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COMMITTEE PRINT

~~STAFF~~ STAFF STUDY

OF THE

ROLE OF THE INSURANCE INDUSTRY
IN DEALING WITH ARSON-FOR-PROFIT

PERMANENT SUBCOMMITTEE ON INVESTIGATIONS
OF THE
COMMITTEE ON GOVERNMENTAL AFFAIRS
UNITED STATES SENATE



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MEMORANDUM

MAR - 5 1978

ACQUISITIONS
U.S. SENATE,

COMMITTEE ON GOVERNMENTAL AFFAIRS,
SENATE PERMANENT SUBCOMMITTEE ON INVESTIGATIONS,
Washington, D.C.

To: All members of the Permanent Subcommittee on Investigations.
From: Sam Nunn, Chairman, and Charles H. Percy, Ranking
Minority Member.

Re: Staff Study on Insurance Industry Role in Arson-for-Profit.

As part of its investigation into arson-for-profit in the United States, the subcommittee endeavored to determine, through a standard questionnaire, how major fire insurance companies deal with this rapidly rising crime. The information provided by the companies and sworn testimony from witnesses during public hearings in August and September, 1978, raises serious questions concerning the diligence employed by some companies in combating arson in their fire insurance underwriting and loss adjustment practices.

Arson-for-profit is growing at a rate reliably estimated as high as 25 percent a year. The industry reported 1977 arson payouts at more than \$1.6 billion. Arson is not only a serious economic crime. It also deepens the blight and undermines the social fabric of the nation's cities.

It appears to be the industry's view that a reduction in the incidence of arson-for-profit is primarily the responsibility of law enforcement agencies. Yet, insurance officials themselves conceded at the hearings that there is frequently an absence of diligence on the part of the companies when it comes to checking the background of applicants for policies and following up on suspicious fire losses.

We have no doubt that arson-for-profit in the United States can be reduced substantially if the insurance industry reviews its present approach toward arson and more carefully screens applicants and their requests, as well as fire loss claims.

The recommendations contained in the staff study result from a comparison of data provided by the industry with sworn testimony presented at the subcommittee's hearings. These recommendations encourage individual companies and the industry as a whole to exercise a higher degree of diligence in reviewing risks before binding themselves to cover them, and to more carefully examine present policies regarding claims challenges.

The proposals also take into account the degree of expertise of claims adjusters and urge the companies to develop systems to make their adjusters more proficient at detecting suspicious fires.

We hope that this informative staff study will lead fire insurance companies to reexamine their present practices toward underwriting and adjusting fire losses. For diligence in screening risks and in adjusting claims by the insurance industry is essential if the "profit" is to be taken out of arson-for-profit.

Finally, we note that this inquiry was initiated by the subcommittee minority. We commend the minority staff for its work in carrying the inquiry forward and their preparation of this staff study.

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ARSON-FOR-PROFIT: THE INSURANCE INDUSTRY'S ROLE

BACKGROUND

According to insurance sources, arson claims cost insurance companies \$1.6 billion in 1977, and the figure is growing. Recent hearings held August 23 and 24 and September 13 and 14, 1978 by this subcommittee developed substantial evidence confirming that arson-for-profit is a nationwide problem which demands far greater attention than has been accorded to date by both the Federal Government and private insurers.

The subcommittee hearings, and three reports from the General Accounting Office, document a minimal Federal response to arson-for-profit, and demonstrated that Federal agencies with responsibility in the area had done virtually nothing to deal with this fast-growing problem.

Since the "profit" in arson-for-profit comes from insurance company treasuries, Senators Charles H. Percy, Republican, of Illinois and Sam Nunn, Democrat, of Georgia, ranking Republican and vice chairman respectively, determined on May 3, 1978, that it would be useful to submit a questionnaire to major fire insurance companies in the United States to determine what their policies and practices were with respect to arson loss claims. The questionnaire, sent to 15 of the Nation's largest fire insurance companies, was designed to ascertain whether business practices and attitudes within the private insurance market may be a factor contributing to the upsurge in arson-for-profit. A second purpose was to elicit comment on obstacles faced by the companies in improving performance against arson-for-profit. Recipients of the questionnaire were selected from "Best's Aggregates, Property Casualty 1977," an industry trade publication. To encourage forthright responses to sensitive areas of inquiry—some of which might have a bearing on pending litigation—the subcommittee approved anonymity to all the companies respecting their responses. The companies did permit the subcommittee to list their names as respondents. Appendix B lists carriers that participated in the subcommittee survey.

The major areas addressed in the questionnaire were the following:

- Inspections and underwriting;
- Claims investigation;
- Claims adjuster training;
- Statistical information;
- Obstacles to limiting arson-for-profit; and
- Organized crime involvement.

The responses to the subcommittee's questionnaire, and testimony from insurance company officials and law enforcement officials received during the subcommittee's 4 days of hearings, raised disturbing questions concerning the private insurance industry's role in the Nation's arson crisis, and the adequacy of the industry's commitment to combating the problem.

INSPECTIONS AND UNDERWRITING

The "profit" in arson-for-profit derives from insurance money. Because preliminary evidence developed by the staff indicated that arson profiteers often participate in all facets of the crime—including the procurement of insurance—one portion of the subcommittee questionnaire sought to discover whether prevailing inspection and underwriting practices contribute to the incidence of fire insurance fraud.

Overinsurance

Insuring properties for more than their true value plays a key role in most arson-for-profit schemes, subcommittee witnesses testified. Mr. James McMullen, director of security investigations for Farmers Insurance Group, testified to his belief that "nearly all" arson-for-profit cases involve deliberate overinsurance of properties (p. 131).¹ Former insurance adjuster Joseph Carter, convicted by Federal prosecutors in Tampa, Fla. for participating in a major arson-for-profit conspiracy, informed the subcommittee that, in his view, 99 percent of arson-for-profit involves deliberate overinsurance.

