."

28. Defendant Wilson was at all relevant times the CEO and Chairman of the Board of Allstate, and he has held those roles since 2007 and 2008, respectively. Wilson was also President of Allstate from 2005 to 2015 and has worked at Allstate for over 20 years. Wilson's director profile emphasizes his "in-depth understanding of Allstate's business," including its products and customers, and states that Wilson "[c]reated and implemented Allstate's risk and return optimization program."

29. Defendant Winter joined Allstate as the CEO and President of Allstate Financial in 2009. Winter served as President of Allstate Protection Lines ("APL") (which includes Allstate brand auto insurance) from 2012 to December 2014, at which time he was promoted to President of Allstate. Winter was at all relevant times "responsible for all business operations and distribution within APL."

30. Defendant Macellaro was at all relevant times the Vice President of Investor Relations at Allstate.

31. Wilson, Winter and Macellaro (the "Individual Defendants"), because of their positions with the Company, possessed the power and authority to control the contents of Allstate's quarterly reports, press releases and presentations to securities analysts, money and portfolio managers and institutional investors, *i.e.*, the market. They had access to and/or were provided with copies of the Company's reports and press releases alleged herein to be misleading prior to or shortly after their issuance and had the ability and opportunity to prevent their issuance or cause them to be corrected. Because of their positions with the Company, they had access to material information available to them but not to the public, such as Allstate's underwriting practices (and changes thereto) and Allstate's frequency reports and analyses, and Defendants knew or recklessly disregarded that the adverse events and trends specified herein had not been disclosed to and were

being concealed from the public and that the positive representations being made were, as a result, materially false and misleading.

FACTUAL BACKGROUND

Industry Background

32. Insurance companies develop underwriting standards to determine whether to offer insurance or to decline potentially risky business and to determine through careful analysis of factors, including decades of historical claims experience, the appropriate premiums to charge.³ Increasing the number of policies-in-force can result in increased revenues but not necessarily increased profitability. For example, if an insurance company increases its policies-in-force by selling to accident prone drivers, it may pay more in claims than it collected in premiums resulting in a net loss on the additional policies.

33. Insurance companies can increase their policies-in-force by loosening underwriting standards and can decrease the number by tightening underwriting. In general, to tighten underwriting means to impose more stringent requirements that result in fewer policies being issued. In addition to looking at characteristics of the insured, such as prior driving behavior, insurance companies look to other factors, such as geography, in assessing risk. For example, insuring drivers in states with severe weather and heavy traffic patterns may lead to higher accidents and claims. An insurance company seeking to maximize profitability will either have to charge such customers higher premiums or avoid insuring such customers altogether. To loosen underwriting is the opposite of tightening, and generally means to lower the standards or pricing relating to matters such as the characteristics of the driver or the geographies in which the insurance is offered.

³ The premium is the price the consumer pays for an insurance policy. A premium is calculated based on the insurance “rate,” which can vary significantly based on risks. In general, insurance companies utilize a base rate, which is then increased or decreased based on “rate adjustment factors” that attempt to assess and price for risk. Thus, an insurance company can modify its rate by changing the base rate or the weight given to particular adjustment factors. As explained herein, rate increases must be filed with state regulators.

34. There can be a significant lag in time between an accident and the ultimate payout. A critical process used by insurance companies to evaluate the performance of their business and estimate future claims so that they can adjust underwriting standards and/or rates on a timely basis is to monitor whether the frequency of auto claims is increasing or decreasing. For example, if an insurance company loosens its underwriting to increase policies-in-force and revenues, it will then monitor the frequency of auto claims to determine if they are increasing at a faster rate, which may be a sign that the new business is too risky and may result in lower overall profitability.

35. In addition to monitoring trends in the frequency of claims, insurance companies, including Allstate, carefully analyze the source of increases, as it can have a significant impact on business decisions. For example, if claims spike due to a rare weather event, an insurance company may determine to leave its underwriting guidelines unchanged and recoup the losses over time by maintaining or moderately increasing premiums to avoid overcharging and losing the otherwise profitable customers to competitors. On the other hand, if a claims spike is the result of loosened underwriting standards and selling insurance to a collection of poor drivers or drivers facing unusually difficult driving conditions, then the insurer may decide that it is better off tightening its underwriting to avoid such unprofitable customers and to focus on less risky customers.

36. The insurance industry is regulated primarily by individual states. To increase rates, insurance companies apply for rate approval in the various states in which they operate, receive approval from state regulators (unless the state allows for immediate use of increased rates upon filing for approval), implement rate increases, and then earn the premiums into revenues over the period covered by the policy. For Allstate, it takes another six months for the increased pricing to work its way through policy renewals on the entire legacy book. Failure to act timely to address negative events can depress margins into the foreseeable future.

Allstate's Segments and Brands

37. Allstate has four business segments: Allstate Protection, Allstate Financial, Discontinued Lines and Coverages, and Corporate and Other. In the Allstate Protection segment, Allstate principally sells homeowners and private passenger auto insurance. This case primarily relates to Allstate's auto insurance business.

38. Allstate's auto insurance products are sold under three different brand names: Allstate, Esurance and Encompass. The Allstate brand is the Company's largest and most profitable, making up about 90% of Allstate's entire auto written premiums for 2015. Allstate brand auto insurance is sold through its exclusive agencies. Esurance is sold directly to consumers online, through contact centers, and through select agents. Encompass insurance is sold predominantly in the form of a bundled annual package policy, which is sold through independent agencies.

Performance Metrics

39. Allstate tracks and reports various ratios as a means of measuring its business performance. Allstate's "loss ratio" is the ratio of claims and claims expense (*i.e.*, "loss") to premiums earned. Its "expense ratio" is the ratio of operating costs, restructuring charges and other expenses to premiums earned. And its "combined ratio" is the sum of the loss ratio and the expense ratio. The difference between 100% and the combined ratio represents the Company's underwriting margin.

40. Allstate also reports an "underlying combined ratio," which is the combined ratio excluding the effect of certain extraordinary business events, including (i) catastrophes, (ii) prior year reserve re-estimates, and (iii) amortization of purchased intangible assets. Allstate's annual report to investors states that the underlying combined ratio "is useful to investors and it is used by management to reveal the trends in our Property-Liability business that may be obscured by catastrophe losses, prior year reserve reestimates and amortization of purchased intangible assets."

According to Allstate, such items could have a significant impact on a particular quarter, but excluding them for the underlying combined ratio is “useful for investors to evaluate these components separately and in the aggregate when reviewing our underwriting performance.”

41. Allstate management also makes disclosures regarding various other industry metrics, including:

(a) Catastrophe losses: these are losses resulting from various events, including natural events such as high winds, winter storms, tornadoes, hailstorms, wildfires, tropical storms, hurricanes, earthquakes and volcanoes, or man-made events such as terrorism or industrial accidents;

(b) Policies-in-force (or “PIF”): this refers to the total number of active insurance policies underwritten by Allstate and is based on items rather than customers. Thus, a multi-car customer would generate multiple policy counts, rather than a single policy;

(c) New issued applications: this refers to new automobile insurance policies issued during the period. Allstate executives sometimes refer to this as “new auto insurance volume”;

(d) Claim frequency (or “frequency”): this refers to the number of claims (*i.e.*, insured seeking payment for damage or injury) per policy in force. Allstate separates frequency into two categories: Bodily Injury (“BI”) and Property Damage (“PD”). Allstate reports quarterly and annually the year-over-year increase or decrease in frequency on a percentage basis⁴; and

(e) Claim severity (or “severity”): this refers to the average cost per claim. Allstate also separates severity into BI and PD.⁵

⁴ BI claims are more costly than PD claims. According to reported industry data for 2015, the average PD claim was around \$3,500 whereas the average BI claim was around \$17,000. Defendants have explained that low-impact collisions – from winter weather, for example – generally result in increased PD frequency, but not BI frequency.

