Riot Insurance: Recent Developments on the State and Federal Level

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COMMENT

RIOT INSURANCE: RECENT DEVELOPMENTS ON THE STATE AND FEDERAL LEVEL

Increasing attention has focused on the threat of civil disorder since the Watts riots in August, 1965. The uprisings in Detroit and Newark and the rash of violence following the assassination of Dr. Martin Luther King in April, 1968, have substantiated the magnitude of the problem. In 1967, there were 233 disorders in 34 states, causing property damage estimated at $69,000,000.1 In 1968, the month of April alone (following Dr. King’s assassination) brought 202 disorders in 36 states with estimated property damage of $58,000,000.2 While the property damage was concentrated in three cities,3 the large number of states experiencing disorder indicates a problem of nationwide concern.

With the risk of a riot that could completely destroy his business, a merchant cannot afford to stay in the urban core area without the financial protection of insurance. Without property insurance, it is difficult to procure loans secured by mortgages. As a result, urban redevelopment programs are stifled, and the urban core areas continue to breed the discontent and demoralization that promulgate the violence. Thus, insurance is a social necessity; “communities without insurance are communities without hope.”4

Because fire (except for deterioration) represents the greatest single cause of physical loss to property, the basic form of property insurance protection is fire insurance.5 The standard fire insurance policy excludes fire losses caused by “insurrection, invasion, bombardment, rebellion, revolution, or military or usurped power; [or] by order of any civil authority . . . .”6 The standard policy also excludes

2 Id. Between January and August of 1968 there were 313 racial disorders resulting in 78 deaths and $78,000,000 of property damage. U.S. News & World Report, Oct. 7, 1968, at 29, 30.
4 PRESIDENT’S NATIONAL ADVISORY PANEL ON INSURANCE IN RIOT-AFFECTED AREAS, MEETING THE INSURANCE CRISIS OF OUR CITIES 1 (1968) [hereinafter cited as HUGHES REPORT].
5 Id. at 18-19.
6 N.Y. INS. LAW § 168(6) (McKinney 1966).
loss occurring “as a result of explosion or riot, unless fire ensue, and in that event for loss by fire only.” The standard fire insurance policy is commonly combined with an extended coverage endorsement, which in the typical instance covers losses due to “windstorm, hail, explosion, riot, riot attending a strike, civil commotion, aircraft, vehicles, and smoke.” These insured losses, unlike the standard fire coverage, include “pillage & looting” resulting from riots. Because insurrections are expressly excluded from the policy, there has been much discussion about whether the violence is insured riot or uninsured insurrection. However, insurance companies have been willing to indemnify any damage resulting from the recent civil disorders under extended coverage endorsements.

Insurance companies have been hesitant about writing policies in the urban core. These areas usually consist of older homes, built closely together, with a certain disregard of fire prevention codes. Furthermore, unlike windstorms, floods, and brushfires, there is no basis of experience (except for the last few years) from which to predict accurately, for rating purposes, potential riot damage. The losses thus far attributable to riots are well within the financial capacity of the insurance industry. It is the unascertainable, potential loss that concerns the industry and leaves it hesitant about writing insurance in the urban core area.

Because of this undesirable risk of writing insurance in the urban core, the industry faces a dilemma: On the one hand, there is the social need for property protection in these areas; while on the other

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7 N.Y. INS. LAW § 168(6) (McKinney 1966).
8 See, e.g., Extended Coverage Endorsement No. 4, N.Y. Standard Form 820, reprinted in E. PATTERSON, CASES AND MATERIALS ON INSURANCE 770 (3d ed. 1955).
9 Id.
10 For a good discussion, see Johnson, The Insurer and Civil Disorders, 35 INS. COUNSEL J. 408 (1968); Comment, Insurance Protection Against Civil Demonstrations, 7 B.C. IND. & COM. L. REV. 706 (1966); Comment Compensation for Victims of Urban Riots, 68 COLUM. L. REV. 57 (1968).
12 HUGHES REPORT, supra note 4, at 122.
13 The approximately $50 to $75 million total of insured losses in 1967 from riots represented about 10-15 percent of the total extended coverage premiums. Id. at 19. The Watts riot caused an insured loss equal to 20 percent of the national extended coverage premiums for 1965. However, Hurricane Betsy alone caused an insured loss of $715 million, more than the total annual premiums for extended coverage. Hearings on S.J. Res. 102 Before the Senate Comm. on Commerce, 90th Cong., 1st Sess., Ser. 24, at 27 (1967).
14 Hearings on S.J. Res. 102 Before the Senate Comm. on Commerce, 90th Cong., 1st Sess., Ser. 24, at 14 (1967); HUGHES REPORT, supra note 4, at 40: “Unless a rate has a proper allowance for an accumulation of contingency reserves, catastrophe losses deal a severe blow to profits, and may even impair the solvency of the company.”
hand, there is the desire of stockholders to realize sound profits. These two alternatives seem hardly reconcilable, thus fostering the inadequacy of basic coverage available to the “inner city.”