He told of one building in Tampa that was purchased for \$30,000, insured for \$290,000, then set ablaze for profit (p. 99). Mr. McMullen also told of a building worth \$27,000 which burned shortly after being insured for \$90,000, under circumstances where fraud was suspected (p. 131).

Overinsurance is widespread, according to subcommittee testimony, because of the failure of insurance companies to verify the value or condition of properties they insure. Mr. Leonard Mikeska, chief arson investigator for the city of Houston, testified:

Arson is on the increase, because of the ease with which people can obtain insurance on their properties, frequently at amounts that make it hard, even for the average honest citizen, to resist at least contemplating arranging for his place to be burned (p. 173).

Ronald Ewert, acting executive director, Illinois Legislative Investigating Commission, testified:

Private insurance companies also contribute to the arson problem by failing to inspect applicant background or to perform value appraisals on properties prior to issuing policies. This allows potential arsonists to insure their properties for much more than their fair market values (p. 202).

Responses to the subcommittee questionnaire indicate that none of the 15 companies surveyed regularly perform inspections on properties, prior to coverage.

Underwriting inspections usually occur after coverage is bound, if at all. Responses varied as to how often or under what conditions such inspections occur. Commercial properties appear to receive inspection more frequently than private dwellings.

Two companies surveyed stated that they inspect most insured properties. Another said they inspect commercial risks valued at more

¹ Refers to pages in the printed hearings of the Permanent Subcommittee on Investigations entitled "Arson-for-Hire."

than \$20,000, private dwellings under \$10,000 or over \$75,000, non-owner occupied dwellings, and three- and four-family dwellings.

Only one company acknowledged outright that it follows no standard inspection guidelines. However, the responses indicate this may well be the case with most of the companies surveyed. One company wrote that, "as a general rule, fire insurance risks are not subject to physical inspection."

Survey responses confirm testimony that companies rely heavily upon the judgment of their agents in accepting or refusing risks. But, agents often do not heed their responsibility to become familiar with the risks they accept, according to Mr. McMullen, because "their profit motive through the sale is placed at a bigger priority than their responsibility toward their insurer" (p. 130). The agent's income depends on the number and dollar value of the policies he writes. Subcommittee witnesses testified that rather than keeping coverage to a minimum, many agents prefer to sell as much insurance as the owner requests, and sometimes more. A Minneapolis arsonist, testifying under an alias, noted that agents often refuse to sell less coverage than is specified in a standard policy, even if the owner requests it:

You can't buy the amount of insurance you want on these buildings. They stuff it down your throat. You try to buy \$10,000 worth of insurance, they stuff you with \$25,000. It just makes it very profitable (p. 25).

According to insurance adjuster Joseph Carter, agents routinely accept poor, unexamined, and overinsured risks:

Building owners would routinely tell the insurer that their buildings, while in fact vacant, were tenant-occupied. Often a building owner will come into an agent's office, give him the address of the structure, how large it is, and what kind of coverage he wants. The agent will then tell him how much the premium is, the building owner will give him a check and the property owner is immediately covered under a binder until the company issues a policy. The agent does not inspect the property.

In my experience as an adjuster in Tampa, I was appalled at the number of buildings on which I adjusted fire and other types of loss which were unbelievably overinsured (p. 86).

Carter also said, "I didn't think the insurance companies should cover properties with code violations, but they did it all the time" (p. 86). Thus, reliance on poorly-monitored agents, understandably interested in boosting their own commissions, leaves companies wide open to arson profiteers who, unlike most honest property owners, seek as much coverage as possible for maximum potential gain.

Companies contend that routine prior inspections would prove prohibitively expensive. However, subcommittee witnesses indicated that more such inspections—perhaps triggered by unusual circumstances or performed randomly—could save money in the long run. Mr. McMullen told the subcommittee that building inspections could be made at nominal expense. Mr. Eades Hogue and Ms. Eleanor Hill—the Federal strike force attorneys who prosecuted the Tampa arson-for-profit case—noted that many structures insured as dwellings by

the participants in that conspiracy were certified by Tampa housing officials as unfit for human habitation. It was their feeling that agents or their companies could readily learn of such risks simply by telephoning the local housing inspector (p. 122).

CLAIMS INVESTIGATION

Because it appeared that arson profiteers are rarely challenged, either in criminal or civil court, one portion of the subcommittee questionnaire explored whether claims investigation procedures provide a significant deterrent to attempted arson-for-profit.

Eleven companies stated that they investigate fully all suspected arsonists, regardless of cost. At the same time, witnesses before the subcommittee testified that companies will often negotiate settlements with suspicious claimants, if money can be saved by doing so. For example, Tampa adjuster Joseph Carter stated that he would often "buy out" suspicious fire claims. Suspecting arson in connection with a particular fire, he would confront the culprit, threaten him with prolonged legal harassment, and instruct him to settle for less than the full face value of the policy. He testified that companies "which wanted to settle claims quickly at the least amount of cost" applauded his work, since it freed them from paying the full face amount of the policy and avoided costly litigation. He suggested that many companies operate in this fashion:

If they can get out for less than the face value of the policy and they don't have to hire an attorney to handle the claim in court, which costs them more money, they are willing to settle without any big hassle (p. 94).

Mr. Mikeska of the Houston arson squad commented that, "Most (insurers) are not very vigilant. It is extremely difficult to convince them to file a complaint against a suspected arson conspirator (p. 173).

Mr. Ewert of the Illinois Legislative Investigating Commission concurred. His study showed that insurers often fail to pursue investigations fully, preferring to save money by negotiating settlements with suspicious claimants.