⁵ Unless otherwise noted, references to PIF, new issued applications, frequency, or severity herein are with respect to the Allstate brand auto business.

Defendants Disclose Plans to Boost Auto Policies While Maintaining Profitability

42. In 2005, Allstate sustained billions of dollars in losses in its homeowners business following Hurricane Katrina. As a result, Allstate attempted to mitigate further risks by reducing policies-in-force in risky geographies. From around 2008 to 2012, Allstate again sustained significant losses in its homeowners business due to claims from non-catastrophic severe weather, such as hail storms and straight line winds. Allstate reportedly continued its efforts to minimize its risk exposure.

43. However, since customers often use the same insurance company for both auto and homeowner policies, reducing homeowner policies or raising rates also puts pressure on Allstate's auto insurance growth. Auto claims frequency had generally declined between 1996 and 2008 as a result of improved safety features and had remained relatively flat from 2008 through 2013. Thus, Allstate announced it was going to spur growth in its auto policies.

44. Heading into the Class Period, Allstate began to embark on an aggressive campaign to boost growth in auto policies purportedly without sacrificing profitability. Defendants hosted a conference call on May 7, 2014 to discuss Allstate's 1Q 2014 results. Wilson told investors that "[o]perationally we are making good progress on all of our 2014 annual operating priorities," and Winter reassured investors as to management's timely and exhaustive review of trends, stating: "We're overall feeling very good about where we stand in auto," and "we break down our combined ratio and our loss ratio in what I would call almost agonizing detail. We know what's happening there" Winter said Allstate was "trying to optimize the point between growth and profitability to ensure we are able to continue the kind of growth that we've been experiencing recently" and claimed "[w]e just had, in terms of new business production, one of the best total auto quarters since 2001."

45. On May 28, 2014, Wilson participated in an analyst conference. Wilson told analysts that Allstate's growth plans would not come at the expense of profits, stating: "Our growth priorities are now squarely focused on growing market share of both revenues and profits." Wilson highlighted Allstate's ability to grow while maintaining profit margins, stating: "The momentum we established in 2013 has continued this year. Our first quarter premium policies in force increased and our underlying combined ratio was within our full year outlook despite impacts from severe winter weather."

46. Despite several years of frequency having remained flat or declining, in October 2014, Allstate experienced a significant spike in auto claims frequency as a result of its aggressive growth practices. Defendants initially concealed this increase, but when it continued and could no longer be denied, they disclosed the spike but concealed that it and the resulting lower margins were caused in substantial part by the new auto growth.

DEFENDANTS' FALSE AND MISLEADING CLASS PERIOD STATEMENTS

Defendants' October 2014 False and Misleading Statements

47. On October 29, 2014, Defendants issued a release reporting Allstate's 3Q 2014 results. The release highlighted not only Allstate's growth in policies-in-force but also the purported profitability of the new growth. Specifically, the release stated, in part: "The Allstate brand grew insurance policies in force by 572,000, or 1.9% in the third quarter of 2014 compared to the prior year quarter, *after reflecting a comprehensive plan to generate profitable growth*. This growth was driven by an increase of 504,000 Allstate auto policies, 2.6% higher than the third quarter of 2013"

48. Defendants hosted a conference call the next day, October 30, 2014. During the call, Defendants continued to emphasize Allstate's purported ability to grow auto policies without compromising profitability. Wilson stated: "We continue to have broad-based auto policy growth,

which is 2.6% higher than the prior year.” Wilson also stated that “[t]he underlying combined ratio for [the] third quarter was 86.1, which brings that year-to-date total then for the first nine months to 86.4 which is better than the full-year outlook range of 87 to 89 that we provided in February.” Defendants claimed frequency trends were “lower” and “extremely favorable” while reaffirming that they were not trading off profitability to obtain growth. Specifically, during the call:

(a) In providing an overview of personal lines insurance results, Macellaro noted that a purported “**lower frequency of claims**” offset increased severity of losses.

(b) An analyst asked: “With gas [prices] sub \$3 [per gallon] in a lot of areas, are you pricing for increased frequency yet or [are] you waiting to see what will happen?” Wilson said that Winter’s team “has proven their ability to micro-target that stuff” and asked Winter “to make a comment about frequency and profitability.” Winter stated they did not expect gas prices to “be a core driver” and said “**our frequency so far has been extremely favorable to prior year,**” adding, “**so our frequency trends have been good.**” Winter assured investors that Defendants “stay on top of” frequency trends and “have a pretty long-term history of managing our margins well and keeping an eye on both frequency and severity and reacting accordingly.”

(c) Another analyst said that “[m]anagement’s stated goal has been to maintain the margin and yet you have blown past it and done extremely well for the last couple of quarters,” and asked if Defendants planned to increase growth at the expense of margins or maintain them. In response, Wilson stated, in part:

So we like where we are operating today. You could hear from Don’s comments **we are all-in for growth, but it’s got to be profitable growth.** Sometimes we get growth and it’s not profitable and then we shrink it. Other times we get growth and it’s profitable, a little more profitable than we think.

We toggle between those at a relatively micro level, but **we don’t have any desire to reduce our returns in auto or homeowners or our other businesses today to get more growth. We don’t think we need to.** We think we are accurately priced.

. . . So we are happy with where we are at. We are not looking to sort of say combined ratio is going to go up so we can grow another point. That's not a good trade for shareholders.

49. The October 2014 statements were materially false and misleading when made. The true facts, which were concealed and known to or recklessly disregarded by Defendants, were:

(a) Despite choosing to emphasize favorable frequency trends, with Winter stating that “our frequency so far has been extremely favorable to prior year” and Macellaro claiming that frequency trends were “lower,” Allstate had just experienced a spike in frequency throughout October that contributed to the largest and most financially impactful quarterly increase at Allstate in several years and reversed long-standing trends of flat or declining frequency and stable operating ratios.

(b) Defendants had not achieved “profitable growth” to avoid reducing returns in auto, but had underwritten less profitable and riskier business, which was causing a spike in claims frequency that would reduce overall margins and worsen the Allstate brand auto underlying combined ratio as claims from the new policies were processed.

(c) In claiming they were not looking to depress margins in order to achieve growth because it was not a good “trade for shareholders,” Defendants concealed that, in truth, Allstate had made that trade, as it had been aggressively pursuing growth at the expense of margins, and Defendants were well aware that claims had spiked as of the date of their statements.

50. Analysts reacted positively to the false and misleading information regarding Allstate’s reported profitable growth, which was achieved without an adverse impact on the frequency of claims or on margins. For example, after Defendants issued the release, UBS issued a report on October 29, 2014, which stated that “[s]trong underlying results drive earnings beat again” and “[a]uto PIF growth remains strong in 3Q14.” After the conference call on October 30, 2014, MKM Partners also issued a report, stating that “[t]he auto business continues to grow and generate

very good underwriting results. The company's goal here is to continue to maintain profitability while attracting new customers." The MKM Partners report further noted that "[f]requency and severity trends remained relatively benign." On the same day, Sterne Agee reported that the "[a]uto core loss ratio was about 0.9 pts better than a year ago," and the "[l]oss trend was generally favorable with declines in frequency for both auto and homeowners."

