

# RISK AND THE INSURANCE BUSINESS IN HISTORY

Edited by

JERÒNIA PONS AND ROBIN PEARSON



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Jerònia Pons and Robin Pearson

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Publishing Department: Ana Sojo Gil  
Edition: Miriam López Díaz

© 2020, Fundación MAPFRE  
Paseo de Recoletos, 23  
28004 Madrid (España)

[www.fundacionmapfre.org](http://www.fundacionmapfre.org)

ISBN: 978-84-9844-753-8  
Legal Deposit: M-4151-2020  
Graphic Design and Layout: Cyan, Proyectos Editoriales, S.A.

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## ACKNOWLEDGEMENTS

First, the editors would like to express their gratitude for the support of institutions that helped smooth the way for the Risk and the Insurance Business in History Congress where the works presented in this book were presented and debated. Thanks to the International University of Andalusia, and its academics who, due to their international calling, understood the possibilities of this event. A special thanks to José Ignacio García Pérez, at the time Vice Rector of Non-formal training, quality assurance and research at the International University of Andalusia, and now Rector. Thanks also to the Cajasol Foundation, for letting us use their magnificent building, with its origins in the sixteenth century, to host the event.

We must also thank other institutions that helped bring about the conference. We are grateful for the help of the Mansutti Foundation, the Vice-Rectorate for Research of the University of Seville and the Doctoral Programme in Economic, Business and Social Sciences of the University of Seville. Moreover, the conference was possible thanks to the vital work of the Scientific Committee (Geoffrey Clark, Magnus Lindmark, W. Jean Kwon, Allan Manning, Grietjie Verhoef and Takau Yoneyama) and the local committee (Pablo Gutiérrez González and María Dolores Oliver). We would also like to express our gratitude to the Mapfre Foundation for offering to publish this book as part of its support for the conference. Finally, a special mention for all the participants in the international congress from different disciplines linked to insurance activity who ensured a high academic level with their papers and participation in subsequent discussions.

Jerònia Pons and Robin Pearson



## **ABSTRACTS**

### **CHAPTER 2. TAXING JOURNEYS: BRITISH LIFE INSURANCE AND THE WHITE MAN'S BURDEN, 1840-1914, BY TIMOTHY ALBORN**

For the thousands of British soldiers, engineers, and civil servants for whom empire potentially posed a mortal burden, the ever-present possibility of death was also a financial burden. Foreseeing what price should be charged to cover the risk of death overseas was the job of successive generations of actuaries, who tabulated Britain's imperial death toll and translated their findings into annual premium payments. Long before they took much interest at all in the relative mortality of their colonial subjects, the British developed a large mass of statistical information concerning their own ability to survive in colonial climates; and neither life insurance actuaries nor their directors could bring themselves wholly to disregard the risk posed by residence overseas. This chapter discusses the accumulation of British expatriate mortality data from varied sources between 1840 and 1914; then, using company archives, it surveys the (usually haphazard) application of that data by several British life insurance companies. The same archives reveal a consistent pushback against extra charges for foreign residence, both by travelers in general and by specific occupations such as soldiers and missionaries; to which many insurers responded by reducing or eliminating these – always weighing these more liberal policies against the likelihood of losing money on these risks. The final section examines the half-hearted, and often contradictory, efforts of British companies to extend the civilizing mission of insurance to their non-white colonial subjects.

### **CHAPTER 3. AGENTS, REGULATIONS, AND SCANDALS: US LIFE INSURANCE COMPANIES IN LATE-NINETEENTH-CENTURY LATIN AMERICA, BY SHARON ANN MURPHY**

This chapter examines a few of the principal episodes of exit, re-entry, and final exit of the Equitable Life Assurance Society of New York and the New York Life Insurance

Company from the major markets of Latin America during the late-nineteenth century. On the surface, changes in national regulatory regimes drove most of these corporate decisions. But cutthroat competition between the two companies, problems of local agency oversight, and corporate scandals all greatly complicated this simplistic narrative, eroding their first-mover advantages in the region and providing an opening for domestic companies to establish themselves as viable alternatives. The intense anti-Americanism that followed the Spanish-American War would solidify – rather than cause – an already established retreat from the region.

#### **CHAPTER 4. RISK IN FIRE INSURANCE LAW AS AN EMPOWERMENT TOOL FOR THE STATE DURING THE CONSTRUCTION OF COLONIAL CANADA, BY DAVID GILLES AND SÉBASTIEN LANCTÔT**

Canadian insurance legislation had its roots in Great Britain, the United States of America and France. When the Canadian State was constituted in 1867, insurance corporations and insurance laws were already in existence in some of the provinces. For instance, Lower and Upper Canada had a strong legal framework rooted in the civil code and the common law. As Canadian insurance laws have developed through the years, they have shown their foreign influences. Canadian legislators tried to deal with a firm but restrained legislative interference with the insurance business. They have followed a middle course of publicity, supervision, regulation and freedom between the French and American models, with a lot of state interventions, and the British model, with little governmental intervention or supervision of the fire insurance business.

#### **CHAPTER 5. MARKETS CREATED AND DESTROYED BY THE STATE: CASUALTY INSURANCE AND THE EXPERIENCE OF THE ZURICH INSURANCE COMPANY 1850-1914, BY CHRISTOFER STADLIN**

The emerging constitutional state of the 19th century was an important driver of the insurance business especially for accident and liability insurance. These were new types of insurance developed to cover risks that, on the one side, were the direct result of technological progress like railways and the industrial workplace, on the



other the indirect result of changing attitudes how respective misfortunes and accidents were perceived especially regarding the question of responsibility and ultimately of liability for the material consequences resulting from the bodily injuries they caused. The chapter investigates how relevant legislative state action impacted the insurance business, how such action created and destroyed business opportunities and how private insurance adapted and took advantage. It does this by looking at the Zurich Insurance Company and its history from its foundation in 1872 to WWI. Zurich is especially suited for such an inquiry. By the 1880s the company was active in most mayor continental European states, especially in Germany and France where the handling of the industrial accident risk took different trajectories. Accordingly, the development of the business in these two countries, which were also Zurich's main markets in terms of premium income up to WWI, stands in the centre of the paper as case studies and provider of most source materials.

## **CHAPTER 6. INSURANCE AND REGULATION MODES IN FRANCE AND SPAIN FROM THE END OF THE NINETEENTH CENTURY UNTIL THE END OF WORLD WAR TWO, BY LEONARDO CARUANA DE LAS CAGIGAS AND ANDRÉ STRAUS**

In this chapter we present the development of insurance regulation in France and Spain with a clear difference in its timing because the economic growth of the former was greater and the insurance industry was clearly more important in France in the nineteenth century. The control of the insurance industry experiences a turning point in both countries at the end of the century and had a crucial development up to the Second World War. Many elements are common and the influence of France over Spain is evident in the nineteenth century, however other countries also did built up the insurance industry in Spain, for example United Kingdom or United States in life insurance

## **CHAPTER 7. SWEDISH INSURANCE INSTITUTIONS AND EFFICIENCY 1920-1980, BY PETER HEDBERG, LARS KARLSSON AND MIKAEL LÖNNBORG**

According to previous research, the insurance market accounted for a key role in the welfare policies in post war, corporatist Sweden. It became the norm that

insurance should be distributed in a similar way to all public utilities. However, since the industry was considered to be too decentralised and too market oriented to meet the requirements of serving the public, new regulations were introduced. Shortly thereafter, the new legislation developed oligopolistic features, which are commonly associated with inefficiency problems. Was the regulation successful in light of its purpose? By quantifying the asset flows, we examine the impact of the regulation on the market structure, the market efficiency, and the market profitability of the Swedish insurance industry.

## **CHAPTER 8. REGULATORY OVER-REACTION TO THE GLOBAL FINANCIAL CRISIS: INSURANCE REGULATION IN SOUTH AFRICA, BY GRIETJIE VERHOEF**

Since the financial deregulation of the 1980s, other accounting crises facilitated growing regulatory intervention in financial markets. Globally regulatory intervention followed the US example. An international wave of demutualisation programmes left the industry with a range of different organisational forms. This functional diversification contributed to increased risk, following the credit crisis. Specific deficiencies in risk management and supervision gave rise to regulatory overreaction and diminishing public choice. Specific country contexts have also contributed to growing regulation, leaving the market increasingly constrained. This chapter considers the case of South Africa. Regulators leveraged chaos created by the global financial crisis of 2008 to implement unnecessary and costly insurance regulatory reforms.

## **CHAPTER 9. REGULATORS AND VALUATION. DECOUPLING INSURANCE ASSETS FROM MARKET PRESSURE IN FINANCIAL CRISIS, BY LUCA FROELICHER**

This chapter discusses the significant role of valuation techniques for financial assets of insurance companies in financial crisis. And its significance in reducing or aggravating vulnerability towards financial shocks. A question that has regained much attention in discussing the regulation authority's role for the financial performance of insurance companies in the Great Financial Crisis 2007-2009 (Fair Value Accounting vs. Historic Costs Accounting). Historical examples can

contribute to this crucial question. Therefore, this chapter shows that during the Great Depression 1931-1934 insurance companies in the United States were officially allowed by the regulation authorities to decouple asset prices from market pressure. Instead of valuating financial assets with their market prices, insurance companies could value them with “fantasy prices”. This remarkable policy might have saved many insurance companies from solvency problems and guaranteed public trust in the industry. The chapter shows, with newly discovered archival material, how such a deviation from market principles at that time was justified and implemented by the regulators.

#### **CHAPTER 10. BANCASSURANCE AT THE HEIGHTS: THE BANESTO-LUYEFE CASE (1879-1993), BY JOSÉ L. GARCÍA-RUIZ**

By ‘bancassurance’ we understand the relationship between banks and insurance companies in order to help each other in their financial business. Bancassurance types are varied: distribution agreements, strategic alliances, joint ventures and integration in a financial group. In twentieth-century Spain, large banks had insurance subsidiaries, with institutions based in Madrid dominating the financial system until the oil crisis of the 1970s and 1980s. In this chapter we address the relationship between two institutions that were leaders in their industry, Banesto (bank) and Luyefe (insurer), until their simultaneous collapse in 1993. Drawing on research based on the archives of the firms, we reconstruct the relationship to establish whether there was a situation of dependence of the insurer with respect to the bank. Since the development of the insurance industry was much slower than the banking industry, the insurers could have been in a position of weakness. We pay attention to the role of regulation and supervision in the rise and decline of this bancassurance experience.



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## **CHAPTER 1. RISK AND THE INSURANCE BUSINESS IN HISTORY: AN INTRODUCTION**

Jerònia Pons and Robin Pearson

### **RISK AND INSURANCE: THEORY, HISTORY AND RESEARCH AGENDAS**

In the spring of 1961 the communist labour brigade of Liu Ling, a remote village of 50 households in Shaanxi province, north-western China, resolved after much debate to invest in an electric pump to help irrigate their vegetable fields. The village was without electricity and memories were still vivid of the great drought of 1928-29, when some died from starvation and others were reduced to eating grass, bark and chaff. Once their decision was taken, the brigade sat down to a communal meal of wheat noodles, for they believed that the noodles would bring good luck to their investment.<sup>1</sup>

The villagers of Liu Ling, many of whom were illiterate and innumerate, appear to have known nothing about insurance, but their investments in the pump and the ritual meal combined technological and cultural devices to mitigate an existential risk. For centuries risk and insurance have, of course, been inextricably linked. People, however, have found a great variety of ways to spread, pool, mitigate, manage and prevent risk, through formal and informal cultural, religious, political, social and economic institutions, through collective beliefs and customary practices, and through adjustments to individual behaviour. In short, insurance has just been one part of the complex business and history of risk.

Because of this complexity, disciplinary approaches to aspects of risk and insurance have been highly varied, ranging from actuarial science to computational modelling of catastrophe risk pricing, to business, economic and cultural histories

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<sup>1</sup> Myrdal (1967), p. 255.

of insurance, socio-legal accounts of insurance as a form of governance, and studies of behaviour under uncertainty pioneered, from different directions, by econometricians, behavioural economists, psychologists and cultural theorists. There is general agreement across much of this literature that different political and cultural environments help shape behaviour and attitudes to risk and uncertainty, and to insurance and other forms of risk mitigation.<sup>2</sup> Thus, to understand the historical relationship between risk and insurance one must look not only at, but also beyond, the role of markets, science and technological innovation.

Some anthropologists and development economists, for example, have questioned whether western concepts of insurance apply at all in many traditional agricultural communities. Jean-Philippe Platteau, for example, has argued that fishing villages in Senegal have no true concept of mutuality in the western insurance sense for two reasons: first, because they have no sense of accident as a matter of chance – mishaps and fortunate events occur either because of evil spirits or wickedness or because of the good behaviour of the individuals to whom they befall; second, because membership of their mutual sea rescue associations is contingent on the principle of 'balanced reciprocity', namely that an individual expects to get back at some point in the not too distant future more or less what he or she puts into the insurance pool.<sup>3</sup> Platteau found the associations to be dysfunctional. They exhibited both a great dissatisfaction with what was perceived to be the free riding of some members and a high drop-out rate. The Senegalese fishermen possessed no true insurance notion that payments into the pool provided themselves with protection against an uncertain hazard, even where that event did not materialise. It was common practice for those members resigning from their associations to be paid back at least their full money contributions – if not compensation for the time, labour and materials they had also contributed.

Definitions of risk and liability, therefore, vary between cultures, and the boundary between voluntary and involuntary risks is a moveable one that is socially, rather than scientifically, constructed. What is regarded as a normal risk changes not only with technology and knowledge, but also with cultural and social institutions.

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<sup>2</sup> The classic statement is by Beck [1986].

<sup>3</sup> Platteau [1997].

One modern example is the increasing number of suits for medical malpractice in the US that have transformed the definitions and boundaries of medical negligence and raised insurance premiums for medical practitioners.<sup>4</sup> The cultural and social institutions of a community reflect and determine the 'worldviews' of members of that community. Such views function as orienting mechanisms that help people navigate an uncertain world. To the extent that judgments about any risk are influenced by 'worldviews' and cultural biases, technical information about that risk may have little impact on popular attitudes towards it. As Slovic and Peters have put it, 'our risk attitudes are part of "who we are"', and these are not easily changed by science.<sup>5</sup>

Approaching the issue from a different direction to the cultural theorists, but converging with them in their conclusions, psychologists and behavioural economists have explored the ways in which popular perceptions of risk are cognitively determined. Kahneman and Tversky famously concluded from their experiments that people are generally risk averse, but only for positive outcomes. If the choice is between a certain small gain and an uncertain larger one, people mostly chose the former. The reverse is true for negative outcomes. Where a small loss is certain and a greater loss is only probable but uncertain, people mostly chose the latter.<sup>6</sup> People's evaluations of risk are also commonly affected by 'probability neglect' and the 'availability heuristic'. People usually make risk judgments by 'rule of thumb'. They often single out a few risks as 'salient' and ignore others. Risks are most often considered 'salient' if people can easily think of instances when those risks manifest themselves, or if they are particularly vivid 'worst case scenarios', even with a low probability of occurrence.<sup>7</sup> Moreover, most people are not very good judges of probabilities, not just because of imperfect knowledge, but also because their sense of what is probable or improbable is limited by social conditions, by culture and by shared cognition. One example is the way that a sense of future time is foreshortened by poverty. The poor live largely in the present and have difficulty in imagining the future. Time is, therefore, a social construction that

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<sup>4</sup> Douglas and Wildavsky (1982), pp. 20, 32-34.

<sup>5</sup> Slovic and Peters (1998). See also Dake (1992).

<sup>6</sup> Kahneman and Tversky (1979).

<sup>7</sup> Sunstein (2005).

is bound up with anticipation and memory, and estimating the time scale for a problem of choice is influenced by cultural bias.<sup>8</sup> Thus individuals do not, or cannot, take account of all the possible risks surrounding them. Instead, they exercise a selection that is contained by their social environment, which 'sorts and clips the prospects before them'.<sup>9</sup>

Risk assessment, measurement and management – the essence of insurance – also impinge on political questions. In non-industrial societies pollution myths and social taboos, through the process of diffusing, moralising and politicising risks, help maintain social institutions.<sup>10</sup> Interpretations of risks and mishaps, and their attribution to transgressions of moral norms, have been used to hold individuals, including those in power, to account. A similar effect might be claimed for insurance in modern societies. Modernity is usually characterised by scholars as emancipation from providence, sin and taboo. Actuarial insurance, emerging in the western world during the eighteenth and nineteenth centuries, has been viewed as part of the emasculation and domestication of risk, the 'taming' of hazard, and also as part of the individualistic culture that sustains modern capitalism.<sup>11</sup> As Karl Dake has put it, somewhat echoing Knight's seminal account of profit and risk, risk-taking in the western world has come to be regarded as 'an opportunity cost for the creation of wealth', in which protection for the individual rather than the community is held to be paramount.<sup>12</sup> Thus risk has been employed as a rhetorical resource to defend particular worldviews and institutions.

Closely related to this is the view taken by sociologists and socio-legal scholars that insurance performs a function of governance beyond the state, an institutional force that acts on individuals and organisations.<sup>13</sup> Insurance is at once an expensive product, directed at long term imagined futures, and unique, because consumers – as members of the risk pool – are part of the product. Given the uncertain levels of moral hazard among consumers, insurers devise elaborate

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<sup>8</sup> Douglas and Wildavsky (1982), pp. 86-88.

<sup>9</sup> Douglas and Wildavsky (1982), p. 72.

<sup>10</sup> Tansey (2004).

<sup>11</sup> Daston (1987); Daston (1988).

<sup>12</sup> Dake (1992), pp. 22-24; Knight (1964).

<sup>13</sup> Ericson, Doyle and Barry (2003).

technologies for designing, selecting and policing the risk pools they sell. Risk pools are then subject to governance in order to increase the predictability of losses. Insurance is thus political in the way it functions as a 'social technology of justice', by grafting norms of moral behaviour onto economics, by moralizing risks and subjecting them to attributions of responsibility and citizenship. Furthermore, strategies that insurance organisations employ to manage uncertainty and moral hazard – via what have been called direct and indirect command and control regulations – can affect both perceptions of and behaviour towards risk. Insurance, therefore, as a moralizing technology can play an important role in the social construction of risk and responsibility.<sup>14</sup>

The above survey shows that there is a rich fund of theories, ideas and empirical results in the fields of risk and insurance for historians to mine. Disciplinary walls, however, have remained stubbornly high. To date, cultural theory, behavioural economics and sociology, for example, have had at most a modest impact on historical research on insurance. The influence has been most noticeable on a few pioneering scholars writing about social aspects of life insurance. Geoffrey Clark and Viviana Zelizer, working, respectively, on eighteenth-century England and nineteenth-century America, have each argued that the industry straddled the divide between speculative and prudential uses of life insurance.<sup>15</sup> Timothy Alborn has shown how British life insurance offices in the nineteenth century became adept at juggling multiple modernities – new narrative genres, new statistical thinking, new medical thinking, and a newly abundant commodity culture. Towards the end of the century companies began to relax their regulation of people's behaviour in order to increase the number of lives they insured. The older moral norms associated with insuring only regulated 'healthy' lives were abandoned, and the life insurance contract was 'liberalised' in order to accommodate groups with more limited means to pay premiums.<sup>16</sup> In a similar vein, Horstmann has examined the role of physicians as 'gatekeepers' in Dutch life offices. Nineteenth-century medical science served the companies as a 'technology of trust', helping to establish insurance as a public institution with a welfare purpose. By

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<sup>14</sup> Baker (2000); Chu (2017).

<sup>15</sup> Clark (1999); Zelizer (1979).

<sup>16</sup> Alborn (2009).

1920, however, the influence on insurance companies of physicians had diminished, and Dutch life insurers increasingly based their selection decisions solely on commercial grounds.<sup>17</sup>

These and other authors have contributed important insights into the ways the 'scientific' construction of risks have been shaped by social and economic forces operating within and outside the modern insurance industry. There remains, however, a large research agenda that has barely commenced. To date, relatively little has been written, for instance, on the encounters between western insurance and non-western cultures, nor on the varying cultural perceptions affecting insurance within the western world.<sup>18</sup> We do not yet well understand how consumers and suppliers of insurance factored in worldviews and cultural bias when buying or selling insurance cover against various types of risk. The relative balance of influence between cultural perceptions of hazards and scientific knowledge of hazards is likely to have changed considerably over time in different societies, according to a variety of external factors such as education, standard of living, lifestyle, economic structures and political institutions. Nor do we know much about how successful insurance organisations were in their attempts to govern, regulate and impose norms of moral behaviour on their risk pools in different places at different times.

Finally, another important area that calls for further historical research is the relationship between the state, risk behaviour and insurance. The state, of course, as a regulator, policymaker, monopoliser, predator and warmonger has itself always represented a political risk to private economic activity.<sup>19</sup> Regime change and revolution have added to this risk. For ideological as well as financial reasons, various governments have prohibited or imposed discriminatory fiscal and regulatory burdens on foreign insurers to deter entry, or have intervened in the supply of insurance by granting monopoly privileges to private entities or state-owned corporations. States have also helped grow insurance markets by legislating to reduce risk, by collecting and publishing information on hazards, and by helping

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<sup>17</sup> Horstman (2001).

<sup>18</sup> Exceptions include Zwiertein (2011); Eriksson (2010).

<sup>19</sup> Haufler (1997).



private insurers cope with the risks arising from new technologies. The regulation of road traffic is an obvious example. Other areas include engineering insurance, stimulated initially by nineteenth-century legislation regulating boilers and various classes of powered machinery. Similarly, governments have stimulated new markets in insurance against personal and professional liability by regulating in areas of consumer and environmental protection and health and safety, or by providing tax incentives for people to buy health insurance.<sup>20</sup>

By the exercise of these functions states have, at different times and in different places, constricted, created, grown and distorted markets both to the cost and benefit of consumers and suppliers of insurance. Government have powers to influence risk-taking or risk-mitigating behaviour on a scale that private insurers do not, including the ability to limit adverse selection by compelling individuals and businesses to enrol in public insurance programmes, to drive vehicles with seatbelts fastened or to take medical tests before operating dangerous equipment.<sup>21</sup> Governments often have deeper pockets than private companies to provide emergency relief, victim compensation and recovery support in the wake of large disaster events. It has, however, been widely argued that state intervention of this type generates serious asymmetric information and adverse selection problems, and that public insurance is inefficient and crowds out privately provided alternatives. It is claimed, for example, that US federal disaster relief has encouraged risk-taking and underinsurance by property owners in catastrophe-prone regions such as California and Florida, or that social security and national health insurance discourages savings and the purchase of private insurance.<sup>22</sup> There is more scope for scholars to test these claims from a historical perspective, or to examine the alternative view that public insurance emerged because of the failure of private markets, and that without state provision, the insurance gap – the proportion of the population without basic cover – even in affluent societies like the United States, will remain unacceptably wide.

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<sup>20</sup> Thomasson (2000).

<sup>21</sup> Wright (2010).

<sup>22</sup> Froot (1999); Cutler and Gruber (1996).

## THE DEVELOPMENT OF INSURANCE AS A FIELD FOR HISTORICAL RESEARCH

It was in this spirit of endeavour to stretch the boundaries of insurance history, thematically, geographical, temporally, and to break down the disciplinary barriers that have isolated different approaches to the study of risk and insurance, that the conference underpinning this book was initiated. In the autumn of 2016 Jerònia Pons and Robin Pearson met to discuss her idea of organising the world's first major gathering of scholars working on multiple aspects of risk and insurance in history. This ambitious project was realised with the conference on 'Risk and the Insurance Business in History', which was held at the Casajol Foundation in Seville in June 2019 and attended by 140 participants from over 25 countries, representing a wide variety of disciplines, including history, economics, accounting, law, sociology, as well as the private insurance industry. The conference was inaugurated by the Rector of the International University of Andalusia, José Sanchez Maldonado, and by the Deputy Regional Minister of Economy, Knowledge, Companies and University, Lorena García de Izarra. Keynote lectures were given by Professor Grietjie Verhoef of the University of Johannesburg, and by Professor Allan Manning, CEO of the Loss Management International (LMI) Group of Australia. Sponsors included the Spanish insurance giant's Mapfre Foundation in Madrid, the Mansutti Foundation of Milan, the Cajasol Foundation and the International University of Andalusia (UNIA).

It had been a long road since the first international workshop of British and Japanese historians organised by Takau Yoneyama in Kyoto in 1995. At that time there were only small numbers of historians in a few countries who specialised in insurance, and insurance historical research continued to be largely characterized by the commissioned corporate history.<sup>23</sup> Following the Kyoto workshop, however, the increasing interest in aspects of risk and the insurance business

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<sup>23</sup> By the 1980s and early 1990s some exceptions to the company-focused study had begun to appear, including the volume edited by Westall (1984), and articles by Borscheid (1985), Westall (1988, 1994), Pearson (1990, 1991, 1992). Earlier generations of scholars such as Vance (1908), Golding (1927), Stalson (1942), Raynes (1948), North (1954), Dinsdale (1954), Arps (1965), Melis (1975), Gerathewohl (1980/82), either wrote histories of their national industries, published studies of singular aspects of insurance history, or used historical analysis in their technical texts. However, their work remained largely isolated from the mainstream of business and economic history and failed to establish a consolidated and growing field of research.

was captured by successive scientific meetings that brought together a growing number of international experts in the field. The World Economic History Congress (WEHC) in Madrid in 1998 was the first to include a dedicated session on insurance, and included some of the first explorations into the history of several European insurance industries.<sup>24</sup> In the mid-2000s Peter Borscheid, Geoffrey Clark, Robin Pearson and others organised several meetings on the subject, which established a much wider international and comparative scope for the field and produced several publications.<sup>25</sup> Beyond these specialized meetings, insurance history enjoyed a growing presence in general economic history conferences around the world. Sessions were organised on aspects of insurance history, for instance, at the Spanish Economic History Association meetings in Santiago di Compostela (2005), Carmona (2011) and Salamanca (2017), and at successive World Economic History Congresses in Utrecht (2009), Stellenbosch (2012), Kyoto (2015) and Boston (2018). These meetings resulted in numerous publications, either as volumes of essays or as articles by individuals in leading journals.<sup>26</sup>

Corporate support has played an important role in helping to expand the breadth of research and the global network of researchers. Of particular importance were the contributions of Swiss Re, Mapfre and Dai-ichi Life. In 2008, the Mapfre Foundation sponsored an international conference held in Madrid on the history of national insurance industries. Between 2010 and 2012 Dai-ichi Life funded an international project on corporate forms in insurance, directed by Takau Yoneyama and Robin Pearson. From 2007 Swiss Re of Zürich, in conjunction with a corporate history project to mark its 125<sup>th</sup> anniversary in 2013, supported a global study of insurance by a large team of scholars from around the world. All of these produced important streams of new research.<sup>27</sup>

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<sup>24</sup> Núñez (1998).

<sup>25</sup> Borscheid and Pearson (2007); Clark *et al.* (2010).

<sup>26</sup> Pons-Pons and Pons Brías (2010); Pearson (2010); Straus and Caruana (2017).

<sup>27</sup> Caruana (2010); Borscheid and Haueter (2012); James *et al.* (2013); Pearson and Yoneyama (2015); Jones and Haueter (2017).

In addition to the above activities there have also been new developments in the histories of marine insurance, insurance law and social insurance.<sup>28</sup> Particularly innovative was the conference organised by Allan Manning in Bengkulu, Indonesia, to commemorate the 250<sup>th</sup> anniversary of Lord Mansfield's seminal ruling on utmost good faith, a key legal principle of modern insurance.<sup>29</sup> Other meetings bringing together historians and practitioners included the workshop organised by the Association of Italian Insurance Companies at Bocconi University, Milan, in 2011, the conference on insurance and risk management in history organised by the European Association for Banking and Financial History in Zurich in 2014, the conference on Spanish and Italian insurance history held in Catanzaro in 2015,<sup>30</sup> and the insurance history session organised by Takau Yoneyama for the Asia-Pacific Risk and Insurance Association meeting in Chengdu in 2016.

Scholarly histories of individual companies and national industries, of course, have continued to play a valuable role in the growing body of research.<sup>31</sup> Moreover, as a further indication of the health of the field, in addition to a string of new doctoral theses, several recent or ongoing research projects have received major funding from public bodies.<sup>32</sup> These include Philip Hellwege's (Augsburg) project, "*Comparative History of Insurance Law in Europe*", funded by the European Research Council; "*The Dynamics of Public Welfare: Industrial Accident Insurance in Sweden 1880-1939*", directed by Magnus Lindmark and Lars-Fredrik Andersson (both Umeå University) and Michael Adams (Bath), funded by the Swedish Research Council; and "*Global Cultures of Risk: Insurance in Non-Western Contexts (1870-1980)*", directed by Martin Lengwiler (Basel) and Robin Pearson and funded by the Swiss National Science Foundation.<sup>33</sup> In sum, historical research on risk

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<sup>28</sup> Leonard (2016); Röder (2012); Leimgruber (2008a); Pons and Silvestre (2010); Harris (2012); Pons and Vilar (2014).

<sup>29</sup> Manning (2016). See also the essays from this conference in *Insurance Law Journal*, 27 (2016).

<sup>30</sup> Barciela, Vittorio and Ostuni (2016).

<sup>31</sup> Examples include Feldman (2001); Smith and Wright (2004); Alborn (2009); Tortella *et al.* (2009); Murphy (2010); Larsson, Lönnborg and Svärd (2005); Llorca Jaña (2011); Tortella *et al.* (2014); Larsson and Lönnborg (2014); Bähr and Kopper (2016); Van Leeuwen (2016); Verhoef (2018).

<sup>32</sup> Recent PhD theses completed include Eriksson (2011); Petersson (2011); Gutiérrez (2016); Hagedorn-Hansen (2017); Liljegren (2019); Camprubí (2019).

<sup>33</sup> Hellwege's project was completed in 2018 and produced three linked publications, Hellwege (2018a, 2018b, 2018c). The other projects mentioned are ongoing.

and insurance has emerged as a field in continuous expansion, characterised by a high level of internationalisation and by a large capacity for generating scientific knowledge that is subject to the most rigorous international scholarly standards. New horizons have been opened by the growth of academic networks that combine experts from a range of other disciplines. This has enabled the development of exciting new approaches and methodologies to the study of changing perceptions of risk and the performance of insurance in the long term.