In this context, four surveyed companies acknowledged to the subcommittee that they might settle a claim with a suspected arsonist, if investigatory costs seemed too high compared with the value of the claim. One company wrote that, "the value of the claim is a factor in determining how thorough an investigation should be, because of economical (sic) consideration." Another wrote that, "the amount of expense we are willing to incur would depend to some extent upon the size of the loss."

Though aware of the financial risks facing companies attempting to challenge suspicious claims, witnesses nevertheless felt that the industry should increase the current level of commitment to claims investigation. Discussing possible remedies to the arson problem, Mr. Carter suggested that:

Insurance companies should be much more willing to hire outside, independent investigators to do a full-scale inquiry into suspected arson. This would be money well-spent because it would get the word out on the street that the companies are beginning to be much more conservative in paying out on fire claims (p. 94).

PROFESSIONALISM OF CLAIMS ADJUSTERS

Sometime called the "elusive" crime, arson commonly escapes detection by all but the most trained eye. Physical evidence tends to be consumed by the blaze or buried in the rubble. Evidence of fraudulent intent may also lie undiscovered, if insurance and law enforcement authorities fail to conduct investigative interviews and to examine public and private records that might reveal motive. To gain information on the current level of professionalism within the claims adjustment business, one portion of the Subcommittee survey focused on arson detection training.

Only six of the companies queried could specify how many hours of arson detection training they required of each property claims adjuster. Five companies indicated they required no arson detection training for their adjusters. The four remaining insurers said they required arson detection training, but could not specify the number of hours, chiefly because training usually comes only as part of overall adjuster training programs.

Training varies considerably in quality. One company sponsors a two-day arson fraud workshop for all new adjusters, given at a special training facility. Another requires only three hours of arson detection training, but relies solely on outside programs rather than in-house training.

Subcommittee witnesses testified that arson detection training for adjusters is spotty. Mr. Carter, whose 20-year career in the adjusting business included service with several major companies, said: "I never received any training when I began fire adjustment, except what I learned on the job. No type of formal training or seminars or schooling" (p. 94).

Mr. Gary Bowdach, a subcommittee witness on organized crime matters, testified on August 2, 1978 concerning growing mob involvement in arson-for-profit. Acknowledging that "arson-for-profit is the easiest thing there is to get away with," and that "the chances of getting caught are almost nil," Bowdach suggested that insurance companies could greatly alleviate the problem by contesting suspicious claims more vigorously:

I think the insurance companies really should be the ones to do it because they have the biggest stake. (They) should have a staff of trained investigators in arson and trained investigators in seeking out the people and motivation behind these things. They leave it up to the local fire marshals and the police department arson squad and it just does not seem to get the job done because the police departments have to take things in priority.²

Mr. Carter concurred. Stressing the crucial role of adjusters in originating claims investigations, he indicated that formal training would upgrade their alertness and efficiency. Thus, through well-trained adjusters, insurers could challenge a larger number of fraudulent claims.

Reports from adjusters of suspected fraud or bribery sometimes go unheeded by central offices. Companies which disregard advice from

² Hearings "Organized Criminal Activities—South Florida and U.S. Penitentiary, Atlanta, Ga.," U.S. Senate Permanent Subcommittee on Investigation, August 1978, pt. 1, p. 90.

the field may sap morale, undermine professional diligence, and encourage cynical attitudes toward responsibility in this area. Mr. Carter cited an example of insurer indifference which he believes to be typical of what adjusters encounter in the field. Following a partially successful Tampa arson fire which he adjusted, Carter advised the two companies holding the risks on the building to stop coverage: "Only one, however, followed my advice. The other company continued covering the partially burned building until it burned all the way down on (the) second try" (p. 92).

Subcommittee witnesses were also questioned about the extent of corruption within the adjusting business. Asserting that adjusters are "grossly" underpaid as a profession, Mr. Carter felt that this fact, combined with frequent temptations in the form of bribe offers, produces extraordinary levels of corruption in the business (p. 106). Based upon his knowledge of adjusting practices, Mr. McMullen, of the Farmers Insurance Group, agreed, estimating that "probably about 25 percent of adjusters would succumb to proposals to participate" in an arson-insurance fraud conspiracy (p. 132). Such assertions from persons experienced in the field indicate that potential arson profiteers may find it all too easy to enlist cooperative insurance adjusters.

STATISTICAL INFORMATION

Reports from the GAO, the Illinois Legislative Investigating Commission and the Aerospace Corp. (under a grant from the Law Enforcement Assistance Administration) all indicate a shortage of basic statistical information on arson, making it difficult to assess the precise nature of the problem and its possible solutions. The Subcommittee queried companies on their recordkeeping practices, seeking to ascertain how much in-house information currently exists among insurers.

Only eight companies surveyed said they retained cumulative data on both the number of structures covered by fire insurance and the number and value of structures lost to fire. Of these eight, five keep this data only for dwellings, not for commercial properties (including businesses and most large apartment buildings). Consequently, most insurers have no firm grasp of the magnitude of their own arson losses.

Only one company said it records how many structures undergo inspection prior to coverage. One records how many fire losses were inspected by adjusters prior to payment. No company surveyed retains cumulative records in both of these categories. Consequently, insurers frequently know little about the diligence of agents and adjusters working for them.

Only one company stated that it records the number of losses that are followed by interviews with the property owner or his acquaintances, witnesses, or law enforcement authorities. That same company was the only one to say it records the number of losses followed by financial background checks on the owners. Thus, most of the surveyed companies indicated little awareness of the thoroughness of their own adjusters in investigating suspicious fires.