51. On November 5, 2014, Deutsche Bank increased Allstate's price target, stating: "While we believe Allstate is in a position to achieve profitable growth, we also believe that the valuation reflects a consensus view that this is indeed the case." Similarly, on December 17, 2014, RBC Capital Markets issued a report increasing Allstate's price target and stating: "Underwriting actions paying off: Management's efforts to remain selective in growing its auto book have proved positive"

Defendants' February 2015 False and Misleading Statements

52. After the market closed on February 4, 2015, Defendants issued a release reporting Allstate's 4Q 2014 and FY 2014 results and admitted that auto claim frequency had spiked, but specifically blamed it solely on external factors. The release emphasized the success of Allstate's growth strategy and quoted Wilson as stating: "'Our strategy to serve customers with unique value propositions enabled the property-liability businesses to increase policies in force across all three underwritten brands by 840,000, which led to a \$1.5 billion increase in premiums written in 2014.'" In addition:

(a) The release disclosed the increase in frequency of claims, stating that "[a]n increase in claim frequency in the first two months of the quarter adversely impacted the combined ratio for auto insurance, with Allstate brand auto combined ratio rising to 97.0, [which] was 1.7 points higher than the prior year," but the release identified only external factors as the cause, and specifically the "*impact of precipitation in select markets and general economic trends.*"

(b) The release quoted Wilson as stating that “[t]he underlying combined ratio was at the favorable end of the full-year outlook range, **as the negative impact of adverse fourth quarter frequency on auto margins was more than offset by our focus on profitable growth.**”

53. Defendants hosted a conference call the next day, February 5, 2015. During the call, Defendants continued to tout the success of the new business growth, with Wilson stating that “[f]ourth-quarter auto margins were off somewhat,” but maintaining that “[f]inancial results for the year were excellent,” while emphasizing “[a]uto policy growth of 2.9% versus the prior year . . . **driven by strong new business results** and stable retention.” Defendants blamed the spike in frequency on purely external factors while claiming that new business was not a cause. Specifically:

(a) Analysts asked what caused the increased auto claim frequency. Wilson said that Winter “has been waiting anxiously for your question, because he’s spent [an] untold number of hours over the last really three months since we saw a tick-up in October. So we were on this early, and he can give you all the specifics.”⁶ Winter reassured investors by stating: “**Let me start with what is not driving it. Number one, we saw nothing to indicate that it’s a quality of business issue or that it’s being driven by growth, which is a natural question that you would have . . .**” Winter explained the detailed analysis they conducted and repeated that they “**saw nothing in there that would indicate it was a quality of business or a growth-related issue.**” Winter attributed the spike in frequency to “**two factors [that] traditionally drive PD frequency: miles driven and precipitation.**”

(b) Winter assured investors that Defendants closely study the issue to the point they are “paranoid” and that they “get paid to worry a lot and to focus intensely” on the issue.

⁶ Notably, although Defendants had claimed frequency was good in October, here Wilson acknowledged they saw the increase in October and were on it “early.”

Winter then repeated Defendants' definitive conclusion: "***In no way are we concerned that it's a quality issue.***"

(c) Signaling the importance of the issue, analysts sought to confirm yet again that the frequency increase was related solely to miles driven and weather and not new business. A Goldman Sachs analyst asked: "So there's not a third factor of why is this happening and what can we do about it that you are concerned about?" Winter again responded: "***We are confident we have analyzed this to death, some might say. We understand the drivers.***" Wilson reaffirmed Winter's assurances and jumped in, stating: "Which is why we committed to 87 to 89 for next year." Winter reemphasized that the causes were external factors, stating that "***precipitation and employment rates are not Allstate-peculiar issues***" and "***not . . . related specifically to the Company,***" but instead were "***related to the general environment.***"

(d) Macellaro also claimed that auto growth was "***driven by continued favorable new business*** and stable retention trends."

(e) Macellaro likewise acknowledged that Allstate brand auto "did experience a spike in the underlying combined ratio in the fourth quarter," and attributed the increase to "higher levels of accident frequency experienced in the first two months of the quarter," but claimed the frequency spike "was ***driven by a combination of increased economic activity and non-catastrophe weather.***"

(f) A Barclays Capital ("Barclays") analyst asked: "[O]n the frequency issue, you said that the frequency recovered in December. Was that also the case in January?" Defendants assured investors that they monitor frequency prior to earnings calls and on a daily and even an hourly basis. Winter began responding: "We just closed the month. Let's just say that obviously we were looking at it on –" and Allstate's Chief Financial Officer ("CFO"), Steven Shebik ("Shebik"), interrupted and said "an hourly basis." Winter reassured analysts that January was looking good,

stating: “You know, we get claim counts daily. So let’s just say we looked at it. We don’t give out the results but we did know what the numbers were before we committed to 87 to 89.”

54. Defendants’ February 2015 statements were materially false and misleading when made. The true facts, which were concealed and known to or recklessly disregarded by Defendants, were:

(a) Despite Defendants’ assurances that they had thoroughly studied the frequency increases and had analyzed the causes “to death,” and despite their definitive statements that there was “nothing” to indicate anything but external factors were responsible, in truth, the uptick in Allstate’s frequency trends was being driven in substantial part by the new business growth.

(b) Allstate’s new business was not “strong,” “profitable” and “favorable,” nor was it offsetting negative frequency trends, but, in fact, it was driving in substantial part the negative trends.

(c) Defendants knew the spike in frequency was related to the new business growth and likely to recur, which is why Wilson cashed out \$33 million of his own stock years before his options were set to expire.

(d) Allstate’s growth in auto policies was the result of underwriting less profitable and riskier business, which was causing a spike in claims frequency that would reduce overall margins and worsen the Allstate brand auto underlying combined ratio as claims from the new policies were processed, which was reflected in the largest spike in claims frequency in nearly five years and reflective of a deterioration in the quality of the business.

55. As a result of the disclosure of negative frequency trends, Allstate’s stock price dropped from a close of \$72.58 per share on February 4, 2015 to a close of \$70.93 per share on February 6, 2015. However, because of Defendants’ materially false and misleading statements

and/or failure to disclose the full truth regarding the cause of the negative trends, the price of Allstate stock remained artificially inflated.

56. On February 5, 2015, Wells Fargo analysts increased their valuation of Allstate, claiming that the stock was dropping “in response to the reported higher auto claims frequency, something we believe to be an overreaction.” The analysts referred to it as a “[f]requency blip,” noting that “Company commentary on the call pointed to satisfactory frequency experience in January as well.” The analysts reiterated that “Allstate does not think the frequency increase is associated with the quality of the business being written or the greater pace of business growth.”

57. Deutsche Bank analysts likewise increased their price target for Allstate, and, significantly, in doing so noted the material difference between increased frequency resulting from external versus internal factors:

On the 4Q14 earnings call management claimed it well-understood the underlying causes [of the increase in frequency claims], and appropriate actions were being taken to remediate the issue.

The cause of the problem was explained to be increased economic activity and non-catastrophe weather. We note that an explanation involving issues in the quality of business would have been much more troubling to investors.

58. Similarly, Morningstar analysts reported that they saw the increased frequency “as a one-time event.”

Defendants’ May 2015 False and Misleading Statements

59. After the market closed on May 5, 2015, Defendants issued a release reporting Allstate’s 1Q 2015 earnings results. The release disclosed the continuation of the negative trend in frequency, stating that “Allstate brand bodily injury frequency increased 6.8%” and “[p]roperty damage frequency increased 2.1%” on a year-over-year basis. Despite the continued increase in frequency, the release continued to divert blame away from new business growth, quoting Wilson: “*Allstate’s strategy of building a broad-based business model continued to generate profitable growth The Allstate brand had good growth and returns in auto*”

60. Defendants hosted a conference call the next day, May 6, 2015. During the call:

(a) Wilson reemphasized to investors that Allstate's business model "***enables us to generate profitable growth despite a changing economic and competitive environment.***"

(b) Macellaro again reported the increased frequency, but assured investors that Defendants looked closely at frequency, stating that "we've continued to dig into the drivers of increased frequency since the trends began to emerge in the fourth quarter of last year," and that "[w]e leverage our data and analytic capabilities to continuously analyze our business from the macro level down to the micro segments that our local teams use to underwrite and price." Macellaro explained that "examples of items we have investigated include the impact of new to renewal loss ratio relativities often referred to as the new business penalty from writing higher volumes of new business." As a result of this extensive analysis, Macellaro assured investors that "***[b]ased on our analysis we continue to be comfortable with the quality of both our new and renewal business.***" Macellaro claimed the "***analysis also reinforces our conclusion that recent frequency fluctuations are due primarily to macroeconomic trends in weather and while we believe industry-wide auto frequency will continue its long-term downward slope over time, there will be periods of variability within that trend that are driven by external factors.***"

(c) An analyst said he was confident Allstate could maintain auto margins, but was "less confident that you could continue to grow PIF at the current rate," and he asked if they planned to take pricing actions that could "lose some PIF [growth] momentum." Defendants Wilson and Winter jointly responded:

(i) Wilson stated:

[T]he first thing you have to get through: ***is this our problem or is this everybody's problem?*** If it is our problem then obviously the actions we take will be different and the impact on shareholder value and long-term value creation is different than if it's everybody's problem.