### **THE SEVILLE CONFERENCE AND THE CONTRIBUTIONS TO THIS BOOK**

The organisers of the 2019 conference in Seville, therefore, believed that the field had reached a critical mass of scholars and experts around the world who would benefit from participating in a large conference that could generate new intellectual synergies. Across 21 sessions the participants in Seville covered a huge range of topics and methodologies from the history of marine insurance and maritime law since the Middle Ages, to risk management and insurance in the Atlantic slave trade, to the operation of micro-insurance among rural populations in the developing world, to the recent growth of alternative risk transfer products and insurance-linked securities. Most corners of the globe were also covered with papers on North America, Europe, Africa and Asia and an entire session on the development of insurance in the former Soviet states and Eastern Europe. To try to compile a volume truly representative of all these areas and topics would risk the usual pitfall of edited conference volumes, namely a lack of coherence. To mitigate this risk, the editors have selected papers from a small number of sessions that were to an extent related by period (the nineteenth and twentieth centuries) and by theme (the business, economic and social history of insurance). Despite the need to be selective, we think that the papers in this volume are illustrative of some of the best new research in the field and the variety of its methodological approaches. Furthermore, we understand that other session organisers are preparing volumes and special issues for journals on different themes discussed at the conference, which happily should multiply the published outcomes from this interdisciplinary encounter.

The first section below contains two papers by the leading historians of life insurance in the United Kingdom and the United States, both of whom look at the

issues confronting insurers trying to underwrite lives in foreign and colonial contexts. Timothy Alborn examines the problem of applying relevant mortality data to inform the underwriting of life insurance risks in overseas markets, specifically on soldiers and missionaries travelling to British colonies before 1914, a process, as he puts it, of quantifying and negotiating the white man's burden. Alborn finds an array of inconsistencies in British life insurance practice. On the one hand, companies sought to price risk in a quasi-scientific way, while on the other hand they often yielded to policyholders pushing back against attempts to levy extra charges for foreign residence. On the one hand, they presented life insurance as part of the imperial civilising mission, while on the other they subordinated their assessment of risk of non-white lives to their own racist prejudices. Sharon Murphy examines the entry and exit decisions of two large US life insurance companies operating in Latin America. She finds that not only unpredictable regulatory changes, but also the uniquely intense competition between the US offices operating there, together with agency problems, scandals and embezzlement, complicated these decisions. This provided openings for local companies to establish themselves as viable alternatives and eventually squeezed the Americans out of the region.

Part two consists of two case studies of Canada and Switzerland that examine, respectively, fire and casualty insurance and state regulation in the long nineteenth century. David Gilles and Sébastien Lanctôt describe the development of early fire insurance and its legal context in Colonial Canada. Before Confederation in 1867 the limited provincial regulation of the industry meant that insurers generally had to self-regulate their business through their own collaborative organisations. Afterwards, Canadian legislators steered a middle course by drawing upon both French and US legislative models, while at the same time following the British model of limited intervention and supervision. Christofer Stadlin examines how national governments shaped the growth of accident and liability insurance markets in late nineteenth-century Europe and both created and destroyed business opportunities for the private insurance industry. He shows that astute insurers like the Zurich Insurance Company could adapt their tactics to take advantage of cumbersome state legislative processes and changing legal definitions of liability, and grow their workmen's compensation business, albeit up to limits determined by state action.

Part three contains two essays on the long-run impact of regulation on insurance markets. Leonardo Caruana and André Straus examine the different chronologies of regulation in France and Spain and their impact on the development of all branches of insurance through to the Second World War. Mikael Lönnborg, Peter Hedberg and Lars Karlsson together examine the impact of the landmark 1948 insurance law on the performance of Swedish insurance companies. Their regression results show that the law had no discernible impact on the productivity of the companies, but rather that, by raising entry barriers for new companies, it stimulated a trend toward market concentration. The latter did not deliver the efficiency gains nor the contribution to consumer welfare anticipated by the legislators.

Part four concerns insurance industry and regulator responses to modern financial crises. Grietje Verhoef examines the evolution of insurance regulation in South Africa from the 1980s to the Global Financial Crisis of 2008. She argues that deficiencies in risk management and supervision revealed by the GFC gave rise to regulatory overreaction and diminishing public choice. South Africa followed the UK by introducing a twin-peaks type bureaucratic framework that was not appropriate for the domestic insurance industry, which carried much less systemic risk than its UK and US counterparts and manifested strong growth. The regulatory interventions created market distortions and unnecessarily raised costs for shareholders of insurance companies. Luca Froelicher argues that regulatory authorities in financial crises can play a vital role for insurance companies when they allow less transparent financial reporting and decouple financial assets from market pressure, as US regulators did during the crisis of the 1930s. The way that an insurance company's assets are valued has a major influence on its solvency and therefore on its reputation. Regulatory authorities play a critical role of such valuations and thus in the stable functioning of the market.

This volume is completed with the chapter by José García-Ruiz who examines the history of the Spanish credit bank Benesto and its insurance affiliate, Luyefe. From the perspective of Anglo-Saxon countries, where bancassurance has remained a relatively marginal phenomenon, the Banesto-Luyefe tie-up occupied a remarkably commanding position in the Spanish economy, particularly under the Franco regime. García-Ruiz, however, argues, first, that such dominance was heavily contingent on the leadership capabilities of those at the helm of both companies.

Second, the subordination of the insurance company in this major bank-insurance partnership, and the relative neglect of the regulatory authorities, together help explain the weakness of Luyefe during the financial crises of the 1970s and 1980s, and, more generally, the historical underdevelopment of the Spanish insurance sector.

In sum, most of the papers included in this volume address the influence of government regulations on the decision making of insurance companies. This regulatory framework which, on occasion, has mixed international and national legislation, underpinned corporate decisions and strategies. Likewise, state intervention has led to the creation of new and lucrative lines of business, especially in the field of social insurance (industrial accident and health insurance above all) and imposed greater responsibilities on companies and individuals. Moreover, the cultural change associated with welfare states has boosted some lines of private insurance, especially life insurance. The effects of state intervention on insurance regulation were not always the same. As some of the chapters in this book show, state supervision sometimes had significant repercussions on the structure, efficiency and profitability of the market, while at other times it brought about reforms that could be costly and unnecessary for the business, and yet, in some cases, particularly in times of crisis, helped companies survive.



# **1. UNDERWRITING LIFE INSURANCE IN THE AGE OF EMPIRE**



## CHAPTER 2. TAXING JOURNEYS: BRITISH LIFE INSURANCE AND THE WHITE MAN'S BURDEN, 1840-1914

Timothy Alborn

Among the many evocative aspects of the 'White Man's Burden' (1899) indexed by Rudyard Kipling in his famous poem was his call for imperialists to build 'ports ye shall not enter' and 'roads ye shall not tread', paired with the ominous invitation to 'make them with your living / And mark them with your dead'.<sup>34</sup> For thousands of British soldiers, engineers, and civil servants, empire was indeed a mortal burden. For anyone who journeyed to one of Britain's tropical colonies for either public service or private gain, the ever-present possibility of death was also a financial burden, calculable in pounds, shillings and pence. Foreseeing precisely what that price should be was the job of successive generations of actuaries, who tabulated Britain's imperial death toll and translated their findings into annual premium payments. Long before they took much interest at all in the relative mortality of their non-white colonial subjects, Britons amassed voluminous statistical information concerning their own ability to survive in colonial climates. But such information was not easy to apply, since colonial conditions were always changing and emigrants (or temporary visitors) were always arriving to perform new tasks. This chapter focuses on the general problem of collecting useable vital statistics for travel to foreign locations before turning to the specific cases of soldiers and missionaries. It concludes by addressing the related issue, which British insurers increasingly faced during the decades before and after 1900, of how much to charge indigenous residents of British colonies.

From invocations of 'the white man's burden' to adventure stories set in exotic lands, risk-filled travel became a Victorian pastime and, increasingly, a source of national identity. Life insurers swam against this tide when they imposed

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<sup>34</sup> Quoted in Conklin and Fletcher (1999), pp. 58-59.

surcharges to cover foreign risks or forbade travel upon pain of forfeiture, and they left themselves open to charges of unfairness by rated-up parties. A typical outcry, appearing in a letter to the *Times* in 1867, bemoaned 'the arbitrary control exercised by certain life assurance offices over travellers', based 'upon no scientific *data*, and... governed by no intelligible principles'. The writer went on to contrast the 'serious restrictions upon... personal liberty' faced by a traveler who took a steamer to San Francisco with the free pass given to a doctor during an epidemic or a 'lord of an entailed estate... addicted to the noble sport of fox-hunting'. It was perverse, he concluded, to treat travelers as though they lacked enough 'regard for their own lives' to avoid risky situations when visiting foreign climes. Thirteen years earlier, another *Times* correspondent complained that a man could climb the Alps without paying an extra charge, but had to pay anywhere from £30 to £100 extra on a £2000 policy if he visited the 'extremely salubrious' climates of Lima, Santiago, or Buenos Aires.<sup>35</sup>

Some of this talk, including the complaint about a lack of uniform extra charges, was not much different from the insurance customer's standard response to being charged extra for a medical blemish. Some of it cut deeper, since it exposed an arbitrary decision on the part of insurers to focus on one kind of risk that transpired after the policy had been issued and to ignore a whole range of other types of moral hazard.<sup>36</sup> Not coincidentally, actuaries responded to this argument more sympathetically than they did to most other complaints about charging extra to guard against adverse selection. In 1869, a consensus at an Institute of Actuaries discussion endorsed the idea of uniform travel extras for all destinations. One actuary argued that the 'varying and unequal risks' that were presented by travel to different parts of the world 'exist in our everyday business' – citing the fact that most companies charged butchers and clergymen the same premium despite a demonstrable difference in mortality.<sup>37</sup>

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<sup>35</sup> *London Times*, 11 February 1867, 9 December 1854.

<sup>36</sup> On the practice of focusing more on adverse selection than moral hazard in nineteenth-century British life insurance see Alborn (2009), pp. 220-223.

<sup>37</sup> Bailey (1869), p. 91.

On the other hand, neither actuaries nor their directors could bring themselves wholly to disregard the risk posed by residence overseas. Especially in the early nineteenth century, when hard data on foreign mortality were mostly unavailable, life insurers felt a pressing need to guard themselves as best they could. There was also a sense that British people behaved less reliably when abroad than they did at home, and that tropical climates were more likely to punish bad behaviour with death. John Stott of the Scottish Amicable learned from West Indian doctors that 'in nine cases out of ten' yellow fever was 'brought on by the individuals themselves through imprudent acts, such as exposure to the mid-day heat, or... intemperate habits', and policyholders living in Africa and India came under similar suspicion.<sup>38</sup> Even well-behaved merchants and soldiers could never wholly avoid dangerous climates, since they needed to go there to earn money or glory. One actuary pointed out that the 'first settlements of commerce' were 'unhealthy, but convenient for shipping', and added that '[t]he necessities of war may require large bodies of men to pass through or remain where the dangers of the climate are... well known'.<sup>39</sup>

The main reason life insurers policed travel, however, was because it was much easier to monitor than other sorts of moral hazard. Although many people doubtless got away with taking a short trip without being detected by their insurance company, it was virtually impossible to die in a foreign land without an insurer knowing about it. A would-be beneficiary discovered this in 1856 when Thomas Haire, a merchant based in Gibraltar, died in Casablanca, 'a town in Africa considerably beyond the limits for which the License had been granted'. The Scottish Equitable refused to pay the £2000 policy on Haire's life, and his creditor lost a succession of lawsuits trying to force the company to do so. The creditor's arguments that Casablanca was 'remarkably salubrious and healthy' and that Haire's fatal heart attack could have happened 'in any corner of the globe' stood for little against the hard geographical fact that the town was 'several degrees nearer to a tropical sun' than Tangiers, which was the southernmost point Haire's policy had permitted him to visit.<sup>40</sup> In the end, however, the £2000 that the Scottish Equitable

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<sup>38</sup> Stott (1877), p. 28. On Africa see Morgan (1841), p. 4; on India see 'Report' (1840), p. 114.

<sup>39</sup> Brown (1863), pp. 1-2.

<sup>40</sup> Scottish Equitable, Papers (1859); Fowler (1859), p. 13; *Post Magazine* 21 (1860), p. 175.

saved may have been counteracted by the negative publicity produced by the trial: the creditor published a widely circulated pamphlet disparaging its decision, and competing firms rushed to claim that they followed 'a much more liberal course' in accommodating customers who ventured abroad.<sup>41</sup>

The requirement to pay extra for a license to travel gave policyholders one more thing to worry about at a time when a myriad of other details needed to be attended to, and one more expense to be added to the cost of a journey. When Charles Dickens took out a £5000 policy from the Eagle prior to embarking on a tour of North America in 1842, his extra fee of £30 amounted to roughly half of the cost of his berth on the *Britannia* steamship. For people who traveled more frequently or to riskier regions, the extra fees could be substantial; and especially if their policy had been in force for a decade or more, they had little option but to pay it. A Glasgow merchant who had been paying less than £23 a year for a £1000 policy from the Norwich Union since 1850 took two trips to Bombay and one to Shanghai between 1860 and 1862, for which he paid £104 in extra premiums. If caught, failure to pay such extras resulted in a fine and a scolding, if not forfeiture.<sup>42</sup> Such annoyances added up – and in the process, added another layer to life insurance's capacity to act as a 'creator of culture'.<sup>43</sup> This chapter adds an insurance side to a story that those who study empire, missionaries, travel and tropical medicine have told about what happened when Victorians negotiated 'illness, environment and authority' – and the closely related topic of racial bias – on their frequent excursions abroad.<sup>44</sup>

## ASSESSING TRAVEL RISK

Although Victorians were famous for their wandering proclivities, the actual proportion of nineteenth-century policyholders who ventured abroad was very small.

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<sup>41</sup> Fowler (1859); 'The Pamphlet Recently Published' (1860), p. 298.

<sup>42</sup> Carlton (1955), p. 135; Norwich Union Life, Board Minutes (11 January 1864); Eagle, Board Minutes (5 March 1851); Church of England Fire and Life, Board Minutes (12 November 1862).

<sup>43</sup> Alborn (2009), p. 13.

<sup>44</sup> Howell (2014), p. 17; see below, notes 60 and 69, for sources on tropical medicine and missionaries.

There were enough travelers and foreign residents to sustain a handful of specialist companies, including the British Empire (1820-45), the Asylum (1824-57), the Colonial (1845-66), and the Universal (1834-1901). For most companies, though, applications for overseas travel and residence represented a departure from standard practice, which they needed to accommodate in order to maintain business connections but which they underwrote with difficulty.<sup>45</sup> A few, like the Eagle, published fixed extra rates for 'all the principal commercial and colonial establishments' to enable a policyholder to calculate ahead of time how much it would cost 'to proceed wherever his future fortunes may call him'.<sup>46</sup> Most arrived at travel extras on a case-by-case basis, usually in consultation with other companies.

For popular destinations such as India and North America, it was possible to base travel surcharges on reasonably thorough vital statistics from pension fund registers, army rolls, and sanitary reports – although the tabulated lives in these collections seldom corresponded to the typical insurance customer. Further off the beaten path, the quantity and quality of information diminished considerably. For these cases, insurers mainly depended on local intelligence from branch secretaries (if they had a foreign branch), directors with business connections abroad, expatriate physicians, and sometimes even the person who was applying for the license. This information was idiosyncratic and often contradictory, but for places such as Java or Nicaragua it was all a mid-Victorian insurer could get. Given the partial state of geographical knowledge in the nineteenth century, even finding a destination on a map could sometimes be difficult.

In setting rates for foreign travel, the usual pattern was for a pioneering company to offer bold reductions in foreign premiums and dare its competitors to follow suit. In the case of Standard Life and its sister company the Colonial, this gambit led to an industry-wide reduction in travel surcharges in the late-1840s. In the case of the Positive Government Security, which in 1870 took the radical step of offering the same premiums to customers at home and abroad, other companies called its bluff and it reverted to a higher scale. This pattern of action and reaction

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<sup>45</sup> Fewer than 1200 of 130,243 lives in the Healthy Males dataset traveled abroad, not including the 1186 that were on the books of the London Assurance (which had absorbed the Asylum): Bailey [1869], p. 81; Aldcroft [1900], p. 370.

<sup>46</sup> Eagle, Prospectus [1847].

was especially common in the Indian market, which enough companies cultivated to make parity in rates a meaningful objective; surcharges for other destinations were more haphazard. Over time, though, the general tendency was a reduction in travel extras and an expansion of the limits within which 'free' travel was permitted. Although the statistical grounding for this trend never approached a solid foundation, a steady stream of new data and qualitative evidence of health improvements apparently did justify it in at least most cases.

The most basic subject that came into play in assessing travel risk was geography, which was still far from an exact science for much of the Victorian era. When the Legal & General fixed 'forbidden limits' in the interior of South Africa in 1879, that part of the world was sufficiently well-mapped for its actuary to draw a line 'from the Coast 10 miles north of the River Umgeni to a point 10 miles North West of the Capital Pietermoritzburg; and a further line from such point to the mouth of the River Umkomaas'. Two decades earlier, the Scottish Equitable's 'inspection of the map of Africa' was less helpful in figuring out whether Thomas Haire had gone too far on his fatal trip to Casablanca. Since the map did not include that town, the directors told their manager 'to make inquiries on this point at one of the most eminent geographers of the present day' – who proceeded to get the distance from Gibraltar wrong by 133 miles. The company finally figured out where Casablanca was by consulting a French map of Morocco.<sup>47</sup> Besides using maps to pin down a policyholder's destination, life offices also used them as visual aids for salesmen and customers: as when the Scottish Provident issued a map of the world with pink-shaded 'free' and yellow-shaded 'prohibited' areas, or when the Prudential bounded its 'tropical' zone on a map with a thick pink line.<sup>48</sup>

Once they figured out where their customers were going, insurers needed to determine what their chances were of surviving. Before 1850, the best data on the mortality experienced by Europeans abroad related to soldiers, whose ages were easy to infer and whose deaths were carefully recorded. One of the earliest and most comprehensive of these studies was a four-volume blue book compiled between 1835 and 1840 by an army captain and two army surgeons. Their findings indicated that

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<sup>47</sup> Legal and General, Board Minutes (22 July 1879); *Statement* (1859), p. 7.

<sup>48</sup> Steuart (1937), p. 27; Prudential (1884), map facing, p. 142.



troops died 15 per cent more often than in Britain if they were stationed in Canada, 2.6 times more often in Mauritius, and 3.5 times more often in Madras; this ratio rose to 8.6 for Jamaica and 34.5 for Sierra Leone, where 48 per cent of all European soldiers who served died within a year.<sup>49</sup> Actuaries doubted the relevance of such studies for insurance purposes, since enlisted men were 'placed in very unfavourable circumstances in regard to health when compared with the upper and middle classes', but this did not prevent them from hiring their compilers as consultants.<sup>50</sup>

In India, military data was first used to calculate East India Company pension contributions before being reapplied (often in combination with material from the funds themselves) to life insurance rates. Most of the six major pension funds that formed between 1804 and 1824 called in actuaries to make sure their contributions were adequate. When Samuel Brown and Peter Hardy valued the Madras Military Fund in 1863, they found 'a great change for the better, owing to improvement in habits or better sanitary regulations' among British soldiers in India. Companies staking a claim to the Indian market embraced each new wave of military and pension fund data to justify lower premiums. The first of these was the Universal, which formed in 1834 with Indian rates 15 to 30 per cent less than the premiums imposed by other British firms.<sup>51</sup> For less-frequently visited destinations, actuaries continued to consult government statistics well into the twentieth century. After comparing the mortality of England and Wales with census returns from Barbados, Jamaica, and New Zealand in 1876, James Meikle of the Scottish Provident concluded that his office could reduce its West Indian extra and charge only 10 per cent above its home rates for New Zealand. Actuaries learned about European mortality in sub-Saharan Africa from Henry Morton Stanley's Congo expedition, Colonial office reports, and death registers of British missionaries, Scandinavian emigrants, and Belgian civil servants, all of which again indicated improvement over time.<sup>52</sup>

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<sup>49</sup> 'Report' (1840), p. 142; *Oxford Dictionary of National Biography* (entries on Alexander Tulloch and Henry Marshall).

<sup>50</sup> Bailey (1869), p. 82; Cornelius Walford, discussion of Humphreys (1874), p. 188; Walford (1871-80), vol. 1, pp. 611-612.

<sup>51</sup> Alborn (1999), pp. 66-68; Brown and Hardy (1863), p. 7; Universal, Minute Book (1834).

<sup>52</sup> Meikle (1876), pp. 290-291; Sprague (1886), pp. 437-439; Lutt (1907), pp. 476-477; Raynes (1927), pp. 21-23.

Although statistical evidence played an important role in determining foreign insurance premiums, insurers also scoured the globe for qualitative evidence of health conditions abroad. One of the many advantages that both Standard Life and the Colonial had in underwriting overseas risks was the presence of salaried managers stationed in Asia and Africa, who regularly went on inspection tours that yielded lengthy reports on local circumstances. Standard Life's superintendent of foreign agencies provided running commentary on health conditions in a report on his 4500-mile tour of South Africa, calling Natal's climate 'the healthiest in all the Provinces' and warning that Johannesburg's dust storms were 'bad for the lungs'.<sup>53</sup> Most other companies had to settle for the random flow of information that filtered in from directors or customers with business ties overseas. The Scottish Amicable relied on a director's familiarity with Panama to license a trip to the 'Pacific side of the isthmus' at a moderate extra, then later proscribed Nicaragua when the same man reported that 'the place is very uncivilized & there is no security for life'.<sup>54</sup> Over time, a few insurers supplemented this mix of second-hand statistics and private intelligence with data gleaned from their own policy registers. As early as 1864, the Colonial's medical advisor organised its claims by region and cause of death, revealing higher rates of lung disease in Canada and more deaths from fever, liver disease, cholera and dysentery in tropical regions. The British Empire Mutual, after absorbing the Positive Government Security's large Indian business, provided data that yielded mortality rates between 1.2 and 1.7 times higher than for insured lives in Britain, which compared favourably to Standard Life's experience.<sup>55</sup>

In the absence of authoritative data, the only way life insurance offices could keep competition from leading to a downward spiral in premiums was to resort to collusion – much as their counterparts in fire insurance recurrently did at home, but which life insurers rarely did domestically.<sup>56</sup> Rate-setting agreements were most formal in Scotland, where offices agreed to common rates for most regions in the world in 1840. The next major shift in Scottish practice came in 1845, when William Thomson collected, on behalf of Standard Life, 'all the accessible information

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<sup>53</sup> Norman (1950), p. 292; Standard Life, Reports (report by Edward Blount, 31 January 1913).

<sup>54</sup> Scottish Amicable, Boardroom Memorandum Book (16 January 1867) and Memorandum Book of Extra Rates (4 September 1888, 19 April 1907, 18 May 1909).

<sup>55</sup> Walford (1871-80), vol. 1, pp. 615-616; Lutt (1907), pp. 474-476; Winter (1909), pp. 373-376.

<sup>56</sup> Ryan (1983), p. 236.

as to the duration of life in British North America, West Indies, East Indies, Cape of Good Hope, Australia, and other places'. The following year he submitted this report to his fellow Scottish managers and indicated that he had even more information in his capacity as the Colonial's manager but was not authorised to share it. Within a few months, he had translated this data into a set of premiums for the Colonial and the other Scottish companies revised their extra charges to correspond closely with the new company's rates. Crucial to this arrangement was the managers' trust in Thomson, who had assured them that the new premiums had been 'formed on the most correct observations which exist as to the value of Life' in foreign lands.<sup>57</sup>

In England, most companies set extra charges informally, with an actuary asking a few colleagues what they charged. J. J. Downes at the Economic arrived at extras for North America and Australasia after consulting with actuaries from the Atlas, Alliance, and Universal, and the Norwich Union fixed a surcharge for Algiers after asking what the Rock and Law Life 'would do in a similar case'. At least in England, this failure to establish a common set of foreign rates translated into widely varying surcharges, especially before 1870.<sup>58</sup> Although English travel charges steadily declined after that point, the way they did so had more to do with entrepreneurship than statistics – and Scottish-style collusion was seldom if ever evident. The episode that best illustrates this dynamic occurred in the early 1870s, when the Positive Government Security Life Assurance Company, citing reports by the Royal Commission on the Sanitary State of the Army in India, decided to charge the same premium to all its customers regardless of their destination. An actuarial outcry forced the company to back down within six years – but not before several other firms had significantly lowered their own rates in order to remain competitive in the Indian market.<sup>59</sup>

Although the Positive Government's experiment was a bridge too far, most Victorian actuaries did assume that mortality abroad would decline over time. In 1876

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<sup>57</sup> Norman (1950), p. 21; Associated Scottish Life Offices, Minute Book (4 February, 7 July and 24 November 1846).

<sup>58</sup> Economic Life, Minutes (8 November 1839); Norwich Union, Board Minutes (19 November 1860); Tait (1855), p. 28.

<sup>59</sup> Alborn (2009), p. 120.

James Meikle anticipated the day when 'the world will be looked upon as a whole rather than composed of many dissimilar parts', and predicted that when that day came life offices would 'give permission to reside anywhere for the same continuous rate of annual premiums'. An insurance company had a strong incentive to be the first to identify *bona fide* signs of such progress, since a failure to do so was sure to alienate customers. Although visitors to Ceylon and Mauritius pestered life offices from the 1830s onwards with reports of 'the healthful climate' and 'improvements ... that have totally changed the face of the country', it was not until after 1870 that actuaries started taking such reports seriously.<sup>60</sup> By the turn of the century, sanitary improvements, breakthroughs in tropical medicine and the wider availability of hill stations and sanatoria contributed to lower death rates in most corners of the world. One doctor included 'improved systems of drainage, a better water-supply, [and] facilities for rapid escape from noxious influences' on his list of reasons for improved mortality in India as of 1878, and a later insurance doctor cited 'the feat of cleansing the Panama canal-zone of its death plagues' as grounds for lifting proscriptions on travel to that destination.<sup>61</sup>

Over the course of the nineteenth century, insurers gradually widened the sections of the globe where they would allow policyholders to stay without an extra premium; they also carved out classes of policyholders who qualified for 'whole world' licenses. Starting with Standard Life in 1851 and soon copied by most other Scottish offices, the first class of customers to receive this privilege were those who had been insured for at least five years and were not, 'from their profession or circumstances... likely at a future time to proceed abroad'. Companies routinely excluded mariners and military men from this class, as well as younger customers whose future career was still uncertain.<sup>62</sup> The main objective in issuing such licenses was to improve the value of insurance policies as collateral. The Colonial noted in 1860 that people would 'lend more freely on the security of policies where

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<sup>60</sup> Meikle (1876), p. 294; *London Times* 19 January 1836; Economic Life, Minutes (9 January 1837); Colonial Life, Minute Book (4 November 1863); Scottish Amicable, Memorandum Book of Extra Rates (October 1875).

<sup>61</sup> Francis (1878), p. 785; Fox (1914), pp. 8-9. On colonial medicine and mortality see Bhattacharya (2012) and Arnold (1993).

<sup>62</sup> Military risks are discussed below. On mariners see Humpherson (1952), and *Assurance Magazine* 2 (1852), p. 170.

there is no restriction as to going abroad', and that trustees would be more likely to allow such a policyholder to dip into his wife's settlement.<sup>63</sup> The five-year waiting period meant that 'whole world' licenses were off limits to most customers who might actually want to travel abroad. Many people purchased insurance specifically because they were about to travel, and most others traveled within five years of becoming insured.<sup>64</sup>

## **INSURING MISSIONARIES AND SOLDIERS**

In 1859 the doctor James Paget met with Elizabeth Mackenzie, whose brother Charles was about to lead a mission from Natal into Central Africa; its goal, in the words of Charles's biographer, was 'the promotion of the spread of true religion, agriculture, and lawful commerce'. By way of warning Elizabeth of 'the personal risk of the undertaking', Paget asked her to 'consider what would be the view taken by a Life Assurance Company', which 'would not estimate his chance of life at more than two years'. At this point Charles Mackenzie entered the room. He agreed with Paget's assessment (which had 'shocked' his sister), taking it 'as a matter of course, not treating it lightly, but as a subject which he had already well considered'. Whether he did apply for an insurance policy is unknown, but if he had it would have cost him around four times the usual price – and the life insurance office would still have lost money. Mackenzie died in January 1862 in present-day Malawi, less than a year after he first crossed the Zambesi River.<sup>65</sup>

Along with military men, missionaries such as Mackenzie belonged to a risk group that life insurers identified as peculiarly vulnerable to foreign residence. In insuring them, companies translated the white man's burden into a form that was uniquely quantifiable, but also negotiable – since these would-be imperialists often drove a

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<sup>63</sup> Standard Life, Sederunt Book (10 April 1851); Associated Scottish Life Offices, Minute Book (3 May 1851); *London Times*, 22 November 1860.

<sup>64</sup> *Post Magazine*, 24 May 1851. 272 of 419 travel extras granted by two of the companies that contributed to the Healthy Males investigation (64.9 per cent) were charged at the outset of the policy and the remainder waited an average of five years before applying for a license to travel: Walford (1871-80), vol. 3, pp. 100-101.

<sup>65</sup> Goodwin (1864), pp. 218-219; Porter (2004), pp. 185-186.

hard bargain in determining the extent of their surcharge. Taxing Britain's civilizing mission raised a further issue. Civilisation could be defined in terms of improved sanitation, higher standards of living, or religious conversion, but it could also be defined (and frequently was, by insurance salesmen) in terms of a desire to buy life insurance. It was easy enough to extend this rhetoric, which first applied to British insurance customers, to non-white customers abroad – as when an advocate of missionary activity in China evinced a 'progressive spirit' among the Chinese by citing 'the readiness with which they insure their lives in European insurance offices'.<sup>66</sup> Once insurers decided to export the civilizing mission of life insurance, however, they needed for the first time to consider how much to charge non-British lives. As will be discussed in the final section of this chapter, they brought to this task a host of racist assumptions about insurability, along with their usual combination of entrepreneurship and statistical ignorance.

