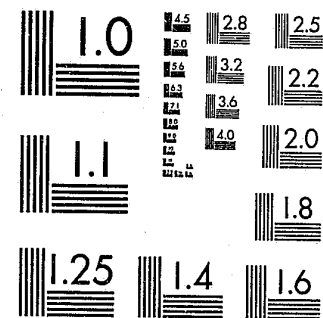


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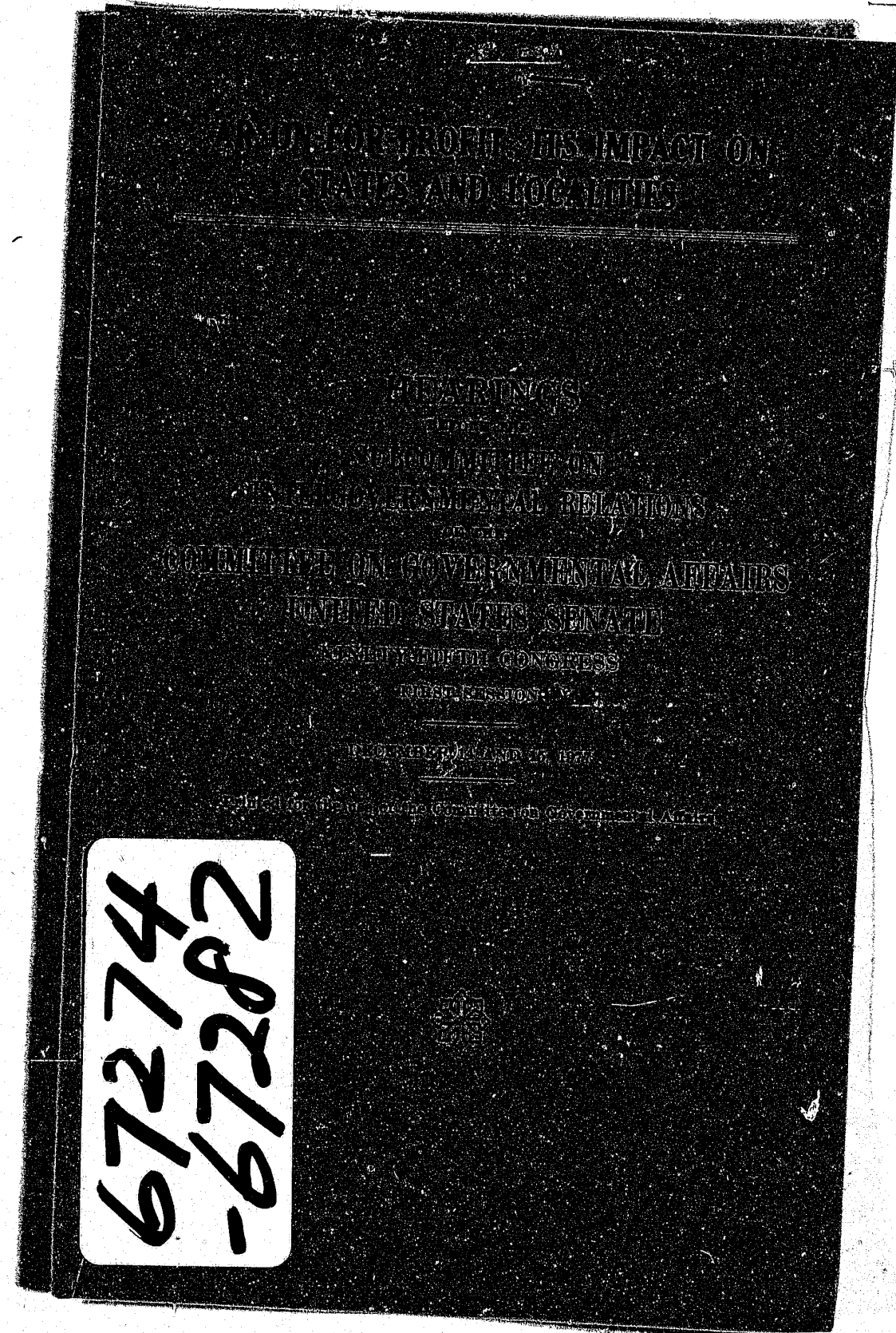
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National Institute of Justice
United States Department of Justice
Washington, D. C. 20531

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7/13/81



**ARSON-FOR-PROFIT: ITS IMPACT ON
STATES AND LOCALITIES**

NCJRS

APR 28 1980

HEARINGS
BEFORE THE
SUBCOMMITTEE ON
INTERGOVERNMENTAL RELATIONS
OF THE
COMMITTEE ON GOVERNMENTAL AFFAIRS
UNITED STATES SENATE
NINETY-FIFTH CONGRESS
FIRST SESSION