If it is everybody's problem then the actions we take and the impact on both growth, profitability, customer satisfaction, ability to expand the agency is

completely different. *So we feel like this is at this point everybody's problem, Matt can help you understand why we believe that is the case.*

(ii) Winter added:

Let me expand a little bit on what Tom just said. *As we talked about last quarter actually, the frequency pressure is a combination of miles driven and weather.* And I believe I said last quarter we thought that miles driven was about three times as influential as the weather. *That pattern seemed to⁷ hold up again this quarter.*

But we want to validate that and verify it. And as Pat [Macellaro] referred to in his opening remarks, *we did a very intense deep dive into our business to ensure that the increases in the frequency we are seeing* are proportional and consistent across multiple segments of the business no matter how you cut it, to make sure in effect that these *aren't our problems but are in fact external.*

And so we looked at new and renewal business, we looked at higher growth states versus lower growth states. We looked across quality characteristics, we looked across driver age, household composition, insurance scores, full coverage versus liability across different rating plans to see whether or not perhaps rating plans had influenced it.

And all of that review showed that this trend is externally driven primarily by miles driven.

* * *

So we validated it with our internal data, we validated with external data and then we look[ed] at other sources to ensure that that in fact is true. . . .

* * *

So you look at all of that and you come to the conclusion that in fact this is an external trend. So given that it is an external trend we believe that our competitors will react to it the same way we will react to it. I don't think they will react to it with the level of sophistication and granularity we might or in the exact same ways, but *they will have to react to the trends.*

(d) An analyst with Credit Suisse asked why the external factors were not impacting competitors, to which Wilson responded: "[W]e can't answer the question as it relates to other people," but "[w]e can answer the question which Matt [Winter] talked extensively about which is we don't see anything [in] the way we have done our business. We have the ability to slice and dice our data as if we were our own competitor, right. So we can slice and dice it a whole bunch of ways and we do think it is comprehensive."

⁷ One transcript reported "seemed to" as "(technical difficulty)" whereas a transcript from Bloomberg LP includes "seemed to."

61. As a result of the disclosure of a continuation of the negative frequency trend, Allstate's stock price dropped from a close of \$70.00 per share on May 5, 2015 to a close of \$67.31 per share on May 6, 2015. However, because of Defendants' materially false and misleading statements and/or failure to disclose the full truth regarding the cause of the negative trends, the price of Allstate stock remained artificially inflated.

62. On May 28, 2015, Wilson presented at the Sanford C. Bernstein Strategic Decisions Conference. Wilson told investors "our auto business was up 3.2% in units in the last year and I don't think there was 3.2% new cars [sic] added to the United States last year. So that would tell me, we picked up share [in the auto insurance business] last year by doing a better job for those customers." Wilson was asked about the increased frequency, and he discounted the negative trends in frequency, stating, in part: ***"It just looks sort of benign. If you look at the normal volatility, I would say, we just had a normal volatility. I don't think it's any worse or better than any other time."*** He added: ***"Frequency – the reason we only give a range. I said 87 to 89 [as 2015 guidance for the underlying combined ratio], the reason we give a range is because you kind of can't predict the weather, right, like frequency can bounce around by 1 percentage point in a year"***

63. Defendants' May 2015 statements were materially false and misleading when made. The true facts, which were concealed and known to or recklessly disregarded by Defendants, were:

(a) Allstate's increased frequency was not "everybody's problem" and a purely external trend, but was specific to Allstate, as the increased frequency at Allstate was being driven in substantial part by its new business growth.

(b) Despite Defendants' assurances that they had done a deep dive to ensure the negative frequency trends were the result of solely external factors, the negative frequency trends were not being driven solely by external factors, but also by the new business growth.

(c) Contrary to Defendants' statements that they had not seen "anything" to suggest internal factors (such as new business growth) were impacting the negative frequency trends, Allstate's negative frequency trends were in fact being adversely impacted by higher claims frequency in the new business, which meant it would take several quarters to attempt to resolve.

(d) Contrary to Defendants' assurances, auto policy growth was not driven by profitable, "quality" new business, but by new business that was considerably more risky and less profitable, which was causing claims frequency to increase.

(e) Allstate's frequency trends were not "benign," but included the largest increases in many years, and were not being impacted by unpredictable events like "weather," but by the predictable consequence of underwriting new business for which Allstate had decades of historical experience with which to correlate increased frequency.

64. Rather than understanding that the continued negative trends in frequency were caused in substantial part by the new business growth, analysts accepted Defendants' explanation that the problem was solely external, and thus would not impact Allstate's policy growth or ability to obtain regulatory approval for, and push through to customers, planned rate increases. For example, analysts from Credit Suisse noted that Allstate's "view is that the pickup in trend is driven by external factors so rate increases should be easier to obtain," which made the analysts "more confident that this is not an [Allstate] specific issue," enabling Allstate "to push through rate at a faster than expected pace." Analysts from RBC Capital Markets agreed, reporting that "[w]e don't believe this phenomenon is specific to just Allstate, which should make it easier for them to take corrective pricing actions without sacrificing much policy-in-force growth." In other words, the news was considered positive. As an MKM Partners analyst summed it up: "[W]e would expect better auto results are ahead."

THE TRUTH BEGINS TO EMERGE

65. On July 16, 2015, Allstate pre-announced \$797 million in catastrophe losses for 2Q 2015, which analysts estimated would have a negative impact on operating earnings per share (“EPS”)⁸ of around \$1.25. Taking this into account, and before Allstate reported its 2Q 2015 results, the consensus estimate among analysts for 2Q 2015 operating EPS was \$0.97.

66. After the market closed on August 3, 2015, Defendants issued a release reporting 2Q 2015 financial results. Allstate shocked investors by reporting disappointing financial results that reflected the third consecutive quarter of the negative trend of increased claim frequency. Allstate reported quarterly operating income of \$262 million, which was \$350 million (57%) less than the prior quarter, and disappointing operating EPS of \$0.63, a \$0.34 (35%) shortfall from analysts’ consensus. The release, quoting Wilson, attributed the dismal operating EPS to “‘increased frequency and severity of auto accidents,’” which also “negatively impacted” loss and combined ratios. Both BI and PD frequency increased nearly 7% on a year-over-year basis.