Mr. Ewert of the Illinois Legislative Investigating Commission noted that the lack of good fire loss data makes it highly difficult to

identify evolving patterns of insurance fraud and obscures questions of policy and allocation of resources. The Illinois Commission interviewed industry officials who reiterated this view. Companies may fail to take effective and timely action against arson, partly because they are poorly informed. In an address before the Fire Marshal's Association of North America in November 1975, Ralph J. Jackson, loss prevention manager of Allstate Insurance Co., discussed possible reasons for insurance company inaction on arson:

The insurance companies do not know how serious the arson problem is. Very few companies have been collecting information on arson, so it just isn't available in their computers.

During the subcommittee hearings, Senators Percy, Nunn, Chiles, and Glenn, all expressed surprise that insurers retain so little information on arson, while at the same time compiling extensive, up-to-date data, for example, on auto claims. Because auto claims information provides a useful basis for denying or limiting coverage to poor risks, the Senators wondered why insurers have not compiled and recorded comparable claims information on fire losses.

While several companies advised the subcommittee that they are developing systems to provide data on the number and value of arson losses, nine out of fifteen companies stated that they have no plans to develop more useful procedures for compiling and analyzing arson-related data.

PRIVACY AND FAIR CLAIMS PRACTICES LAWS

Aware that legal problems may discourage insurers from taking effective action against arson profiteers, the subcommittee sought comments on this matter.

Most companies surveyed criticized existing privacy laws and fair claims practices acts for seriously obstructing their efforts to investigate suspicious claims.

Privacy laws, designed to protect individuals against unwarranted disclosure of confidential information concerning them, are cited by insurers as impeding the exchange of information between insurers and law enforcement authorities. Evidence gathered by law enforcement agencies, though often insufficient to prove criminal charges, may be useful in civil proceedings by companies attempting to demonstrate fraud. Privacy laws, however, prevent exchange of information by establishing grounds for slander suits against public authorities who release incriminating information to private companies.

Likewise, the companies commonly noted that an individual can sue the insurer for releasing information to enforcement authorities seeking to build a criminal case.

Lack of information and fear of law suits were both cited as preventing companies from aggressively pursuing suspected arson incidents. Mr. McMullen related a case in which his company had to pay \$4 million in damages for releasing to police facts detrimental to the policyholder (p. 132).

Fair claims practices acts, designed to insure fair treatment of policyholders, require companies to decide promptly whether to pay

claims and to disclose grounds for decisions not to pay. The subcommittee survey confirms that payment must often be made before time-consuming arson investigations yield any concrete proof of fraud. Yet, payment delays, while the company evaluates its position, may result in assessment by the courts of heavy punitive damages against a company. On the other hand, companies complain, too-quick assertion of suspected fraud may leave the insurer open to a slander suit, unless subsequent investigation substantiates the charge. Companies indicate that they hesitate to charge fraud when their evidence is not complete. Thus, they maintain, legal requirements and financial hazards often force them to pay claims that might be successfully contested, if enough time were allowed.

Several other laws also received criticism from survey respondents. One company noted that state arson laws often lack severe enough penalties and fail to specify who is responsible for enforcement. In addition, a number of states require insurers to pay full face value on policies—well above a property's fair market value—thereby encouraging arson-for-profit. Another respondent criticized local ordinances which require burned buildings to be demolished quickly, often leading to the destruction of physical evidence of arson.

ROLE OF GOVERNMENT

The companies surveyed were not in agreement in their assessment of law enforcement efforts against arson. Several sympathized with the lack of adequate training and manpower. Criticism was leveled at the Federal Bureau of Investigation for lack of interest and reluctance to share information.

The companies offered a number of suggestions, encouraging the Federal Government to:

- Use the Law Enforcement Assistance Administration to fund state and local anti-arson programs aimed at acquiring better equipment, at putting more and better people on the job, and at improving arson training and detection programs;

- Provide more funding for the National Fire Prevention and Control Administration in the Department of Commerce;

- Establish a nationwide bureau of records on suspicious fires and offenders, along with a national fire academy, modeled on the national police academy;

- Review insurance requirements of the Department of Housing and Urban Development, the Small Business Administration, as well as various banking regulations, with an eye toward reducing arson-for-profit;

- Make arson a part I crime in the FBI's uniform crime reports, thus expanding the available data and inducing local authorities to give more attention to the crime;

- Prosecute arson more vigorously, particularly through use of the Federal Racketeer Influenced and Corrupt Organizations (RICO) statute; and

- Revise the privacy laws to foster freer exchange of arson-related information.

In addition, respondents proposed that State and local governments should:

Revise definitions of arson to include any intentional destruction of buildings by fire in order to defraud;³

Stiffen penalties for arson;

Loosen fair claims practices requirements to facilitate good faith arson investigation;

Enact state laws modeled on the Federal RICO statute;

Establish clear lines of responsibility for arson investigations and

Publicize neighborhood arson patrol and confidential informant reward programs.

ORGANIZED CRIME

Subcommittee witnesses left little doubt that organized crime now views arson-for-profit as a low-risk means to garner whopping profits. Gary Bowdach, who committed four mob-linked arsons in a 1-month period in Florida, termed the available revenues "inviting" for organized crime, and suggested that crime families may now employ traveling professional torches who can easily make lucrative incomes plying their trade throughout the country.⁴ Mr. Carter warned that crime syndicates "are becoming well-acquainted with the vast amount of moneys that could be made out of arson-for-profit" (p. 100). Mr. Angelo Monachino, another subcommittee witness, who participated in 11 arsons-for-profit as a soldier in the Rochester, N.Y., Mafia, agreed that "organized crime is becoming increasingly involved in arson-for-profit" (p. 60). San Jose Police Chief McNamara commented that, "arson is but a visible manifestation of the traditional techniques of organized crime" (p. 183).