Precisely because 'Victoria's little wars' were all fought in distant lands – in regions as diverse as Gibraltar, India, Egypt, South Africa, and the Crimean Peninsula – Victorian military service posed a hybrid risk: one part exposure to battle, one part exposure to dangerous foreign climates. Dysentery and fever accounted for 60 per cent of the deaths experienced by European troops in the Gold Coast campaign of 1874, while typhoid and other diseases took 43 per cent of the lives lost in the Egyptian campaign of 1882, 70 per cent in the Nile expedition of 1884-5, and 65 per cent in the Anglo-Boer War of 1899-1902.<sup>67</sup> When military men asked for a license to fight abroad, they typically faced a steep surcharge. An officer who normally paid £30 for his £1000 policy paid between £60 and £83 to serve in the Crimean War or Zulu Wars, up to £114 for the Sepoi Rebellion in 1857, £135 for fighting the Ashanti in 1873, £53 to £114 during the onset of the second Boer War, and £62 to £135 for Egypt in the early 1880s. The default war extra was £55 per £1000, which was enough to protect the company if one in nineteen insured soldiers died.<sup>68</sup> The basis for these

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<sup>66</sup> *London Times*, 19 September 1901.

<sup>67</sup> Curtin (1989), pp. 68-69, 169, 218.

<sup>68</sup> Church of England Fire and Life, Board Minutes (1854-55); Legal and General, Board Minutes (11 July 1854); Associated Scottish Life Offices, Minute Book (24 October 1854, 21 February 1879, 18 July 1882, 30 July 1883); Eagle, Board Minutes (19 February 1879); Legal and General, Letter Book (11 November 1857); Provident Life, Notes on the Company's History, 97; Life Offices Association, Committee Meeting Minute Book (9 October 1899, 18 February 1901); *Post Magazine*, 43 (1882), p. 444; Associated Scottish Life Offices (1895), p. 28.

surcharges was even shakier than was the case with regular travel. As one actuary noted, war extras 'had to be decided upon quickly, without much notice, and with a very slender basis of fact to go upon'. Even if data could be collected for prior wars, they would leave actuaries 'more or less in the dark' regarding the next one, since no two wars were alike.<sup>69</sup> All actuaries could do was determine after the fact if the rates they had charged had been sufficient – which they invariably were not.

British missionaries faced similar dangers as soldiers, especially when they pushed into Africa in search of unsaved souls. Forty-two of the 140 men the Church Mission Society sent up the Niger in 1841 died within two months, and the Baptist Missionary Society in the 1880s had trouble recruiting enough new missionaries to replace those who died in the Congo.<sup>70</sup> Compared to the military, however, life insurers were less likely to treat missionaries as a distinct risk group or to make special inquiries into their mortality. Apparently, however, many missionaries made do without an insurance policy, and their societies factored potential loss of life into the general expense of training and provisioning their members. In some cases uninsurability was itself part of the appeal for men who were willing to sacrifice their lives to do God's work. The *Quarterly Review* indicated the zeal of the African bishop Edward Steere by recalling that he invited Oxbridge students 'to risk their lives with him where no Insurance Office would allow them to set foot'.<sup>71</sup>

Regardless of whether life insurers gained or lost financially by the bargains they struck with soldiers and missionaries, the fact that they surcharged these imperial activities at all was itself a source of constant complaint.<sup>72</sup> From soldiers' perspectives, the primary frustration concerned their own uncertainty regarding where they would be stationed in the future. As an Exeter army captain told his solicitor, 'A friend of mine, an officer on our staff, was anxious to have visited the French and Sardinian armies during the summer, and to have seen something of their

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<sup>69</sup> Associated Scottish Life Offices Minute Book (20 May 1874); Schooling and Ruser (1903), pp. 3–6, 24, 73, 75.

<sup>70</sup> Williams (2000), p. 152; Stanley (1992), p. 125.

<sup>71</sup> Lindsay (1987), p. 53; Edinburgh Life, Directors' Minute Book (26 March 1857); University Life, Minute Book (22 October 1890, 11 January 1899, 29 August 1900); Waller (1889), p. 235.

<sup>72</sup> A related complaint arose from white settlers in temperate colonies who appealed to local vital statistics to argue that they should be paying *less* than the going British rates: see, e.g., Newman (1883), p. 501.

strategy and tactics. His Insurance Office said 'You sha'nt.' I should not like my Insurance Office to say so to me, if I were to make a little expedition'. Adding to their frustration, as the *Post Magazine* observed in 1882, such men were 'very much in the hands of the Companies, with little time for negotiation or debate'.<sup>73</sup> Over the course of the nineteenth century, life insurers increasingly responded to these concerns by offering special policies to military men that covered, for a fixed fee from the outset of the contract, military service in all parts of the world.<sup>74</sup>

A rare archival example of a missionary's agent bargaining with an insurance office suggests a different dynamic. In this case, involving the Scottish Amicable's rejection of a proposal to insure a missionary about to embark to China, the missionary societies' tradition of self-insurance carried over into the agent's rejoinder to his branch manager. The agent argued that the missionary society, like the life insurer, had a financial stake in the candidate's life and hence would do everything in its power to guarantee his continued health. Once he was ready to venture abroad, the agent claimed, a missionary had 'necessarily cost the Missionary Society a comparatively large capital sum, and is in a sense a very valuable life to them even if only from the financial standpoint'. The agent also responded to his manager's concern that missionaries (like soldiers) were subject to removal from a safe to an unsafe climate at any time, by pointing out that moving would mean learning a new language: 'it means a very great waste for a missionary to be moved from the point of view of language alone... [since] a missionary's efficiency depends absolutely upon his knowledge of that language'.<sup>75</sup>

## INSURING THE CIVILISED COLONIAL SUBJECT

As long as 'commerce and Christianity' persisted as a face of British imperial power during the nineteenth century, British life insurers faced a potentially awkward problem.<sup>76</sup> Although actuaries and salesmen regularly identified the spread of life

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<sup>73</sup> Legal and General, Board Minutes (21 June 1859); *Post Magazine*, 43 (1882), p. 444; *Policyholder*, 3 (1885), p. 338.

<sup>74</sup> Walford (1871-80), vol. 1, p. 373; *London Times*, 15 January 1900.

<sup>75</sup> Scottish Amicable, Memorandum Book of Extra Rates (Y. Eccles to head office, 12 September 1911).

<sup>76</sup> On 'commerce and Christianity' as an imperialist slogan see Stanley (1983).



insurance in and beyond Britain with the spread of civilisation, they were not always as quick to admit that non-white colonial subjects were ready for the brand of civilisation they were selling. In most other forms of commerce, racial prejudice did not as obviously impede the sale of goods or services to non-white British subjects. It played a larger role in life insurance, since it informed the companies' perception of risk. Most insurers discerned a range of alleged behaviours among non-white subjects that they assumed would result in more claims, including intemperance, uncleanliness, and a propensity to fraud. A Madeira physician warned Standard Life in 1843 that the 'indolence and guzzling propensities' of the '*natives* of the Island... must tend in a great degree to shorten the appointed term of human existence'. Insurance doctors also worried that non-white residents could pose a risk to the white insurance pool, either through poor sanitation or intermarriage. A Mauritius doctor reported to Colonial Life that a recent cholera epidemic there had resulted from 'the filthy habits of the natives of the lower class and the imported coolies from India', and Briton Life's medical advisor noted that 'deterioration of race' had deprived the Ceylonese burghers of 'the sturdy characteristics of their forefathers'.<sup>77</sup>

In Africa, the majority of British insurers shied away from most indigenous lives most of the time. Standard Life's Cairo medical examiner thought that Egyptians were 'very liable to tubercular and urinary diseases', that they lied about their family history, and that there was 'sometimes difficulty in proving their age'; he added that 'Natives in a low position should not under any circumstances be accepted'. In South Africa, a Gresham branch manager recommended that canvassers in the bush bring along field glasses so as 'to distinguish at a distance whether a building... is a farm, store, or merely a Kaffir's kraal or hut' – since crossing the veldt to reach the latter was 'so much time and distance wasted'. Standard Life refused all black lives in South Africa until 1913, when it consented to accept (with a 10 per cent surcharge) 'Natives who are highly educated' for endowment policies maturing at age sixty. The same report that fixed this rule revealed the actuarial uncertainty that accompanied the colonial project of 'civilizing the Natives and converting them to Christianity': it foresaw a transition period that would be 'worse than the original', as indigenes 'lose their own heathen morality and... do not grasp the Christian and white man's'. Adding to the confusion was race-mixing in

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<sup>77</sup> Moss (2000), pp. 48-49; Colonial Life, Minute Book (4 November 1863); Sieveking (1874), pp. 22-23.

the Cape Colony, which had produced customers 'varying from half caste to those with only a touch of the tar brush'.<sup>78</sup>

If Victorian insurers in Africa could more or less afford to act as if black lives did not matter to their bottom line, this ceased to be the case in India by the end of the nineteenth century. The early bird in this market was the Oriental Government Security Life Insurance Company, founded by McLauchlan Slater in 1874 in Bombay from the ashes of the Albert branch he had managed there (the Albert's London office had spectacularly failed in 1870). From the outset, the Oriental insured indigenous and European customers at identical rates. The only relevant data Slater might have had regarding such lives would have come from his own tenure at the Albert, which included a large proportion of mixed-race (so-called Eurasian) customers on its rolls. Statistically as well as commercially, however, his gamble paid off. An investigation in 1891 revealed that the company's indigenous mortality was running 20 per cent above the norm for policyholders living in England, compared to 50 per cent above the norm for its European customers – figures that would be confirmed in later studies, and that fell safely within the predicted mortality on which the Oriental had based its premiums.<sup>79</sup>

The Oriental's commercial success, combined with increased competition for European customers, eventually led other British firms to follow its lead in liberalizing their terms. But change came slowly and was seldom accompanied by anything approaching Slater's relatively buoyant attitude towards non-white risks. After looking into the matter in 1880, Standard Life decided to retain its policy of adding 10 per cent on Eurasian policies and rejecting Indians 'except in very special circumstances'. A further inquiry in 1881 led it to permit its Indian branches to accept such risks; it found two doctors in India who agreed that the 'educated and well to do native' could be relied on to take the same health precautions as Europeans. The British merchants who served as local Standard directors in India, however, were less enthusiastic about pursuing Indian risks. Few knew when they were born, they claimed, and determining how a policyholder died would be

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<sup>78</sup> Standard Life, Reports and Valuations (report on Egypt, March 1905; Edward Blount, report on South Africa 31 January 1913); Pritchard (1898-99), p. 35.

<sup>79</sup> Martin (1981), pp. 62, 66-67; Tait (1864), p. 325; Slater (1893), p. 22. 'Well-to-do natives' also served from the outset on the Oriental's board of directors: *Short History* (1924), pp. 16-19, 38-41.

difficult because he 'would probably be burned in a few hours of life being extinct'. One director spoke for the group when he declared: 'even with the better classes of Natives... civilization has hardly penetrated beneath the surface. Many of their ways of living are objectionable and their habits unwholesome'.<sup>80</sup>

Around the same time that Standard Life was changing its official policy on Indian risks, several other British offices doing business in India followed suit. The Positive started accepting Indians at its Eurasian rates in 1880, the Church of England lifted a ban on Indian lives in 1882, and the Caledonian began accepting 'assurances on the lives of those occupying good positions' in 1883. The short-lived Sun of India, which was quickly absorbed by its sister London company, formed in 1892 with a mandate to divide business 'equally between Europeans and natives'. Still, permitting branch managers to seek Indian risks was not the same thing as actually insuring non-whites, and the sort of grumbling emanating from Standard Life's Indian directors was typical of other companies.<sup>81</sup> Such reticence prompted the growth of new home-grown Indian life insurance companies in addition to the Oriental, beginning with a wave of short-lived 'assessment'-style firms in Bengal in the 1890s.<sup>82</sup> The nationalist *Swadeshi* movement in 1906 prompted the formation of three dozen firms within six years, which swelled to nearly a hundred by 1928.<sup>83</sup> By that point, local insurers held 513,955 policies in force in India, compared to 202,703 held by non-Indian firms.<sup>84</sup>

## CONCLUSION

The insurance version of the white man's burden continued to vex British life insurers into the twentieth century. At issue was the relationship between civilization and longevity, which even back in Britain could never be assumed to be

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<sup>80</sup> Moss (2000), p. 131; Colonial Life, Minute Book (16 September 1880 and 2 August 1881).

<sup>81</sup> Positive Government Security, Board Minutes (30 October 1880); Church of England Fire and Life, Board Minutes (19 July 1882); Caledonian, Board Minutes (26 June 1883); *London Times* 29 April 1892; Tarn (1899), p. 528.

<sup>82</sup> Rungta (1970), pp. 190-193.

<sup>83</sup> Desai (1973), pp. 9-25. On the Swadeshi movement see Goswami (2004), pp. 242-276.

<sup>84</sup> Jitschin (2010), p. 134.

always straightforwardly correlated. At home, non-industrial insurers routinely excluded working-class lives whose lack of sufficient disposable income signified a lack of civilisation to many Victorians, but they also screened out customers whose 'West End lives' were too civilised for their own good. A Manchester insurance doctor worried that 'the modern rush of life' was depriving policyholders of 'the very necessary and healthy exercise of a vigorous walk', and an Australian actuary observed these same dangers occurring in Melbourne – where 'the Arcadian tastes of the early residents' were giving way to 'civilised luxuries'. As this progressed, he worried, 'diseases of the nervous system [will] assert themselves, and deaths from old age will less frequently be seen'. In airing these concerns, insurers echoed (although they rarely explicitly endorsed) eugenicists' contemporary fears regarding race degeneration, whereby society's 'savage' members won the upper hand by outbreeding their more civilised masters.<sup>85</sup>

When British insurance officials turned from risks of civilisation at home to risks sustained from civilizing others abroad, they were less certain about where to draw the line between protecting themselves against increased mortality and taxing policyholders unfairly. Although few were willing to erase that line entirely, many were cognizant both of certifiable health improvements abroad and the competitive advantage that came from being the first to pass the benefits of such improvements on to their customers. Pressing against such views was always the hard statistical truth, gleaned from studies of soldiers and pensioners as well as the life offices' own records, that Britons died at a higher rate in many foreign climates than they did at home. Although optimists could always point to progress in sanitation and tropical medicine, insurance companies had a habit of placing a higher priority on institutional memory than on hoped-for improvements. A new competitor was often, like the Positive Government Security, willing to step into the resulting breach, but it was not always able to alter the inertia of the wider community.<sup>86</sup>

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<sup>85</sup> Pollock and Chisholm (1889), p. 163; Darwin (1906), p. 48; *Policy-holder*, 4 (1886), p. 315; Soloway (1990).

<sup>86</sup> On this general issue see Supple (1970), pp. 401-402; Trebilcock (1985), vol. 1, pp. 427, 701.

Finally there was the matter of non-white colonial subjects, who were the alleged beneficiaries of Britain's civilizing mission. Where these people were concerned, the discord between insurers' assumptions and experience regarding civilisation and longevity could reach jarring levels. A doctor by the name of H. Birrell, speaking at the Insurance Society of Edinburgh in 1911, admitted that 'the resisting power of a native in respect of... climatic factors must, owing to his evolutionary history, be superior to that of the European stranger in his land'. On the other hand, he was confident that 'the sanitary environment of the unsophisticated native is distinctly less favourable than that which the European brings with him'. These two premises should have yielded the conclusion that a 'sophisticated' indigenous policyholder would be the best risk of all. Instead, his lesson was that both varieties were vicious in different but equally uninsurable ways: 'the civilised native nearly always affects some at least of the vices of civilisation, and the net result is that, on the average, he is probably a less satisfactory life than his less cultured brother'.<sup>87</sup>

Nor did statistics solve everything, although they might (as in the Oriental's case) once in a while dispel an especially opaque corner of racist thought. A policyholder of color who thought otherwise did not take into account the thicket of assumptions through which vital statistics passed before being translated into premiums. Statistics, for instance, apparently had little to do with the Scottish Equitable's table of Nigerian rates as of 1903, to judge from its actuary's anecdote regarding a complaint he had lately received. A 'native of Lagos' informed him that 'the "Registrar-General" showed that, while the yearly rate of mortality among natives in Lagos was *only* 49 per 1000, it was 190 for Europeans, and natives ought therefore to be charged much lower premiums'. The actuary confirmed that 'a very interesting report, prepared and issued in the colony... showed that my correspondent was right as to the facts' – but did not go on to say whether he granted the customer's request.<sup>88</sup>

These assumptions were baked into the racial blinders that tempered Kipling's 'White Man's Burden' and its accompanying imperial ideology, which was equal

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<sup>87</sup> Birrell (1911), p. 74.

<sup>88</sup> J. J. McLauchlan, discussion of Thomson (1903), p. 351.

parts self-congratulatory and dismissive of any real potential for 'civilisation' to take root. This was clear from the New York insurance writer who cited Kipling's poem (which had specifically urged Americans to civilize their recently-acquired colony in the Philippines) by way of promising 'to send forth a few of 'the best we breed'' to sell insurance to the local population there, 'and thus give Mr. Kipling a chance to advise our peers in lofty verse to do likewise in India'. The writer concluded, however, by implying that 'boring holes into our ill-advised, 'new-caught, sullen peoples'' would take an enormous amount of time, and until then western insurers would 'lug the Indian [and] Negro... bundles in our burden with as much cheerfulness as heretofore'.<sup>89</sup> The result of such pessimism, from the perspective of non-white colonial subjects, was to take matters into their own hands in the matter of insuring their lives – as evidenced by the rapid growth of *Swadeshi*-inspired insurers that appeared in India after 1906, and also the creation of life insurance companies by and for liberated slaves following the American Civil War.<sup>90</sup> Ultimately, the same result would also unfold in the political realm several decades later, whether in the form of colonial independence or the American civil rights movement.

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<sup>89</sup> *The Chronicle*, 63 (1899), p. 74. For context on the American response to Kipling see Murphy [2010].

<sup>90</sup> On African-American life insurance see Weare (1993).

### CHAPTER 3. AGENTS, REGULATIONS, AND SCANDALS: US LIFE INSURANCE COMPANIES IN LATE-NINETEENTH-CENTURY LATIN AMERICA

Sharon Ann Murphy

On January 4, 1882, New York merchant Alexander Louis died in a hotel room in Havana, Cuba. While the obituary in the newspaper said he died in bed, the report of the local medical examiner indicated that he had died in the bathtub from some kind of heart failure. The body remained soaking in the cold water for ten hours before someone found and removed him.<sup>91</sup> No one alleged any foul play, and the Equitable Life Assurance Society of New York quickly paid the death claim on his insurance policy. The family also wished to have his body embalmed in Havana and then transported back to the United States for burial. Henry B. Hyde, President of the Equitable, personally requested that the local company agent, Vicente M. Julbe, take care of this task.<sup>92</sup>

Unfortunately for all involved, a “mishap” occurred, leaving Julbe to “deeply regret that the corpse has not arrived in the good condition that we all desired.”<sup>93</sup> Julbe was understating the problem just a bit. When the corpse disembarked in New York a full two weeks after his death, Louis’s representatives – Messrs. Leissner and Louis – were so horrified with its state, that they called in outside experts to consider whether or not any embalming had even taken place. These experts determined that the corpse “had arrived in a more or less advanced state of putrefaction” (“habia llegado en un estado más o ménos avanzado de putrefaccion”) and that “it had no traces of embalming” (“no tenia huellas de embalsamamiento”).<sup>94</sup> Louis’s representatives implied that the Cubans had either been dishonest in

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<sup>91</sup> ‘Obituary’, *Providence Journal*, January 5, 1882, p. 1; Dr. Serafin Arteaga to V. M. Julbe, January 20, 1882, ELAS carton 10.

<sup>92</sup> Julbe to Leissner & Louis, January 21, 1882, ELAS 10.

<sup>93</sup> Julbe to Leissner & Louis, January 21, 1882, ELAS 10.

<sup>94</sup> Arteaga to Julbe, January 20, 1882, ELAS 10.

stating that the body had ever been embalmed, or that they were too incompetent to undertake this type of medical procedure.

Julbe was incensed by this “offensive reproach,” especially since it struck at the very integrity of the Cuban agency, which he had personally established in 1864 as one of the Equitable’s first foreign offices.<sup>95</sup> Being so far removed from the firm’s headquarters in New York, the Havana agent continually needed to reestablish “the trust you placed in me” as the company’s representative on the island. Reminding Hyde of his longstanding relationship with the company, Julbe was “confident that you know me well” and would not blame him for the incident. Yet also desiring to “secure a happy & satisfactory result” on behalf of this customer, Julbe induced Dr. Serafin Arteaga, whom he described as “one of the most prominent and respectable physicians, of Habana,” to respond to the accusations. He then forwarded the doctor’s detailed analysis to Leissner and Louis through President Hyde.<sup>96</sup>

Dr. Arteaga methodically outlined the conditions in this case that would make proper embalming by even the best doctors difficult, including the corpse’s ten hours submerged in water. Additionally, another full day passed in the tropical climate before the body – which was now in a state of full decay – was embalmed.<sup>97</sup> One can only imagine the series of telegrams which must have passed between Havana and New York over those twenty-four hours, first informing the next of kin of Louis’s death, and then requesting the immediate embalming and shipment of the body.

Arteaga proceeded to demonstrate his knowledge of the most up-to-date embalming practices, describing the “Gannal procedure” as the most appropriate and cost-effective “given the state of the cadaver and how expensive another procedure would have been, which take out the internal organs and embalm them one by one” (“dado el estado del cadáver y lo costoso que hubiera sido otro procedimiento, cual sacar las vísceras y embalsamarlas una por una”).<sup>98</sup> At a time

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<sup>95</sup> ‘Cuban Manager Here’, *The Insurance Press*, October 7, 1903, p. 6; Buley (1959), p. 51.

<sup>96</sup> Julbe to Hyde, January 21, 1882, ELAS 10; Julbe to Leissner & Louis, January 21, 1882, ELAS 10.

<sup>97</sup> Arteaga to Julbe, January 20, 1882, ELAS 10.

<sup>98</sup> Arteaga to Julbe, January 20, 1882, ELAS 10.



when the transnational dissemination of scientific knowledge to the periphery was an issue of debate, it was important for Dr. Arteaga to establish his own legitimacy and skill as a medical examiner, as well as vouch for the abilities of the entire Cuban medical community.

Arteaga also questioned the expertise of the men hired by Leissner and Louis in New York, asserting that surely these “experts would have scientifically explained the state in which the body arrived” themselves, if they had actually considered all the facts in the case. (“Los expertos se hubieran explicado científicamente el estado en que llegó el cadáver, si se hubieran fijado en estas consideraciones”). At a minimum, they should have “discovered the sign of the operation, practiced in the lateral and anterior part of the neck, on the right side, for embalming by the Gannal procedure” (“hubieran descubierto la señal de la operación, practicada en la parte lateral y anterior del cuello, en el lado derecho, para el embalsamamiento por el procedimiento de Gannal”).<sup>99</sup> In repeatedly questioning the abilities and conclusions of the New York experts – with an air of disbelief and disdain – Arteaga now placed himself and the Cuban medical community in a position of superior knowledge.

Further proof of the successful embalming was that the health inspector at the port of departure, Dr. Montemar, certified the body for transit, which would not have been allowed if the body was in an active state of decay, “to the effect of ensuring that it could not injure passengers’ health through decomposition.”<sup>100</sup> Several other individuals also saw the body at the port, who could testify that “the physiognomy was perfectly distinguished and that the state of conservation was satisfactory, even though two days had elapsed from embalming and three and a half days after the death.” (“[Q]ue se distinguía perfectamente la fisonomía y que era satisfactorio el estado de conservación, por más que habían transcurrido dos días de embalsamado y tres y medio del fallecimiento”).<sup>101</sup> Surely a corpse without proper embalming could not have survived three or four days in the Cuban

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<sup>99</sup> Arteaga to Julbe, January 20, 1882, ELAS 10.

<sup>100</sup> Julbe to Leissner & Louis, January 21, 1882, ELAS 10.

<sup>101</sup> Arteaga to Julbe, January 20, 1882, ELAS 10.

heat without significant signs of decay. Logic alone dictated against the conclusions of the New York experts.

Rather than a failed embalming, Arteaga blamed “some collision in the loading or unloading” (“algún choque en la carga o descarga”) that caused “the glass of the metal box in which it was hermetically closed” to break, “giving rise to a new atmosphere, an accident which activated the decomposition.” (“[S]e rompió el cristal de la caja metálica en que iba hermeticamente cerrado, dando lugar á una nueva atmósfera accidente, que activó la descomposición”).<sup>102</sup> With this final rhetorical step, Arteaga completely removed all responsibility for the failed shipment from the local agency and the Cuban medical community, blaming instead a third-party shipping company – probably based out of New York.

With no further mention of this incident in the archival record, beyond Julbe’s comment to Hyde a week later that “the explanations given I hope will have satisfied those gentlemen,” it appears that Dr. Arteaga’s careful dissection of the events quieted Louis’s representatives. That same week, President Hyde instructed Julbe to “advertise [the Equitable] in your best papers.”<sup>103</sup> In 1881, the year immediately prior to the incident with Alexander Louis’s body, the Havana office had underwritten over \$3 million of insurance in Cuba and the surrounding Caribbean, which was more than any of the Equitable’s other foreign agencies anywhere in the world.<sup>104</sup>

## US LIFE INSURANCE ABROAD

Beginning in the 1870s, United States life insurance companies – particularly the New York Life and the Equitable – began expanding their operations globally. In England they faced competition from a well-established domestic industry, but also benefited from a knowledgeable customer base and no language barrier. The Western European countries had also started to embrace life insurance by the

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<sup>102</sup> Arteaga to Julbe, January 20, 1882, ELAS 10.

<sup>103</sup> Julbe to Hyde, January 26, 1882, ELAS 10.

<sup>104</sup> Insurance Department of Massachusetts (1882), p. 3; Agency chart, October 21, 1882, ELAS 2A.

middle of the nineteenth century, and the US companies quickly established agencies in cities like Paris, Hamburg, and Madrid to tap into these emerging markets.<sup>105</sup> They also began eyeing new markets where they would face less competition from domestic firms, everywhere from Eastern Europe and Russia, northern Africa and South Africa, to Asia and Australia.<sup>106</sup> According to one insurance historian, “by 1900 the Equitable was active in almost a hundred nations and territories the world over; the NYL, in almost fifty; the Mutual, in about twenty.”<sup>107</sup>

The most lucrative emerging market for the US firms were the countries of Latin America. During the last three decades of the nineteenth century, both the New York Life and the Equitable – and to a much lesser degree, the Mutual Life of New York – devoted substantial time and resources to establishing agencies throughout the Americas. By the early 1890s 12-13 per cent of all insurance in force for these two companies came from Latin America (see figure 3.1), compared to approximately 15 per cent from their agencies in Europe and Great Britain.<sup>108</sup> Despite this considerable initial success, life insurance in force for the region would drop to under five per cent for both firms by the 1905 Armstrong investigation, even as European sales remained strong. These Latin American agencies are now barely a footnote in the official corporate histories.<sup>109</sup> This decline substantially predated withdrawals from other foreign markets which occurred largely between the Armstrong investigation in 1905 and the outbreak of World War I. And the importance of the region had already been more than halved prior to the anti-American backlash that followed the Spanish-American War in 1898.

The US companies faced several challenges in establishing Latin American agencies, but most of these issues mirrored their earlier expansion experiences within the United States. They needed to find honest, respected local agents who would

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<sup>105</sup> Agency chart, October 21, 1882, ELAS 2A; Pons (2008), p. 88.

<sup>106</sup> Agency chart, September 23, 1891, ELAS 2A, and Lindsay (no date).

<sup>107</sup> Keller (1963), pp. 81-82.

<sup>108</sup> Hudnut (1895), p. 356.

<sup>109</sup> While Hudnut's 1895 history of New York Life contains a mere two paragraphs on the Spanish-American department, Abbott's 1930 history makes no mention at all. Buley's 1959 history of the Equitable similarly skims over the experience of the firm in Latin America. See Hudnut (1895), pp. 178, 277; Buley (1959), pp. 51, 54, 77, 79-80.

represent and look after the best interests of the company with little direct oversight from the distant New York headquarters. They needed to develop premium rates that accurately reflected the local mortality experience, and carefully select the lives eligible to buy at these rates. They needed to educate people on the benefits and virtues of insurance in general, while simultaneously promoting their own company as superior to both smaller domestic companies and other large US firms. And they needed to deal with regulatory regimes which often privileged local over foreign companies. Yet New York Life's experiences expanding outside of the Northeast into the western and southern United States during the 1840s and 1850s, and the Equitable's rapid expansion from its founding in 1859, prepared them both well for each of these challenges. Their experiences with southern policyholders during the American Civil War would even provide a model for dealing with military conflicts in Latin America and fluctuations in exchange rates between countries.<sup>110</sup> Yet despite these parallel experiences, their attempt to establish a permanent foothold in Latin America failed. Since a full examination of the late-nineteenth-century experience of US companies in Latin America is not possible in this short space, this chapter will instead look at a few of the principal episodes of exit, re-entry, and final exit of the Equitable and the New York Life from the major markets of Latin America, with specific focus on Brazil, Argentina, and Mexico.

On the surface, changes in national regulatory regimes drove most of these corporate decisions. Brazil passed strict regulations regarding foreign insurers in 1886-87 and again in 1894-95; Argentina and Mexico followed suit in 1891-92. Yet while these laws were certainly intended to provide opportunities for domestic competitors to flourish and to prevent large specie outflows, they also were not unique to Latin America. These regulations were similar to protective legislation passed in countries around the world during the second half of the nineteenth century, which also mirrored the numerous laws against out-of-state firms in the mid-nineteenth-century United States. And the companies often responded effectively to these laws, at least initially. On the other hand, these regulatory changes were greatly complicated and exacerbated by the behavior of the companies themselves. Cutthroat competition between agents, problems of local agency oversight,

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<sup>110</sup> For the experiences of these companies expanding within the United States, see Murphy (2010).

and corporate scandals all eroded their first-mover advantages in the region and providing an opening for domestic companies to establish themselves as viable alternatives. The intense anti-Americanism that followed the Spanish-American War would solidify – rather than cause – an already established retreat from the region.