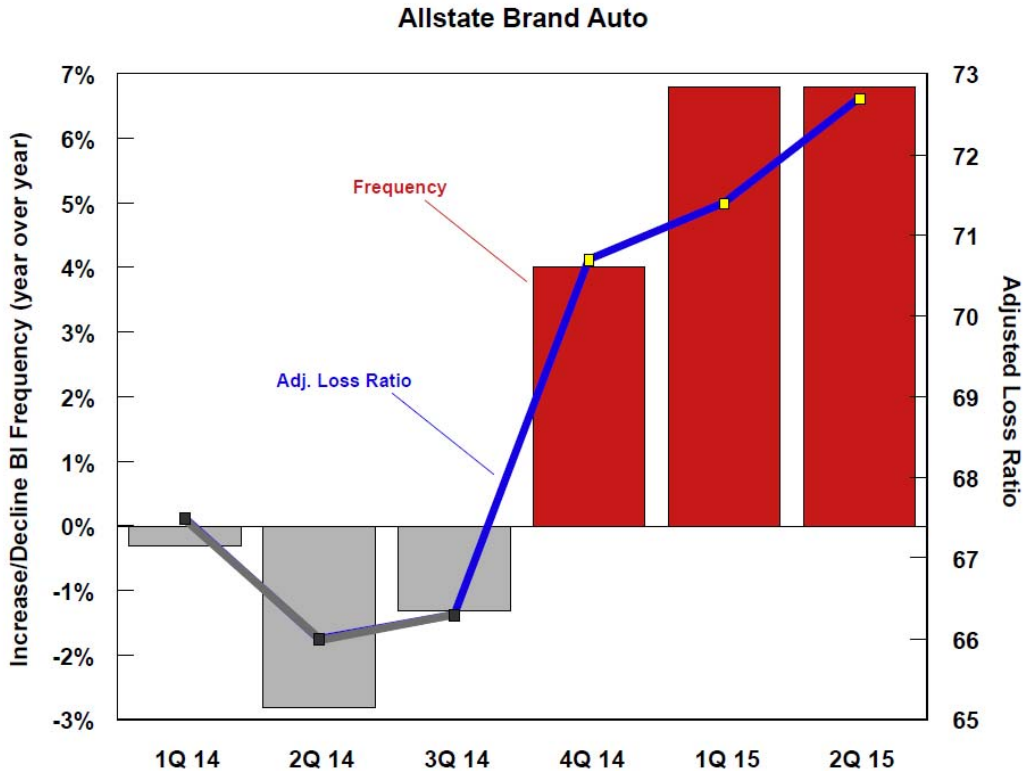
67. The negative trend in Allstate’s operating performance is reflected in the following chart:

Quarter	Operating Income	Operating EPS
4Q 2014	\$736 million	\$1.72
1Q 2015	\$616 million	\$1.46
2Q 2015	\$262 million	\$0.63

68. This negative trend was the result of deteriorating margins from increased claim frequency, which is further illustrated by the following comparison of quarterly frequency increases with increasing margin pressure from Allstate brand auto losses:⁹

⁸ Operating income is Allstate’s net income excluding certain non-recurring, infrequent or unusual items, such as business combination expenses. Operating EPS is the operating income per share.

⁹ The adjusted Allstate brand auto loss ratio depicted in the chart excludes the effects of catastrophe losses, which are reported in quarterly investor supplements posted on Allstate’s website. The Allstate brand auto loss ratio for 1Q 2014 through 2Q 2015, sequentially, was 67.9, 70.1, 68.1, 70.9, 71.7, and 75.9, and the effect of catastrophe losses was 0.4, 4.1, 1.8, 0.2, 0.3, and 3.2, resulting in the adjusted Allstate brand auto loss



69. The August 3, 2015 release quoted Wilson as admitting for the first time that “recent growth in Allstate brand auto policies in force did increase frequency, since new business typically has higher relative frequency.” It also quoted Wilson as stating that Allstate had responded with “tighter underwriting standards.”

70. Defendants held a conference call the next day, August 4, 2015. Defendants faced numerous questions from analysts about the deteriorating auto business and increased frequency. One analyst noted that “the main topic of the call will be on auto insurance and how those margins can be improved.” During the call, Defendants admitted, contrary to their Class Period statements, that the negative frequency trends were being caused by the new business growth and not solely by external factors, which meant that the negative trend would continue. Wilson said that the lower quarterly profit was “driven by a deterioration in auto insurance margins” and explained that “[a]uto

ratios reflected in the chart of 67.5 (1Q 2014), 66.0 (2Q 2014), 66.3 (3Q 2014), 70.7 (4Q 2014), 71.4 (1Q 2015), and 72.7 (2Q 2015).

insurance margins decreased as higher claim frequency and severity more than offset average auto insurance price increases.”

71. Winter said that “[t]he largest difference in the second quarter was that there was not a material impact to auto claim frequency from weather.” With weather eliminated as a cause, Winter continued to blame an increase in miles driven, but acknowledged that “miles driven isn’t the sole driver of our increased loss trends.” Winter then said that “new business normally runs at a higher frequency level than renewal customers. We often refer to this as a new business penalty.” Winter also stated that “[o]ur analysis indicated that the new business growth rate is having between 0.5 and 1 point impact on the auto loss ratio.”¹⁰

72. Directly contradicting Defendants’ Class Period claims that they saw nothing to indicate increased frequency was a quality of business issue or the result of anything other than external factors, Winter admitted that new business growth “is, however, a contributing factor to the higher frequency we are seeing,” and shockingly conceded that this impact “was expected.” Winter said that in response, “we are in fact tightening some of our underwriting parameters.”

73. With these admissions, analysts recognized that the negative trends that began in October 2014 were not attributable to a collection of one-time, external events, but were the expected negative result of Allstate’s less profitable new business growth. For example, on August 3, 2015, analysts from Barclays cut their price target for Allstate. The analysts stated that the “2Q results reflect weak . . . underwriting results particularly in auto insurance in what now looks like an issue that will likely take at least several quarters to fix.”

74. Analysts from UBS likewise noted that the “[c]ontinued increase in frequency is troubling.” UBS expressed doubt as to the amount by which external factors contributed to the

¹⁰ Deutsche Bank reported that “[a]s a frame of reference, a 1% change in Allstate’s auto combined ratio is equivalent to \$0.33 of after-tax EPS.”

negative trend, since competitors were not facing the same level of adverse results, and reported that since “other major personal auto carriers have not reported the same magnitude of increases in frequency, the persistent increase in frequency is a concern.”

75. Analysts from Wells Fargo explained that the EPS shortfall was caused in substantial part by the “continued elevated auto claims frequency,” and that the negative frequency trend “appears set to linger longer than anticipated.” The analysts stated that they expected Allstate “shares to trade down following the Q2 earnings release on continued high auto claims frequency.”

76. Analysts from Deutsche Bank also explained that “the EPS miss all comes from underlying weakness” due to frequency increases. The analysts warned that “[t]he magnitude of this pace of loss acceleration seems severe.”

77. The Deutsche Bank analysts further reported after the conference call that “[s]trangely, Allstate’s woes did not appear in competitor accident-year loss ratios for 2Q15” and noted that the results “could suggest some operational control problems as the company has quickly added customers.” The analysts pointed out that management had dismissed the frequency increases in 4Q 2014 and 1Q 2015 as aberrations and ““noise,”” but the continued impact “suggest[s] that a much more negative overall trend was afoot.” The analysts also noted that “[t]his spike in claims trend is the sharpest in five years.”

78. A few days later, Deutsche Bank reported that “no peers are reporting trends that corroborate Allstate’s view of auto accident frequency.”

79. Media also reported Allstate’s disappointing results and remarked on investors’ disappointment with Defendants’ “vagueness” and “puzzling” disclosures. *Crain’s Chicago Business* published an article on August 4, 2015 entitled “Why are Allstate’s auto claims rising when rivals’ aren’t?” *Crain’s* reported that Allstate’s “second-quarter earnings greatly disappointed investors” and observed that Allstate “suffered from much higher-than-expected claims costs in

Allstate's core auto insurance business – disappointment emanated from management's vagueness in identifying the root cause of its payout increases." The article further explained that 2Q 2015 was the first time Allstate had lost money in its auto business since 4Q 2012, when catastrophe losses due to Hurricane Sandy on the east coast skyrocketed, and observed that 2Q 2015 "was relatively benign weather-wise." The article continued: "Making matters more puzzling, other publicly traded auto insurers aren't experiencing the same problems. Progressive, which is based in Mayfield Village, Ohio, said second-quarter losses as a percentage of premiums collected fell substantially year over year. The same was true for New York-based Travelers." The article reported that "[i]nvestors are skeptical that Allstate has its good hands around the problem, given that key rivals are telling far different stories."