One portion of the subcommittee survey asked insurers to provide any information known to them concerning organized crime involvement in arson-for-profit. None of the companies could supply any information. One company commented that, "We have seen no evidence of involvement on the part of national organized crime syndicates." A more typical response was that, "We are not in a position to answer this question." Such responses raise serious questions about the lack of attention being paid by insurers to what appears to be a major aspect of the Nation's growing arson problem.

Organized crime's growing stake in the arson business lends special urgency to the search for solutions. Any reluctance by insurers to take strong steps against arson-for-profit—or any barriers to their doing so—can only abet the growth of organized crime's involvement in the increasing number of arsons. Contrary to assertions from some quarters of the industry, arson-for-profit cannot be eliminated solely through improved efforts from government and law enforcement. Nor should the industry limit its involvement to publicity campaigns and financial support for study groups, though these are usually worthwhile. Companies truly wishing to contribute must pay closer attention to the problem and show greater willingness to alter their own day-to-day business practices, several of which currently make it easy for arsonists and their clients to commit their crimes with little fear of apprehension.

³ A Minneapolis arsonist, "Michael Smith," told the subcommittee how he escaped prosecution for arson because Minnesota law at that time defined arson only as fire started without the owner's consent, which is rarely the case in arson-for-profit (p. 24).

⁴ Hearings "Organized Criminal Activities—South Florida and U.S. Penitentiary, Atlanta, Ga.," U.S. Senate Permanent Subcommittee on Investigations, August 1978, pt. 1, p. 111.

INDUSTRY AND GOVERNMENT REACTION

In the 4 months that have passed since the conclusion of the subcommittee's hearings, key segments of the industry—the American Insurance Association, Insurance Information Institute, National Association of Insurance Agents, and National Association of Independent Insurers, among others—have not contacted the subcommittee either by way of responding to criticisms of industry policies, or setting forth anticipated reforms for the future. It should be noted, however, that other than the questionnaire submitted to 15 major companies, the insurance industry was not specifically asked for its response to the hearings.

The Federal bureaucracy, moving with commendable dispatch, was specifically contacted by the subcommittee in connection with the August-September hearings and has affirmatively responded to the crisis. The Federal Bureau of Investigation; the Law Enforcement Assistance Administration; and the Alcohol, Tobacco and Firearms Bureau of the Treasury Department have all informed the subcommittee that they will begin targeting arson-for-profit as a major law enforcement priority. Specifically, the FBI has advised each of the 59 Bureau offices throughout the country to identify, actively pursue, and monitor arson-for-profit cases involving organized crime. The LEAA has actively encouraged each of its state and territorial law enforcement planning agencies to look favorably upon and to begin investing funds in arson control programs. And the ATF has established expert task forces in 17 cities that will focus on arson-for-profit schemes.

One industry trade association—the Alliance of American Insurers (AAI)—did submit a post-hearing statement to the subcommittee. Its message was that the arson upsurge is "completely beyond the control of insurance underwriters," a contention disputed by witness after witness at the hearings. The response from AAI expresses that organization's "serious" concern about the "rapidly spreading cancer of arson-for-profit," while defending current industry practices (p. 463). AAI asserts that "substantial sums" have been invested for arson detection training for adjusters and maintains that companies do not make a "policy" of paying off on fraudulent or suspicious claims (p. 477). While it may not be a "policy" to pay suspicious claims, evidence received by the subcommittee from numerous witnesses suggests that refusals to pay are rare; particularly when costly investigation would be involved. Finally, AAI disputes other testimony before the subcommittee by stating, without specific reference, that dishonesty among insurance adjusters is rare, and by denying that there is any need for tighter standards on precoverage risk inspection.

In sum, the AAI agrees that there is a problem, but absolves the industry of any blame for that problem.

FINDINGS AND RECOMMENDATIONS

The subcommittee hearings and insurance company survey together confirm substantial shortcomings in the response of the industry as a whole to the current arson crisis. As Chief Mikeska of Houston's arson squad told the subcommittee:

I recently attempted to get \$10,000 life insurance increased on my life. I was required to go to my doctor to have a complete physical. If I want to increase my insurance on my

home, I get on the telephone, advise my agent I would like to increase my insurance by \$50,000, there is a binder put on it, no questions asked whatsoever (p. 176).

The insurance industry over the years has controlled and minimized its auto and life insurance risks. But fire fraud losses—made possible in part by laxity in underwriting and claims adjustment procedures—continue to cost billions of dollars each year.

The upsurge in arson-for-profit stems primarily from two conditions: the enormous profits available and the ease of obtaining them without fear of penalty. In light of arson's skyrocketing human and financial costs, leaders of the American insurance industry should review and reformulate current operating procedures so as to screen out poor risks, reduce incentive to commit arson, and increase the odds against getting away with fraud.

The following recommendations are advanced:

(1) *Insurers should require routine risk reviews prior to coverage, including property inspection and background checks on applicants.*

Urban devastation due to arson cannot be halted unless access to big insurance dollars can be more tightly restricted. Even more than police and fire authorities, the insurance industry can help take the "profit" out of arson-for-profit.

Through routine prior-to-coverage risk review, insurers or their agents could:

Verify that properties in question are being occupied or utilized as stated and are not tax delinquent or deteriorated to a point where they might be abandoned and burned;

Ensure that requested coverage corresponds to actual property value, thus avoiding overinsurance; and

Screen applicants for prior history of fire losses.

Witnesses agreed that insurers must undertake greater initiative in this area. Mr. Carter noted:

The insurance agent should be much more selective in choosing which properties are covered by his company. It is incumbent upon him to go out and inspect each and every risk. I think they should inspect every single property they insure (p. 94).