## **BUILDING LOCAL AGENCIES**

Beginning in 1879, the New York Life hired Charles Seton Lindsay to travel the globe establishing agencies for the company. The plan was for Lindsay to go into the target market, drum up a large number of initial sales, recruit and train a local representative to take over the new agency, and then move on to the next location. In areas where an agency for the company already existed, Lindsay was to ensure that the agent was representing the New York Life honestly and diligently, replacing him if necessary. Lindsay began his work in the West Indies around 1881, but initially found it difficult to establish the firm. Island colonies often had strong ties to the British insurance industry. In Bridgetown, Barbados, for example, he encountered “two local companies, both as old as the NYL... they were British companies organized and carried on among British people in British territory.”<sup>111</sup> Even finding someone to represent the company as an agent was difficult: “every firm was agent for one or more good English Life Companies; the Barbadoes Mutual and Jamaica Mutual were established and being native companies, got 95 per cent of the business; it was impossible to compete with them.”<sup>112</sup>

Lindsay determined that he needed to think outside of the box, soliciting the help of people not typically engaged in the insurance business. “The right man, to be of any use, must be one of the very first men in the place; this always meant a man of forty or more, for on his influence in my favor, much depended. A less prominent man would be of little use.”<sup>113</sup> In order to convince these target agents that

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<sup>111</sup> Lindsay (no date), p. 90.

<sup>112</sup> Lindsay (no date), p. 96.

<sup>113</sup> Lindsay (no date), p. 99. Here Lindsay seems to imply that he mainly sought non-natives as his agents. In other places, he implies that most policyholders would be non-natives as well. But it is difficult to ascertain to what extent this was a personal bias or a company-wide bias. The Latin

the position was worthwhile, he needed to demonstrate that sales through a New York company were possible by selling several large policies himself.<sup>114</sup> Finally, he had to ensure that “the physician selected by the Company as examiner” was suitable to the role.<sup>115</sup> For the next two years, Lindsay traveled throughout Mexico, Central and South America, and the Caribbean, shoring up old and establishing new agencies for the company. In 1883, the head office decided to send him to Asia in a similar role.<sup>116</sup>

As the two largest insurers in Latin America, the New York Life and the Equitable often engaged in intense battles for competent agents like the men Lindsay recruited. In May of 1882, Vicente Julbe of Cuba warned Hyde about a negative article from a policyholder in the US newspapers: “if I call your attention to this, it is because I understand that the New Y[ork]. L[ife]. is having it translated, no doubt for publication”. Being a dedicated agent, Julbe stated that “I understand that it is my duty to defend the society in this locality.”<sup>117</sup> Similarly, he took seriously his role as the translator of both language and culture. When a local newspaper mocked the popular (but often controversial) tontine insurance policies offered by the company, Julbe helpfully explained: “I send you herewith slip of ‘El Triunfo’ by which you will see the malicious joke, said paper makes, of the word *tontine*. You must know that *tonto*, in Spanish, means a *fool*.”<sup>118</sup>

Both companies regularly published Spanish-language ads (see figures 3.4 and 3.5) and articles about their firms, often taking veiled (but sometimes explicit) swipes at their competition. These articles ranged from positive stories of satisfied customers and families saved by a timely insurance policy, to negative depictions of litigation, scandals, and dissatisfied policyholders who claimed to be defrauded by a competing agent or company. One typical article from the May 24, 1888 issue of

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American agents in this period for both the New York Life and the Equitable were a mixture of locals, US transplants, and Europeans. I have found very little information on the policyholders themselves.

<sup>114</sup> Lindsay (no date), p. 100.

<sup>115</sup> Lindsay (no date), p. 99.

<sup>116</sup> Lindsay (no date), pp. 183-184.

<sup>117</sup> Julbe to Hyde, May 6, 1882, ELAS 10.

<sup>118</sup> Julbe to Hyde, January 13, 1883, ELAS 10.

*Las Novedades*, a Spanish-language publication in New York whose articles circulated widely in Latin America, detailed the history and success of the Equitable and emphasized its superiority over other companies like the New York Life.<sup>119</sup> After another series of articles comparing the New York Life unfavorably to the Equitable in 1883, Julbe noted that “The New York Agents here are furious...they show themselves indignant and threaten to take the revanche [revenge].”<sup>120</sup>

While Cuba was initially the centerpiece of the Equitable’s Latin American business, by the early 1890s about half of their sales in the region were to South Americans, with another 21 per cent in Mexico and 16 per cent in the West Indies. By contrast, three-quarters of the New York Life’s policies were sold in South America, with 14 per cent in the West Indies and only eight per cent in Mexico. The New York Life’s Spanish-American department was headed by the firm of Joaquin Sanchez and Julio Merzbacher. Both men had been employed with the New York Life for many years, with Merzbacher starting out in 1876 as private secretary to the manager of the Spanish-American department. Headquartered in Mexico City, this partnership took over the department in 1888 and “handled all the business of the company in Mexico, Central and South America, and the West Indies, a business aggregating the enormous sum of from \$20,000,000 to \$30,000,000 annually.”<sup>121</sup> Total insurance in force for the Spanish-American department of New York Life was actually just over \$60 million in 1889, with a premium income that year of \$2.77 million. This was slightly less than the \$3 million in premiums collected by the Equitable for their \$74 million in Latin American policies.<sup>122</sup>

Recognizing the stronger sales by New York Life among the South American countries, in 1888 the Equitable sent its agency inspector, Colonel Tisdell, to examine the Buenos Ayres agency in Argentina. He found that the New York Life was “leading all other companies... they have the finest offices in town and employ a corps of

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<sup>119</sup> “Secreto del buen éxito del seguro de vida americano,” *Las Novedades*, May 24, 1888, pp. 8, 13; Spanish-language ads listed the names and contact information for all their Latin American agencies. “La Equitativa de Los Estados Unidos,” *Las Novedades*, May 10, 1888, p. 20.

<sup>120</sup> Julbe to Hyde, January 13, 1883, ELAS 10.

<sup>121</sup> “Not Far from a Million,” *New York Times*, June 13, 1891, p. 1; “A Trusted Agent’s Theft,” *New York Times*, June 12, 1891, p. 1.

<sup>122</sup> *Annual Report of the Insurance Commissioner of Connecticut* (1890).

most competent agents, many of whom have been lured away from the Equitable". In contrast, the Equitable office was "small, insignificant and cheap looking, and ... the class of people who hang around are not of a kind to inspire confidence." Part of the problem (according to Tisdell) was the Equitable's general manager, Ismael Morales. Although he was honest, he was too involved with other business ventures to focus on insurance sales, and too stingy in his hiring terms "to secure the best men" as subagents. Tisdell was hatching a plan for "boosting the Equitable," which would include having Morales "taking a back seat or getting out entirely," and enticing away all of the New York Life agents (except, he noted significantly, Joaquin Sanchez).<sup>123</sup> The following year, the Equitable began "negotiating with one of the *New York Life* men who has been at work in Russia, to send to Buenos Aires. He is a German, speaks French, Spanish and Portuguese... [and] he is a good producer."<sup>124</sup>

Whereas the Equitable was trying to lure away the best agents in the New York Life-stronghold of Buenos Aires, they were simultaneously concerned about losing their lucrative Mexican agents to the competition. The New York Life agency had only a quarter of the sales of their Equitable rival in that country, despite the fact that their Spanish-American department was based in Mexico City. The firm of de Oca & Crocker, who oversaw the Equitable's operations in Mexico, warned that "Sanchez, the New York Life man, is on his way to the city of Mexico and threatens to pay more than the Mutual." De Oca & Crocker promised the head office that they had the means to fight off the threat by both companies to poach personnel and "to see to it that they lose none of their agents."<sup>125</sup> This intense competition for the best, most productive agents made loyalty a key attribute for the companies.

Just as Vicente Julbe was central to the Equitable's management in the West Indies, de Oca & Crocker served the company in Mexico for several decades. Having started as an agent for the company in the 1870s, Dionisio Montes de Oca and his partner took over as general managers for the entire Mexican business in 1883. As

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<sup>123</sup> To Hyde, April 20, 1888, ELAS 5.

<sup>124</sup> E. W. Scott to Hyde, February 9, 1889, ELAS 12.

<sup>125</sup> Scott to Hyde, February 9, 1889, ELAS 12.



a typical Spanish-language article celebrating the history of the Equitable recounted, de Oca “has done more than anyone to promote the business and spread the principles of insurance among the inhabitants of Mexico.” (“Este señor ha hecho más que nadie por fomentar el negocio y difundir los principios del seguro entre los habitantes de México”). In particular, he was able to overcome “popular concern against the American corporations” by convincing his fellow Mexicans “that insurance has broader aspirations than those of mere nationality, and that differences of race and language do not constitute a limit to the application of the principles.” (“Él ha hecho gradualmente ver a sus compatriotas que el seguro tiene aspiraciones más vastas que las de mera nacionalidad, y que las diferencias de raza y lengua no constituyen un límite en la aplicación de los principios”).<sup>126</sup> While this was a self-serving article certainly commissioned by the company, it still demonstrates the importance of strong, trusted agents for the success of a company – particularly in a foreign nation.

The Equitable also benefited from the patronage of General Porfirio Díaz in Mexico. In 1881, the former (and future) president took out a \$25,000 life insurance policy with the company, which the local agent noted was “a great honor to the Equitable as he is the Ex-President of this Country and the greatest man that ever produced in every sense of the word.”<sup>127</sup> Díaz would later join the local board of directors for the company, serving as the board’s president while he was simultaneously president of the Mexican Republic (see figure 3.4).<sup>128</sup>

Of course, even the best of relationships could turn sour. After serving the company for close to two decades, de Oca abruptly resigned from the Equitable in 1892, and began putting his energy into a competing domestic company known as La Mexicana.<sup>129</sup> La Mexicana had begun operations in 1887 in Chihuahua, before moving its headquarters to Mexico City, where it benefited from the expertise of de Oca.<sup>130</sup> Whether intentional or not, de Oca timed his departure with the enactment of

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<sup>126</sup> “Principios y desarrollo de un gran negocio en México,” *Las Novedades*, March 20, 1890, p. 14.

<sup>127</sup> A. G. Greenwood to Hyde, March 9, 1881, ELAS 4.

<sup>128</sup> Del Ángel (2012), p. 602, and *Las Novedades*, May 10, 1888, p. 20; Buley (1959), p. 80.

<sup>129</sup> To Hyde, December 27, 1892, ELAS 5; George T. Wilson to Hyde, November 2, 1893, ELAS 12.

<sup>130</sup> Minzoni (2005), p. 28.

Mexico's Ley Sobre Companias de Seguros in 1892, which was the country's first specific regulations governing foreign insurance firms. De Oca also sued the Equitable and its new Mexican general agent, former cashier Galwey, for commissions he believed he had earned as part of his agreement with the company. In 1895, the firm decided that it was cheaper to pay de Oca \$5,000 US "conditioned upon our obtaining a full, final, legal release" of all his claims. Galwey "earnestly recommend[ed] this payment" as the best way to end the whole affair.<sup>131</sup> Mexican sales, which had accounted for eight per cent of all foreign insurance in force in 1889 and six per cent in the year de Oca resigned, steadily declined for the remainder of the decade, falling below three per cent by the turn of the century (see figure 3.2).

Even the Equitable's first foreign agent, Vicente Julbe of Cuba, occasionally clashed with the Equitable leadership. In October 1893 he was "much disturbed" because the head office had mandated a new policy requiring "the return of renewal receipts when premiums are unpaid". Julbe had been exercising great discretion in allowing his policyholders anywhere from 30 to 90 days of grace in paying their premiums. He claimed to have been given this privilege "years and years ago by the Second Vice President," but the company had no record of it. In his back and forth with New York, the foreign manager offered to allow him to extend 30 days grace "in individual cases where the same might be found necessary," but "Julbe says that this is not sufficient, and asks that the more general authority heretofore enjoyed by him be given back to him." Vice President Alexander reported to President Hyde that "The Department of Foreign Collections inform me that Julbe's account is one of the best on the books, and that they had no criticism to make of his observance of the rules about collections". He left it to Hyde to determine whether or not this longstanding agent should be granted special privileges with regard to his accounts.<sup>132</sup>

Yet the Cuba office – once the shining jewel of the Equitable – was also in decline by the early 1890s. Life insurance in force for the West Indies (as a whole) had dropped from 6.3 per cent of the firm's foreign business in 1889 to 4.5 per cent in 1895 (see figure 3.2). Sharply reduced exports of Cuban cigars and sugar to the United States

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<sup>131</sup> Wilson to Hyde, May 11, 1895, ELAS 12.

<sup>132</sup> James W. Alexander to Hyde, October 2, 1893, ELAS 12.

in the early 1890s prefaced an economic recession, while several deadly hurricanes in 1894 brought further misery to the island. These conditions, combined with years of suffering at the hands of the Spanish empire, led to the eruption of the Cuban Revolution by February 1895.<sup>133</sup>

Whether by design or by accident, the head office decided that this was also an opportune moment for new blood in Havana, after more than three decades with Julbe as general agent. They were considering promoting A. Firpo, their agency inspector in Antiqua, to replace him as general agent, but worried “Whether he or any other man would care to take hold of the agency at the present moment when the bottom is quite dropped out of things there.”<sup>134</sup> But the head office ultimately had little say in the matter. Julbe would “not give up voluntarily,” instead defining the terms of his retirement for the company. He agreed to resign *eventually*, but only after a transition period during which the company would hire his twenty-seven-year-old son (also Vicente M. Julbe) as his successor.<sup>135</sup>

Two years later, as the war in Cuba raged on, life insurance in force in the West Indies had dropped to 3.5 per cent of the firm’s foreign business and company executives considered abandoning the agency altogether. “[The Havana Agency] does show badly for 1896. We are on the qui vive and seriously discussing whether after all it will not be better for us to terminate Julbe’s contract and take over the collection ourselves on the best terms possible.”<sup>136</sup> But the Julbes persisted. During the summer of 1897, the firm was still trying to finalize the contract for the son, with President Hyde advising “I would not propose to make as liberal a one as we did with the old man.”<sup>137</sup> In late January 1898, just two weeks before the explosion of the US battleship *Maine* in Havana harbor initiated the Spanish-American War, Hyde congratulated Vice President Alexander for finalizing the contract terms. Despite the “demoralized condition” of the country, “now, through young Julbe, we may do business again in Cuba.”<sup>138</sup> The junior Julbe shepherded the

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<sup>133</sup> Tone (2006), pp. 26-29.

<sup>134</sup> Wilson to Hyde, May 28, 1895, ELAS 12; Agency chart, October 21, 1882, ELAS 2A.

<sup>135</sup> Wilson to Hyde, May 28, 1895, ELAS 12. For his birthdate, see Herringshaw (1922), p. 303.

<sup>136</sup> Wilson to Hyde, March 29, 1897, ELAS 5.

<sup>137</sup> Hyde to Alexander, August 19, 1897, ELAS 2a.

<sup>138</sup> Hyde to Alexander, January 26, 1898, ELAS 2a.

agency through the war, and would remain general agent of the Equitable in the region until at least 1905. Insurance in force in the West Indies stabilized at about 2.5-3 per cent of foreign business by the turn of the century, and would remain at that level through the Armstrong investigation of 1905.<sup>139</sup>

Whereas most agency issues revolved around questions like productivity and compensation, the distance of these agencies from the home office opened them up to wider principal-agent issues, including fraud and embezzlement. The most spectacular insurance scandal of the period involved Julio Merzbacher of the Spanish-American branch of the New York Life, aided and abetted by company President William Beers himself. Around February 1891, Joachin Sanchez abruptly sent a letter to all policyholders of the Spanish-American department that Merzbacher would be retiring due to "ill health". By June, the *New York Times* had broken a front-page story that Merzbacher – far from being unwell – had actually embezzled a substantial sum of money from the company (originally estimated at \$300,000, but eventually reaching \$720,000.) The New York leadership immediately went into public relations mode to try and head off the scandal. Some executives denied the allegations, others downplayed the amount embezzled as being a minor accounting annoyance. The defalcation had allegedly taken place during a six month period when Sanchez was traveling in Europe, exonerating him from involvement.<sup>140</sup>

As soon as the story broke, the company shut down the Mexico City office, transferring the headquarters of the Spanish-American department to Barcelona, and sending Sanchez with all the agency records – "between twenty and thirty cases of books, papers, and records" – on a slow boat to Spain.<sup>141</sup> Accompanying him was the son-in-law of President Beers, Leon Berthelot, whose position as "inspector" for the New York Life in South America was an openly mocked sinecure. All of this just further fueled speculation about the affair. Company vice presidents and trustees claimed that the losses were minimal, while simultaneously admitting that they were unable to examine any of the books (now in transit) to confirm the amount of the shortfall. Journalists also began questioning the timing of the

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<sup>139</sup> "La Equitativa," *Diario de la Marina*, February 24, 1905, p. 1.

<sup>140</sup> "A Trusted Agent's Theft," *New York Times*, June 12, 1891, p. 1.

<sup>141</sup> "It Grows Worse Daily," *New York Times*, June 14, 1891, p. 5.

embezzlement, given Merzbacher's very public reputation. He was "known to have bought and paid for the brownstone house adjoining the Plaza Hotel; his manner of living was most extravagant; ... he lived with a woman not his wife; he owned a team of fast horses; he consorted nightly with men to whom money is no object, and finally, upon his own statement to Sanchez, he lost very large sums in speculations in Wall Street". Several New York Life executives acknowledged that they were aware of Merzbacher's reputation as a gambler, speculator, and dandy, but few had raised any questions.<sup>142</sup> Equally curious was the decision not to arrest Merzbacher. He continued to be "seen nightly at his favorite haunts, the up-town barrooms," and even visited the Mexico City office on several occasions after his alleged retirement. After the scandal became public, the newspaper quoted Merzbacher as saying "If they want me they know where to find me. They are not anxious to have me arrested". The company claimed that it was Sanchez's responsibility, not theirs, to initiate an arrest.<sup>143</sup>

The executive most willing to talk with reporters was New York Life head cashier Theodore Banta, who went on the record saying that several company executives were fully aware of Merzbacher's behavior which was "current gossip".<sup>144</sup> He also criticized Vice President Welch's assessment that the amount stolen "was too small a sum to worry about," calling this "not true." Banta, in fact, was a longtime critic of his employer, and particularly President Beers. Three years earlier, he had approached the Trustees with evidence of "irregularities" in the books involving several hundreds of thousands of dollars. The trustees conducted an internal investigation, during which they exonerated all those Banta had accused, including Beers, and then suppressed the final report.<sup>145</sup> Banta never backed down from his accusations, nor did he leave the company, which opened up a whole new area of inquiry for the *Times*: "If the cashier of the company, acting in his official capacity, unwarrantedly attacked his superior officers in this way, the question has been asked, Why was he not removed when his charges were disposed of? Did the management [not]

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<sup>142</sup> "Not Far from a Million," *New York Times*, June 13, 1891, p. 1.

<sup>143</sup> "It Grows Worse Daily," *New York Times*, June 14, 1891, p. 5.

<sup>144</sup> "Not Far from a Million," *New York Times*, June 13, 1891, p. 1.

<sup>145</sup> "It Grows Worse Daily," *New York Times*, June 14, 1891, p. 5.

care or dare remove Mr. Banta?"<sup>146</sup> The company preferred to keep Banta on the payroll, presumably to keep him quiet about all he knew or suspected.

What had begun as an embezzlement scandal in the Spanish-American department now threatened to engulf the entire company as the management decisions of President Beers were placed under a microscope. Plum executive posts for his two unqualified sons-in-law, extravagant salaries for his favorite employees (Sanchez had just signed a new 10-year contract worth \$30,000 *per year* or approximately \$854,000 annually in 2018 dollars), aiding and abetting embezzlement, and speculative real estate ventures were all just the tip of the iceberg.<sup>147</sup> The *Times* soon uncovered a series of other embezzlements by New York Life agents in Latin America, all of which had been covered up by President Beers.<sup>148</sup> "It is now openly stated that something worse than incompetency is at the bottom of the trouble, and that nothing short of a complete overhauling of all the company's books and papers since President Beers took charge can possibly save the company from a serious blow."<sup>149</sup>

The relentless reporting of the *Times* ultimately forced the reluctant Insurance Commissioner of New York James F. Pierce to conduct a full investigation of the firm. The final report assured the public that the company remained solvent, yet its damning assessment found Beers guilty of all of Banta's accusations. As *The Chronicle* insurance journal reported, "There is little or nothing in the report...that is creditable to Mr. Beers."<sup>150</sup> The superintendent's report was the last straw. Although Beers was determined to maintain his position, the trustees forced his resignation in February 1892, replacing him with John A. McCall, the former superintendent of the New York insurance department, and the current comptroller for the Equitable.<sup>151</sup>

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<sup>146</sup> "That Insurance Scandal," *New York Times*, June 16, 1891, p. 5.

<sup>147</sup> "A Very Expensive Lot," *New York Times*, January 30, 1892, p. 8; Sanchez's salary was converted using the real wage calculator on MeasuringWorth.com.

<sup>148</sup> "It Grows Worse Daily," *New York Times*, June 14, 1891, p. 5; "That Insurance Scandal," *New York Times*, June 16, 1891, p. 5; "Beers is Still in London," *New York Times*, June 29, 1891, p. 8.

<sup>149</sup> "New-York Life Methods," *New York Times*, June 28, 1891, p. 3.

<sup>150</sup> "The Condemnation of Beers," *The Chronicle*, January 28, 1892, p. 38.

<sup>151</sup> "Mr. Beers' \$37,500 a Year," *The Chronicle*, June 9, 1892, p. 297.

While the details of Beers' resignation and McCall's subsequent reorganization of the New York Life are not relevant here, this scandal did coincide with the debates throughout Latin America over regulation of foreign insurance companies. *El Progreso*, another Spanish-language periodical, remarked that the scandal "confirms what this paper has been publishing for years regarding the New-York Life Insurance Company. Time and again, in letters and editorials, we have demonstrated the utter lack of honor in the management of that company."<sup>152</sup> The scandal reverberated throughout the world; even the New York Life's Asia representative Charles Seton Lindsay commented on it in his memoirs.<sup>153</sup> But nowhere did it receive more coverage than in Latin America:

*The intense feeling that has been aroused in Europe, Spanish and Portuguese America, and the West Indies with reference to the notorious mismanagement of the New-York Life Insurance Company under President William H. Beers has almost reached fever heat in Rio de Janeiro, Brazil. THE TIMES has received a number of the newspapers of that city, notably the Correio do Povo and the Jornal do Comercio, in which the exposures of Mr. Beers's corrupt management are printed in detail, with editorial comment that will go far toward increasing the anxiety and distrust of the policy holders... The policy holders of the New-York Life in Brazil appear to have been suspicious of the company for a long time.*

In particular, the paper cited "the unrestrained competition" between companies in South America as the root of all of this problematic behavior.<sup>154</sup> These ongoing scandals only further fueled support for greater regulatory oversight of insurers.

## **REGULATORY CHALLENGES**

Throughout the 1880s and 1890s, numerous countries around the world began passing strict laws regulating the foreign insurance companies in their midst. These laws were designed to protect smaller domestic insurers (where they existed), as

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<sup>152</sup> "A Protest Against Beers," *New York Times*, July 27, 1891, p. 5.

<sup>153</sup> Lindsay (no date), p. 301.

<sup>154</sup> "They All Know Mr. Beers," *New York Times*, September 30, 1891, p. 8.

well as to keep specie from leaving the country. Most of these regulations took the form of extra taxes, deposit and investment mandates, and agency fees.<sup>155</sup> The Equitable often met the requirements of investment laws by purchasing (or constructing) large buildings in the center of major cities. Like the monumental edifices insurance companies were constructing throughout the United States at this time, these buildings conveyed the idea of financial permanence and stability – essential concepts for the success of any insurance firm – while simultaneously fulfilling investment obligations.<sup>156</sup> The Equitable intended not only to house the local agency offices in these buildings, but also to rent out any excess space to generate additional income from the investments. By 1893, the Equitable had buildings for this purpose in Paris, Madrid, Vienna, Berlin, Santiago [Chile], Mexico City, Sydney, and Melbourne. That same year, the New York Life owned five buildings in Europe, but none in Asia or Latin America.<sup>157</sup> Although not directly in response to an investment law, in 1884 Julbe proposed a building for the company in Havana as “the best way... of assuring and monopolizing the sympathy [sic] of the people and consequently the better success of the company in the Island”; the company never acted on this suggestion.<sup>158</sup>

The major Latin American countries to pass restrictive legislation in this period were Argentina and Brazil, followed by less onerous laws in Mexico and Chile. Brazil struck first, passing a strict regulatory law “requiring a heavy deposit” by foreign insurance companies around 1886-87.<sup>159</sup> This was likely part of the Brazilian monarchy’s economic reforms in the late 1880s which sought to promote the development of domestic financial institutions.<sup>160</sup> Both the New York Life and the Equitable initially decided that it was “unprofitable and undesirable” to remain in the country and “withdrew simultaneously” from the market – a move which Vice President James W. Alexander later claimed was “at the suggestion of [President]

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<sup>155</sup> For example, see Pons (2008), pp. 93-96.

<sup>156</sup> Marchand (1998), pp. 36-41.

<sup>157</sup> *Annual Report of the Insurance Commissioner of Connecticut* (1893), part 2, pp. 113, 228; Keller (1963), p. 91; Buley (1959), pp. 79-80.

<sup>158</sup> Julbe to Hyde, January 17, 1884, ELAS 10.

<sup>159</sup> Scott to Hyde, December 14, 1888, ELAS 12.

<sup>160</sup> Topik (1991), p. 254.



Beers of the New-York Life." Yet the New York Life quickly reopened its agency and enjoyed a monopoly of this market for a period.<sup>161</sup>

The Equitable also began to reevaluate its decision, based both on the success of the New York Life and the rapidly growing Brazilian economy. By 1888, Brazil was entering the Encilhamento, an economic boom period based on coffee and rubber exports, coupled with the emancipation of its slaves and growing capital investment in industry.<sup>162</sup> In examining the Brazilian market, Tisdell of the Equitable wrote that "he hopes we will resume business there again as he feels sure that it is the great field for the future in South America."<sup>163</sup> By the end of the year, the Equitable was actively lobbying the Brazilian government, in concert with the New York Life, for a modification of the most draconian aspects of the law, and by the spring or summer of 1889, both companies "had obtained concessions from the monarchical Government empowering them to do business in Brazil, and both had established branch offices at Rio de Janeiro."<sup>164</sup>

Unfortunately for these firms, within a few months a military coup had overthrown the Brazilian monarchy and instituted a provisional republican government led by General Deodoro da Fonseca.<sup>165</sup> The new government informed foreign corporations that, in order to continue business in Brazil, they would need to reapply with the Department of Agriculture and Public Affairs for both their charters and these concessions. Each company submitted the necessary paperwork to Minister Demétrio Nunes Ribeiro; New York Life "obtained its concession without delay, and was doing business uninterruptedly" whereas the Equitable was "debarred from doing business in Brazil" while it waited to hear from Ribeiro's office. Tisdell repeatedly applied to Ribeiro for an explanation, while rumors began to spread that "the New-York Life was spending money to gain an advantage over its rival." Ribeiro defended his department, claiming that some of the necessary renewal documents had been stolen, but a Brazilian lawyer and "intimate friend of Minister

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<sup>161</sup> "Bribery Charged to Beers," *New York Times*, November 20, 1891, p. 2.

<sup>162</sup> Topik (1991), p. 248.

<sup>163</sup> To Hyde, April 20, 1888, ELAS 5.

<sup>164</sup> Scott to Hyde, December 14, 1888 and February 9, 1889, ELAS 12; "Bribery Charged to Beers," *New York Times*, November 20, 1891, p. 2.

<sup>165</sup> Donghi (1993), p. 202.

Ribeiro” offered to expedite the renewal for Tisdell upon the payment of \$10,000. Refusing to be blackmailed, Tisdell appealed to new President Fonseca, who “ordered that the renewal of the Equitable’s concession be granted without delay,” and by December 30, 1889, the Equitable had resumed its agency. Almost exactly one month later, Ribeiro resigned from the provisional cabinet “due to an attempt to blackmail a New-York life insurance company.” According to a *New York Times* report, President Fonseca’s ensuing investigation revealed that Julio Merzbacher had bribed Ribeiro to withhold the renewal of the Equitable, in exchange for at least \$25,000.<sup>166</sup> During this tumultuous period, the New York Life’s presence in South America strengthened from 31 per cent of its foreign business in 1889 to 36 per cent by 1893, while the Equitable’s presence weakened from 21 per cent of foreign life insurance in force to under 18 per cent in the same years (see figures 3.2 and 3.3).

In early 1891, just a year after the Ribeiro scandal in Brazil but before news of the Merzbacher embezzlement scandal in Mexico broke, Joaquin Sanchez solicited the Equitable to try and reach a “joint work” arrangement between the two companies in order to cut down on their intense competition in Brazil. Although the New York Life dominated the Brazilian market, it still trailed the Equitable in other parts of South America (particularly in Mexico), and Sanchez intended this deal as an opening for further “joint work” agreements in other countries. The Equitable’s head of foreign agencies, E. W. Scott, thought that “a mutually satisfactory arrangement” might be reached in Brazil but did “not think it would be advantageous to include any other countries in the arrangement under consideration.”<sup>167</sup> Discussions between the companies went nowhere, most certainly hampered by the questionable past practices of the New York Life’s Spanish-American directors, as well as the Merzbacher embezzlement scandal which would come to light that summer. But some kind of cooperation between the companies was necessary if they were to be successful in countering difficult regulatory regimes. President McCall of the New York Life and President Hyde of the Equitable chastised their respective agents – Sánchez and Thomas T. Watson – “to make up” so that

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<sup>166</sup> “Bribery Charged to Beers,” *New York Times*, November 20, 1891, p. 2. See also, “The Week,” *The Chronicle*, February 6, 1890, p. 1; Keller (1963), p. 104.

<sup>167</sup> Scott to Hyde, February 6, 1891, ELAS 12.

mutually beneficial progress could be made in Brazil and Argentina.<sup>168</sup> And in 1895, the two companies reached a loose agreement to limit the excessive competition of their agents and advertisements in South America, but much of the damage had already been done by this point.<sup>169</sup>

Beginning in 1891, Argentina also implemented a new law “in favor of national institutions” known as the Foreign Corporation Act. The law stipulated a seven per cent tax on premium income, minimum deposits in the state bank, and annual agency licensing fees. Domestic firms were exempt from the deposit requirements and faced significantly lower taxes and fees.<sup>170</sup> The Equitable initially determined that “compliance with the new laws simply meant ruin” and immediately suspended business.<sup>171</sup> But the company soon changed course. Upon closer examination, the wording of the law led them to believe that the firm “may be exempt from the greater obstacle in the way of continuing” if they could have themselves declared a “national” company which would make them “not liable to the excessive taxation under the new law.” They could do this by appointing a local board of directors and investing a certain amount of their capital domestically.<sup>172</sup> The company ultimately decided to purchase and renovate a building in the heart of Buenos Aires as an investment property.<sup>173</sup> This setup appears to have satisfied the provisions of the law, and the Equitable successfully operated as a national company until the spring of 1895.<sup>174</sup> In his 1893 assessment of the two South American offices, Watson was downright bullish about their prospects, gushing that “when the Argentine and Brazil Branches are both working at full speed, we may expect a total annual business equal to about \$9,000,000 or \$10,000,000, Gold.”<sup>175</sup> The New York Life, on the other hand, closed its agency in Buenos Aires, relocating its South American headquarters to Montevideo, Uruguay.<sup>176</sup>

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<sup>168</sup> Alexander to Hyde, April 6, 1893, ELAS 5.