80. After the adverse revelations on August 3 and 4, 2015, the Company's stock price dropped from a close of \$69.38 per share on August 3, 2015 to a close of \$62.34 per share on August 4, 2015, or more than 10% in a single day, on very heavy trading volume. The stock drop wiped out more than \$2 billion of the Company's market capitalization, revealing the economic loss and damages to the putative class who bought the stock at artificially inflated prices prior to the disclosure.

POST-CLASS PERIOD DEVELOPMENTS

81. After the Class Period, Defendants made a series of additional admissions that further corroborate that the new business growth was a substantial, known and even expected cause of the increased frequency of claims.

82. On September 17, 2015, Wilson and Macellaro participated in a Barclays Global Financial Services Conference. Wilson noted that the negative trends in auto were continuing and were not solely the result of miles driven, and that "[o]ur analysis did show that there are other factors." In response to an analyst's question about those other factors, Wilson explained why new

business contributed to the negative trends, admitting that they “knew about it,”¹¹ and that, contrary to his Class Period claim that the tradeoff of increased growth for lower margins was not worth it for shareholders, attempted to claim the exact opposite, stating, in part:

The growth we had, there are some people who have said gees [sic], your growth is over 3% in auto, that’s better than Progressive at 2%, so you must’ve written a lot of bad business. We’ve kind of crawled through that to make sure that our pricing algorithms are right. We think they are right. The growth does hit your combined ratio because first time you price somebody who is not as good as the second, third, fourth, and fifth time you price somebody, you can’t be as accurate. And that’s probably hit the combined ratio by 0.5 points to 1 point. So that’s manageable. We knew about it. We’re actually okay with that because over time, at 3% growth rate, you’re picking up share, and that adds value.

83. In terms of corrective actions, Wilson reiterated that they “will slow growth” and that “there are underwriting standards and things that you ask . . . your agencies to do[,] stuff that weed[s] people out from the customers that you will take,” adding that “we’ve put [in] a bunch of new underwriting standards, and that will probably cost us” in growth. Later Wilson conceded the new business growth came through riskier low margin business, stating “you could obviously improve your combined ratio by just shutting down new business and getting rid of the customers you’re losing money on.”

84. On September 21, 2015, analysts from Sterne Agee - CRT Capital Group, LLC issued a report initiating coverage on Allstate. Citing Allstate data and CRT Capital Group LLC research, the analysts stated: “Allstate’s auto insurance margins deteriorated over the past three quarters as the company pursued growth through lower pricing than peers and looser underwriting standards, which also contributed to higher frequency of losses vs. peers. . . . We believe a faster pace of PIF growth vs. peers and lowering of underwriting standards also contributed to the increase in frequency.” The analysts noted that management “is now taking aggressive actions to improve future margins through,” among other things, “[t]ightening underwriting.”

¹¹ The slide presentation accompanying Wilson’s remarks also stated that new auto growth “negatively impacted loss results,” which was “in line with [management’s] expectations.”

85. On October 16, 2015, analysts from William Blair noted that Allstate's "auto underwriting margins have been deteriorating for two years. This negative trend appears to be due to the onset of aggressive underwriting in concert with a worsening macro environment." The analysts noted that "Allstate appears to have gotten aggressive from a risk perspective just as loss trends began to move up," and that "Allstate is attempting to repair its underwriting issues in a deteriorating market." The analysts also observed that "Allstate has seen a larger uptick in frequency in recent quarters than most auto insurers likely due to a combination of aggressive pricing, poor risk selection [*i.e.*, underwriting standards], and a push for higher growth in certain states." They explained that because the "level of deterioration" in the auto business was so significant, "[t]he company may need two underwriting cycles to completely cull the bad business."

86. On November 2, 2015, analysts from Gordon Haskett Research Advisors noted that Allstate would be reporting its 3Q 2015 results. The analysts noted that this "represents an opportunity for [Allstate] to reverse a stink that has been with the company since it reported disappointing Q2 results in August."

87. Later that day, Defendants issued a release reporting Allstate's 3Q 2015 results. Allstate reported the continuation of the negative trend in its auto claims frequency and combined ratios. The release stated that Allstate had "made underwriting guideline adjustments in all three underwriting brands [Allstate, Esurance and Encompass] in geographic areas and customer segments experiencing less than acceptable returns."

88. On the November 3, 2015 earnings conference call, Wilson reiterated that Allstate's new business had higher loss ratios and that to correct the frequency increases Allstate "made underwriting standards more restrictive which has the effect of reducing the higher loss ratio new business. As a result, Allstate brand auto policy growth declined to 3.1% with larger reductions at Esurance and Encompass." Moreover, contrary to Defendants' Class Period statements that the

negative trends were solely caused by external factors and non-recurring circumstances, Winter acknowledged that the higher claims frequency from new business growth was a recurring issue that would take months to resolve when he conceded that “we are assuming the trend line continues to go up at its current levels” and “we continue to operate as if the frequency will continue.”

89. On December 9, 2015, Allstate held a conference call with investors. Wilson noted that the Company had “experienced a divergence from the very favorable auto frequency starting in the fourth quarter of 2014. That trend continued through the first three quarters of 2015 . . . and it’s now at the highest level since 2003.” Contrary to his statements during the Class Period that Defendants’ analysis showed external factors were the sole cause of increased frequency, Wilson admitted the analysis showed other factors, stating that “[o]ur conclusions were that the frequency increase was largely [*i.e.*, not solely] externally driven.” Wilson said Allstate was tightening underwriting and told investors that they “will see a double-digit decline in new business in terms of – because we’ve tightened underwriting standards.” Wilson again confirmed the visibility Defendants had into frequency trends by stating that “we know highly specifically how many customers will not get through the system because we can go back and look at who came through the filter before and what we did to the new filter.”

90. On August 4, 2016, Allstate held its 2Q 2016 conference call. Wilson reiterated that Allstate had “intentionally reduced new business levels until we improve returns on capital for auto insurance,” while still noting “continued increases in frequency and severity.” Macellaro commented that “the results we’ve seen in the past 18 months have taken us back to levels not experienced since 2003 for gross frequency.” He said they “first identified the uptick in gross frequency during the fourth quarter of 2014, and our analysis indicated it was being driven mainly [*i.e.* not solely] by environmental factors unrelated to our pricing and underwriting.” However, he

also acknowledged that they had “tightened underwriting guidelines in 2015 to reduce new business in underperforming segments and reduce the new business penalty.”

91. Consistent with Defendants’ post-Class Period admissions, when Allstate’s efforts to stunt new policy growth through tightened underwriting began to materialize, the rate of claim frequency increases declined, despite miles driven remaining consistently elevated on a year-over-year basis from 2Q 2015 through 2Q 2016. Analysts from Wells Fargo described Allstate’s rapid decline in growth as “[t]rading growth for improved profitability,” and analysts from Sterne Agee - CRT Capital Group, LLC viewed “the tradeoff as reasonable as investors don’t consider Allstate a growth stock and getting back to adequate profitability i[s] a priority.”

ADDITIONAL INDICIA OF SCIENTER

Defendants’ Close Monitoring of Frequency Trends

92. Throughout the Class Period, Wilson, Winter and Macellaro held themselves out to investors and the market as the persons most knowledgeable about Allstate’s earnings performance and business operations. At all relevant times, Wilson was Allstate’s CEO and Chairman of the Board, Winter was the President of APL and/or Allstate, and Macellaro was the Vice President of Investor Relations of Allstate. Defendants were the persons with ultimate responsibility for directing and managing the Company’s business, affairs and communications to investors. In these roles, Defendants were required to not only keep themselves informed of the Company’s day-to-day business and operations, but to keep Allstate’s non-management directors apprised of the state of the Company’s business and operations.

93. Allstate has years and decades of experience in underwriting and trend analysis. As set forth in ¶¶5, 34, 44, 48(b), 53(a)-(c), 53(f) and 60(b)-(d) above, prior to and during the Class Period, Defendants repeatedly discussed their efforts to monitor claims frequency on a daily and

even hourly basis and their ability to identify trends, and causes of trends, in response to analyst questions on these matters.