Mr. Hogue, one of the Federal prosecutors in the Tampa case, said:

First of all, they need to inspect the property. They need to go out and look at the property. Additionally, the companies are going to have to screen applicants for fire insurance more closely. They are going to have to insist that they scrutinize who wants fire insurance (p.125).

These practices would inevitably entail added costs, but would foreseeably save enormous sums in the long run. Rather than examining all risks, insurers could minimize their inspection loads by obtaining and sharing information with building code authorities and realty agents. Insurance agents and underwriters could further protect their companies by researching an applicant's financial history, along with the fire history and age of the property. Such research could alert companies to possible motives behind sudden requests for sizeable increases in coverage.

(2) *Insurers should scrutinize current policy on claims challenge, develop effective arson investigation teams, and make more frequent civil challenges on arson fraud.*

As survey respondents pointed out, insurance companies often confront hard choices while handling suspicious claims. In some cases, even the most thorough investigation may fail to turn up enough evidence to support suspicion of fraud. Because most State laws require prompt decisions on whether to honor or to challenge claims, insurers understandably prefer routine settlement to the riskier course of challenge based on less-than-complete evidence.

Nevertheless, the current upsurge in arson-for-profit poses a challenge to the insurance industry. In the ABC-TV news closeup, "Arson: Fire for Hire," an informed source claimed that arson rings know which companies pay off most easily and with the least careful investigation. He said torches and their clients prefer to "do business" with these companies. Subcommittee investigators confirmed the accuracy of those observations. But an arsonist may think twice before attempting to defraud a company with a reputation for being "tough" on claims. Many companies claim vigorous followup procedures, but nationwide arson statistics and Subcommittee testimony both indicate considerable room for improvement throughout most of the industry. Aggressive claims challenges may prove an effective way for companies to protect their assets, and thus keep premiums down.

(3) *Companies should develop in-house investigative expertise and be prepared to pursue arson investigations.*

As Mr. Carter and other witnesses indicated, insurers must take measures to improve their success ratio substantially. With capable assistance on hand or on ready-call, companies would be better prepared to challenge borderline cases, where appropriate.

(4) *Insurers should work together with government officials toward modifying privacy laws and fair claims practices laws.*

The record before the subcommittee indicates that changes in these laws may enable insurers more easily to contest fraudulent claims. Insurers could assist in drafting model arson laws, spelling out key definitions, expanding immunity or exemptions for information exchange, and lengthening claims payment deadlines in cases of good faith suspicion of arson.

(5) *Companies should require claims adjusters to have better arson investigation training.*

To challenge claims successfully, insurers must be alert to possible instances of fraud, and adept at gathering the evidence needed to support denial of fraudulent claims. Insurers often cannot rely on fire and police authorities to perform these tasks. Even where authorities are well-trained to detect arson, they sometimes fail to relay essential information to the insurer. Hence, fraudulent claims are paid routinely, simply because companies are unaware of the situation. The survey results show that some companies have already developed comprehensive programs, suggesting that other companies could offer much-improved anti-arson training. Without their own cadre of well-trained adjusters, many companies may continue each year to pay uncounted millions in fraudulent claims, while fire insurance premiums soar.

(6) *Companies should investigate the possibility of serious corruption in the ranks of claims adjusters.*

To ensure honesty and professionalism among adjusters, companies should more assiduously monitor settlement arrangements and pay close heed to allegations from adjusters concerning attempted bribery and suspected fraud. Because relatively low-salaried adjusters who oversee huge outlays of money may be too frequently exposed to lucrative bribe offers, insurers may want to review the salary situation of their adjusters.

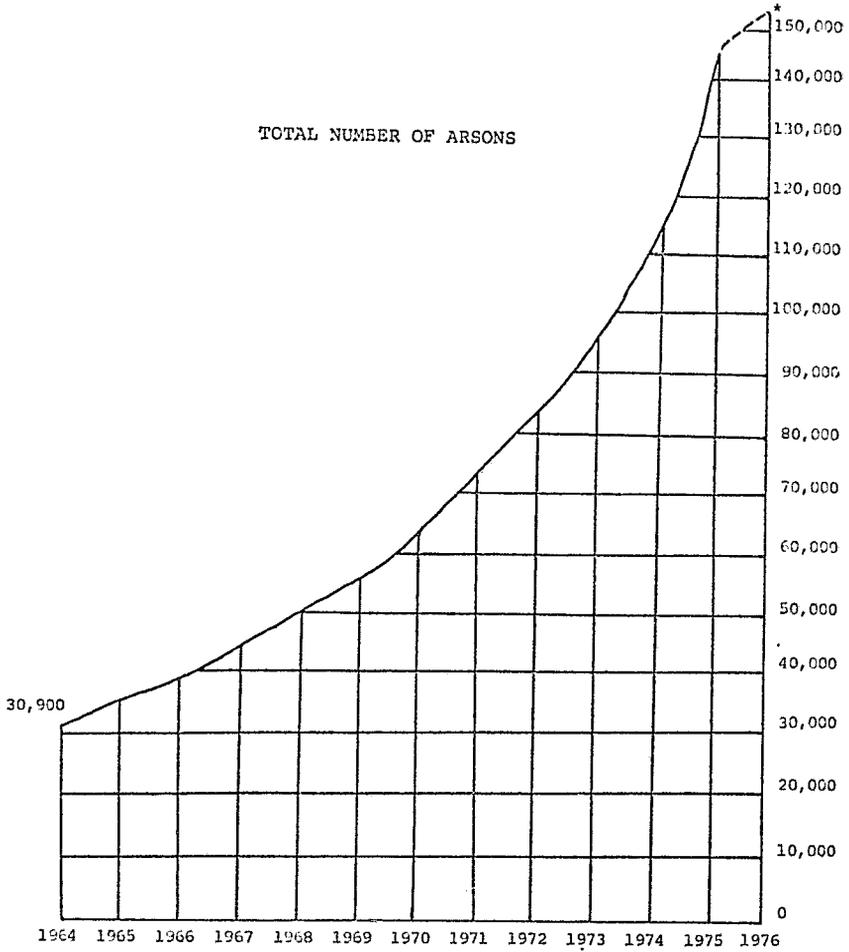
(7) Companies should retain and share information on the number, value, and location of all arsons and suspicious fires, as well as information concerning the owners of such properties.