<sup>169</sup> Keller (1963), p. 88.

<sup>170</sup> Blasco and Rabetino (2012), p. 623.

<sup>171</sup> Alexander to Hyde, June 4, 1891, ELAS 12.

<sup>172</sup> Scott to Hyde, February 6, 1891, ELAS 12; Alexander to Hyde, June 4, 1891, ELAS 12.

<sup>173</sup> Alexander to Hyde, June 4, 1891, ELAS 12.

<sup>174</sup> Wilson to Hyde, May 13, 1895, ELAS 12.

<sup>175</sup> J. Stahel to Hyde, April 26, 1893, ELAS 5.

<sup>176</sup> “Mr. Beers is Coming Home,” *New York Times*, June 20, 1891, p. 1.

In 1895, the New York Life – possibly at the instigation of Joaquin Sánchez – petitioned to reopen its Argentine agency as a national company on the same terms as the Equitable. In making their case with the government, they unleashed a full-scale re-evaluation of the law. Rather than allowing the New York Life to operate in a similar fashion as the Equitable, the government instead determined that the original interpretation of the law in 1891 had been “erroneous,” and the Equitable could no longer continue operations without paying the full seven per cent tax on all business conducted in the country and doubling its domestic deposits.<sup>177</sup> The Equitable decided to fight the decision, leading to a protracted, expensive lawsuit.<sup>178</sup> In the meantime, they also raised premiums on existing customers to offset the increased expenses, leading several policyholders to sue the company.<sup>179</sup> The Buenos Ayres agency was quickly becoming more of a liability than an asset, and by early 1898 they had completed shut down their offices in Argentina.<sup>180</sup>

The two US companies also faced an existential challenge in Brazil as the Congress in 1894 and 1895 debated a new foreign insurance law which would have forced both companies to exit the market. Decree 294 would require foreign life insurers to invest all of their reserves domestically, pay an initial charter fee of 200 *contos de réis* (about \$40,500), and be subjected to much tighter government oversight.<sup>181</sup> Working closely with the US Department of State, the companies unsuccessfully lobbied against the legislation.<sup>182</sup> Yet unbeknownst to the New York-based executives, New York Life’s Spanish-American director Joaquin Sanchez was working behind the scenes to ensure *passage* of the law. As acting US Secretary of State Alvey A. Adee informed the Equitable, the restrictive law “has been supported throughout by the local management of the New York Life Assurance Society.”<sup>183</sup> Sanchez had assured the Brazilian government “that the New York Life would continue business even if the law passed” and that the repeated statements by New York Life President McCall that they would exit were merely “rumors” and

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<sup>177</sup> Wilson to Hyde, May 13, 1895, ELAS 12.

<sup>178</sup> JCR to Hyde, September 23, 1897, ELAS 5.

<sup>179</sup> Alexander to Hyde, September 24, 1897, ELAS 5.

<sup>180</sup> Hyde to Alexander, January 26, 1898, ELAS 2A.

<sup>181</sup> Abreu and Fernandes (2012), p. 582.

<sup>182</sup> Alexander to Hyde, August 28, 1895, ELAS 12.

<sup>183</sup> Alvey A. Adee to Alexander, August 28, 1895, ELAS 12. See also, Keller (1963), p. 104.

“entirely false.” Executives of both firms suspected that Sanchez had effectively gone rogue, and “that he intends to organize a Company of his own in Brazil, in which case he would naturally make every effort to drive out the Equitable and the New York Life.”<sup>184</sup> With the passage of the law in 1895, both companies closed their Brazilian agencies, and Sanchez transferred his substantial knowledge of the life insurance industry to the Súl América Life Insurance Company, which was newly established in 1895. By 1900, Sanchez had become president of the latter firm.<sup>185</sup>

In 1898, three years after Sanchez’s Brazilian betrayal, New York Life Vice President George W. Perkins approached George T. Wilson of the Equitable to suggest that they “join with them, and share the expense, of an attempt to have the present law... rescinded” in Brazil. Commenting on this proposal to Equitable President Hyde, Wilson “remarked that it was somewhat amusing for him to ask us to join hands and share expense with them in *rescinding a law which they had put through to oust us*.” Watson, their South America general manager, also advised, “I do not think that it would suit your interests to join forces in any way with the New York Life to secure a modification of the law, as they are not in good repute in Brazil since their conduct in 1895. They are too ‘unclean’ there to touch or have any relations with them.” Regardless of any change to the law, the Equitable leadership no longer believed that Brazil was a desirable market. As Wilson concluded, “I did not suppose that even if the law was rescinded, we would be willing to resume business in Brazil.”<sup>186</sup> The statistics bear out this waning focus on South America. The region declined from 20 per cent of the Equitable’s foreign business in 1895 to under 14 per cent by the early twentieth century. But the fate of the New York Life in the region was even more dramatic, reflecting the impact of the recurrent scandals. South American insurance plummeted from a peak of 36 per cent of foreign business for the New York Life to only seven per cent during the same period (see figures 3.2 and 3.3).

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<sup>184</sup> To Hyde, July 3, 1895, ELAS 12.

<sup>185</sup> Peterson (1977), p. 223; *The Insurance Year Book 1900-1901*, pp. 150-151; Abreu and Fernandes (2012), p. 581.

<sup>186</sup> Wilson to Hyde, February 25, 1898, ELAS 10.

## ABANDONING THE MARKET

Both the Equitable and the New York Life enjoyed a substantial presence in Latin America during the 1880s and early 1890s. Although sales in the region were growing at a slightly slower rate than company sales overall, they remained robust through 1894-95. Yet as is apparent from figure 3.1, sales for both companies began a steep decline starting in 1895-96 and continuing into the twentieth century. In 1898, President Hyde provided the following assessment of the Equitable's Latin American business: "We are out of Brazil and suppose we are out of Buenos Ayres... We ought to be very particular about our doctors in Chili [sic] and they should be thoroughly overhauled... I believe we are out of Central America. I would advise doing business on a small scale in half a dozen of the chief cities in Mexico."<sup>187</sup>

Numerous factors contributed to this withdrawal. According to insurance historian Morton Keller, Hyde decided to withdraw the Equitable from "Latin America and Asia because of currency and exchange problems, difficulties with premium collection and risk selection, and high mortality rates."<sup>188</sup> Yet while a distrust of Latin American medical examiners was a recurring theme throughout the Equitable's correspondence, a 1903 analysis of mortality and expenses found few problems in Latin America that were not adequately addressed by routinely charging tropical and semitropical premium rates. Vice President Alexander viewed Buenos Ayres, for example, as "a sort of banner agency because the expenses are moderate as well as the mortality." He also complimented the agencies in Havana, Mexico, and Chile as being among "the best of our foreign agencies" in terms of their ratio of premiums to expenses.<sup>189</sup> Concerns over currency depreciation were also occasional complaints, yet the Equitable's "business in the West Indies and all South American countries, except Chili [sic] and Argentine Republic, has been nearly all done on the basis of American or Spanish Gold."<sup>190</sup> While these were problems with which the companies had to contend,

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<sup>187</sup> Hyde to Alexander, January 26, 1898, ELAS 2A.

<sup>188</sup> Keller (1963), p. 96.

<sup>189</sup> Alexander to Wilson, July 14, 1903, ELAS 12.

<sup>190</sup> J. E. Van Cise to Hyde, November 4, 1893, ELAS 12.

they were neither unique to Latin America nor especially crippling in that region. These factors were not the main ones driving US companies out of those countries.

Keller also misplaces the timing of the regulatory efforts in the region, stating “Latin American goodwill toward the US, never abundant, was especially sparse in the imperialistic aftermath of the Spanish-American War” in 1898.<sup>191</sup> Yet most of the major legislation occurred during the late 1880s and early 1890s, several years before the war. While these laws were certainly intended to provide opportunities for domestic competitors to flourish and to prevent large specie outflows, they also were not unique to Latin America. These regulations were similar to protective legislation passed in countries around the world during the second half of the nineteenth century, which also mirrored the numerous laws against out-of-state firms in the mid-nineteenth-century United States.

What was unique to this region was the intensity of the competition between the two largest United States insurers (with few other competitors to buffer these battles) combined with a series of scandals principally involving the New York Life. Rather than working together to mitigate the effects of oppressive legislation – as they successfully did in Brazil in 1889 as well as in Europe on several occasions – the agents of the two firms viewed each other suspiciously and more often attempted to undermine their competitors in any way possible.<sup>192</sup> Scandals relating to the New York Life’s Spanish-American department in 1891 and again in 1895 further eroded confidence in the behavior of foreign agents, galvanizing support for restrictive legislation and the development of domestic companies throughout Latin America.

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<sup>191</sup> Keller (1963), p. 97.

<sup>192</sup> Pons (2008), p. 98; Buley (1959), p. 95.

Figure 3.1. Foreign Insurance as a Percentage of Total Business, 1889-1906 (Equitable Life and New York Life)

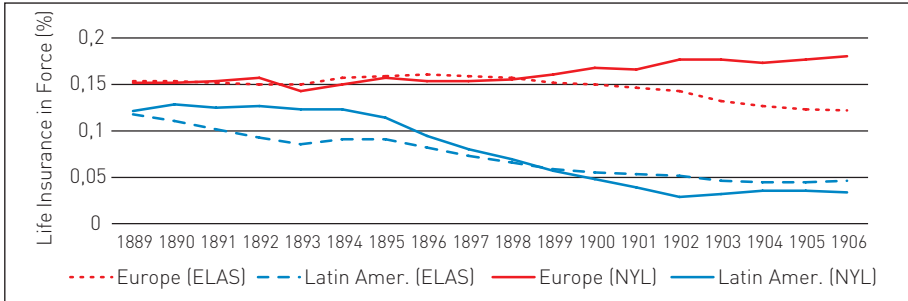


Figure 3.2. Latin American Sales as a Percentage of Equitable's Foreign Business, 1889-1906

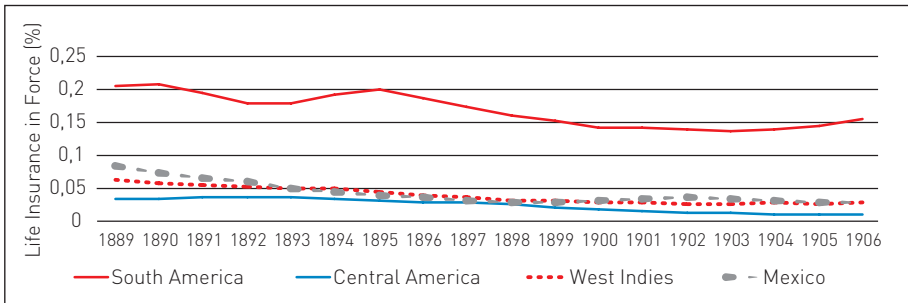
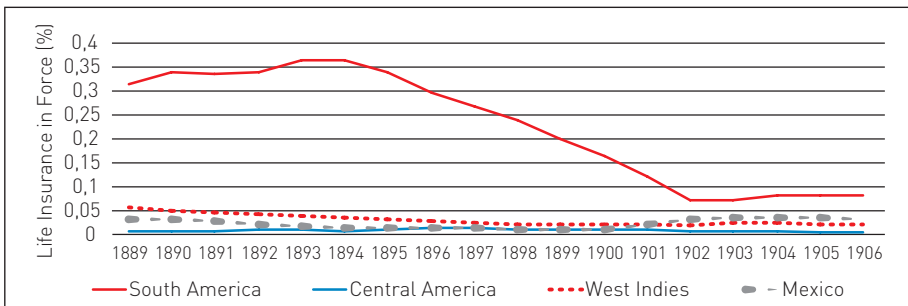


Figure 3.3. Latin American Sales as a Percentage of New York Life's Foreign Business, 1889-1906



Sources: The Connecticut Insurance Commissioners was unique in requiring companies to report annually on their foreign sales from 1890 through 1907. Unfortunately, this data was not required before or after these years, or by other state insurance commissions. Annual Report of the Insurance Commissioner of Connecticut, 1890-1907; Life Insurance History, 1843-1910: Yearly Business of All Active United States Life Insurance Companies from Organization. New York: The Spectator Company, 1911.



Figure 3.4. *La Equitativa de los Estados Unidos* (advertisement of 1888)

<b>LA EQUITATIVA DE LOS ESTADOS UNIDOS,</b> <b>SOCIEDAD DE SEGUROS SOBRE LA VIDA,</b> <b>BROADWAY 120, Nueva York.</b> (THE EQUITABLE LIFE ASSURANCE SOCIETY OF THE UNITED STATES.)		
<b>Balance vigésimo-octavo anual del año que terminó en 31 de Diciembre de 1887.</b>		
ACTIVO SEGUN EL LIBRO MAYOR EN 1º DE ENERO DE 1887..... \$70,106,860.30		
<i>Ingresos.</i>		
Premios pagados.....	\$19,116,776.47	
Intereses, alquileres, etc.....	4,125,073.29	\$23,242,849.29
		\$93,437,109.69
<i>Desembolsos.</i>		
Pagado por Sinistros y Dotes vencidas.....	\$6,748,845.60	
Dividendos, Pólizas compradas, Rentas vitalicias y Dotes descontadas...	4,313,064.21	
<b>Suma total pagado á tenedores de pólizas.....</b>	<b>\$10,062,509.81</b>	
Dividendo sobre el capital originario.....	\$7,000.00	
Franquos, Comisiones, Anuncios y Cambio.....	2,321,647.21	
Gastos generales, Contribuciones del Estado, del Condado y de la Ciudad....	1,747,997.11	14,139,151.13
<b>Saldo á cuenta nueva, Diciembre 31, 1887.....</b>	<b>\$79,297,055.40</b>	
<i>Activo.</i>		
Bonos á Hipotecas.....	\$23,542,376.43	
Propiedades valores, incluyendo los edificios de LA EQUITATIVA, y otras adjudicadas en remate judicial en virtud de hipotecas.....	14,335,771.67	
Acciones de los Ests. Unidos, del Estado y de la Ciudad y otras inversiones.....	26,516,182.34	
Préstamos con garantías de bonos y acciones (valor en la plaza \$227,362)....	507,000.00	
Propiedades raíces fuera del Estado de Nueva York, incluyendo adjudicaciones en remate judicial en virtud de hipotecas.....	6,399,151.74	
Efectivo en los Bancos y Compañías de Crédito, ganando interés; y en tránsito (recibido después de invertido).....	2,677,967.50	
Saldos que deben algunos agentes á cuenta de premios.....	122,565.49	\$79,297,055.40
Valor en la plaza de Acciones y Bonos sobre el valor inscrito en los libros.....		2,224,921.78
Intereses y alquileres tenidos y acumulados.....		812,361.61
Premios diferidos y en tránsito.....		1,562,664.00
<b>Suman los bienes en 31 de Diciembre de 1887.....</b>	<b>\$81,378,994.85</b>	
<b>Pasivo, incluyendo la Reserva legal para todas las Pólizas existentes (valuacion al 4 por 100).....</b>	<b>\$66,274,650.00</b>	
<b>Sobrante sobre la Reserva al 4 por 100, Diciembre 31, 1887.....</b>	<b>\$18,104,254.85</b>	
<b>Nuevos riesgos aceptados en 1887.....</b>	<b>\$138,023,105</b>	
<b>Total de riesgos vigentes.....</b>	<b>483,029,592</b>	
REPRESENTACION GENERAL EN MEXICO. M. DE OCA y CROCKER, ORRENTES, Esquina de Vergara y Cinco de Mayo, Méjico. JOAQUIN PALOMO RINCON, CAJERO. JUNTA LOCAL CONSULTIVA. General PORFIRIO DIAZ, Presidente. Sr. D. M. G. DE LIZARDI. Vice-Presidentes. Sr. D. FRANCISCO M. DE PRIDA.		
EN CUBA, SANTO DOMINGO Y HAYTI. V. M. JULBE, REPRESENTANTE, O'Reilly, 38, HABANA. AGENTES.		
Federico G. Mora, } Juan B. Oliver, } Habana. Emilio Romay, } A. B. Zanetti & Co., Matanzas. Federico Hünick, Cifuentes.	Indalecio Ramos, Sagua la Grande. Antonio Salorio, Caba. Gabriel B. Molina, Santiago de Cuba. Sebastian Conas, Manzanillo. Luis A. Columbré, Baracoa. Rojas, Larrieu & Co., Cárdenas.	Pedro Rojas Orca, Remedios. Vecino, Rodriguez y C <sup>a</sup> , Gibara. Ginestra Hernandez, Puerto Plata. Miguel Pou, Santo Domingo. D'Aubigny & Co. Port-au-Prince
JUNTA LOCAL CONSULTIVA Y DE REFERENCIAS EN LA HABANA PRESIDENTE: J. M. BORJES, Banquero. VICEPRESIDENTE: Señor Don FRANCISCO GONZALEZ OSMÁ, Propietario. VOCALIOS.		
Excmo. Sr. D. Antonio Telleria, Diputado provincial y propietario.   Sr. D. Sebastian Fernández de Velazco, Jurisconsulto y Propietario.		

Figure 3.4. *La Equitativa de los Estados Unidos* (advertisement of 1888) (cont.)

Excmo. Sr. D. Juan Pedro y Roig, Hacendado y Propietario.	" " " " J. F. Hernández, Comerciante.
Excmo. Sr. D. Raimon Herrera, Comerciante y Propietario.	" " " " Enrique Morik, "
Excmo. Sr. D. Mamerto Polido, Hacendado y Propietario.	" " " " Antonio Estanillo, Comerciante y Propietario.
" " " " Leopoldo Carrvajal, Comerciante y Propietario.	" " " " Miguel Nuño, Notario Público y Propietario.
Sr. D. Fermín Calbetón, Diputado á Cortes y Abogado.	" " " " Francisco Altrarez y Muro, Comerciante y Propietario.
" " " " Manuel de J. Ponce, Jurisconsulto y Propietario.	" " " " Alberto Jurrin y Moliner, Hacendado.
	" " " " Francisco Rosell, Hacendado y Propietario.
	" " " " Narciso Gelada, Banquero.
	" " " " Miguel Genet, Abogado.
	" " " " Francisco González Altrarez, Comerciante y Propietario.

**SEÑS. FACULTATIVOS RECONOCEDORES.**

Dr. Don J. B. Landeta.      Dr. Don Raimundo de Castro,      Dr. Don Serapio Asteaga.

**Los señores arriba nombrados están asegurados en La Equitativa por más de seiscientos mil pesos.**

**BANQUEROS DE LA SOCIEDAD: J. M. BORJES Y COMPAÑIA.**

**EN PUERTO RICO.**

SEMY BAIZ, *Agente General, D. cañon, Arroyo, P. R.*  
 A. J. Alcáide, *Arroyo,*      AGENTES      F. Weston, *Ponce.*  
 S. Melon & Co., *San Juan.*      J. M. Montano, *Mayagües.*  
 Jaime Carreras, *Humacao.*

**EN LA AMERICA CENTRAL.**

JAMES THOMAS, *Agente General para la América Central.*  
 ADOLFO WILKOMM, *Agente Viajero.*

Cecil Sharpe, *Agente; San José, Costa Rica.*      Martín F. Sosa, *Agente, Sonsonate, Salvador.*  
 Miquel Yudica, *Agente, San Salvador.*      Teodoro A. Whitney, *Agente, Guatemala.*  
 Nicolás Urbagué, *Agente, Granada, Nicaragua.*      Agurcia & S. o T *Yaguajay, Honduras.*

**EN COLOMBIA.**

J. FERRO, *Agente general.*

**EN ECUADOR.**

M. J. KELLY, AGENTE, GUAYAQUIL.

**EN VENEZUELA.**

ROBERTO CONN, JR., *Agente General é Inspector, Esquina de la Pedrera núm. 45, Caracas.*  
 H. L. BOULTON y Ca., CARACAS.

**EN PERÚ.**

ABRAHAMSON Y CIA., *Agentes, Lima.*

**EN CHILE.**

FERNANDO MAYER, *Agente General, Santiago de Chile.*  
 JUNTA DE VIGILANCIA EN CHILE.  
 Señor D. Adolfo Ibañez,      Señor D. Aniceto Vergara Ibañez.      Señor D. Ricardo Trumbull.

**EN ARGENTINA.**

ISMAEL MORALES, *Agente General, calle de Fiedad 116, Buenos Aires.*  
 JUNTA DE REFERENCIAS EN BUENOS AIRES.  
 Presidente: FRANCISCO URIBURU,      Secretario: EDUARDO CASEY.

**DIRECCION GENERAL PARA ESPAÑA Y PORTUGAL.**

Presidente, Antonio Angel Moreno, (Viuda é hijos de A. G. Moreno.)      Médico-Director, Esteban Sanchez de Ozaña, Catedrático, Decano de la Facultad de la Real Cámara.  
 Vice-Presidente, Enrique García Calamarie, (García)      Médico-Vice-Director, Rafael Ulecia Cardona, Direc.

Source: *Las Novedades*, May 10, 1888:20.

Figure 3.5. *La New York* (advertisement of 1891)

2056 EL PERU ILUSTRADO

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**"LA NEW YORK"**  
(*La New York Life Insurance Company.*)

**COMPANIA PURAMENTE MUTUA DE SEGUROS SOBRE LA VIDA**  
**ESTABLECIDA EN EL AÑO DE 1845—346 & 349 BROADWAY, NEW YORK.**

**ACTIVO EFECTIVO.... \$ 105.053,600**

**La New York** cuenta con 45 años de no interrumpida prosperidad y tanto por su antigüedad y su **GRAN ACTIVO EFECTIVO**, como por su sólido y poderoso estado financiero, resultado de su prudente y sabia administración goza de universal crédito y popularidad, como lo prueban los inmensos negocios de Seguros escrupulosamente escogidos que efectúa en todas las Naciones del mundo, incluidas las Repúblicas del Pacífico, así como los muchos millones que anualmente recibe por premios.

**La New York** ha estado establecida en esta República durante los últimos 8 años y ha pasado en ella inmediatamente 12 pólizas por valor de más de \$ 60,000 oro americano.

Se libera libremente y que se compone de los hombres más eminentes del Comercio y la Banca de los Estados Unidos. Conforme a la Ley del Estado de Nueva York, el «Departamento Oficial de Seguros» vigila é inspecciona todas las transacciones y publica anualmente el informe respectivo.

La administración de **La New York** está, como se ha dicho, puesta por los mismos asegurados, para pagar religiosamente, sus pólizas, de donde se sigue que ningún interés tiene aquella en demorar los pagos y que las pólizas de esta Compañía revisten todo el carácter de **INDISPUTABLE**, siendo por consiguiente verdaderas promesas de pago á la vista de un importante valor, inmaculado.

**La New York** emite todas las formas de pólizas más acreditadas del mundo. Su redacción es clara y precisa. Esas pólizas sobren á las familias de los asegurados aún en los casos más desgraciados.


Igualmente dan las facilidades más amplias para viajes y residencia del asegurado.

En **La New York** las pólizas no caducan después del pago del tercer premio anual, y pueden ser cedidas por un valor salido ó por dinero efectivo.

En corroboración de lo que se ha dicho con respecto á la alta posición financiera de **La New York**, esta Gerencia pone á disposición de las personas que desean consultarlo, el 31.º informe anual del Estado de New York, que demuestra la verdad de dicha posición.—El Banquero de **La New York** es el Banco del Callao.

Los doctores don Manuel T. Espinosa y don Manuel C. Barrios, forman el Cuerpo Médico de esta Compañía.

Se admiten riesgos en soles de plata del Perú, pesos oro americano, Libras Esterlinas ó Francos.



De los Balances de **La New York** ajustados á las más severas prácticas y veracidad mercantiles, se desprende entre otros brillantes datos el de que solo la Renta Anual que deriva por **INTERESES** sobre su **ACTIVO EFECTIVO**, le basta para cubrir más del 89 %, del importe total de siniestros por muerte.

**La New York** es una Compañía absolutamente mutua en la cual todos los asegurados son los socios con voz y voto en las Juntas Generales de la Compañía. Los asegurados, pues, se reparten entre ellos las utilidades y son los jueces y árbitros de todo el **ACTIVO EFECTIVO**. Ellos conducen sus negocios por medio de un Consejo de Administradores fiducicomisarios, que eligen

**A. B. Leguía,**  
Sub-Gerente

**J. A. Fesser,**  
Gerente en el Perú, Ecuador y Bolivia

Oficina en Lima.—Calde la Coca No. 70.—Casilla del Correo N. 125.—Teléfono N. 137

Source: *El Perú Ilustrado*, May 9, 1891: 2056.



## **2. FIRE AND CASUALTY RISK AND THE NINETEENTH-CENTURY STATE**



## CHAPTER 4. RISK IN FIRE INSURANCE LAW AS AN EMPOWERMENT TOOL FOR THE STATE DURING THE CONSTRUCTION OF COLONIAL CANADA

David Gilles and Sébastien Lanctôt

Historically, individual savings can be viewed as a mode of risk transfer based on the fact that consumption needs can be pooled over time. In essence, it is a primitive form of self-insurance. The fundamental principle of insurance is a pooling of risks. While types of insurance vary widely, their primary goal is to allocate the risks of a loss from the individual to a great number of people. Each individual pays a “premium” into a pool, from which losses are paid out. Regardless of whether the particular individual suffers the loss or not, the premium is not returnable. Insurance companies are the safe keepers of the premiums. Because of its importance in maintaining economic stability, the government and the courts are very strict in ensuring these companies are regulated and fair to the consumer. At the beginning of North American insurance, in the early eighteenth century, all contracts were issued in England. Fire was the primary risk in the 1800s and early 1900s. As new risks were added and interest in protecting against these risks increased, new policies were proposed. In 1872 Chief Justice Wilson of the Supreme Court of Ontario asked for a state and provincial legal intervention to lead the development of the fire insurance companies:

*The conduct of companies, when enforcing rigidly such, conditions, has often been complained of by the courts by reason of the number and nature and difficulty of the conditions they introduce into their policies; and the time perhaps has come when the legislature should interfere, to stand between them and those they insure or pretend to insure, or, in other words, the public, by limiting them to such conditions which the courts shall determine to be reasonable.<sup>193</sup>*

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<sup>193</sup> *Smith v. Commercial Union Insurance Company* (1872), 33 U.C.Q.B. 69, p. 89.

As new risks were added and interest in protecting against these risks increased, new policies were proposed. Nineteenth-century urbanization and industrialization created new sources of fire hazards, greatly augmented the concentration of urban property at risk, and perpetuated or even exacerbated settings in which minor blazes could develop into major conflagrations.<sup>194</sup> These problems were particularly acute in North America, where new, hasty and imperfect modes of urban life outpaced rudimentary means of fire prevention and control.<sup>195</sup> Canadians, who were not only predominantly living and working in wood structures but, to a large degree, sustained by the milling, fabrication and the export of wood products, were especially susceptible to fire risk. In 1891, 81.5 per cent of Canada's houses were built of wood.<sup>196</sup> Although blazes were hardly confined to Canada's large cities, the impact of less spectacular fires in smaller urban places has commanded little scholarly interest. As Darrell A. Norris wrote, "nonetheless, modern and historical evidence both indicate that city size differentials of fire risk, fire protection, and fire insurance rates, were all to the detriment of small urban centres".<sup>197</sup> Although a conflagration was a constant *threat* in major cities, because of their limited ability to contain an outbreak it remained a relatively commonplace *event* in smaller communities.

The insurers that began to operate in Canada at the beginning of the nineteenth century were mostly English, although others were American and pre-Canadians and Canadians. The development of damage and personal insurance contracts should be seen in the context of the general development of other forms of commercial enterprises that took place during the early nineteenth century.

The success of the English ventures and the legal weakness of their monopoly encouraged other companies from America to enter the same market. The fire risk follows the development of the Canadian State. Some of these insurance

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<sup>194</sup> Weaver and De Lottinville (1978).

<sup>195</sup> Norris (1987), p. 62.

<sup>196</sup> *Census of Canada, 1890-91*, t. 8, table 1.

<sup>197</sup> Norris (1987), p. 63.



companies collapsed because they failed to evaluate the risk of fire properly. While the State intervened minimally during the first half of the nineteenth century, Provinces and the Federal State adopted legal structures to promote Canadian insurance companies, and mitigated fire risk during the second half of the century. During the same period, and because of the lack of regulation by provincial governments between 1800 and 1867, insurers themselves had to find forms of self-control to ensure a degree of stability in their operations. As a transnational perspective, various fire insurance boards were set up under the Dominion Board of Fire Underwriters, which later became the Insurers' Technical Group. The objective was to compile the technical results, establish rules for prevention and determine the tariffs. In 1857, a similar organization was set up in Halifax by the Island's insurers, followed by the Nova Scotia Board of Fire Underwriters, established in 1864, the first provincial body in Canada for control and pricing. All provinces later followed, grouped under the famous Canadian Underwriters Association. The Federal State and the provinces had to insert this private legal system in the general common law system through a number of laws. In 1910, the first major regulation of the insurance sector took place with the enactment of the *Insurance Act*. It had its origin in legislation of Old Canada existent at the time of the Confederation.<sup>198</sup> The object of the Act was to require companies and persons engaged in carrying on the business of insurance to provide security for the performance of their obligations. This Act, in its section 4, prohibited an insurance company incorporated by a foreign state from carrying on its business within Canada if it did not hold a license from the Minister under the said Act and if such carrying on of the business was confined to a single province.<sup>199</sup> But for the Supreme Court of Canada's Justices in a 1913 decision, section 4 of the *Insurance Act* was "*ultra vires*" and section 70, which imposed a penalty on those that would carry on the business of insurance without taking out that license was also illegal".<sup>200</sup> This decision emphasized the boundaries of the governments' intervention spectrum. We will explore first the development of the fire risk prevention under the influence of American and English insurance private companies, and then, the regulation

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<sup>198</sup> See Acts of the Parliament of the United Kingdom, registered by the Parliament of the United Canada, 23 Vict. (1859) c. 33, and 26 Vict. (1862) c. 43.