In 1967, the President’s National Advisory Panel on Insurance in Riot Affected Areas conducted a survey of urban core property owners in six cities. Of the people interviewed, 20.1 percent of the commercial risks and 6.5 percent of the dwelling risks did not carry fire and extended coverage insurance. An even greater percentage did not have burglary and theft coverage. These high percentages of uninsured risks can be attributed to several factors. Of all the commercial property owners interviewed, 5.8 percent claimed they did not carry fire and extended coverage because they could not afford it. Of the dwelling risks, only 1.7 percent of the total attributed lack of insurance to cost. Unavailability was listed by 7.2 percent of the commercial property owners and by 3.4 percent of the dwelling owners as the reason for not having fire and extended coverage insurance. Many people who had been able to obtain insurance at

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16 Approximately 3000 personal interviews were conducted in Boston, Cleveland, Detroit, Newark, Oakland, and St. Louis. Hughes Report, supra note 4, at 126. This survey is, to date, the only comprehensive survey made on the cost and availability of insurance in the urban core area.

17 Id. at 130, 143. The survey demonstrates the fact that insuring commercial risks presents a greater problem than insuring dwelling risks. This is what would be expected, as the merchandise in stores is the primary target of looters during riots.

18 48 percent of the commercial risks did not carry burglary and theft insurance. Id. at 131.

19 5.8 percent is derived in the following computation from the data supplied in Tables 5 and 8 of the Hughes Report. Id. at 130, 132. 

283 (number of uninsureds) X 29.1 (percent of uninsureds who attributed lack of insurance to cost).

20 1.7 percent is derived in the following computation from the data supplied in Tables 28 and 29 of the Hughes Report. Id. at 143, 144.

90 (number of uninsureds) X 27.9 (percent of uninsureds who attributed lack of insurance to cost).

21 7.2 percent is derived in the following computation from the data supplied in Tables 5 and 8 of the Hughes Report. Id. at 130, 132.

1393 (total interviewed) X 35.4 (percent of uninsureds who attributed lack of insurance to unavailability).

3.4 percent is derived in the following computation from the data supplied in Tables 28 and 29 of the Hughes Report. Id. at 143, 144.

90 (number of uninsureds) X 55.3 (percent of uninsureds who attributed lack of insurance to unavailability).

Only 4 percent of the commercial property risks of Oakland claimed unavailability to be the reason why they had no insurance. This is derived in the following computation from the data supplied in Tables 5 and 8 of the Hughes Report. Id. at 130, 132.

22 (number of uninsureds in Oakland) X 4.5 (percent of uninsureds in Oakland attributing lack of insurance to availability).
one time subsequently incurred policy cancellations. During a three-year period, 3.2 percent of the commercial risks reported cancellations as compared with 1.9 percent of the dwelling risks.\textsuperscript{22}

On the other hand, 6.2 percent of all the people surveyed gave no reason whatsoever for not having fire and extended coverage on commercial risks.\textsuperscript{23} Property owners in the core area need to be better educated to the need for having a certain minimum amount of insurance.

The problem, then, is as follows: The inability to obtain adequate insurance is itself a serious cause of blight by holding back development and rehabilitation; yet, without this development and rehabilitation, the insurance industry is reluctant to provide the needed insurance protection without some assistance. The resulting by-product is a demoralization of the people,\textsuperscript{24} accompanied by a certain distaste for insurance companies and by political pressure for governmental intervention. Urban redevelopment programs are vitally needed to assist in rebuilding the urban core areas to a level of prosperity and safety that will induce private industry to provide the needed insurance coverage.\textsuperscript{25} Fortunately, programs implemented by private industry, the federal government, and several state governments have also assisted in meeting the crisis by providing insurance for deserving property owners in the urban core areas.

\textbf{Private Industry}

\textit{Pools}

The evening exploded with the cry which became the slogan of the Watts riots. Someone shrieked "Burn, Baby Burn!" The spark was lit and for six days the city of Los Angeles underwent the most severe disorder in its history.\textsuperscript{26}

By the time order was restored, estimated property damage was over

\textsuperscript{22} Hughes Report, supra note 4, at 139, 149.

\textsuperscript{23} 6.2 percent is derived in the following computation from data supplied in Tables 5 and 8 of the Hughes Report. \textit{Id.} at 130, 132.