Successful anti-arson planning may well depend on each company's efforts to compile accurate, up-dated data on the nature of its own arson problem. Although the American Insurance Association in 1970 discontinued its former Fraud and Arson Bureau and arson loss reference files, it recently established a new property insurance loss register which should expand the fund of arson information available to insurers for claims challenges.

Individual companies, however, could much improve their own data-gathering procedures. Currently, uncertain both of the size and nature of their arson losses, too many companies appear inadequately prepared to map out better tactics for coping with arson. Some companies have recently initiated efforts to improve their arson data-keeping procedures, indicating awareness that such efforts may help them combat arson more effectively.

(8) Insurance industry representatives should be afforded an opportunity to testify at public hearings to present evidence concerning measures being taken to materially reduce the criminal attractiveness of arson-for-profit.

Such hearings would serve to demonstrate how the industry is responding and proposes to respond to the arson epidemic, while providing the American public with a fuller understanding of the industry's role in combating this crime. They would also serve as a vehicle for the industry to express its views on the problem and suggest changes in the law that would assist the companies in coping with this insidious crime.



Source: Data released by the U.S. Fire Administration show 146,500 arson incidents (fires reported in the "incendiary" or "suspicious" categories) for 1976, 177,000 for 1977.

APPENDIX A

QUESTIONNAIRE SENT TO
15 INSURANCE COMPANIES
BY THE PERMANENT SUBCOMMITTEE ON INVESTIGATIONS

Company name: _____

Company address: _____

Official responding: _____ Position: _____ Tel. No. _____

1. Prior to issuing a fire insurance policy, what practices does your company follow with respect to physical inspection of structures?

2. Which of these factors influence your decision to research the background of an applicant for fire insurance?

Farm Pro- perty	Commercial Property	Private Home
--------------------	------------------------	-----------------

Newness of
ownership

_____	_____	_____
-------	-------	-------

Depends on value
of property to
be insured

_____	_____	_____
-------	-------	-------

Location of
property

_____	_____	_____
-------	-------	-------

Type of use

_____	_____	_____
-------	-------	-------

a. If decision to research an applicant's background is based on value insured for, state amount.

Farm Pro- perty	Commercial Property	Private Home
--------------------	------------------------	-----------------

\$ _____	_____	_____
----------	-------	-------

3. What factors influence your decision to conduct a physical inspection of each property fire loss?

a. Size of loss?
(state amount)

Farm Pro- perty	Commercial Property	Private Home
--------------------	------------------------	-----------------

\$ _____	_____	_____
----------	-------	-------

b. The difference between the cost of investigation, if arson is suspected, and value of claim.

c. Other factors (please specify on separate sheet of paper).

4. Please specify at what amount of loss does the adjustor interview the following:

	<u>Farm Pro-</u> <u>perty</u>	<u>Commercial</u> <u>Property</u>	<u>Private</u> <u>Home</u>
Police Dept. \$	_____	_____	_____
Fire Dept. \$	_____	_____	_____
Witnesses to fire and causes \$	_____	_____	_____
Persons familiar with claimant \$	_____	_____	_____
Business associates of claimant \$	_____	_____	_____
Relatives of claimant \$	_____	_____	_____

a. If there are no dollar loss criteria for conducting any of the interviews cited in this question, please attach a statement explaining what criteria is used to determine the scope of investigation by the adjustor..

5. Is each adjustor required to participate in a program involving training in arson detection? Yes ___ No ___
- a. If yes, how many hours of arson detection training is required of each adjustor? _____ hours
6. Are current state laws or local regulations regarding fire insurance any impediment to investigation of arson by your company? Yes ___ No ___
- a. If yes, explain.
7. What actions can the federal government take to remove the profitability from arson?
8. On a separate sheet of paper, please evaluate the degree of cooperation your company receives from local, state and federal law enforcement agencies on arson fraud detection, as well as any reasons you may think explain the degree and kind of cooperation or non-cooperation?
9. What could local, state and federal officials do to curb arson-for-profit?

10. In view of the increasing incidence of arson, how have your company procedures and policies changed to deal with this problem?

11. Do you believe that organized local rings, acting without assistance from national crime syndicates, are responsible for arson-for-profit operations?

Yes ___ No ___

a. Please provide specific examples of such activities.

12. Do you believe that national organized crime syndicates are responsible for arson-for-profit operations?

Yes ___ No ___

a. Please provide specific examples of such activities.

13. What factors other than profitability make arson attractive?

PART I

14. Please check the categories for which your firm maintains records which indicate the following facts during 1977:

- a. Number of structures covered by fire insurance _____
- b. Number of structures physically inspected inside and out before insurance coverage was granted _____
- c. Number of structures involved in fire loss, together with amount of loss _____
- d. Number of losses which were inspected by adjustors prior to payment _____
- e. Number of structural losses which were followed up by interviews with:
 - (1) owner _____
 - (2) police dept. _____
 - (3) fire dept. _____
 - (4) witnesses _____
 - (5) business associates of owner _____
 - (6) friends of owner _____
 - (7) neighbors of owner _____
 - (8) relatives of owner _____
- f. Number of investigations of financial status of owners of property which incurred losses _____

PART II

Do you expect to have any additional compilations of statistics referenced in Part I pertaining to 1977 available later in the year?