94. Monitoring frequency data and causes was critical because the Allstate brand represented 90% of Allstate's auto insurance business and, as Wilson said during the February 5, 2015 conference call, auto insurance was Allstate's "biggest line of business." Macellaro said on the same conference call that "[m]aintaining auto profitability remains a critical priority for us." As such, Winter "spent [an] untold number of hours" analyzing the frequency increase.

95. As further confirmation that Defendants reviewed the latest frequency trends before holding conference calls, during the August 4, 2015 conference call, analysts asked questions regarding how Allstate responds to changes in paid and incurred frequency of claims. Wilson responded that "when we're closing July right now we know exactly how many claims we had in July." Allstate and the Individual Defendants also had years and even decades of experience and claims data to analyze the impact of their new business growth and changes in underwriting standards. Defendants well knew the impact of the new business growth they pursued.

96. For example, after the Class Period, Wilson admitted this relationship by stating on the August 4, 2016 conference call that "[w]e tightened underwriting guidelines in 2015 to reduce new business in underperforming segments and reduce the new business penalty." Similarly, on the December 9, 2015 conference call, Wilson said with regard to tightening underwriting that "we know highly specifically how many customers will not get through the system because we can go back and look at who came through the filter before and what we did to the new filter." The opposite is also true, in that Defendants can know "highly specifically" how many and what type of customers will get through the system in pursuing strategies to increase policies-in-force.

97. Defendants well knew that by attributing the spike in frequency solely to external factors, rather than admitting that the new business was a substantial cause of the spike in frequency,

the market would discount the spike as a non-recurring event that would not change Allstate's overall financial performance and outlook.

98. As a further example of their historical experience and frequent monitoring of frequency trends and causes, during the November 3, 2015 conference call, an analyst asked whether the increased frequency in 3Q 2015 was "generally within your expectations." Winter responded: "I don't think there was anything that caught us off guard. . . . [I]t certainly didn't shock us or look to be a spike that was totally unexpected" because, as Wilson stated, "we have great visibility and transparency" into frequency. This echoed Winter's comments during the August 4, 2015 conference call that the negative impact on frequency from the aggressive new business growth "was expected."

Insider Trading

99. Wilson took advantage of his material, non-public information to sell his Allstate stock at artificially inflated prices. After a massive two-month spike in auto claim frequency, and while the increased frequency and causes thereof were concealed from the public, Wilson liquidated a material portion of his Allstate stock. On November 25-26, 2014, he exercised and liquidated options netting him over \$33 million, nearly 3,000% of his 2014 annual base salary of \$1.15 million.

100. Specifically, Wilson exercised over 750,000 options with a strike price of approximately \$16 when the stock was trading at then all-time highs of more than \$67 per share. Many of the shares were surrendered to Allstate to cover taxes and his acquisition costs, and approximately \$15 million worth of the shares were sold to investors in the open market. After disposing of approximately 675,000 directly owned shares, Wilson was left with approximately 113,000 shares. This sale was dramatically inconsistent with his prior trading patterns, as Wilson last sold in 2005, before he became CEO.

101. In addition, by May 2015, Allstate had suffered consecutive quarters of negative trends in claims frequency that were continuing into 2Q 2015 for a third consecutive quarter. Wilson was in possession of material non-public information – namely that the negative trend was continuing and the true causes of the trend. On May 26, 2015, Wilson exercised more stock options and sold over 90,000 shares of his Allstate stock for approximately \$6.2 million.

102. Similarly, on May 12, 2015, with Allstate's stock still trading at artificially inflated prices of around \$67 per share, CFO Shebik, who directed the team responsible for setting loss reserves, exercised stock options and sold more than \$2 million worth of his Allstate stock, almost twice as much as he sold prior to the Class Period in 2014, and almost 300% of his 2015 salary of \$750,000. Because Allstate establishes reserves based on reported claims on a "very real-time basis," Shebik had intimate knowledge regarding auto claim frequency.

LOSS CAUSATION

103. During the Class Period, as detailed herein, Defendants made false and misleading statements and engaged in a scheme to deceive the market and a course of conduct that artificially inflated the price of Allstate common stock and operated as a fraud or deceit on Class Period purchasers of Allstate common stock by misrepresenting the Company's true state of affairs and prospects, and omitting to disclose the increase in frequency and that the new business growth was a substantial cause of the increase in frequency of auto accident claims.

104. Defendants' false and misleading statements had their intended effect and directly and proximately caused Allstate common stock to trade at artificially inflated levels, reaching a Class Period high of \$72.58 per share.

105. As a result of Defendants' fraudulent conduct as alleged herein, the price at which Allstate common stock traded was artificially inflated throughout the Class Period. When plaintiff and other members of the Class purchased their Allstate common stock, the true value of such

common stock was substantially lower than the prices actually paid. As a result of purchasing Allstate common stock during the Class Period at artificially inflated prices, plaintiff and other members of the Class suffered economic loss, *i.e.*, damages, under federal securities laws, when such artificial inflation dissipated.

106. In addition, Defendants assured investors that the increase in frequency of auto claims was solely related to external factors and that Defendants monitored frequency daily, and at times hourly. Defendants' assurances were nothing more than a further attempt to mislead the market's expectations for the Company. To that end, Defendants' false and misleading statements maintained and increased the artificial inflation in the price of Allstate common stock.

107. As a result of Defendants' materially false and misleading statements, as well as the adverse, undisclosed information known to the Defendants, plaintiff and other members of the Class relied, to their detriment, on such statements and documents, and/or the integrity of the market, in purchasing their Allstate common stock at artificially inflated prices during the Class Period. Had plaintiff and other members of the Class known the truth, they would not have taken such actions.

108. When the misrepresentations and omissions that Defendants had concealed from the market were revealed through the series of partial disclosures beginning on February 4, 2015, and continuing through the close of the market on August 4, 2015, the price of Allstate common stock fell dramatically, causing substantial losses to investors.

109. After the market closed on February 4, 2015, Defendants revealed a significant increase in auto claim frequency, partially disclosing the negative impact of Allstate's recent aggressive growth on auto losses. As a result of the disclosure of negative frequency trends, Allstate's stock price dropped from a close of \$72.58 per share on February 4, 2015 to a close of \$70.93 per share on February 6, 2015. This decline in the price of Allstate common stock was the direct result of the nature and extent of the partial revelations made to the market. The partial

removal of artificial inflation from the price of Allstate stock would have been greater had Defendants fully disclosed the truth. However, because of Defendants' materially false and misleading statements and/or failure to disclose the full truth regarding the cause of the negative trends, the price of Allstate stock remained artificially inflated.

110. After the market closed on May 5, 2015, Defendants revealed a second consecutive significant increase in auto claim frequency, partially disclosing the negative impact of Allstate's recent aggressive growth on auto losses. As a result of the disclosures of continued negative frequency trends, Allstate's stock price dropped from a close of \$70.00 per share on May 5, 2015 to a close of \$67.31 per share on May 6, 2015. This decline in the price of Allstate common stock was the direct result of the nature and extent of the partial revelations made to the market. The partial removal of artificial inflation from the price of Allstate stock would have been greater had Defendants fully disclosed the truth. However, because of Defendants' materially false and misleading statements and/or failure to disclose the full truth regarding the cause of the negative trends, the price of Allstate stock remained artificially inflated.

111. On August 4, 2015, the artificial inflation came out of the stock as Allstate's stock price plummeted, declining more than 10% on unusually high trading volume of over 13 million shares. After the fraud became generally known, the market, which reacted by punishing the Company's stock price and wiping out more than \$2 billion of its market capitalization, understood that there had been new revelations – that Allstate's financial condition and the increased frequency of auto accidents were not one-time events related to adverse weather and increased miles driven, but were the result of internal factors relating to the quality of business obtained during Allstate's growth efforts, contrary to what was previously (and misleadingly) presented to the market.