\textsuperscript{24} The attitude of people in the ghetto is shown by the fact that of a sample taken in the Watts area of Los Angeles following the 1965 riots, 34 percent were somewhat in favor of what had occurred, while up to 15 percent of the Negro adult population had been active at some time during the rioting in more than a spectator role. \textit{Hearings on S.J. Res. 102}, supra note 13, at 81.

\textsuperscript{25} Some programs have been initiated. See, e.g., Housing and Urban Development Act of 1968, Pub. L. No. 90-448 (Aug. 1, 1968); Economic Opportunity Act, 42 U.S.C. §§ 270-2981 (1964). However, the former development act had trouble obtaining sufficient appropriations in Congress to implement the program adequately. San Francisco Sunday Examiner & Chronicle, Oct. 13, 1968, § A, at 9, col. 8.

\textsuperscript{26} \textit{Hearings on S.J. Res. 102}, supra note 13, at 79.
$40,000,000.27 Thereafter, the insurance market in Watts tightened; in a survey taken of the area, 14 percent of the merchants questioned had experienced cancellations, while 44 percent indicated an availability problem.28 After receiving numerous complaints, the California Insurance Commissioner called several insurance executives together and formed a committee to help process the complaints. From this committee came the idea of creating a pool to provide fire and extended coverage insurance for those deserving commercial risks in Watts that could not obtain such protection in the normal market.29 Thus, the pool was developed as a supplementary insurance market for the "hard core problem" risk and was intended chiefly to distribute these risks throughout the industry.30

When a property owner had been unable, after a diligent effort, to obtain coverage in the normal market, he, along with his agent, could apply to the pool for aid. The pool then determined whether or not the applicant was insurable in the normal market. The property was inspected to help answer this question. If it was decided that coverage was unobtainable in the normal market, the information from the inspection was used to decide whether the property met the pool's underwriting standards and at what particular rate the property might be insured. All policies were written by a front organization—the United States Liability Insurance Company. This company was in turn reinsured by 110 companies that did business in the Watts area. The amount of reinsurance by each company was in proportion to the volume of its California business.

By March 1, 1968, the pool had written fire and liability coverage for 553 risks accounting for coverage of $15,521,421.31 Because this was only about 2 percent of the commercial risks in the area, the pool seemed to be successful as a supplementary insurance market. The 98 percent of the businesses not written in the pool obtained fire and extended coverage insurance through normal channels or did not report any difficulty in obtaining insurance.

There were several criticisms of the Watts pool. The policies written by the pool were limited to fire and extended coverage insurance on commercial risks in the Watts area. Thus, it did not provide a source of burglary and theft coverage,32 nor did it provide protection

27 More than 600 buildings were damaged, and 200 were destroyed by fire. Governor's Commission on the Los Angeles Riots, Violence in the City—An End or A Beginning 23 (1965).
28 Hearings on S.J. Res. 102, supra note 13, at 83.
29 For a good discussion of the Watts Pool, see Hughes Report, supra note 4, at 75-76; Hearings on S.J. Res. 102, supra note 13, at 83-84.
30 Hearings Before the President's National Advisory Panel on Insurance in Riot Affected Areas, at 55 (1967).
31 Insurance, April 6, 1968, at 38.
32 As already seen, there is more of a problem in obtaining burglary and theft insurance than there is in obtaining fire and extended coverage. See note 17 and accompanying text supra.
for residential risks. While insurance was made available by the pool for commercial risks, the premium rates were generally from 2.5 to 3 times the rates in the normal market. These rates, however, were not prohibitive. One survey indicated that retailers insured in the pool usually paid 50 cents or less for fire and extended coverage insurance for every $100 of net sales, that is, less than 1 percent of net sales.

Another problem with the Watts insurance pool was that of persuading insurance agents to encourage and assist the deserving property owners in seeking insurance through the pool. As one agent explained: "We avoid the writing of property insurance in . . . [Watts] as much as possible because of: (1) Difficulties in placement, (2) The complicated procedure of the Industry Facility, and (3) The high cost." One suggested solution to this problem is that the industry could contribute to the development of an indigenous agency that would be more responsive to the problems of the property owners in the urban core area.

In conclusion, while the Watts pool was perhaps not the best answer, it was nonetheless an answer. Many of the participants in the pool considered it a temporary measure to alleviate the crisis until some plan could be established by the federal government.

Urban Plans

Another solution adopted voluntarily by insurance companies to solve the problem of providing basic property insurance to urban core areas was the creation of urban plans. Typical of such plans was the Oakland, San Francisco, and Los Angeles County Fire and Extended Coverage Insurance Inspection Plan, created July 19, 1967. This plan was offered by the insurance industry as an alternative method (to proposed assigned risk legislation) of providing insurance for property owners who had experienced difficulty in acquiring fire and extended coverage protection.