DECEMBER 14 AND 15, 1977

Printed for the use of the Committee on Governmental Affairs



U.S. GOVERNMENT PRINTING OFFICE
WASHINGTON: 1978

26-264 O

For sale by the Superintendent of Documents, U.S. Government Printing Office
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Urban Arson

STATEMENT OF J. ROBERT HUNTER

DEPUTY FEDERAL INSURANCE ADMINISTRATOR
Department of Housing and Urban Development
Submitted for the Record to the

SUBCOMMITTEE ON INTERGOVERNMENTAL AFFAIRS

I appreciate the opportunity to present the position of the Federal Insurance Administration on the subject of Arson for Profit.

The Federal Insurance Administration shares with this Subcommittee a deep concern about the problem of arson and our office has consistently been a leader in calling for vigorous enforcement of laws pertaining to arson of all types. At the same time, however, we have been concerned lest this problem be used as an excuse to justify invidious redlining in urban areas.

As you know, the Riot Reinsurance Program which our office administers makes federally supported riot reinsurance available to those insurers who participate in state-wide FAIR Plans (Fair Access to Insurance Requirements) and who pay the necessary reinsurance charges. This program, which was authorized by statute in 1968, has substantially succeeded in guaranteeing availability of essential insurance to inner-city areas of our Nation. Since mortgages are often contingent upon maintenance of such insurance this guarantee of availability is absolutely vital to reversing the trend toward the disappearance of much of our very usable housing stock and inner-city shops and stores.

Since the beginning of the program, the FIA has had to undertake a delicate balancing act between the positions of those who would stop writing insurance altogether in center cities in the name of overcoming arson and those who would guarantee insurance to everyone no matter what the condition of the property or the reputation of the individual. Our work has been made no less easy by the dearth of statistics relative to the problem of arson. While some may hypothesize that arson for profit occurs more frequently in the FAIR Plans than in other insurance markets, we have yet to see the first statistic that demonstrates that hypothesis is accurate. What evidence is available from States such as Texas, Florida, and other States which have no FAIR Plans, indicates that arson appears to be escalating there as rapidly as it appears to be in the FAIR Plan states. We applaud the cooperation which the FAIR Plan in Massachusetts gave to the investigation conducted by Attorney General Francis X. Bellotti which uncovered an "Arson for Profit" ring in the Boston area. However, we note that the FAIR Plan losses so far identified in this connection appear to be less than fifty percent of the total.

The problem of data unavailability also hinders us with respect to the question of what type of arson is involved in fire claims. There is a great difference, in our view, between arson for profit by

an owner of a property and arson initiated either through such motives as revenge or the vandalistic tendencies of certain individuals. A New York Times article on May 18, 1975, quoted Assistant Fire Chief Francis Cruthers, the Fire Department Commander in the Bronx, as stating that the reasons for arson were revenge, insurance fraud by landlords, and desperation of tenants. Of the fires deliberately set, fire officials reported that about 90% of the 430 arson arrests in New York City were related to revenge as the motive. Thus, we perceive the problem as complicated. The combatting of arson involves two broad areas, post-claim and pre-claim action. Regarding post-claim activity, FIA fully supports vigorous prosecution of all suspicious fire cases and has taken that position since the inception of the program.

Regarding pre-claim action the situation is much more difficult to resolve. FIA has questioned certain general insurance practices which appear to provide disincentives to the detection and prompt prosecution of arson. For example, since loss payable clauses in favor of mortgagees require payment to be made to the latter notwithstanding the insured's fraud, insurers may well abstain from incurring the expense of investigating suspicious fires since they are required to pay the mortgagee in any event.

While the mortgagee, as an innocent party, is entitled to a recovery we believe that the need to investigate such suspicious blazes is no less important than in cases where a successful investigation would give grounds for denying payment on the claim.

Additionally, some of the recent programs escalating policy limits to match inflation could result in raising limits above market values and thus creating what is known in insurance as "moral hazards."

The FIA program is intended to provide essential insurance in areas where insurers are redlining or otherwise refusing to insure. In approaching this issue, we are, in effect, trying to predict who, specifically, might be an arsonist for profit. We respectfully submit that it would be inappropriate to deny coverage to those who may well be the victims of arson and not the arsonist. The balancing act which this necessitates is complex, but the continued viability of our inner cities hinges upon it.