Yes _____ No _____

- a. If yes, please provide a statement describing the statistics which will be available.

PART III

Do you plan to begin collecting any of the data referenced in Part I in the future?

Yes ___ No ___

a. If yes, please provide a statement describing your plans.

15. Overall, how effective do you think your underwriting and adjusting practices are in curbing arson-for-profit?

Very good ___

Good ___

Fair ___

Poor ___

a. What changes in your practices could be made to reduce arson-for-profit?

16. Please provide any suggestions you think relevant in connection with the Subcommittee's inquiry into arson-for-profit.

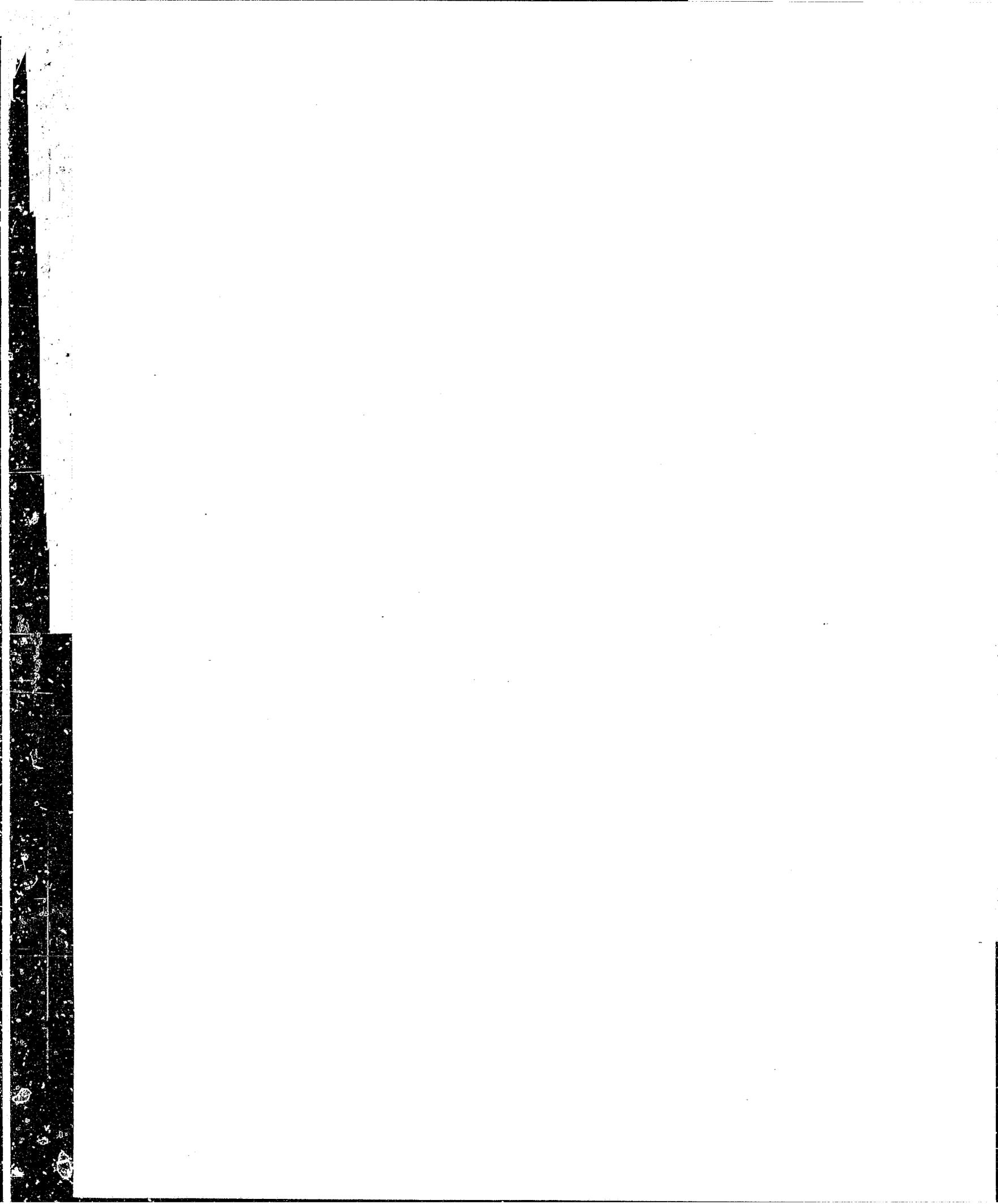
APPENDIX B

The following companies responded to the Permanent Subcommittee on Investigations' questionnaire:

Aetna Life and Casualty Co., Hartford, Connecticut
Allstate Insurance Companies, Northbrook, Illinois
Commercial Union Insurance Co., Boston, Massachusetts
Aetna Insurance Co. (affiliate of Connecticut General Life Insurance Co.), Hartford, Connecticut
Continental Assurance Co., New York, New York
Fireman's Fund Insurance Co., San Francisco, California
Hartford Insurance Group, Hartford, Connecticut
Home Insurance Co., New York, New York
Insurance Company of North America, Philadelphia, Pennsylvania
Reliance Insurance Co., Philadelphia, Pennsylvania
Royal Globe Insurance Co., New York, New York
Safeco Insurance Company of America, Seattle, Washington
St. Paul Fire and Marine Insurance Co., St. Paul, Minnesota
Transamerica Insurance Co., Los Angeles, California
Traveller's Corp., Hartford, Connecticut

(21)

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END