35 HUGHES REPORT, supra note 4, at 27.
36 The Boston Plan (1960); The Michigan Fire Insurance Inspection Plan (Jan. 1, 1966); Cleveland Fire Insurance Inspection Plan (April 18, 1966); The Voluntary Inspection and Advisory Committee for Milwaukee Core Area Fire Insurance (Oct. 24, 1966); The Buffalo and New York City Fire and Extended Coverage Inspection Plan (April 1, 1967); The Pennsylvania and Delaware Sub-Standard Plan (Mar. 1, 1965); The Louisiana Owner-Occupied Insurance Dwelling Program (April 1, 1967); The Minnesota Core Area Plan (June 12, 1967); The Oakland, San Francisco, and Los Angeles County Fire and Extended Coverage Insurance Inspection Plan (July 19, 1967); The North Carolina Fire and Extended Coverage Plan for Properties in Beach Area of Zone 1 (Sept. 18, 1967); The Wichita Agents' Plan (Dec. 1, 1967); Chicago Home Inspection Plan (Dec. 1, 1967). For a short discussion of each plan, see the HUGHES REPORT, supra note 4, at 56-75.
The plan called for an inspection of the owner’s property by a designated rating bureau upon request by the insurance agent. The purpose of this inspection was to distinguish between properly maintained property and property in a substandard condition. After inspection the insurance company either wrote the coverage at standard rates, wrote it at surcharged rates, or refused to write it altogether. In the latter two cases, the company was required to supply the reasons for its decisions to the rating bureau and the property owner. However, each company was free to apply its own surcharged rating plan. The rating bureau, in turn, periodically informed the state commissioner’s office of the results in each case.

The urban plan in California was limited to residential risks. As a result, the plan did not have a sufficient number of applicants to permit a fair evaluation of its performance. In one year in San Francisco only 58 residential owners had taken advantage of the plan.37

Several criticisms of the urban plans, which were in effect in 13 states by December 1, 1967, were expressed. One broker said that the New York urban plan operated too slowly, cost too much, and did not expand the market for insurance. The inspections usually took two months, and the surcharges frequently did not reflect the actual fire hazard.38

In a Boston survey, 10.3 percent of the people living in dwellings covered by the Boston Plan were unaware of it, and 45.5 percent did not have their property inspected under it.39 A substantial number of those who could have benefited by an inspection did not avail themselves of it because of their unawareness, demonstrating the problem of communication between the insurance industry and the urban core property owner.

Municipal Liability

Fourteen states have enacted statutes imposing liability on municipal corporations or counties for damage caused by riots.40 It has

37 UNDERWRITERS’ REPORT, July 4, 1968, at 3.
38 Hearings Before the President’s National Advisory Panel on Insurance in Riot-Affected Areas, at 4 (1967).
39 10.3 percent is derived in the following computation from the data supplied in Tables 33 and 34 of the Hughes Report, supra note 4, at 146. (number of people who did not have their property inspected) X 22.2 (percent of uninspected who were not aware of the plan). 45.5 percent is found in Table 33 of the Hughes Report. Id. at 146.
been argued that placing the financial burden on the municipalities
does provide a certain deterrence to future rioting.\textsuperscript{41} Imposing liability
on the community may inspire it to maintain law and order. However, it is doubtful that many taxpayers, upon whom the ultimate
financial burden rests, have any knowledge of such statutes;\textsuperscript{42} nor
does it seem likely that law enforcement officers have a greater con-
cern for maintaining law and order in those cities with municipal
liability than in those without it.

Most of the statutes impose some form of strict liability.\textsuperscript{43} Conse-
quently, the normal incentive for an owner to protect his property
against riot damage is decreased, since he knows he will receive
compensation from the municipality anyway.\textsuperscript{44} In those states having
statutes imposing liability on municipalities for negligence,\textsuperscript{45} the in-
jured property owner has the difficult burden of proving that local
authorities did not use due care under the circumstances. Because
financial protection from riots is not dependent upon the condition
of the property (as is the case when seeking insurance), there is less
incentive for the property owner to maintain and improve the con-
dition of his property.