<sup>199</sup> *Ibid.*, sec. 4.

<sup>200</sup> *In Re Insurance Act*, 1910, [1913] 48 S.C.R. 260.

movement of the State, first from the Lower Canada (1866), by the codification, and second from the Canadian Confederation, by the *Insurance Act* (1910).

## **DEVELOPMENT OF THE FIRE RISK PREVENTION UNDER INFLUENCE? AMERICAN AND ENGLISH COMPANIES AT THE CONQUEST OF CANADA**

Under the French regime, the sources of French law applied in the colony, essentially the custom of Paris, royal ordinances, Roman law in the matter of obligation. There were few standards for insurance tools. However, under the Ancien Régime, various types of fire protection agencies – fixed premium insurance companies, embryos of mutualist institutions, diocesan funds – were slowly developing. In the eighteenth century, insurance against fire is embodied in French law in the context of charitable actions or public beneficence, then in full development under the effect of secularization of the Enlightenment. As early as 1717, Paris set up a fire department. Several bishoprics created Emergency Caisses. Thus, within the diocese of Toul, but also of the diocese of Nancy, it is decided not to allow the fires to make special quests in the parishes, but it creates a “special charity office in their favor”.<sup>201</sup>

In France, as in Quebec, it was necessary to wait for the proliferation of mutuals against the fire around the years 1820 and 1830, coinciding with an industrial development. It was essentially an evolution, a catch-up vis-à-vis a reaction to the risk. Fire in North America is the major risk. It is rife at all times and in all places.<sup>202</sup> It ruins individuals, families, businesses, breaks economic growth, and destroys the accumulation of capital. Naturally, the efforts of mutualists were in terms of compensation but also in terms of prevention and firefighting. Many of the first mutual companies against fire decided that the contributions would not be established according to the intensity of the risk but related to the financial capacity of each member. The most sought-after company, since it had already been doing business overseas for twenty years, was undoubtedly the Phoenix Company of London, directed by Alexander Auldjo esq., agent of the company for the

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<sup>201</sup> Guillaume (1867), p. 67.

<sup>202</sup> For a comparison with France, see Lion (2008), p. 28.

provinces of the High and Lower Canada. In 1804 this became the first company to offer insurance in Canada.<sup>203</sup> Auldjo opened an office in Montreal. The first insurance company, however, was the Benevolent and Friendly Society of Quebec, created in 1789 with the aim of establishing a fund for “mutual support in sickness, old age and infirmity”. Quebec Provident, Benevolent and Friendly Society and the Quebec Mechanic, Benevolent and Friendly Society, both founded in 1810, followed soon after.

### **A. Fire Risk in North America**

At that time, it was necessary to buy separate policies for each risk: fire, lightning, earthquake, theft, etc. The definition of risk in this context was intimately linked with English practice and international relations between Upper Canada, Lower Canada, the United States and Nova Scotia. One of the first fire insurance contracts in Canada, used by people from all over America, on the whole, without any border distinction: New Brunswick, then an isolated colony, Upper and Lower Canada, and finally the United States, was focused on risk. It was divided into three parts: the risk classes, called First Class, Second Class and Third Class, the rates (Table of Rates); and finally, Conditions of Insurance. The conditions of insurance are particularly interesting. The insurance came into effect with the payment of the premium. The fire contract had some exclusions: earthquakes,<sup>204</sup> hurricanes, military invasions and war, cash and bills of exchange. In the event of a claim, a statement of damage under oath certified by a notary or a magistrate was to be drawn up and presented to the insurer’s office in London.<sup>205</sup> In 1809, five years after the opening of the Phoenix agency, a group of Nova Scotians founded the first all-Canadian property and casualty insurance company, called the Halifax Fire Insurance Association, renamed in 1819 the Halifax Fire Insurance Company. The insurers that began to operate in Canada at the beginning of the nineteenth century were mostly English, although others were American and pre-Canadians. The development of damage and personal insurance should be seen in the context of the general development of other forms of commercial enterprise and insurance

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<sup>203</sup> Moreau (2009), p. 157.

<sup>204</sup> See Parizeau (1989), p. 42.

<sup>205</sup> Moreau (2009), p. 157.

contracts that took place during the early nineteenth century. The success of the English ventures and the legal weakness of their monopoly encouraged other companies from America to enter the same market. Many multinational companies chose the 1820s to enter the Canadian insurance market.

J. Grove Smith described 59 conflagrations in Canada between 1750 and 1917. Ideal circumstances existed in Canadian villages, towns, and cities, for the outbreak and spread of fire. Break out and spread it did, destroying large areas of Quebec City (1845 and 1866), Toronto (1849),<sup>206</sup> Montreal (1852), Halifax (1859), and Saint John (1877),<sup>207</sup> and earlier in the 1900s, Ottawa-Hull (1900),<sup>208</sup> and Toronto (1904).<sup>209</sup> Henry Morgan, Chief Clerk of the Department of State, published an annual miscellany entitled the *Dominion Annual Register and Review*,<sup>210</sup> and assembled a remarkable record of 494 such fires between 1882 and 1886, systematically recording their location, type, the number and ownership of premises destroyed, the damage inflicted in dollar terms, and its insurance coverage, if any. Even if Morgan omitted one-third of the fires causing at least \$20 damage,<sup>211</sup> Morgan's record was scanty for all but the major centers, notably Montreal, Winnipeg and Quebec City.<sup>212</sup> The fire risk followed the development of Canada. Some of these insurance companies collapsed because they fail to evaluate properly the risk of fire. For example, in Quebec, the Montreal Insurance Company, the second company founded in this city, disappeared after a few years due to the unheard-of fires that ravaged the country's first city for the entire nineteenth century. If it was fire that favored the development of the Canadian property and casualty insurance industry, few insurers managed to survive.<sup>213</sup> Fire protection was non-existent at first, and progress remained limited in Canada until the end of the nineteenth

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<sup>206</sup> See Armstrong (1961); Armstrong (1978).

<sup>207</sup> Norris (1987), pp. 61-68.

<sup>208</sup> Taylor (1979), 7-3.

<sup>209</sup> Smith (1918), pp. 277-289.

<sup>210</sup> Morgan (1879).

<sup>211</sup> As estimated by Norris (1987), p. 65.

<sup>212</sup> 'Only 2 of the 64 reported major fires in Ontario's four largest cities (Toronto, Hamilton, Ottawa, London) involved extensive spread', *Ibid.*, p. 66.

<sup>213</sup> The City of St. John, Newfoundland, was almost destroyed in 1816. The City of Quebec underwent severe disasters and recoveries, first in 1845, and again in 1866, shaved by fire. Montreal suffered the same fate in 1852: 18,000 people lost their homes or died as a result of a

century. If volunteer firefighters were trained, as well as fire companies, both in Quebec and Montreal, their mission was to combat fire more methodically. But the two major organizational weaknesses were rudimentary equipment and lack of water. From 1804 to 1867, the year of the Confederation, only wells could be relied on to extinguish fires.<sup>214</sup>

In the United States before 1752 all fire insurance contracts were with British companies. In 1752, Benjamin Franklin, the famous American politician and physicist founded the first fire insurance company, a kind of mutual insurance, in Philadelphia, which was owned by the owners of the policies. He also wanted to identify the risks. He undertook in Philadelphia a campaign to clean houses, banned wood fireplaces, formed the first fire brigade, and invented a furnace (the main cause of fire) that enclosed both flames and embers (the famous Franklin stove). This prevented embers from escaping the stove and falling to the ground. Finally, the inventor of the lightning conductor and insurer refused to insure houses if the trees, which attracted lightning, were too close to them.<sup>215</sup>

By 1760, Lloyd's had expanded its activities to cover American marine insurance business at the "Café of London" in Philadelphia. In 1768 and in 1784 two other American companies appeared: The Philadelphia Contributionship for the Insurance of Houses of Losses by Fire and the Mutual Assurance Company. From 1782 a London insurer, the Phoenix, ventured into insurance abroad. At the beginning of the nineteenth century American companies began to proliferate across the country. In spite of everything, the development of American insurance was rather slow (possibly due to a lack of fire prevention facilities and insufficient state control). In 1835, a black year, a fire caused New York a total fire damage of \$15 million and led to the bankruptcy of 23 of the 26 insurance companies operating in the state. For various reasons, "mutuelles", favored by the population, gained the upper hand. There were 62 in New York State in 1853. Canadian companies are reported to have been heavily influenced by American methods and ways of doing things.

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spectacular conflagration. Saint John, New Brunswick was also in flames during the "Great Fire" of 1877: Moreau (2009), p. 163.

<sup>214</sup> *Ibid.*, p. 163.

<sup>215</sup> *Ibid.*, p. 169.

## **B. Globalization from America to Canada**

In 1821, an American company settled in Montreal, the Aetna Insurance Company, which had its headquarters in Hartford, one of the main centers of American insurance at the beginning of the nineteenth century after Philadelphia. Then, in 1833, at Toronto, a minor city in this period, the British American Assurance Company was founded, which developed rapidly. The Gore Mutual Insurance Company, the oldest mutual fire insurance company in England, was formed in 1836 under the *Mutual Fire Insurance Act*, to practice insurance in Canada on a regular basis. The cooperative, simple, direct, mutually supportive and mutually beneficial form was particularly well suited to Canadian pioneers.<sup>216</sup> Mutual benefit insurance societies were based on the desire to integrate economic insurance activities into a fraternal support culture. One of the most dynamic Canadian companies was the Western Assurance Company, founded in Toronto in 1851, which enter the American market after a few years. After the 1830s, there was a proliferation of mutual societies, formed according to the laws regulating the mutuality adopted by Upper and Lower Canada.<sup>217</sup> These companies specialized above all in fire insurance but would quickly extend their business into the life and accident insurance markets. The Canadian insurance market was thus dominated by these multinationals through to the early twentieth century thanks mainly to the absence of any market regulation, but also were in concurrence with the domestic initiative. By the end of the nineteenth century foreign companies found a market characterised by hard competition.

### **THE NEED FOR REGULATION: THE STATE AS DEUS EX MACHINA**

Apart from fire insurance, the other main insurance branch in the nineteenth century was marine insurance, since trade was mainly maritime. Terrestrial insurance was then only governed by custom and general common law. Land insurance laws, both in terms of property and liabilities, were evolving with the Industrial Revolution and the arrival of big industry. It should be remembered that marine

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<sup>216</sup> *Ibid.*, p. 163.

<sup>217</sup> *Ibid.*, p. 161.

insurance was by far the most important form of insurance both in practice and in litigation in Canada. In several cases the more developed rules of contracts of marine insurance were applied to the fire insurance contracts, but the development of insurance was linked in Canadian context to the notion of risk. Despite the growth of the fire insurance industry, Canadians were notably underinsured by modern standards during the nineteenth century. "In constant dollar terms, Canada achieved a twenty-fold growth in per capita fire insurance between 1870 and the mid-1950s."<sup>218</sup> Much of this growth, however, reflected the accumulation of real property per capita rather than the diffusion of the fire insurance habit. Inequities of insurance coverage were even more marked in late nineteenth century Canada and served to exacerbate the differential impact of fire damage in various geographical settings. Under-insurance of the damage inflicted by uncontrolled fire spread was a national Canadian problem. "Two thirds of the 104 fires of this type reported by Morgan were less than fifty per cent covered by insurance."<sup>219</sup> Half of the fires reported were confined to industrial establishments. A noteworthy feature of these fires is that reasonably adequate insurance coverage was most characteristic of the biggest industrial fires. The latter typically consumed small-scale mills manufacturing wood or grain products. "More than half the industrial fires causing at least \$10 thousand damage were at least fifty per cent covered by insurance, whereas only 19 per cent of smaller industrial fires were that well insured."<sup>220</sup> In the nineteenth century Canada and America developed wide-ranging trading relations. There was a development and modernization of insurance companies during the century. The process gradually eliminated the need for intermediaries acting between the insurer and the insured, thereby facilitating an increase in insured values. At the same time the insurance business became markedly more professional. The companies initially had unlimited liability and were managed by two main agents: the owner and the treasurer. Later, they were transformed into stock companies and progressively limited the liability of their stockholders. Most of these were very local in their operation and they were characterized by low levels of invested capital. As a result, many of them failed to survive more than a few years. In these companies, initial capital funds were

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<sup>218</sup> Norris (1987), p. 65.

<sup>219</sup> *Ibid.*, p. 66.

<sup>220</sup> *Ibid.*, p. 66.

unduly dedicated to speculative investments or dividend distributions, unlike the situation in other companies where all the capital was fully retained, and a much more restrictive dividend strategy was operated.

### **A. Transnational Law and Reality Fire Risk Regulation**

Foremost among the adaptations of the Canadian urban society to fire hazard was the growth of the fire insurance industry. These developments were linked with the growth of law structure, and the construction of the Canadian State. The federally regulated companies were few in number, large in scale, and equipped to spread their insured risks over a wide geographic area. Fire insurance companies operating under provincial government regulation were numerous and generally small. Because the lack of regulation by provincial governments of the 1800-1867, insurers themselves had to find forms of self-control to ensure a degree of stability in their operations. Various fire insurance boards were set up under the Dominion Board of Fire Underwriters, which later became the Insurers' Technical Group. The objective was to compile the technical results, establish rules for prevention and determine the tariffs. In 1857 a similar organization was set up in Halifax by Nova Scotian insurers, followed by the Nova Scotia Board of Fire Underwriters, established in 1864, the first provincial body in Canada for control and pricing. All other provinces followed later, grouped under the famous Canadian Underwriters Association.<sup>221</sup>

Numerous provincial laws were passed to promote the establishment of mutual fire societies or predisposing and assisting societies in the event of fire incidents at the time, particularly in the Toronto and Halifax areas. In 1836, a law was introduced in Upper Canada, which allowed for the creation of mutual agricultural insurance companies in about twenty districts. These companies had underwriting power only in their own district.<sup>222</sup> This law was amended in 1850 allowing the creation of more agricultural mutual companies with greater powers. Of the 57 companies then established, 52 companies are still operating in Ontario.<sup>223</sup> In this

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<sup>221</sup> Moreau (2009), p. 164.

<sup>222</sup> *Ibid.*, p. 165.

<sup>223</sup> *Ibid.*, p. 166.



province, for example, most of the provincially controlled companies were small mutual concerns serving limited geographical areas, often no more than the farmers in a single township. This was an American practice model, a legacy of the New England factory mutual system of the early nineteenth century.<sup>224</sup> A total of 49 Ontario local fire insurance companies accounted together for \$77 million in insured risk in 1878, the first year in which Ontario figures were published.<sup>225</sup> The mutual companies were generally confined to insuring small-scale, isolated, non-hazardous risks, their limited assets and cash reserves could not survive an urban conflagration. It explains the company failure risk when a fire like the Saint John conflagration happened. As in the case of uncontrolled spread, small places were prone to industrial fire hazard, yet apparently ill-equipped to survive its effects. Underinsured small industrialists would have been hard put to rebuild and resume production in the wake of a major fire.<sup>226</sup>

Under the Union of Upper and Lower Canada the matter was considered so much a question of local interest that those two provinces had each their own mutual insurance law.<sup>227</sup> From 1840 (Union of Upper and Lower Canada), we observe a spirit of reform. At the end of the seigniorial regime, in 1854, municipal governments and school boards were established. It was in this socio-economic context that the first fire mutuals in Quebec were established. Chapter 68 of the Lower Canada Statutes was titled "Joint Stock Companies", and the Upper Canadian legislation was titled "Municipal Institutions". During this union period there were two major laws adopted, the *Act to authorize the Establishment of Mutual Insurance Companies against Fire* (1835) and the *Act respecting the Business of Fire Insurance Companies not Incorporated within the Limits of the Province of Canada* (1860). The growth of the fire insurance industry was paralleled by a reduction in the cost of insurance. In the early 1870s, twelve cents per annum for each hundred dollars of coverage was typical, whereas an eight-cent charge characterized the late 1880s and was still the norm in early twentieth century Canada.<sup>228</sup> The evolution of the

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<sup>224</sup> See Bainbridge (1952).

<sup>225</sup> *Ontario, Sessional Papers* (henceforth *O.S.P.*), 12 (1880), p. 2.

<sup>226</sup> Norris (1987), p. 67.

<sup>227</sup> *Consolidated Statutes of Lower Canada*, 1860, c. 68 and *Consolidated Statutes of Upper Canada*, 1859, c. 52.

<sup>228</sup> Norris (1987), p. 64.

cost of the risk was influenced by the outbreaks of fire in North America: the inflated rates of the 1870s reflected the caution spawned by Chicago's fire experience in 1871 and that of Boston in 1872. After the conflagration in Saint John in 1877, Canada's record of major urban fires abated. Toronto and Montreal were at least fifty per cent covered by insurance, whereas less than half the reported fires in Ontario and Quebec were that well covered.<sup>229</sup> The cost of premiums in hazardous environments was significant, and companies were probably reluctant to accept policyholders in high-risk situations.

The fire insurance problem was even more serious on the eastern and western margins of Canada, for only one third of the major reported fires in the Maritimes and West carried at least fifty per cent insurance coverage<sup>230</sup>. Fire insurance coverage was least adequate in small unincorporated places, and most characteristic of the province's cities. By the 1880s, access to fire insurance was, in theory at least, uniform throughout Ontario's and Quebec's urban systems. In the former, and in Ontario's and Quebec's incorporated villages as well, full insurance coverage was the exception rather than the rule. Even a cursory examination of contemporary provincial and county business directories reveals a network of insurance agents which spanned Ontario and Quebec territories, their agencies often a sideline to other businesses.

## **B. Lower Canada and the First Legal Interventions of the State**

Political authorities frequently attempted to regulate insurance markets by restricting access to the market, restricting what kinds of property could be lawfully insured, requiring centralized registration of policies, taxing transactions, and so on. In some cases, these regulations codified and formalized existing merchant practices, while in others, they represented efforts to change existing practices or impose uniformity in response to perceived abuses or allegations of fraud. The first Quebec legislation on fire insurance was passed between 1835 and 1852.

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<sup>229</sup> *Ibid.*, p. 67.

<sup>230</sup> *Ibid.*, p. 67.

In 1835, the first law authorizing the establishment of mutual insurance companies of counties was promulgated. The Quebec economy was not only the preserve of the rural community and the agricultural class. Mutual or fraternal societies were born out of a desire for fraternal protection in urban artisanal or working circles, or body of trades (carpenters, carpenters, mechanics, typographers, etc.). The mutualist movement in Quebec took its true rise in the second half of the nineteenth century in the urban working communities of Quebec and Montreal. The *Act to authorize the Establishment of Mutual Insurance Companies against Fire* laid down the rules and procedures to be followed for the establishment of mutual societies. Other mutualist laws followed in 1836, 1841 and 1851. It is at this time that we witness the creation of mutual funds for counties: Standard and Sherbrooke (1835), Missisquoi and Rouville (1835), Montréal (1836), St. Maurice, Champlain, Nicolet and Yamaska (1837), Beauharnois (1852). At that time, there were hundreds of mutual companies in the regions of former Lower Canada. Thirty-eight companies of this type are still in operation today.

Legally speaking, the French Civil Code Model, adopted in France in 1804, ignored insurance. A single article contained in the third book defined the random contract. Its wording has remained unchanged since March 20, 1804.<sup>231</sup> At the Canadian level, the Commercial Code governed only the marine insurance contract, which had been inspired both by the Navy Ordinance, promulgated by Colbert under the reign of Louis XIV, and by the British *Marine Insurance Act*.<sup>232</sup> The Commissioners appointed for the Codification of Civil Laws of Quebec in their seventh report, considering the insurance law as a matter of civil law, dealt with the insurance law and enacted the articles 2468 and following of the LCCC, which covered the whole subject.

The preamble to the 1857 Act, which started the codification work, served the purpose of explaining the evils that the enactment was intended to remedy and the

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<sup>231</sup> Article 1964 of the Civil Code is still worded as follows: "The random contract is a reciprocal convention whose effects, in terms of benefits and losses, for all parties, or for one or more of them, depend on an uncertain event. These are: The insurance contract, The big adventure loan, The game and the bet, The life annuity contract. [...]" No specific law came to frame the land insurance contract, which was built on the basis of maritime laws.

<sup>232</sup> See Gilles (2014), pp. 523-560.

objects it was to achieve.<sup>233</sup> There were four principal factors: the diversity and inaccessibility of legal sources, the language of the laws, the absence of legislative or doctrinal synthesis, and the availability of foreign models.<sup>234</sup> If legislation by way of statute, whether provincial or imperial, had traditionally been available in French translation since 1791, the *Coutume de Paris* was only unofficially translated and published in English in the early 1840s, after the Cugnet summaries published in 1775.<sup>235</sup> After six years of work by its draftsmen, the Civil Code of Lower Canada entered into force on 1 August 1866.<sup>236</sup> Its leading ideas were that codification was required to order and co-ordinate the existing law, and to render all of it accessible in both the English and French languages. The three commissioners and two secretaries who were appointed in 1859, René-Édouard Caron, Charles Dewey Day and Augustin-Norbert Morin, were all former practitioners, involved in politics and magistracy.<sup>237</sup> The Commissioners were instructed to proceed in the following manner: '[...to] reduce into one Code, to be called the Civil Code of Lower Canada, those provisions of the Laws of Lower Canada which relate to Civil Matters and are of a general and permanent character, whether they relate to Commercial Cases or to those of any other nature [...] They may suggest such amendments as they think desirable, but shall state such amendments separately and distinctly, with the reasons on which they are found'.<sup>238</sup> It was essentially Charles Dewey Day who was involved in the formulation of the commercial provisions.<sup>239</sup> The book including the insurance provisions, was first written in English by Commissioner Day, then translated into French later.<sup>240</sup> The codification of civil

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<sup>233</sup> *An Act to provide for the Codification of the Laws of Lower Canada relative to Civil Matters and Procedure*, 20 Vict. S.C. 1857, c. 43.

<sup>234</sup> Brierley (1968), p. 534.

<sup>235</sup> *Ibid.*, p. 539.

<sup>236</sup> See Young (1994).

<sup>237</sup> "Discours de George-Étienne Cartier sur le Code civil, prononcé devant l'Assemblée législative", le 31 janvier 1865, *La Minerve*, 4 February 1865.

<sup>238</sup> Sections 6 and 7, *An Act to provide for the Codification of the Laws of Lower Canada relative to Civil Matters and Procedure*, 20 Vict. S.C. 1857, c. 43.

<sup>239</sup> See Assemblée Nationale du Québec, Charles Dewey Day", *Députés*, page mise à jour en février 2009, [Online], <http://www.assnat.qc.ca/fr/deputes/day-charles-dewey-2785/biographie.html>, accessed 20 November 2015; Miller (2003), p. 324.

<sup>240</sup> Young (1994), p. 133.

law (1866)<sup>241</sup> and civil procedure (1867) was made under the influence of a newly ascendant legal profession, and the role of the authors of the codification is important.<sup>242</sup> At the same time, only a few Lower Canadian decisions were used in drafting the Code. 'Only 95 decisions are cited in the Reports relating to the civil and commercial law of Lower Canada; Professor Morel estimates that 72 decisions are invoked with respect to only sixty-four articles in the Reports on the first three Books of the Code'.<sup>243</sup> It seems that the Commissioners paid little attention to "national" legal reflections, in favour of foreign reflections, whereas on the contrary they were ready to attach themselves to the colonial practice rather than to that of the metropolises. The codification took place in a context following the United Kingdom and at a time when the gaze of London was particularly vigilant on the commercial interests of the metropolis.<sup>244</sup> The agglomeration of civil law sources of commercial law,<sup>245</sup> supplemented by the English laws on the subject, formed the basis of codification in commercial matters,<sup>246</sup> as was stated in the preamble of the *Act to provide for the Codification of the Laws of Lower Canada which relate to Civil Matters and the Procedure*.<sup>247</sup> The amendments to the English rules of evidence introduced by the orders of 1777 and 1785 were therefore collected.<sup>248</sup> In commercial and insurance matters, the authors were led by the need to modify the laws relating to commerce in the light of commercial ties with the USA.<sup>249</sup> The Commissioners' task was to reduce the provisions relating to both civil and commercial matters into one code, even if the book on these latter issues was

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<sup>241</sup> See Morel (1970), p. 27; Broodman, Brierley and MacDonald (1993), pp. 5-74; Normand and Fyson (2001).

<sup>242</sup> Normand (1993).

<sup>243</sup> A. Morel, 'Apparition de la Succession Testamentaire', *R. du B.* 26 (1966), p. 499, quoted by Brierley, (1968), p. 555.

<sup>244</sup> *Colonial Laws Validity Act*, 28 & 29 Vict., (1865) c. 63.

<sup>245</sup> Perrault (1936), p. 136; *Acte de Québec de 1774*, 14 Geo. III, c. 83 (R-U.), reprinted in Revised Statutes of Canada (R.S.C.), 1985, ann. II, n° 2, art. 8.

<sup>246</sup> Perrault (1936). See also Neatby (1937).

<sup>247</sup> *Acte pour pourvoir à la codification des lois du Bas-Canada qui se rapportent aux matières civiles et à la procédure*, S.P.C. 20 Vict. (1857), c. 43.

<sup>248</sup> *Ordonnance pour régler la procédure dans les cours de judicature civile de la province de Québec*, 25 février 1777, art. 7; *Ordonnance instituant les procès par jury*, 25 Geo. III, c. 2, art. 10, in Shortt and Doughty (1921), pp. 673, 768.

<sup>249</sup> See Hurst (1970); Newmyer (1976).

identified as a “special title”.<sup>250</sup> For the British doctrine cited, the sources were mainly writers of the eighteenth and nineteenth centuries. While the majority of authors from the United Kingdom came from England, others came from the Associated Realms (the Scotsman George Joseph Bell) or from Continental Europe but whose works were published in London, such as those of the London insurance company director Nicolas Magens’ *An Essay on Insurances*, 1755.<sup>251</sup> A significant portion of the common law sources came from the United States, such as James Kent’s (1763-1847) *Commentaries on American Law*, which was extensively cited, particularly on bills of exchange and insurance matters. It was in these territories that the main rules were formulated and the main economic developments took place. An agreement was sometimes found by the commissioners between the two legal traditions, through the authors of doctrine:

*This subject is treated extensively and with great clarity by Chancellor Kent [...] where we see that the American rule is consistent with that of England and the opinion of Emerigon. The weight of the authorities appearing, as well as considerations of fairness and propriety, to lean in favour of this rule, the Commissioners adopted after careful consideration, and formulated in this article.*<sup>252</sup>

The influence of certain areas of the law in evolution, such as bank securities or the rules of insurance law, was naturally imported from the two main common law countries, the United Kingdom and the United States. In their preliminary observations on maritime law, the Commissioners made the following statement: “It is obvious (...) that it was an easy thing, the decisions in England being in almost all the cases the development of the rules emitted in the French code”.<sup>253</sup> In terms of legislation, we find about a third of the laws cited that are of colonial origin, that is, from the legislatures of Quebec, Lower Canada and then United Canada. The commissioners did not hesitate to seek a source of inspiration in foreign legislation,

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<sup>250</sup> “Memorandum No. 2 pour M. M. les Secrétaires” in *Livre des minutes des procédés de la commission de la codification des lois*, P3 Fonds René-Édouard Caron, Musée de la civilisation, fonds d’archives du Séminaire de Québec, p. 193.

<sup>251</sup> O’Brien (2016), p. 110.

<sup>252</sup> *Code Civil du Bas Canada*, [1865], p. 237.

<sup>253</sup> *Ibid.*, p. 227.

like that of the State of New York.<sup>254</sup> As with the rest of the codification project, the commissioners did not hesitate to take away from the law when they deemed it necessary, by choosing the sources most favorable to their objectives.<sup>255</sup> The Commissioners were pragmatic and did not hesitate to take certain liberties with the nature of applied rights. There was a certain technical and cultural dominance of English law in certain areas such as insurance law. Of course, the choice of the common law for marine insurance was almost self-evident:

*There can be no doubt that the custom among us has given preponderance to English doctrine with regard to marine insurance [...]. Our policies are invariably in the form of those in use in England, and it seems that there is no reason not to bind the parties to their engagements in this contract as in any other, without inquiring into their motives or their actual importance.*<sup>256</sup>

If, in this respect, marine insurance fell under British law, land insurance was in principle based on civil law grounds. Nevertheless, since it was a more developed area of law in England,<sup>257</sup> and English law “[...] states that human life and health can be the subject of insurance”, the Commissioners were favourable to innovation followed in post-revolutionary French law.<sup>258</sup> Commissioners here simply noted the evolution of the law under the influence of common law traditions.<sup>259</sup>

*The form of the police used in this country is the same as that employed in England, where the fire insurance business began much earlier and was more extensive than in France, where find no text on the subject, and few decisions until recently. Much of our jurisprudence has been borrowed from English law.*<sup>260</sup>

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<sup>254</sup> *Ibid.*, p. 259.

<sup>255</sup> *Ibid.*, p. 235.

<sup>256</sup> *Ibid.*, p. 245.

<sup>257</sup> *Ibid.*, p. 257.

<sup>258</sup> *Ibid.*, p. 243.

<sup>259</sup> Claxton (1936), p. 548.

<sup>260</sup> *Code civil du Bas Canada : sixième et septième rapports* (1865), p. 243.