112. The timing and magnitude of the decline in the price of Allstate common stock negates any inference that the losses suffered by plaintiff and other Class members were caused by

changed market conditions, macroeconomic factors or Company-specific facts unrelated to Defendants' fraudulent conduct. From the close of trading on February 4, 2015 through the close of trading on August 4, 2015, during which time Allstate's stock price fell over 14% as a result of Defendants' fraud being revealed through a series of partial disclosures, the Standard & Poor's 500 securities index increased 2.5%, and the Standard & Poor's 500 Property & Casualty Index, comprising public corporations in Allstate's industry peer group, rose 3%. On August 4, 2015, when Allstate's stock price fell over 10%, the Standard & Poor's 500 securities index declined 0.2% and the Standard & Poor's 500 Property & Casualty Index declined 1.9%

113. Analyst reports reflected that the revelation of the previously undisclosed information was responsible for the stock drop. *See* ¶75.

114. As a result of their purchases of Allstate common stock during the Class Period and the subsequent decline in the value of those shares when the truth was revealed to the market, plaintiff and other members of the Class suffered economic loss, *i.e.*, damages, under the federal securities laws.

**APPLICABILITY OF THE PRESUMPTION OF RELIANCE
AND FRAUD ON THE MARKET**

115. Plaintiff will rely upon the presumption of reliance established by the fraud-on-the-market doctrine in that, among other things:

- (a) Defendants made public misrepresentations or failed to disclose material facts during the Class Period;
- (b) The omissions and misrepresentations were material;
- (c) The Company's stock traded in an efficient market;
- (d) The misrepresentations alleged would tend to induce a reasonable investor to misjudge the value of the Company's stock; and

(e) Plaintiff and other members of the Class purchased Allstate common stock between the time Defendants misrepresented or failed to disclose material facts and the time the true facts were disclosed, without knowledge of the misrepresented or omitted facts.

116. At all relevant times, the market for Allstate shares was efficient for the following reasons, among others:

(a) Allstate stock met the requirements for listing, and was listed and actively traded on the NYSE, a highly efficient and automated market;

(b) As a regulated issuer, Allstate filed periodic public reports with the SEC and the NYSE;

(c) Allstate regularly communicated with public investors via established market communication mechanisms, including through the regular dissemination of press releases on the major news wire services and through other wide-ranging public disclosures, such as communications with the financial press, securities analysts and other similar reporting services; and

(d) Allstate was followed by numerous securities analysts employed by major brokerage firms who wrote reports that were distributed to the sales forces and certain customers of their respective brokerage firms. Each of those reports was publically available and entered the public marketplace.

117. As a result of the foregoing, the market for Allstate common stock promptly digested current information regarding Allstate from all publicly available sources and reflected such information in Allstate's stock price. Under these circumstances, all purchasers of Allstate common stock during the Class Period suffered similar injury through their purchases of common stock at artificially inflated prices and a presumption of reliance applies.

CLASS ACTION ALLEGATIONS

118. Plaintiff brings this action as a class action pursuant to Rule 23 of the Federal Rules of Civil Procedure on behalf of all persons who purchased Allstate common stock during the Class Period (the “Class”). Excluded from the Class are Defendants and their immediate families, the officers and directors of the Company, at all relevant times, members of their immediate families and their legal representatives, heirs, successors or assigns, and any entity in which Defendants have or had a controlling interest.

119. The members of the Class are so numerous that joinder of all members is impracticable. The disposition of their claims in a class action will provide substantial benefits to the parties and the Court. Allstate has approximately 371 million shares of stock outstanding, owned by thousands of investors.

120. There is a well-defined community of interest in the questions of law and fact involved in this case. Questions of law and fact common to the members of the Class that predominate over questions which may affect individual Class members include:

- (a) whether the Exchange Act was violated by Defendants;
- (b) whether Defendants omitted and/or misrepresented material facts;
- (c) whether Defendants’ statements omitted material facts necessary to make the statements made, in light of the circumstances under which they were made, not misleading;
- (d) whether Defendants knew or deliberately disregarded that their statements were false and misleading;
- (e) whether the price of Allstate common stock was artificially inflated; and
- (f) the extent of damage sustained by Class members and the appropriate measure of damages.

121. Plaintiff's claims are typical of those of the Class because plaintiff and the Class sustained damages from Defendants' wrongful conduct.

122. Plaintiff will adequately protect the interests of the Class and has retained counsel who are experienced in class action securities litigation. Plaintiff has no interests which conflict with those of the Class.

123. A class action is superior to other available methods for the fair and efficient adjudication of this controversy.

COUNT I

For Violation of §10(b) of the Exchange Act and Rule 10b-5 Against All Defendants

124. Plaintiff incorporates ¶¶1-123 by reference.

125. During the Class Period, Defendants disseminated or approved the false statements specified above, which they knew or deliberately disregarded were misleading in that they contained misrepresentations and failed to disclose material facts necessary in order to make the statements made, in light of the circumstances under which they were made, not misleading.

126. Defendants violated §10(b) of the Exchange Act and Rule 10b-5 in that they:

- (a) employed devices, schemes and artifices to defraud;
- (b) made untrue statements of material facts or omitted to state material facts necessary in order to make the statements made, in light of the circumstances under which they were made, not misleading; or
- (c) engaged in acts, practices and a course of business that operated as a fraud or deceit upon plaintiff and others similarly situated in connection with their purchases of Allstate common stock during the Class Period.

127. Plaintiff and the Class have suffered damages in that, in reliance on the integrity of the market, they paid artificially inflated prices for Allstate common stock. Plaintiff and the Class

would not have purchased Allstate common stock at the prices they paid, or at all, if they had been aware that the market prices had been artificially and falsely inflated by Defendants' misleading statements.

COUNT II

For Violation of §20(a) of the Exchange Act Against Defendants Wilson and Winter

128. Plaintiff incorporates ¶¶1-127 by reference.

129. Wilson and Winter acted as controlling persons of Allstate within the meaning of §20(a) of the Exchange Act. By virtue of their positions with the Company, ownership of Allstate stock, and participation in and/or awareness of the Company's operations and finances, Wilson and Winter had the power and authority to cause Allstate to engage in the wrongful conduct complained of herein.

130. Wilson and Winter were each provided with or had unlimited access to copies of the Company's reports, press releases, public filings and other statements alleged by plaintiff to be misleading prior to and/or shortly after these statements were issued, and had the ability to prevent the issuance of the statements or cause the statements to be corrected.

131. Wilson and Winter had direct and supervisory involvement in the day-to-day operations of the Company and regularly spoke on behalf of the Company. Wilson and Winter exercised control over the operations of Allstate and had the power to control the public statements about Allstate giving rise to the securities violations as alleged herein, and exercised the same.

132. Allstate violated §10(b) and Rule 10b-5 by its acts and omissions as alleged in this Complaint. By virtue of their positions as controlling persons, Wilson and Winter are liable pursuant to §20(a) of the Exchange Act for Allstate's violations of §10(b). As a direct and proximate result of Defendants' wrongful conduct, plaintiff and other members of the Class suffered damages in connection with their purchases of the Company's stock during the Class Period.

PRAYER FOR RELIEF

WHEREFORE, plaintiff prays for judgment as follows:

- A. Determining that this action is a proper class action, designating plaintiff as Lead Plaintiff and certifying plaintiff as a class representative under Rule 23 of the Federal Rules of Civil Procedure and plaintiff's counsel as Lead Counsel;
- B. Awarding plaintiff and the members of the Class damages in an amount to be proven at trial, including interest;
- C. Awarding plaintiff's reasonable costs and attorneys' fees; and
- D. Awarding such equitable/injunctive or other relief as the Court may deem just and proper.

JURY DEMAND

Plaintiff demands a trial by jury.

DATED: November 10, 2016

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