State Legislation

In 1968, the disorders following the assassination of Dr. Martin
Luther King brought further uneasiness to the insurance companies.
The state legislatures, particularly in the large urban states, realized
that remedial legislation was essential for the preservation of the

There has been a trend toward repealing statutes holding municipalities liable. In Muskopf v. Corning Hosp. Dist., 55 Cal. 2d 211, 359 P.2d 457, 11 Cal. Rptr. 89 (1961), it was held that the doctrine of sovereign immunity was unjust and would no longer protect governmental entities from civil liability in tort. Subsequently, a statute was passed stating that neither a public employee nor a public entity is liable for failure to provide police protection. \textsuperscript{41} Cal. Gov't Code § 845. For good discussions of municipal liability for damage due to riots, see Johnson, The Insurer and Civil Disorders, 35 Ins. Counsel J. 408, 415 (1968); Rottman, Riot Damage, Municipal Liability, and Insurance, 1968 Ins. L.J. 597; Note, Compensation For Victims of Urban Riots, 68 Colum. L. Rev. 57, 65 (1968); Note, Municipal Liability For Riot Damage, 16 Hastings L.J. 469 (1965); Comment, Riot Insurance, 77 Yale L.J. 541 (1968).

\textsuperscript{42} Note, Municipal Liability for Riot Damage, 16 Hastings L.J. 459, 464 (1965); Comment, Riot Insurance, 77 Yale L.J. 541, 554 (1968).

\textsuperscript{43} Rottman, Riot Damage, Municipal Liability, and Insurance, 1968 Ins. L.J. 597, 604-05.


RIOT INSURANCE

ghetto market. Michigan, New York, New Jersey, California, and Virginia passed legislation making insurance available to qualified property owners who, after a diligent effort, could not obtain coverage in the normal market.

The purposes of the Basic Property Insurance Inspection and Placement Plan, initiated in California, are to stabilize the residential property market, to assure the availability of insurance, to encourage the use of the normal market in obtaining insurance, and to provide an equitable distribution among insurers of the responsibility of insuring qualified property that could not be insured through the normal market. This program was stimulated by the growing problem of policy cancellations in California's brush fire areas. However, the plan is available to all dwelling risks throughout the state, and thus it encompasses the urban core area as well as the brush fire area.

The California legislation establishes a FAIR (fair access to insurance requirements) plan, an industry placement facility, and a joint reinsurance association. The plan insures only dwelling risks and provides fire and extended coverage as well as vandalism and malicious mischief insurance. However, further coverage may be added from time to time as designated by the placement facility.

The industry placement facility is an organization composed of all companies writing basic property insurance in the state. Its purposes are to assist the owners and tenants of dwellings in obtaining insurance and to administer a program for the equitable distribution among the insurance companies of the risks covered by the plan in accordance with their respective premium volume. There was some disagreement in the insurance industry concerning how a state plan should be implemented. Some favored an assignment of risks to individual companies with reinsurance provided, while others favored a pool arrangement. California's plan incorporates both ideas.

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53 The insurance pool that provided coverage in the brush fire areas had to terminate because of the inability to obtain reinsurance. See National Underwriter, June 7, 1968, at 52. The reason for this termination was that the reinsurance market was not controlled by the government, and thus its actions were related to profitability.
56 See Underwriters' Report, June 20, 1968, at 3.
by stating that "[the industry's placement] facility . . . may provide for the equitable distribution of risks . . . by means of assignment to individual members of such facility or by a pool or association of insurers participating in such facility."\(^{57}\)

The joint reinsurance association, also consisting of all insurers writing basic property insurance in California, provides reinsurance on risks written by insurers under the plan. Participation in the association is likewise equitably distributed in proportion to premium volume.

Membership in the placement facility and the reinsurance association is a prerequisite to conducting insurance business in the state.\(^{58}\) The constitutionality of such a requirement was upheld in *California State Automobile Association v. Maloney.*\(^ {59}\) In that case, the Insurance Commissioner of California suspended the right of the appellant to transact automobile liability insurance business in the state because of its refusal to participate in the California Assigned Risk Plan.\(^ {60}\) The appellant contended the statute violated the due process clause of the 14th amendment on the grounds that it forced insurance companies to enter into contracts against their will and that it forced upon them business in which there was a high risk of loss. The court declared: "[T]he power of the state is broad enough to take over the whole business, leaving no part for private enterprise."\(^ {61}\) Thus, the state did have authority to impose such a requirement. The court also stated: "Appellant's business may of course be less prosperous as a result of the regulation. That diminution in value, however, has never mounted to the dignity of a taking in the constitutional sense."\(^ {62}\)

The FAIR plan provides that a property owner having an insurable interest in a dwelling, after a diligent but unsuccessful effort to obtain coverage in the normal admitted market,\(^ {63}\) may apply to the placement facility for an inspection of his property.\(^ {64}\) If, after receiving the inspection report, the facility decides that the risk is insurable but cannot be written in the normal market, it will in turn provide insurance for the property.


\(^{59}\) 341 U.S. 105 (1951).

\(^{60}\) *Cal. Ins. Code* § 11620. This section provides for the "equitable apportionment, among insurers admitted to transact liability insurance, of those applicants for automobile bodily injury and property damage liability insurance who are in good faith entitled to but are unable to procure such insurance through ordinary methods."