On this occasion, they also underlined the jurisprudential intervention in this area with *Leclair v. Crapser* in accordance with the new codified legislation.<sup>261</sup> The Civil Code of 1866 was the first true regulation of contractual relations between insurers and insureds. This Code was subsequently supplemented by various provincial insurance acts, including the *Quebec Insurance Act*, 1909, inspired by that of the province of Ontario.<sup>262</sup> The statutory conditions for fire insurance were not rewritten to adapt them to the context of the *Civil Code*, as was done for example for article 1056 (cf. *Pantel v. Air Canada*).<sup>263</sup> They were copied from c. 203 of the *Revised Statutes of Ontario*, 1897 (s. 168) as they then stood and included in the *Insurance Act* without any coordination with the articles of the *Civil Code*, which were simply ignored. "Statutory condition" 10(a) of the Ontario Statute became statutory condition 10(a) in Quebec.<sup>264</sup>

### C. Further Canadian regulations

The Ontario Parliament adopted "An Act to secure Uniform Conditions in Policies of Fire Insurance" in 1877, and then in July 13, 1900 *The Fire Insurance Policy Act*.<sup>265</sup> The statutory conditions for fire insurance in Quebec were taken verbatim from Ontario Statute dating from 1876 [39 Vict. c. 24] with all amendments thereto, when the Quebec legislature inserted identical provisions in the *Insurance Act* of 1909 (8 Edw. VII, c. 69). They were not rewritten to adapt them to the context of the *Civil Code*. They were copied from c. 203 of the *Revised Statutes of Ontario*, 1897 (s. 168) as they then stood and "included in the *Insurance Act* without any coordination with the articles of the *Civil Code*, which were simply ignored".<sup>266</sup> That report was made and discussed in Quebec Parliament at about the same time the Confederation resolutions were framed and discussed. The *British North American Act*, which set

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<sup>261</sup> *Leclair v. Crapser* V.L.C.R. 487; Lefebvre (1879), p. 734.

<sup>262</sup> *Quebec Insurance Act*, 8 Edw. VII (1909), c. 69.

<sup>263</sup> *Pantel v. Air Canada* [1975] 1 S.C.R. 472.

<sup>264</sup> See *Commerce & Industry Insurance Co. et al. v. West End Investment Co.*, [1977] 2 S.C.R. 1036.

<sup>265</sup> R.S.O. 1877, c. 162. See R.S.O. 1877, c. 160, *An Act respecting Insurance Companies*; R.S.O. 1877, c. 161, *An Act respecting Mutual Fire Insurance Companies*; 44 V. c. 20, *An Act to give increased stability to Mutual Fire Insurance Companies*; 46 V. c. 15, *An Act relating to the Law of Insurance*.

<sup>266</sup> Supreme Court of Canada *Commerce & Industry Insurance Co. et al. v. West End Investment Co.*, [1977] 2 S.C.R. 1036, p. 1043.



out the written part of the Canadian Constitution was relatively silent about insurance activities. The subject of insurance is not specifically enumerated as a head of legislative jurisdiction either in section 91 (Federal) or in section 92 (Provincial) of the *British North America Act*. The right to carry on that business is a civil right in each province of Canada. In 1864 the question of insurance was mentioned at the Quebec Conference of the delegates of the provinces. A proposition that carried was at first moved that the regulation and the incorporation of fire and life insurance companies should be under the legislative control of the Federal Parliament; but a few days later that proposition was struck out.<sup>267</sup> In the *Re Insurance Act*, Supreme Court Justices wrote that “the insurance laws are pertaining to civil rights and that the subject was in the opinion of the Fathers of Confederation a matter that should be under the legislative control of the provinces”.<sup>268</sup> After the Confederation, in 1869, fire insurance companies operating inter-provincially under Canadian federal government regulation accounted for \$188 million in insured risks. By 1887, their business had more than tripled to \$635 million.<sup>269</sup> By the close of the nineteenth century there were 84 mutual companies in Ontario, covering property insured at more than \$200 million.<sup>270</sup> The largest of the provincially regulated firms were joint stock companies. In Ontario, there were four new companies operating in 1878: the Queen City Company of Toronto (established in 1871), the Mercantile of Waterloo (1875), the Standard of Hamilton and the Union of Toronto (1877). Only the first one survived to face the new century. In the 1860s the leading companies were British; they commanded over 60 per cent of the market in 1869 and were still leaders of the market in the 1880s and 1890s.<sup>271</sup> Canadian firms were ephemeral market leaders in the mid-1870s. The Saint John conflagration of 1877 push a lot of Canadian companies into bankruptcy. American fire insurance companies maintained a weak foothold in the Canadian market from the 1830s to the 1890s. In the 1880s, there was an entry of new English firms, half the 21 British fire insurance companies serving Canada in 1887 had entered the Canadian market during 1880s. Lord Watson said in *Citizens Insurance Company v. Parsons* that

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<sup>267</sup> Pope (1895), pp. 30, 88. See also Pope (1921), p. 238.

<sup>268</sup> *In Re Insurance Act*, 1910, (1913) 48 S.C.R. 260, p. 316.

<sup>269</sup> *Canada, Sessional Papers* (henceforth *C.S.P.*) 21 (1888), 10:9, 12-13.

<sup>270</sup> *O.S.P.* 32 (1900), 1; Norris (1987), p. 64.

<sup>271</sup> *Ibid.*, p. 63.

the business of fire insurance was admitted to be a trade.<sup>272</sup> For Watson, therefore, it seems to fall under federal jurisdiction by the NAA of 1867 founding the Canadian federation. In 1910 the first twentieth century major regulation of the insurance sector took place with the passing of the Insurance Act. It had its origin in legislation of Old Canada existent at the time of the Confederation.<sup>273</sup> The object of the Act was to require companies and persons engaged in carrying on the business of insurance to provide security for the performance of their obligations.

This Act, completed by a Supreme Court of Canada's decision in 1913,<sup>274</sup> in its section 4,<sup>275</sup> prohibited an insurance company incorporated by a foreign state from carrying on its business within Canada if it did not hold a license from the Minister under the said Act and if such carrying on of the business was confined to a single province. But for the Supreme Court Justices, section 4 of the Dominion "Insurance Act" was "*ultra vires*" and section 70, which imposed a penalty on those that would carry on the business of insurance without taking out that license, was also illegal.<sup>276</sup>

## CONCLUSION

For Justice Brodeur,

*The business of insurance is not necessarily a trade. The large companies that are carrying out that business are, generally speaking, commercial ventures with an object of gain or profit for their shareholders. But alongside of that we have the Mutual Benefit Insurance Association, which is entirely beneficial, we have also in the large railway and other companies an insurance fund for the employees to which the employees themselves and their employers contribute that could certainly not rank as commercial enterprise and there is the contract of indemnity made by insurers which can scarcely be considered a trading contract.<sup>277</sup>*

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<sup>272</sup> *Citizens Insurance Company v. Parsons*, 7 App. Cas. 96.

<sup>273</sup> See 23 Vict, c. 33, and 26 Vict. c. 43.

<sup>274</sup> *In Re Insurance Act*, 1910, [1913] 48 S.C.R. 260

<sup>275</sup> *Ibid.*

<sup>276</sup> *Ibid.*, p. 317.

<sup>277</sup> *Ibid.*, p. 313.

Such legislation involved a degree of interference with matters “substantially local” that could not have been contemplated by the framers of the Act. It exempted from its operation any company incorporated by the legislature of a province for the purpose of carrying on the business of insurance within that province alone.<sup>278</sup> Globalization and the current economic crisis have given rise to the need to establish regulatory bodies that can monitor the complex networks formed by financial institutions and large corporations. Such bodies can also be expected to regulate large-scale economic regions in which the insurance market shares many natural links and a common historical background, as Canadian legal history shows.<sup>279</sup>

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<sup>278</sup> *Ibid.*, p. 304.

<sup>279</sup> See Hasson (1995).



## CHAPTER 5. MARKETS CREATED AND DESTROYED BY THE STATE: CASUALTY INSURANCE AND THE EXPERIENCE OF THE ZURICH INSURANCE COMPANY 1850-1914

Christofer Stadlin

### INTRODUCTION

In his *History of Accident Insurance in Great Britain*, W.A. Dinsdale dryly notes about the emergence of employer' liability insurance: "The business is entirely a creation of law".<sup>280</sup> This implies that legislative state action, in this case the Employers' Liability Act enacted by the British parliament in 1880, can by itself create new markets for specific types of insurance. By this means the financial risk of industrial employers to have to pay compensation to the victims of work accidents and their dependants was increased, thereby motivating employers to acquire liability insurance.

Accidents in the workplace became an ever more pressing problem in all industrializing nations across Europe in the nineteenth century. There is very little reliable data on workplace accidents from this period.<sup>281</sup> It is a truism, however, that the ever more intensifying industrial production during the course of the industrial revolution, requiring ever larger numbers of workers, must have increased the number of such accidents. It is clear that the consequences of work accidents for workers and their dependants could be devastating. With ever more people solely dependent on their salaries to cover their needs, the death of a breadwinner or the diminution or complete loss of income could easily push families into poverty and destitution. This became a potent fuel for workers' movements and socialist politics. Even though the exact magnitude of the problem is difficult to estimate, the fact is that, after 1850, workplace accidents, and the consequences they had for

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<sup>280</sup> Dinsdale (1954), p. 147.

<sup>281</sup> Regarding the situation in England, see Bartip and Burman (1983), especially chapter 2, p.37f.

the workers and their families, became everywhere a subject of political debate and ultimately legislative action. This development took different trajectories in different states. It depended on the degree of industrialization achieved, but also on aspects like the existence or absence of some kind of compensation system, like the friendly societies in the UK, which provided at least some recompense for injured workers. Obviously national legal traditions and institutions also played a role.

The first modern liability law specifically introduced to tackle the problem of workplace accidents was the *Imperial Liability Law* enacted by the newly reunited German Empire in 1871. Switzerland came up with a similar law in 1877. The UK followed in 1880 as we have seen. The movement reached Latin Europe when France enacted a law regarding the compensation of workplace accidents in 1898. By 1905 Spain, Italy and Belgium had put similar laws in place.

The German law of 1871 soon led to a rise of liability and accident insurance provided by private companies. The business model and insurance techniques they were using had been pioneered by English insurance enterprises in the 1840s for insuring passengers against railway accidents.<sup>282</sup> The insurance was for predefined and fixed amounts that would be paid in case of accidental death or injury against fixed premiums. In the 1860s some French companies started to apply this model to the insurance of entire workforces, and it was this model that German private insurers took up.<sup>283</sup>

This chapter investigates the interdependence of state action and private insurance from the second half of the 19<sup>th</sup> century to the First World War by focusing on the history of the Zurich Insurance Company. Zurich was founded in 1872 as a marine insurer but in 1875 it took up accident and liability insurance on fixed sums and premiums, which became its sole fields of activity in 1880. When entering accident and liability insurance, Zurich immediately expanded internationally. By 1884 the company was present all-over continental Europe and around the turn of the century it had become one the largest accident and liability insurers on the

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<sup>282</sup> On the history of accident insurance, see Dinsdale (1954), p. 54f; Stadlin (2010), p. 38f.

<sup>283</sup> Engel (1866), p. 295.

continent. During the period of interest Zurich was exposed to state action in all major states in western Europe.

## **ZURICH ENTERS ACCIDENT INSURANCE: INSURING RESPONSIBILITY**

When the accident insurance operations started in August 1875, Germany unsurprisingly became Zurich's main market for the new lines of business. The Imperial Liability Law of 1871 was thought to tackle the problem of workplace accidents by increasing the liability risk for owners of factories and especially accident-prone businesses like mines and pits. The law did not establish strict liability, nor the obligation of owners to compensate the financial consequences of work accidents in any case. Compensation was only due if the actions of the employer, or of one of his representatives, resulted in death or injury of workers. Liability still was dependent on fault. In this regard the Imperial Liability Law did not go beyond the dogma of fault liability strongly defended especially by German legal scholars and ultimately based in Roman law.<sup>284</sup> The lever of the law was the detailed definition of the indemnifications a worker would receive if fault of the employer could be established.<sup>285</sup> This heightened the liability risk for employers considerably. In case of death not only the funeral costs but also the medical costs caused by an eventual attempt to save an injured person as well as the pecuniary loss caused by diminution or loss of income during a phase of sickness before death had to be compensated. Furthermore, if the killed person had been obligated by law to sustain the livelihood of another person, this person could request compensation relative to the amount received from the dead person. Finally, in case of non-deadly bodily injury the compensation of medical costs as well as the pecuniary loss resulting from temporary or permanent disability or diminution of earning power had to be compensated too. Especially the stipulations regarding pecuniary loss

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<sup>284</sup> On German legal dogmatists and the roots of fault liability in Roman law see: Scherpe (2010), p. 134f; Bartip (2012), p. 40.

<sup>285</sup> The Law regarding the obligation to compensate killings and bodily injuries caused by the operation of railways and industrial undertakings of June 7, 1871 (Gesetz, betreffend die Verbindlichkeit zum Schadenersatz für die bei dem Betriebe von Eisenbahnen, Bergwerken etc. herbeigeführten Tötungen und Körperverletzungen. Vom 7. Juni 1871). On <https://de.wikisource.org/>

could result in substantial material liabilities for employers. To cover these liabilities would be the main incentive to acquire insurance.

In 1881, the first year that a breakdown of Zurich's gross written premiums (GWP) by country and line of business is available, Germany accounted for 53 per cent of the entire premium income of the company.<sup>286</sup> The overall GWP from Germany in 1881 was CHF 860,000, split into CHF 194,000 for travel and personal accident and CHF 666,000 for workers' accident and employers' liability insurance. With this premium income Zurich held a significant share of around 10 per cent in the German market for workers' accident and employers' liability insurance at the time.<sup>287</sup>

### **Workers' insurance to avoid liability**

Zurich was very aware of the legislative context of its accident and liability insurance business. The annual reports of the company explicitly connected its workers' business to the existence or absence of respective laws in the various national markets. The report for the business year 1875 explained the meagre workers' accident premiums in Switzerland with the fact that employers were in a waiting position because the so-called Factory Law, which would introduce a liability regime similar to the German law of 1871, was still under discussion in Parliament but not yet approved. It was also noted that this situation neither facilitated the understanding of this new type of insurance nor its welfare effects.<sup>288</sup> This is another important point that must be kept in mind. Even though the introduction of respective laws generated public debate about liability and the responsibility of industrialists regarding workplace accidents, liability and accident insurance on a basis of fixed sums and premiums was not well known and understood, neither by employers nor the wider public, especially in German-speaking Europe.

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<sup>286</sup> All Zurich premium figures are based on ZAZ 62767:1 Unterlagen zur Jubiläumsschrift "75 Jahre Zürich" von A. von Sprecher 1947, Prämienstatistik (premium statistics) 1881-1950.

<sup>287</sup> According to Arps, citing Ehrenzweig's *Assekuranzjahrbuch*, total premium income from workers' and liability insurance in Germany in 1881 was 5.31 million Mark. Taking into account an exchange rate Mark/Swiss franc a little below par 10 per cent is even a conservative figure. See Arps (1965), p. 70.

<sup>288</sup> ZAZ Collection of Annual Reports of the Company 1873-2017: 3. Annual report 1875 of the Transport- und Unfall-Versicherungs-Aktien-Gesellschaft "Zürich", p. 4.



When the Swiss Factory Law was finally approved in 1877 the annual report recorded a *special impulse* for a *favourable development* of the accident business. It also mentioned that, because the Swiss law went decisively further than the German Law of 1871, great care had to be taken when evaluating the accident risks of factories to be insured.<sup>289</sup> The Swiss Factory Law of 1877 fundamentally differed from the Imperial Liability Law in that it stipulated strict liability. A factory owner had to compensate the pecuniary consequences of any work accident at his premises regardless of fault while the German law only applied liability relative to a fault of the factory owner or his managers, as we have seen.<sup>290</sup> A year later Zurich reported that the strict liability regime had led the company to stop writing employers' liability cover on its own in Switzerland.<sup>291</sup> This would only be changed once a consistent court practice stabilizing the effects of the law had emerged. To insure liability in the absence of such a practice would have been like playing *va banque*, it was noted, as it was simply impossible to even approximately determine a possible maximum loss. The annual report of 1878 then went on to explain in detail the benefits of having workers' accident insurance, and the powerful protection it guaranteed against liability, especially if large enough amounts were insured. If workers' insurance was taken out based on three to four times the annual salary of a worker, as Zurich advised its commercial and corporate customers to do, a liability claim could normally be avoided. As workers' insurance was paid in the case of every accident up to the sums insured, bypassing the question of liability altogether, workers or their surviving dependants always received a considerable amount of money as compensation. Even if they had initially demanded a higher sum, such compensation at least provided a good basis to find a compromise and to settle a claim out of court. Adequate workers' insurance made it therefore very unlikely that accident claims, apart from exceptional ones, ended in court where the amount of compensation would be decided in an arbitrary manner, at least from the insurers' perspective.

But Zurich was also aware of the systematic deficiencies and limitations of the legislative approaches, especially of the German law of 1871, and knew that the

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<sup>289</sup> *Ibid.* 5. Jahresbericht 1877, p. 3f.

<sup>290</sup> Federal Law on work in Factories of March 23, 1877 (Bundesgesetz betreffend die Arbeit in Fabriken vom 23. März 1877).

<sup>291</sup> ZAZ Collection of Annual Reports of the Company 1873-2017: 6. Annual report 1878.

accident insurance provided by the company based on fixed sums and premiums was a simple and efficient solution because it decoupled compensation from liability. However, as this solution was new, it was also relatively unknown to the public and to businesses. Therefore, selling the idea, besides having a helping legislative hand, was paramount. So how did Zurich instruct its salesforce?

### **Workers' insurance as moral obligation**

In 1880 Zurich published an agency-instruction for accident insurance.<sup>292</sup> It is a unique document. As far as I know, no similar document was produced thereafter with instructions going to the same level of detail. The instructions provided guidance for agents of the company on all aspects of the business. They started with descriptions of all types of insurance the company offered and their specifics. Then followed instructions on how to go about acquiring business by actually selling insurance and developing portfolios; how to use application forms and what applications were preferred; how to use tariffs and apply premium rates; how to collect and book premiums; how to use the cash-book; how to close the current-account with the general-agency on a quarterly basis; how to correspond with the general-agency and the head office; how to handle claims and how to behave when handling them; how to supervise risks; and finally how to comport oneself towards competitors. The instructions also provided detailed descriptions of the various liability regimes of countries and regions the company did business in.

The first sentence of the introduction to the instructions left no doubt about the insurance scheme Zurich had adopted for its accident business: "Our Company is a stock company, which only insures on fixed premiums".

The liability regimes were detailed according to the concrete rules of the respective laws: the German law of 1871; the Code Civil, the law of France which was also in force in a lot of German states in the western part of the Empire; the Land Law of Baden; and the Swiss Factory Law.

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<sup>292</sup> ZAZ 1738:1 Collection of Printed Matters 1873-2017, Agency Instructions for Accident Insurance, January 1880.

The instructions went on to explain that even though the laws (the German law of 1871 and in particular the Code Civil, the Land Law of Baden and the Swiss Factory Law) did put quite far reaching obligations on employers and thereby made liability insurance a well justified interest for industrialists, the fact remained that a large number of workplace accidents did not fall under legal liability and therefore did not result in an obligation for the employer to compensate, so that the insurance company could not step in. In short, the fact was underlined that many workers injured by accidents did not get any compensation under liability laws at all. What then followed was a sales pitch for workers' insurance with strong moral and normative implications regarding the (personal) responsibility of an employer:

*It can easily happen to the most competent and diligent worker – be his work dangerous or relatively safe – to experience an accident at work, caused by his own imprudence – maybe overeagerly immersed in his work – or completely without fault – by an unfortunate coincidence or by fault of a co-worker. Can an employer really abandon such an unfortunate man, who has maybe done him most loyal service for years, in such a way as to leave him to an anyway sad destiny without any help? Let him and his relatives starve on temporary or permanent disability or even let them miserably and totally waste away? Surely not! An educated and insightful employer will not be stingy even if he hasn't any legal obligation to compensate or cannot claim compensation of his expense from an insurance company. But it is clear that compensation will be more abundant and inexpensive for an employer if he has insured his entire workforce also against accidents which do not fall under liability. And this he can do by acquiring a Workers' Insurance. This insurance provides compensation to the workers and their relatives for all accidents, regardless of whether these fall under legal liability of the entrepreneur or not.<sup>293</sup>*

This clearly played to the bourgeois value of personal responsibility. Even though further values like loyalty and ultimately Christian compassion are invoked, too, responsibility is the focus. Education and insightfulness should have taught an employer / entrepreneur the deep moral value of responsibility in such a way that even in the absence of any legal obligation or insurance he would without

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<sup>293</sup> *Ibid.*, p. 6f.

hesitation come to the help of his injured worker. And it was this kind of responsibility which made it basically a moral obligation to acquire insurance. Seen from this angle, workers' insurance on fixed sums and premiums was quasi the materialization of compassionate rational responsibility.

The agents were reminded to urgently push employers to insure their personnel against all accidents, as employers were often and mistakenly of the opinion that they had taken sufficient precautions for their workers by having insured themselves against their legal liability. "If you encounter this fallacy you must correct it immediately. ...Only by insuring his workforce beyond legal liability does an employer earn his workers' thankfulness".<sup>294</sup>

Finally, a common experience made by the insurer was recounted. The document points out that it was typically exactly those employers, who, out of ignorance or misguided thriftiness, had only insured themselves against liability, who expected generous compensation in case of an accident and who were very indignant to learn that no liability and therefore no obligation to compensate existed for the insurance company. It was this misunderstanding and misguidedness that the agents had to combat.

## **IN THE GERMAN MARKET: RIDING THE WAVE OF LEGISLATIVE PROCESSES AND POLITICAL DYNAMICS**

This battle, however, was ultimately lost, in the sense that the insurance industry was at the time unable to convince the public and the political forces of the viable solution it offered to the problem of workplace accidents, at least in Germany. How this came about during a period of roughly six years provides a neat case study about the way an insurance company like Zurich adapted to the political process almost in real time, and how it could take tactical advantage of the processes making up state action, especially of the relative slowness inherent to them.

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<sup>294</sup> *Ibid.* p. 8.

In November 1880 a circular was sent to Zurich agents in Germany. It could not have escaped their attention that Chancellor Bismarck had taken up the question of workers' insurance in order to get to a solution for the entire German Empire. A legislative proposal was in preparation and would most probably go before the Reichstag for resolution in the coming spring. In view of the scope of the initiative – Bismarck wanted to include not only accident but also sickness and old age insurance – the leadership at headquarters in Zurich did not assume that such a comprehensive legislation would go through quickly. The possibility was assumed to be high, that instead of such a huge proposal a revision of the liability law of 1871 could come out as a result, whereby liability would be tightened, and areas of application enlarged, perhaps even to make accident insurance provided at least partly by private insurers mandatory for the employers. "If this perspective becomes reality, and now there is not much reason to doubt such an outcome, it is clear that accident insurance in the German Empire is poised to undergo an enormous expansion. A respective resolution by the Reichstag would be the signal for activity in this field of a scale undreamt of".<sup>295</sup> Accordingly, the agents were instructed in detail how prepare for such a development. They should cultivate existing relationships to factory owners and employers and develop new ones. Contacts to factory inspectors, to board members of trade-associations etc. should be intensified, as these people could guide employers towards Zurich should the expected measures be taken. As liability legislation or maybe even legislation regarding mandatory accident insurance would most probably be expanded to include the agricultural sector, relations in this field should be established as well. Headquarters even signalled a willingness exceptionally to accept pure employers' liability insurance, even though only for one year. These customers were expected to contract workers' insurance with Zurich too, if it would become mandatory by law.

### **The road to nationalization**

The political-legislative process to which the circular referred to had started in 1878. It became more and more obvious that the law of 1871 failed to live up to expectations. It proved largely ineffective to improve the situation of workers in a

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<sup>295</sup> ZAZ 671 Zirkulare der General Direktion an Vertreter im Ausland 1880-1904, Zirkular an die Vertreter in Deutschland, November 1880.

significant way. To change that, a proposal was brought to the Reichstag in 1878 to reverse the burden of proof. If the employers would need to prove that they acted with due care this would, it was argued, be an incentive to implement safety measures resulting in a reduction of overall accidents and accordingly lead to better social security for workers. In the following debates social democrats proposed to extend liability to all dangerous undertakings, while the conservatives under the leadership of Bismarck developed the idea of abandoning liability altogether and implementing a mandatory state insurance scheme, taking the miners societies (Knappschaften) as their model.<sup>296</sup> Bismarck's well-known distaste for stock insurance companies most probably played a role in this quite radical proposal.<sup>297</sup> Sharing the oldest prejudice that they try to avoid paying claims to be able to pay out high if not outrageous dividends to their stock holders, he had an open ear for ideas implying the nationalization at least of parts of the insurance industry. A further factor was that his fight against social democrats was reaching a climax around 1880. In this regard workers' insurance provided by a state scheme would also be a tool of power in the sense that it would make workers understand that the Reich took care of them directly and in a better way than either socialists or capitalists did, like a Pomeranian estate owner would take care of his servant hit accidentally by a horse.<sup>298</sup> Furthermore, the fact must be considered that workers' insurance provided by private companies, be it mutual or stock companies, failed by far – at least till 1880 – to meet expectations, at least quantitatively. According to Ehrenzweig's yearbook of assurance there were a total of 860,861 workers insured in Germany in 1880 either against accidents falling under legal liability only or workplace accidents in general. A little more than half of these, or 458,437, were insured in the latter way, as advised by Zurich.<sup>299</sup> When comparing this with the number of overall workers in Germany in 1882 of 10,576,000, a very low coverage rate of 4.3 per cent emerges.<sup>300</sup> Even though it is unclear whether the overall figure also includes workers in agriculture, it is clear that even had the coverage ratio reached 10 per cent this would have been much too low for the private

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<sup>296</sup> Scherpe (2012), p. 127.

<sup>297</sup> See Arps (1965), pp. 79, 81f.

<sup>298</sup> *Ibid.*, p. 74.

<sup>299</sup> *Ibid.*, p. 70.

<sup>300</sup> [https://histat.gesis.or\\_g/histat/de/table/details/1677BAF0FADFBF7431870113B4C12DFB#tabelle](https://histat.gesis.or_g/histat/de/table/details/1677BAF0FADFBF7431870113B4C12DFB#tabelle) accessed 4.2.2019, Stockmann *et al.* (1982).

insurance model to be qualified as a success in providing coverage on a scale that could have been seen as a clear improvement in the situation of workers.

### **The Accident Insurance Act of 1884**

In June 1884 the Reichstag approved the Unfallversicherungsgesetz (Accident Insurance Act).<sup>301</sup> The liability law would not be widened to embrace strict liability rules. Instead, liability was to be replaced by a coverage that would apply for all bodily injuries in the workplace, regardless of fault and even of contributory negligence. Payments were to ensure that a victim received equitable compensation but would be limited to the damage suffered: loss of income and medical costs, a pension in case of permanent disability, alimony for dependents in case of death. To this end the Act introduced a public law solution with public insurance schemes, the so called Berufsgenossenschaften (professional insurance associations), collecting contributions and paying claims. These associations would be organized on a regional level, modelled on the miners' societies (Knappschaften) and funded by a pay-as-you-go mechanism fundamentally different from the funded scheme approach applied by private stock companies like Zurich. The Act would forge a 'social bond' between industrialists and their workforces unlike liability insurance which had created, and would continue to create, tension between the parties.<sup>302</sup> The Act was explicitly intended to take the wind out of the sails of the social democrats and socialists by improving the socio-economic situation of the workers.

## **THE FRENCH EXPERIENCE: PRIVATE INSURERS' DREAMS COME TRUE**

### **A different trajectory**

As everywhere else in industrializing Europe, workplace accidents also became an ever more serious problem in France. While industrial accidents till around 1850 were mainly perceived as a problem of workers' negligence, this perception started to change thereafter, especially in the eyes of French industrial employers.

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<sup>301</sup> The following is based on Scherpe (2010), p. 127f.

<sup>302</sup> *Ibid.*

On the legal side, liability in French law under the Code civil remained firmly wedded to fault up to the end of the nineteenth century, and fault liability, as elsewhere, did not help to solve the social side of the problem of workplace accidents.<sup>303</sup> Statistics from 1888 found that only in 12 per cent of the industrial accidents could a *faute* of the employer be established and accordingly a compensation obtained by an injured worker.<sup>304</sup> But in France this situation did not lead to interventionist legislative action as it had in Germany, at least not until 1898. The reasons for this are difficult to pin down, but there are indications. Already under the Second Empire (1852-1870), funds were established to assist victims of industrial accidents and provide compensation. The initiative for these funds seems to have come from industrialists themselves. They were financed by way of fines, employee contributions and employers' donations. The main objective of these funds was to avoid workers being forced to go to the courts to seek compensation.<sup>305</sup> The emperor Napoleon III himself had famously taken the side of the injured workers by declaring them the heroes of industrial development for whom care had to be taken like for the soldiers wounded or fallen on the battlefield.<sup>306</sup> Moreover, specialized private insurance companies entered the picture early on. As mentioned, workers' insurance provided by private companies was present in France since the 1860s. French accident insurance companies were most probably amongst the first private accident insurers on the European continent and the pioneers in applying the fixed sums and premiums system to insurance against workplace accidents. In the mid-1860s a state insurance fund for industrial accidents was even created, but it seems to have met with great resistance by the industrialists who preferred private insurance companies.<sup>307</sup> All in all, the picture of a quite diverse landscape of mostly private organizations and institutions emerges that somehow took care of the victims of workplace accidents in France. Maybe the most important role was played by the insurance funds that the industrialist established themselves. A hint to such a role of the industrialists pops up in a legal discussion in 1895 regarding whether, in the event of workplace accidents, the

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<sup>303</sup> Salmon (2010), p. 109.

<sup>304</sup> *Ibid.*

<sup>305</sup> *Ibid.*, p. 114.

<sup>306</sup> Engel (1866), 295.

<sup>307</sup> Salmon (2010), p. 113.



more generous principles of administrative law should be adopted instead of the fault liability of the Code civil. The need for such a change was the subject of the rhetorical question: “Quelle raison y aurait-il donc d’appliquer un régime différent de celui des nos grandes compagnies industrielles”?<sup>308</sup> This set up, which is visible at least in its outlines, seems to have worked to keep the problem of industrial workplace accidents at bay, at least to the extent that political momentum for a state solution like in Germany could not build up. A similar picture is painted by the fact that in 1897 only 1.6 per cent of labour strikes concerned industrial accidents and that by 1898, before the introduction of the new law, an estimated 50 per cent of all industrial workers in France were already covered by some kind of insurance.<sup>309</sup>

Private accident insurers, however, also played a role. Zurich’s experience in France points in this direction. When entering the French market in 1878, workers’ insurance instantly became its main line of business. The development of Zurich’s French workers’ insurance business from 1881 up to 1897 reflects a situation where gradually more and more employers sought accident insurance cover for their workers. Over these 16 years, workers’ insurance premiums from France grew by a yearly average of 12 per cent and made up by far the largest part of Zurich’s French business, on average 86 per cent. After the nationalization of workers’ insurance in Germany in 1885, the French business became Zurich’s largest workers’ portfolio.