We have worked diligently with State Insurance Commissioners and insurance industry representatives to attempt to create a filter that would not allow arsonists for profit into the insurance system, while not precluding potential innocent victims of arson from access to essential property insurance. We have succeeded in gaining some middle ground positions where FIA has allowed waivers of 30-day cancellation provisions in certain situations under the direct involvement and supervision of the Insurance Commissioner of the State.

If it exercises the necessary initiative, the insurance industry already has adequate underwriting powers, and nothing in the Federal Insurance Administration's FAIR Plan regulations impinges upon its

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ability to apply the sound and proper underwriting standards needed to deter a high incidence of arson for profit. This underwriting freedom can be exercised without refusing to write insurable risks, and, of course, also exists with respect to voluntary writings outside the FAIR Plan.

The following excerpt from the report of a recent St. Louis, Missouri, Grand Jury, which investigated the problem of arson for profit, gives a relevant assessment of the facts. The Grand Jury addressed itself specifically to the claim by certain industry representatives that pressures from Washington forced insurers writing coverage under the FAIR Plan to accept many risks contrary to their best judgment, and it totally rejected all such assertions. Its findings were as follows:

"F. Federal Controls

"State laws set up the FAIR Plan operation and these laws are undergirded by the Federal legislation of 1968, implementation of which is under the jurisdiction of the Department of Housing and Urban Development.

"We have been led to believe that pressures from Washington force insurers writing coverage under the FAIR Plan to accept many risks contrary to their best judgment. Our understanding is directly contrary to this. Nowhere did we find that the Federal directives or guidelines required insurers to assume questionable, let alone ridiculous, risks. The plan established for the States included a list of ten provisions, one of which says in part, 'if the risk meets reasonable underwriting standards

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at the applicable premium rate', it shall be written.

Additional latitude is given insurers under the Federal rule which states, 'plans may vary from state to state due to local conditions'. Taking local conditions here into consideration, it seems to us that the FAIR Plan should have eliminated some of the worst of their risks without any hesitation. The defense that the Federal regulations did not permit this was not supported in our investigation."

In addition to rejecting the industry's attempt to shift responsibility, the Grand Jury report was generally critical of the failure of the insurance industry to police the overall arson problem.

The very manner in which the position of the insurance industry was stated demonstrates how important it is for our Office to maintain its admittedly difficult "balancing act." The Alliance of American Insurers stated, "We, in the insurance industry, continue to adhere to the prevailing wisdom of the old adage which reminds us that, 'an ounce of prevention is worth a pound of cure', particularly when it comes to combatting arson." This overly simplistic approach is precisely the reason that the Congress found in 1968 that, "Responsible owners of well maintained residential, business, and other properties in many of these areas are unable to obtain adequate property insurance coverage against fire, crime, and other perils." This "ounce of prevention" meant not only preventing arson bent property owners from obtaining insurance but also preventing the innocent citizen, including the victims of arson,

from obtaining the insurance protection so vitally needed to make possible the preservation and restoration of inner-city communities. An analog more in tune with this situation might be found in our criminal justice system which operates on the adage that it is better that a guilty man go unpunished than that an innocent man be convicted. We recognize that in making insurance available to citizens in areas where social conditions beyond their control make them more likely victims of arson, we are also increasing the possibility that some who are inclined toward arson for profit may be provided an opportunity to take advantage of the system. But in the name of preventing that opportunity we cannot sacrifice the future of the vast majority of insureds who do not set fire to their properties, a future which is closely interrelated with the future of the cities, and thus the Nation.

FIA pledges to continue to strive for ways to keep arsonists from profiting from the FAIR Plan insurance while serving the basic purpose of the Act in granting insurance availability. Thus with a practical realization of the complexity of the problem, we intend to continue to find more effective ways of performing our "balancing act," and we certainly welcome the many very constructive recommendations made by the Alliance of American Insurers and look forward to working with all groups which are committed to the fight against arson.

The need to guarantee insurance to those currently being redlined by insurance companies in increasing numbers throughout this country must be

answered, notwithstanding our war on the arsonist for profit. We must assure the almost 900,000 policyholders of FAIR Plans, and their families, that their coverage will continue to protect them from the losses caused by arson and from certain underwriting practices which redline them and make insurance unavailable to them. We must let them know that the Federal government does not consider all of the FAIR Plan policyholders to be arsonists for profit simply because they have been spurned by the voluntary insurance market. FIA pledges to do what it can to continue to respond to both vices, arson for profit and the unavailability of insurance for the citizens residing in our cities, being ever mindful that, as the National Advisory Panel on Insurance in Riot-Affected Areas (frequently referred to as the Hughes Panel so graphically put the matter in its report entitled "Meeting the Insurance Crisis of our Cities. "Communities without insurance are communities without hope."

END