\(^{62}\) Id. at 111.

\(^{63}\) "'Admitted,' in relation to a person, means entitled to transact insurance business in this State, having complied with the laws imposing conditions precedent to transaction of such business." *Cal. Ins. Code* § 24.

The Insurance Placement Facility may establish maximum limits of liability and reasonable underwriting standards, subject to the approval of the Insurance Commissioner. While there is no express provision in the act regarding insurance rates, the California Insurance Code provides that no rate shall be "excessive or inadequate . . . [or] unfairly discriminatory." A rate is not excessive "unless (1) such rate is unreasonably high for the insurance provided and (2) a reasonable degree of competition does not exist in the area with respect to the classification to which such rate is applicable." Because of the limitations on underwriting standards and selectivity imposed by The Basic Property Insurance and Inspection Plan, there is not a reasonable degree of competition with regard to insurance provided through the pool. Consequently, if the Insurance Commissioner determines that the rates are unreasonable, they will be excessive and unlawful.

There are certain hazards to be avoided when plans such as California's are implemented. They must not be used as a device to insure the uninsurable. Otherwise, there may be a loss of incentive to maintain the property in good condition because the property owner would know that some company would be required to insure the risk.

Such plans may also discourage maximum use of the normal insurance market, which is precisely what happened in the brush fire areas of California. Instead of renewing expired policies, companies were dumping them into the state inspection and placement plan. As a result, the plan was not being used as a supplemental insurance market as had been intended. To correct such a problem, companies could be given credit for the policies they voluntarily write in high risk areas by proportionately decreasing their required participation in the placement facility and the reinsurance association. Thus, incentive to utilize the normal market would be restored.

**Federal Legislation**

Not only has there been state activity toward initiating an insurance program in the ghettos, this problem also has been receiving close attention at the national level. By October, 1967, there had been introduced in Congress several bills and resolutions concerning

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66 CAL. INS. CODE § 1852(a).
67 CAL. INS. CODE § 1852(a).
69 See id. In previous proposed legislation, such a provision was included. "The system shall permit reduction or elimination of assignments to any insurer which otherwise issues residence fire insurance and homeowner's insurance on single family residences in generally recognized high hazard areas in reasonable proportion to all such insurance it issues in this state." Cal. S.B. 1278 (1966).
civil disorders and the attendant insurance problem. In January, 1968, the President's National Advisory Panel on Insurance in Riot Affected Areas set forth specific proposals in its report, Meeting the Insurance Crisis of our Cities. These proposals were subsequently adopted and enacted by the Urban Property Protection and Reinsurance Act of 1968.

**Urban Property Protection and Reinsurance Act of 1968**

The purposes of the Act are to assist and encourage state insurance authorities and the industry to establish programs offering insurance protection for those meeting reasonable standards, and to provide a federal reinsurance program while placing appropriate financial responsibility on the states.

The new statute commits the federal government to a program of reinsuring risks written by insurance companies in urban core areas. However, for a company to be eligible for participation in the program, there are two basic requirements that must be fulfilled.

1. There must be in each state a plan to assure fair access to insurance requirements (FAIR plan), and each insurer, to be eligible for federal reinsurance, must participate in such plan. The plan may vary from state to state because of differing local conditions. However, all state plans must contain the following provisions: No surcharged rates or refusal to insure may be permitted until after an inspection and a determination that reasonable underwriting standards have not been met; the inspection may be requested by the property owner, the insurance agent or the insurer; a report must be sent to the property owner explaining why his risk has been declined, why the surcharge has been imposed, and what improvements are necessary for the property to qualify for participation.

2. Within one year (or after the close of the next regular session), each state must establish a fund in a minimum amount of 5 percent of the property insurance premium earned in the state during the preceding year. This fund is to reimburse the federal Secretary of Housing and Urban Development for amounts expended for rein-

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71 Hughes Report, supra note 4.
73 Id. § 1102(b), at 2894.
74 Id. § 1211(b), at 2898.
75 Id. § 1212, at 2899.
sured losses occurring in that state in excess of (A) reinsurance premiums received in that state in the same year, plus (B) the excess of premiums (measured from the last year the Secretary was reimbursed for losses in the state) over amounts paid for reinsured losses that occurred in the same period.\textsuperscript{76}

Federal reinsurance may be terminated after thirty days notice to the insurer that the state has not adopted a plan to make property insurance available without regard to environmental hazards. However, this proviso will not become effective until August, 1970. Federal reinsurance may also be terminated after thirty days following notification to the insurer that it is not fully participating in the state's FAIR plan.\textsuperscript{77}

The reinsurance offered by the federal government is for fire and extended coverage, vandalism and malicious mischief, and burglary and theft, including losses from riots or civil disorders. The Act calls for the establishment of the National Insurance Development Fund, which will make payments as required under the reinsurance contracts, will pay administrative expenses, and will repay any sum that is borrowed from the Secretary of the Treasury to pay for riot losses.\textsuperscript{78}

The program is administered by the Secretary of Housing and Urban Development, assisted by an advisory board composed of representatives of the public, the insurance industry and the various levels of government.\textsuperscript{79} This advisory board reviews general policies and provides the Secretary with expert advice. Its composition guarantees to many affected interests that their representatives will have the opportunity to be heard.

The financing of the reinsurance plan is provided in three separate layers. The first layer is private industry's contribution. The industry will assume a certain percentage of the primary risk. If the claims for riot damage exceed this amount, payment is made from the fund created by the premiums paid by the companies for reinsurance.\textsuperscript{80}

The second level consists of the state back-up fund. This fund is tapped only after the private funds have been completely utilized.\textsuperscript{81}

The Secretary of Housing and Urban Development has authority, when the first two levels of finance have been exhausted, to borrow up to $250,000,000 from the Federal Treasury. Any money borrowed will be repaid by subsequent premiums paid by the companies for the reinsurance.\textsuperscript{82}

\textsuperscript{76} Id. § 1223(a)(1), at 2902.

\textsuperscript{77} Id. § 1223(2)-(3), at 2902-03.

\textsuperscript{78} Id. § 1233(a), at 2905.

\textsuperscript{79} Id. §§ 1201-02, at 2895.

\textsuperscript{80} Id. § 1222(b), at 2901.

\textsuperscript{81} Id. § 1223(a)(1), at 2902.

\textsuperscript{82} Id. § 1104, at 2808.
Under this new federal legislation, it can be expected that, within the next few years, states will create FAIR plans, with compulsory participation by insurance companies, for both commercial and dwelling risks. Since a state must, as a condition to obtaining federal reinsurance within the state, provide a financial back-up for riot losses, states will probably insist that the insurance companies doing business in the state participate in a FAIR plan. Companies are not, of course, required to take federal reinsurance; however, those companies which do not must assume 100 percent of the losses they incur. State legislatures can also be expected to provide funds for the financial back-up required for participation in federal reinsurance.83

83 The idea of federal cooperation with private industry to solve insurance problems is not new.


The flood insurance plan is limited to those states that have enacted programs to control land development in flood-prone areas. Id. § 1305(c), at 2917. The act also provides for the creation of a National Flood Insurance Fund, which will make premium equalization payments to private insurers, provide reinsurance, and make repayments of monies borrowed from the Secretary of the Treasury. Id. § 1310(a), at 2921. The Secretary of Housing and Urban Development is to encourage the formation of an insurance pool composed of private insurers. Id. §§ 1331-1332, at 2926-27. If the pool is found inadequate to provide the needed insurance, the Secretary of Housing and Urban Development is to take necessary steps to operate the program through facilities of the federal government. Id. § 1340, at 2929.

As another example, the Export-Import Bank of Washington is authorized to insure and reinsure United States exporters and foreign exporters doing business in the United States against political and credit risks of losses arising in connection with United States exports. 12 U.S.C. § 655(c)(1) (1964).

Application and Appraisal of the Riot Reinsurance Act

The new Urban Property Protection and Reinsurance Act of 1968 guarantees an insurance market for insurable property with a minimum impact on normal industry methods of serving the public. The certainty of market will be provided by the creation of state FAIR plans. These plans will be an improvement over existing urban plans because they will each apply throughout the state to both commercial and dwelling risks, they will cover all major lines of property insurance, and their standards of insurability will be without regard to "environmental hazards." "Environmental hazard" is defined as "any hazardous condition that might give rise to loss under an insurance contract, but which is beyond the control of the property owner . . . ." Factors such as the availability of fire fighting equipment and the condition of the surrounding neighborhood will not be considered when determining whether a property owner is entitled to insurance.

The Michigan Basic Property Insurance Plan appears to have the best approach to determining the standards of insurability by stating that property is qualified for the plan if it

[c]omplies with applicable state and local building codes and ordinances to the extent conditions on the property reasonably related to the perils insured against cannot be the subject of, or provide the basis for, a corrective administrative or judicial order, a criminal prosecution, or a civil fine or penalty . . . . This language eliminates consideration of all "external hazards" and considers only those pertinent "internal hazards." Consequently, one whose own property, disregarding all surrounding circumstances, is uninsurable will not be eligible in Michigan to obtain coverage through the pool. This provides a desirable deterrence to property owners who might otherwise allow their premises to deteriorate. If the property owner were refused insurance for reasons beyond his control, he would lose the incentive to give the property the care it needs.

California's FAIR plan does not expressly exclude consideration of environmental hazards. However, the Insurance Commissioner is given authority by the statute to do those things necessary to enable the state and any insurer in the state to participate in any federal reinsurance program that might be enacted. Therefore, the California FAIR plan will qualify under the Federal Reinsurance Plan, because the Commissioner has excluded consideration of environmental hazards when determining whether property is eligible for insurance. However, considering environmental hazards is not precluded in determining the applicable premium rates.

85 Id. § 1203 (a) (1), at 2896.
The new federal program is desirable in that it leaves regulation of the insurance industry almost exclusively with the individual states. In *United States v. South-Eastern Underwriters Association* the United States Supreme Court held that Congress had the power to regulate insurance under the commerce clause of the Constitution. Nonetheless, shortly thereafter, Congress passed the McCarran-Ferguson Act, which declares that "the continued regulation . . . by the several States of the business of insurance is in the public interest . . . ." The power to withhold federal reinsurance under the Urban Property Protection and Reinsurance Act of 1968, when certain conditions are not met, is not a regulation of the insurance industry, because the existing structure of the industry is left undisturbed and governmental regulation remains in state control. Consequently, the policy of the McCarran-Ferguson Act has not been abridged.

By leaving the existing structure for providing insurance essentially unchanged, the administrative expense of the federal reinsurance program will be minimal. The federal plan affords security to the insurance industry as a whole without involving governmental participation until riot losses in a state exceed what private industry can absorb. The theory underlying the new statute is that any money expended by the federal government to indemnify riot losses will be in substance a loan. As reserves accumulate from the premiums paid by the insurance companies, any sums borrowed from the government will be repaid. In the long run, as urban centers are improved through redevelopment programs, they will become more desirable to insure from a business standpoint. Eventually, the private market will find that insuring these areas has become profitable, and competition within the industry to provide coverage in the urban core will commence. At this point federal and state back-up will be unnecessary, and governmental participation can be gradually eliminated.

Prior to the federal reinsurance act, there had been numerous tax proposals designed to enable private industry to provide insurance for urban centers without federal or state back-up. Many of these plans called for the creation of a catastrophe reserve by insurance companies. As long as this money remained in the reserve or was used to indemnify riot losses, the reserve would have been free from taxation. Other plans called for a long-term period for determining income taxes on premiums instead of the annual period that generally applies. While these tax plans may have been helpful, they would not have produced the necessary funds soon enough.

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88 322 U.S. 533 (1944).
91 See, e.g., id. at 106-07; *Hearings Before the President's National Advisory Panel on Insurance in Riot-Affected Areas*, at 246, 255 (1967).
93 *Hearings Before the President's National Advisory Panel on Insurance in Riot-Affected Areas*, at 246, 255 (1967).
Thus, while they would not have provided an immediate solution as the present reinsurance program does, they should be considered as a possible future alternative. A tax-deferral plan would permit state and federal back-up for the insurance industry to be phased out more rapidly.

The advantage of having separate state FAIR plans under the Urban Property Protection and Reinsurance Act of 1968 is that each state government is more closely attuned to the needs of that state and can implement and administer a plan more responsive to its particular problems. Nevertheless, federal involvement has the advantage of mobilizing greater resources and of focusing public attention on the problem at the national level.

The plan also provides for a greater contribution from states incurring the most riot damage. The only monies used to indemnify riot damage in a state that do not come exclusively from that state are the premiums paid by insurance companies for reinsurance. These premiums serve to spread the risk throughout the nation, relieving the ghetto property owner of having to bear the entire financial burden. This approach would seem to be justified by the fact that problems of the urban core area have been created by the whole of society.

Conclusions

The federal reinsurance program was a necessary answer to the urgent problem of making insurance available to property owners in urban centers. Federal assistance is, however, minimized by providing for initial financial protection by private industry and state governments. This is a desirable approach because greater governmental participation in the plan would have increased the difficulty of returning to a free and independent market. To stimulate this desired independent status further, a tax-deferral program should be considered for future implementation.

By providing for individual state FAIR plans, the federal program leaves insurance regulation at the state level and allows state officials to provide particular solutions for local problems. Besides implementing FAIR plans, the states should provide pools for the equitable apportionment of urban risks among insurers in the state. This would provide full utilization of the industry's capacity before asking the federal government for assistance. However, to prevent these pools from becoming dumping grounds for the large insurance companies, credit systems should be created or specific underwriting standards established.

The enactment of these suggestions, coupled with existing legislation, will provide a most equitable, manageable and yet comprehensive system to aid the urban property owner in obtaining insurance against riot-caused damages.

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