### **German influence kept at bay**

Workplace accidents and the question of compensation entered French political discourse but led to different outcomes than in Germany.<sup>310</sup> This is again most probably because the industrial employers acted themselves. In 1880 the large chamber of the French Parliament voted for a law that called for the substitution of the fault liability of the Code civil with the principle of professional risk and a

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<sup>308</sup> Giliker (2012), p. 105 (footnote 82).

<sup>309</sup> Salmon (2010), pp. 111, 114.

<sup>310</sup> This paragraph is based on: ZAZ 1009:6 Frankreich historischer Überblick die verschiedenen Versicherungszweige 1879-1935, J. Zubler, *Die Arbeiterversicherung unter dem Gesetz vom 9. April 1898*, p. 1.

system of compulsory insurance. What “system of compulsory insurance” exactly meant remains unclear (mandatory workers’ insurance from private companies or mandatory insurance with a state scheme). It is clear, however, that the principle of professional risk was the principle private insurers were already applying in workers’ insurance in France too. Workers’ insurance by private companies paid, in nearly all cases, the sum insured according to the policy contract, regardless of fault. Only in the case of wilfully incurred accidents was payment refused. However the law of 1880 met with resistance in the Sénat and did not get approved. Yet it seems to have motivated the industrialists to go further. In 1883 the *Association des Industriels de France pour préserver les Ouvriers des Accidents du Travail* was founded with the stated objective to protect workers from workplace accidents. By introducing and improving safety measures to bring accident numbers down, the association envisioned a technical solution to the problem. Nothing can be said about the effectiveness of this organization. Nevertheless, further laws regarding work accidents were brought to parliament in 1884, 1887 and 1893 but all failed in the Sénat. This shows that the developments in Germany had not gone unnoticed in France. In particular, the proposal of 1893 envisaged compulsory insurance with regionally organized mutual state schemes like the *Berufsgenossenschaften* in Germany. Private companies would have been excluded.

### **The law of April 9, 1898**

The initial proposal of October 1897 that finally became law, and which was unanimously approved by both chambers on April 9, 1898, also proposed public mutual schemes on a regional level and even a pay-as-you-go financing mechanism.<sup>311</sup> The public mutual schemes would not have had a monopoly like in Germany, but the law was set up in such way as to give them decisive competitive advantage over private companies, as the managing director of Zurich’s French operation, Henri Bachem, wrote to the representatives of the company in a circular in November 1897.<sup>312</sup> He urged them to intervene directly with the senators of their voting districts to convince them to remove such state schemes from the law. Bachem used

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<sup>311</sup> *Ibid.*

<sup>312</sup> *Ibid.*, Circulaire No. 84, Paris, 15 novembre 1897.

the circular and “la situation dangereuse qu’elle vous signale pour l’avenir de l’assurance collective” [workers’ insurance, C.S.], to advise the agents to focus their activities, “d’une façon pressante”, on personal accident and third-party liability insurance, “les véritables éléments d’avenir”. This proved unnecessary, however, because the vigorous resistance by the private insurance companies and the industrialists and their organizations succeeded and led to the idea of mutual state schemes being abandoned.<sup>313</sup> However, the anxiousness in November 1897 that state schemes could be introduced, and the request to the French representatives to contact their senators, are interesting. Obviously being nearly twenty years in the market diminished the reluctance of a foreign company for direct political intervention.

The law approved on April 9, instituted no-fault liability, strict liability for industrial employers in case of work accidents, but left insurance with existing insurers, private stock companies, mutual societies and funds. Strict liability was introduced by stipulating that an employer had to pay predefined indemnifications if an employee was injured in a work accident in such a way as not to be able to return to work within four days (§ 1).<sup>314</sup> Fault was not mentioned anymore. Article 2 set the maximum salary on which compensation would be calculated at FF. 2400. On any part exceeding this sum only a quarter of indemnities were to be paid. In article 3 the indemnifications were defined: total and permanent disability gave right to a (life) annuity of two thirds of the salary; partial and permanent incapacity to a (life) annuity of half of the salary loss due to the accident; temporary disability to half of the salary from the fifth day; death entitled a wife to a life annuity of 20 per cent of the salary; surviving children up to the age of sixteen to an annuity of 15 to 40 per cent, according to their number. On top of that the employer had also to cover medical costs and drugs. The law did not make it mandatory for employers to seek insurance, but it was clear that the detailed specification of indemnities as part of the law itself made insurance very compelling, de facto compulsory.

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<sup>313</sup> *Ibid.*, J. Zubler, *Die Arbeiterversicherung unter dem Gesetz vom 9. April 1898*, p. 2.

<sup>314</sup> *Ibid.*, Loi sur les accidents dont les ouvriers sont victimes dans leur travail votée par le Sénat et la Chambre des Députés en Mars 1898.

## Severe liabilities best covered by stock insurance companies under state supervision

On March 30, 1898 Henri Bachem wrote again to the representatives of the company.<sup>315</sup> The law had already been approved by both chambers and only awaited final resolution. Bachem noted with satisfaction that the law had been amended by the Sénat in ways favourable to both insurance companies and industrial enterprises and that the regional state insurance schemes had been abolished. If the annuities stipulated by the new law were paid either directly by the employer or an insurance company everything would be fine. Only when this was not the case would the state step in with the *Caisse National des Retraite*, which could ultimately also execute a right of recourse against an employer or a private insurer. It would be, therefore, of prime importance for an employer to choose reliable insurance on fixed premiums provided by a financially strong private stock company with abundant reserves. This was even more important because the stipulated life annuities could result in serious liabilities running for 30 or 40 years or even longer. It would be very dangerous to get insurance cover for such risks from mutual societies, trade union funds or insurance companies with insufficient financial guarantees. “Donc, d’une part, nécessité de s’assurer, d’autre part, nécessité de choisir bien son assureur”. In June 1898 a letter was directly sent to employers, existing and potential future customers.<sup>316</sup> They were assured that Zurich would offer complete cover by substituting for the patron employer for all indemnities resulting from the law. The company would strive to provide this complete coverage at the lowest premiums possible. It was stressed that due to its very prosperous situation (15 million in assets and 10 million in annual premiums) Zurich offered a very high level of security. Furthermore, because Zurich was under the supervision of the Federal Insurance Bureau (Eidgenössisches Versicherungssamt EVA) in Berne. Switzerland was one of the first countries to establish a special government agency with the sole objective to supervise the private insurance sector.<sup>317</sup>

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<sup>315</sup> *Ibid.*, Circulaire No. 86, Paris, le 30 Mars 1898.

<sup>316</sup> ZAZ 671 Zirkulare der General Direktion an Vertreter im Ausland 1880-1904, Lettre, Paris, Juin 1898.

<sup>317</sup> See Lengwiler (2012), p. 150. The EVA was created as part of a reorganization of insurance supervision on the federal level under the *Federal Law regarding the Supervision of Private*

## Taking risk to learn and lead

It took another year for the law to go into effect in July 1899. The Zurich had in the meantime perfectly prepared its organization for this moment.<sup>318</sup> Special agreements with industrial associations had been entered into and several agencies (e.g. Roubaix, Reims, Calais, Troyes, Sedan, Fourmies) managed to contract policies with the better part of the industries in their territories. The premiums from French workers' insurance for 1899 grew by a massive 65 per cent and by year end Zurich had one of the largest workers' insurance portfolios in the French market. The vigorous growth continued in 1900 and France became Zurich's largest market in terms of premium income. But to achieve this, concessions regarding pricing had to be made and it also turned out that the claims reserve for 1899 and 1900 had been deficient. This was because it took the jurisdiction some time to turn the new law into a common practice. In 1901 Zurich's growth was already slowing down and it had lost 10 per cent of premium volume by comparison to 1900. Premiums decreased also because of fierce competition. Belgian (Royal Belge) and British (Ocean) companies, in particular, tried to rough up the market with price dumping. After the settlement of the claims reserves for 1899 and 1900 resulted in a book loss of 13 per cent of the net premiums, Zurich hit the brakes in spring 1902. Jacob Zubler, the manager at Corporate Center responsible for the French market and actuarial matters, reviewed and re-underwrote the French workers' insurance portfolio systematically. Zubler had worked in Paris from 1890 to 1900. During this stay he had developed detailed breakdowns of the French workers portfolio by industries and agencies and at the same time come up with a re-underwriting rule for workers insurance.<sup>319</sup> Now he could use both. Against the resistance of the French branch management and agents, 400 policies from a total of c.4000 got cancelled and a further 400 were put on hold for possible cancellation. At the same

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*Enterprises in Insurance* enacted in 1886. The main objective of the law was consumer protection. It set minimal standards for financial reserves to make sure, that the companies were able to fulfil their obligations. On the other hand, the companies had to submit product related business materials, product descriptions, policy forms and conditions, tariffs to the EVA for approval. This was to make sure that the customers were treated fairly, and that insurance products covered real needs and were designed in a sustainable way.

<sup>318</sup> The following is mainly based on ZAZ 1009:6 France Historical overview of the different insurance branches 1879-1935 (Frankreich historischer Überblick die verschiedenen Versicherungszweige 1879-1935), J. Zubler, *Die Arbeiterversicherung unter dem Gesetz vom 9. April 1898*.

<sup>319</sup> On the so-called 'Zubler's rule' see Stadlin (2010), p. 49ff.

Zurich raised premiums for new workers' business by 10 per cent. Only in 1903 did the competition come to realize the state of the business, especially the massive under reserving problem. The British Ocean had to retreat from the French market and at least two French stock companies and one mutual went out of business. The market hardened, and Zurich was perfectly positioned to take advantage. Already in 1903, its workers' premium grew by nearly nine per cent again, in 1904 by 11 per cent, in 1905 by nearly 19 per cent, in 1906 by nearly 20 per cent. Thereafter growth slowed down a little but remained strong. By 1913 premiums from French workers' business stood at CHF 13 million and had more than tripled in ten years from CHF 4 million in 1902. During the three business years, 1906, 1907 and 1908, Zurich was even the market leader in French workers' business, only outflanked from 1909 onwards by the French company *Préservatrice* by a couple of hundred thousand francs in premiums. On the eve of World War One, the French workers' business was by far the largest portfolio Zurich had on its books beating the second largest, the German third party liability book, by a factor of two.

## **CONCLUSIONS**

The initial impulse for the creation of accident insurance provided by private stock companies on fixed sums and premiums came from technological progress, the railways booming in nineteenth century Europe. At that point it was more the moral concept of personal responsibility shared by the evolving bourgeois classes that played a promoting role as well as capitalist entrepreneurship simply looking for business opportunities, and not yet the state. The state was only indirectly and negatively present in so far, as it became quickly obvious that somebody being victim of a railway accident and having an insurance paying compensation would be less inclined to sue the railway company than somebody who had not. This would also hold true for other accidents like those in the workplace, which also increased due to more intensive industrial production processes leaving workers dead, permanently mutilated or at least temporarily incapacitated.

The socio-economic problem of workplace accidents was exacerbated by the fact that workers and their relatives, as an effect of becoming part of the capitalist economy, depended ever more exclusively on wage earnings. The only means at the

disposal of western nation states to tackle the problem of these accidents remained their legal systems and the legal concept of liability. Both proved to be hopelessly inadequate. Because liability was dogmatically tied to fault, an injured worker or his relative had to prove – ultimately in court – that an accident had been the employers' fault. However, not only were legal proceedings around 1850 not easily accessible for members of the working classes, there were further dogmatic legal principles governing liability in the worker-employer relationship that made it even harder to get compensation. Legal dogmatists throughout Europe refused to separate liability from fault. The result was a status quo that did not improve the situation of workers and their relatives in the case of workplace accidents, while at the same time their number and the misery caused by these kept rising.

Workers' accident insurance on fixed sums and premiums, the system pioneered by the UK companies, provided by private companies like Zurich could have been an efficient remedy. But there were mighty barriers. First, as this type of insurance was new there were still too few companies to provide the capacity of cover needed to really improve the situation. Second, neither employers nor workers nor the latter's ever more powerful political representatives were familiar with this type of insurance. Employers were not ready to purchase it and politicians not ready to make it compulsory by law. Third, the legal crux of the matter was the concept of liability, dogmatically tied to fault in most western legal traditions. Accordingly, workers representatives and political forces interested in improving the situation of the workers for different reasons, tried to do that by expanding or redefining liability.

This was first and most prominently the case in Germany. The Imperial Liability Law of 1871 did not abandon the principle of fault liability regarding workplace accidents, but it did make the proof of fault somewhat easier and most importantly defined compensations in a detailed way. In particular, it raised thereby the possible costs employers would have to face and accordingly the motivation to acquire insurance. This motivation was large enough to sustain the development of a specialized private accident insurance sector in Germany which Zurich became part of in 1875. For ten years workers' insurance in Germany was the company's largest portfolio. In this sense the newly established German Empire did drive the business of Zurich by way of the law of 1871. However the law also contained the seeds of the undoing of private workers' insurance in Germany, mainly because

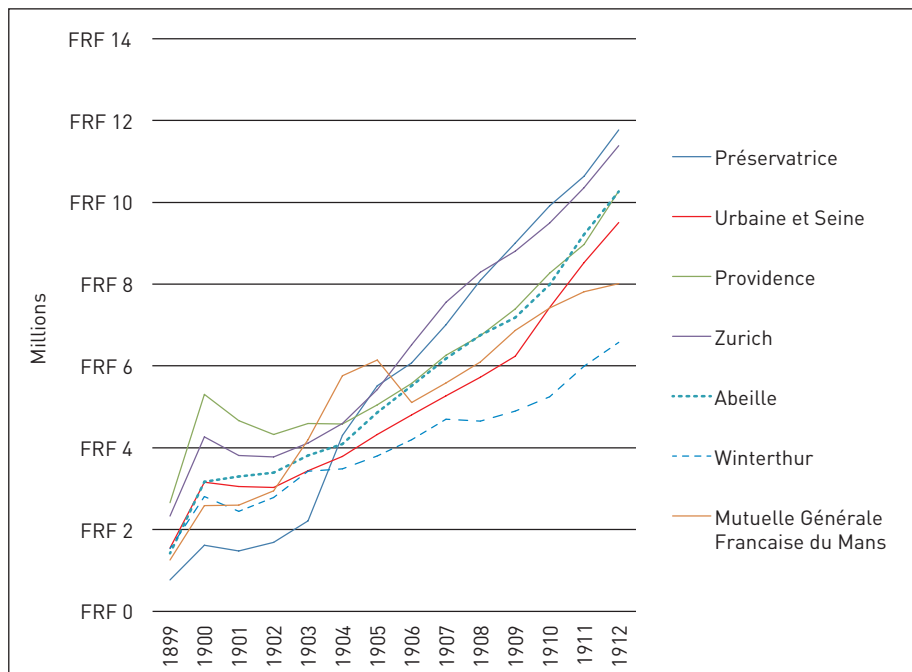
it did not generate a push strong enough to effectively promote workers' accident insurance to the extent necessary. By 1882, over ten years after the introduction of the law, only about five per cent of German workers were insured in this way. To make things worse, by tying compensation to fault the law undermined private workers' insurance from the inside: first, by inciting workers to seek compensation by suing employers in the courts; second, by motivating judges to grant higher than necessary individual indemnities to compensate for the deficiencies of the law. With the resolution of the Accident Insurance Act in 1884 this unsatisfactory situation was resolved in favour of monopolistic mutual state insurance schemes. Workers' insurance in Germany was thus lost for the private insurers.

In France too, the state became the main driver of Zurich's business, but only shortly before the turn of the century. Accidents in the industrial workplace had become an ever more serious social problem in France around 1850 too, but the private sector seems to have been able to resolve it at least insofar that on the political side not up enough pressure built up to successfully push for a state intervention as in Germany. From the 1860s initiatives by the industrial employers aimed at reducing workplace accidents and help injured workers became more visible. The first private stock insurance companies taking up the British accident insurance system on fixed sums and premiums and applying it to the insurance of workforces appeared in the 1860s too. They most probably pioneered the business model that German companies and Zurich were picking up in the 1870s. Foreign companies like Zurich active on the French market obviously played their part as well. On the eve of the law of 1898 up to 50 per cent of workers were somehow already covered by insurance. From 1880 in France there were also political projects taking a German direction, but they went nowhere. All in all, the private insurance industry seems to have been successful in convincing the French public and legislative bodies that the accident insurance they offered was a viable and effective solution for the problem of accidents in the workplace. Most probably this was because their business model circumvented the question of liability. Workers' insurance provided by private stock companies had always treated workplace accidents in the same way as the law introduced in 1898 did: as a simple risk of the workplace, especially the industrial one. Accordingly, liability was not even mentioned in the law anymore. The law did not make insurance compulsory, but the detailed way in which it defined the compensations that a worker or his relatives would receive *de facto* did. The financial risk of not having insurance became



very significant for employers. The law, indeed, produced the intended effect. The premium incomes of the accident insurers literally exploded, which is a strong indication that coverage expanded decisively. The law approved in Parliament in April 1898 was put in force in July 1899 and by the year's end Zurich's workers' premiums had grown by 68 per cent in comparison to the income in 1898. In 1900 they continued to grow by 28 per cent and in the years up to 1913 by a yearly average of eight per cent. The premiums of Zurich's six greatest competitors in the French workers' insurance market grew by a yearly average of 17 per cent from 1899 to 1912. All seven companies together had a combined premium income of 11.5 million FF from workers' insurance in 1899. By 1912 this sum had grown by the factor of six to a total of 65.7 million FF.<sup>320</sup> Clearly, the solution adopted by France worked: social insurance provided by private insurance companies.

Figure 5.1. GWP French workers' insurance by companies, 1899-1912



<sup>320</sup> ZAZ 1009:6 Frankreich historischer Überblick die verschiedenen Versicherungszweige 1879-1935, *L'Assurance Ouvrière Production de les plus grandes Compagnies en France 1899-1912*.



### **3. THE IMPACT OF REGULATORY DYNAMICS AND SOCIAL PRINCIPLES ON INSURANCE MARKETS**



## **CHAPTER 6. INSURANCE AND REGULATION MODES IN FRANCE AND SPAIN FROM THE END OF THE NINETEENTH CENTURY UNTIL THE END OF WORLD WAR TWO**

Leonardo Caruana de las Cagigas and André Straus

### **INTRODUCTION**

The relationship between the state and the economy is a frequent question for economists, economic historians, legalists and politicians. From a theoretical point of view, this question is extremely complex. The most common practice is to oppose the state to the market, or rather to the markets. With this interpretation, markets have by their nature the ability to regulate almost optimally the operating conditions of the economies that are only disturbed by the interventions of the state. One consequence of this interpretation was the wave of liberalism that has occurred since the eighties of the last century in industrial societies, and that has questioned, or put in doubt, the relevance of the economic role of the state and has encouraged deregulation and privatization.

Going back through the centuries, the insurance business has taken on many institutional forms. According to the nature of risks covered, time periods and countries, insurance has been done by the state, municipalities, mutual societies or joint-stock companies. Nevertheless, one of the most striking facts is the antiquity and vividness of the debates about the relationship between private enterprise, whether for profit or not, and the state, because the relationships between insurance companies and the state have indeed a long history.

Modern insurance was born in Europe in the Middle Ages and its oldest form, maritime insurance, started in the Mediterranean in the fourteenth century. The oldest known policy (1347) covered a trip between Genoa and Mallorca.<sup>321</sup> In

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<sup>321</sup> Basas (1963).

France, as in other parts of Europe, for example England, Spain, Germany and Scandinavia, the first organization to fight against the risk of fire was the guild. It was a type of intermediary organization between the family and political associations. Guilds had a common status and a cash income from annual contributions. In the case of France, Charlemagne prohibited guilds because of the threat they posed of political plots. Despite this ban, French guilds continued to act in secret. With the accumulation of reserve funds, fire departments were created that drew on centralized funds from charitable donations. These fire services helped those affected by fires to rebuild their homes. In addition, the Crown, parliament and the municipalities also lent assistance to the victims by reducing taxes or distributing subsidies. In this way, the government associated itself with subscribers, and, at least indirectly, regulated the procedure to be followed in case of a disaster. The authorities became responsible for determining the causes of the fires and controlling the distribution of aid. State intervention, however, was confined to the exercise of police power and to act as the guardian of public morality.

If the state in the case of France had been from the beginning hostile to the guilds, it seems to have been indifferent to the first attempts of mutuality in the seventeenth and eighteenth centuries, maintaining an attitude of passive neutrality towards them as in Spain. On the other hand, when the Perier brothers applied in 1786 for permission to found a fire insurance company, the royal administration granted them the privilege, while subjecting it to certain conditions designed to protect the public against possible fraud. The company's social fund of 4 million livres had always to remain intact and the provost of Paris's merchants was appointed as commissioner to control their placement. The company negotiated by mutual agreement with people wishing to cover their property. In case of damage, it had to pay within six weeks from the date of the official report of the loss. The state now stood as a protector of the victims against the society that insured them and no longer as custodian of compensation funds against unscrupulous claimants. The state controlled from now onward the strict performance of freely contracted obligations. State intervention took a new step when Labarthe, who had also obtained authorization to launch a fire insurance company, set out to conquer the market by a strategy of dumping.

In Spain during the second half of the eighteenth century the advent of stock companies became important to the development of the insurance industry. The first such company was launched in Madrid in 1786 with the name of the *Real Compañía de Seguros Terrestres y Marítimos*. The privilege was requested by Francisco Javier de Santiesteban and Felipe de Orbegozo, supported by the Duke of Osuna. They started with a capital of 45 million pesos, divided into 6,000 shares of 7,500 reales each and shareholders' liability was limited.

Despite these earlier developments, it was at the end of the eighteenth century and particularly during the nineteenth that the principles of modern state-insurance industry relations were established. In France those principles were reaffirmed in the law of June 14, 1938, which unified the modalities of state control over insurance companies. In Spain similar legislation was passed on May 14, 1908. The many problems that characterized the establishment of relations between insurance and the state, were of course, diverse across the several branches of the industry. By the mid-nineteenth century the relationship between fire and marine insurance companies and the state had largely been clarified, while many discussions and controversies continued to take place in the field of life insurance. In general, the state's view changed from a prohibitive approach to life insurance companies, to an attempt to control such companies in the interests of public morality and, in the French case, to protect policyholders against the consequences of possible corporate defaults.

## **THE REGULATION OF THE INSURANCE MARKET IN FRANCE AND SPAIN TO 1945**

An historical comparison of both countries reveals many similarities, for Spain followed French legislation and France invested heavily in Spain during the nineteenth century with the aim of being in at the "take off" of a Spanish Industrial Revolution that eventually proved to be slow. A real "catching up" did not happen up until the second half of the twentieth century and before then Spain's economic gap with France grew. During the second half of the twentieth century Spain changed significantly following the Stabilization Plan of 1959 and today it is approaching the levels of the core economies in the EU.

These important economic dissimilarities in the nineteenth century and the first half of the twentieth century meant that there were chronologically important differences in the history of each country's regulatory regimes. The rhythms of economic growth in the two countries make this more understandable. On the one hand, Spain's late start brought with it some advantages over more developed economies such as France. When new risks emerged, new technologies and insurance products that were responses to these risks had already been tested elsewhere before reaching the Spanish market. On the other hand, Spain's lack of economic capacity during this early period proved to be a major problem for her insurance industry.

In addition, social aspects were crucial in the development of the insurance industry. The different development of their economies had its effect on the transformation of both societies. Spain's larger peasantry and smaller working and middle classes had its effect on the development of social protection through the direct intervention of the State, and on the social factors behind individual decisions to take out fire or life insurance, the mentality to insure risk. The differential social and economic performance of both countries also led to large differences in the political situation. In sum, the path of regulation in Spain followed the more developed countries and had one clear reference point in French legislation and insurance regulation.

The regulation and supervision of the insurance industry in both countries emerged gradually during the eighteenth and nineteenth centuries. The earliest requirement was for a new company to receive government authorization to do business. In France an edict of 1787 authorized the creation of life insurance companies upon the payment of a bond and the approval of the general conditions of the premium rate policies. The 1807 Commercial Code made it mandatory for insurance companies to provide their accounting documents. Another step in regulation by the state came in 1816, when a government commissioner was appointed to a mutual fire insurance company at the time of its foundation. In 1842 a tontines commission reported to the Minister of Commerce, was composed of five members and had the task of carrying out direct checks on the registers and accounting books of companies.

In the Spanish case regulation progressed more slowly throughout the nineteenth century, commencing with the Commercial Code of 1829 that authorized the



registration of insurance companies like any other company. This followed the French Commercial Code of 1807, but also included many features that had been introduced in the *Ordenanzas de Consulado de Bilbao* of 1737. Specifically, the Code regulated maritime transport and land transport insurance (Frax and Matilla, 1996). The liberal revolution of the 1860s that spread in Europe arrived in Spain in 1868 and inspired the creation of private stock companies, influenced by the French company law of 1867 that introduced free incorporation. The French law, however, excepted life insurance companies that remained subject to official authorization and state supervision. These had to provide half-yearly statements and their prices could not be changed without the approval of the administration. What was remarkable about the French law was that it only applied to French companies; foreign companies were exempt from any regulation. As a result, French life insurance companies were subjected to unequal competition. To compound matters, American life companies had begun issuing “accumulation policies” that ensured the policyholder, in return for the payment of a surcharge, a share in the company’s profits. These benefits, however, were only distributed after a lengthy period of time (usually 20 years) and only to surviving insured persons. The French companies repeatedly drew the legislators’ attention to the promises thus made to the public, which they considered to be highly misleading. Some French companies began to employ the same propaganda methods as the Americans. It was in this climate that the bankruptcy of several companies (the *Caisse des familles* – the Life Annuity) occurred, highlighting the inadequacy of the supervision to which they were subject

In the Spain the Commercial Code of 1829 was amended in 1885. It included some specific regulations for life and fire insurance, but aimed to provide full freedom to the private companies and imposed practically no controls over them, whereas in more developed countries at this time governments were already introducing more controls.

One question that was closely related to regulation, and was much debated in France throughout the second half of the nineteenth century, was whether insurance was a public service or not. By contrast, this crucial debate did not happen in Spain, with consequences for both countries during the twentieth century (Frax and Matilla, 2008, p. 87). In Spain the insurance business remained confined to a

relatively elite group in society and did not spread to broader groups as it did in more developed countries like France and Germany.

In France an important milestone in insurance regulation was the Law of 9 April 1898, and specifically article 27 and the decrees issued for its implementation. This clearly marked the starting point of a more sophisticated regime of control. Companies of all kinds, French and foreign, which sold insurance against accidents at work to cover death or permanent disability, were now subject to a more complete and detailed regulation, covering both approval and operating procedures. The supervision was done by the Commissioners Controllers of the Ministry of Commerce and could also be carried out by any person delegated for this purpose by the Minister. In the same year, a decree of 22 January 1898 specified more precise rules for the creation and operation of insurance companies. For limited companies it became compulsory to set up a minimum guarantee capital and a reserve fund and to comply with a list of authorized investments. Finally, these companies were also required to insert a certain amount of information into insurance policies (the share capital paid, the maximum insurable on a single risk, the list of the different risks covered by the same insured capital).

For mutual insurance companies, the regulations were more comprehensive: it became mandatory to publish all rules of the association including the rules of incorporation. The decree also required the holding of regular general meetings, the preparation of accounts, procedures for the termination by the member of his participation, procedures for setting contributions, mandatory clauses in policies, methods for assessing claims, etc.

The introduction of an insurance supervision that involved only part of the industrial accident branch – usually referred to as “serious risks” – was concomitant with the introduction of new legislation imposing on companies or employers the obligation to compensate for accidents suffered by their workers or employees in the workplace. The supervision of insurance companies was one of the measures taken to safeguard the interests of accident victims. In particular, it was intended to avoid too frequent an intervention by the guarantee fund, which had been set up as a substitute for employers, and possibly their insurers, in the event that they did not fulfill their obligations.

Another step was the Law of 17 March 1905, shortly after the introduction of state control over industrial accident insurance, which affected a similar control over other branches. A commission, composed of lawyers, actuaries and the main directors of French life insurance companies, drafted the bill that was promulgated by this law, extending control to both foreign and French companies. The law required life insurance companies to limit their operations to certain classes of insurance. Instead of the theoretically discretionary authorization provided for by the law of 24 July 1867, it introduced a registration that could only be refused for violations of the law, in particular company legislation, or decrees issued pursuant to the law. The Minister was granted the power to revoke the registration, with the assent of an advisory committee, when the company no longer operated under the conditions provided for by law or its statutes. Life insurance companies had to have a minimum share capital and set up a guarantee reserve. Their mathematical reserves had to be calculated on a defined basis. Investments were regulated. Premiums had to be set at a minimum rate. The distribution of profits was to be made annually. Foreign companies and national companies were required to deposit in the *Caisse des Dépôts et Consignations* securities representing their technical reserves relating to transactions carried out in France. A general privilege was instituted for the benefit of policyholders and beneficiaries on the assets of French companies. Securities allocated to cover technical reserves and foreign companies were subject to a special privilege.

To conclude, in France, after the Revolution which had suppressed them, the insurance companies reformed under the Empire and the Restoration. To the French government it was clear that there was a need for close control. Companies had to be authorized and they were subject to strict operating rules. During the Second Empire, Napoleon III encouraged the development of mutual aid societies, alongside the traditional societies, composed solely of workers, so-called authorized societies, which could benefit from the donations and legacies of notables but were subject to the control of the prefects. These two types of societies developed until the end of the nineteenth century, but declined in the twentieth century.

It was thus from the end of the nineteenth century that the state played a direct role in the development of the insurance phenomenon. It had long since then taken charge of the regulation of the profession. In addition, the partition between

private companies, whether commercial or mutual on the one hand, and state insurance on the other, should not lead scholars to a schematic view that diametrically opposes what would emerge from a pure competitive market and what would fall within the public sector, because since the eighteenth century public authorities, like companies, have been concerned about organizing the market.

In the Spain at the end of the nineteenth century fiscal control became an important question for the state. The Royal order of April 11, 1893 fixed through a quota system the taxation of insurance companies. Article 6 established under the general tax system the so-called industrial contribution, and the Budget Law of 1893 and its regulation of November 22 introduce a two per cent tax on premiums. In January 1900 the Law of accident insurance was passed that was clearly inspired by the French Law of 1898. This time the gap was short. The law developed a system of accident insurance for industrial workers in Spain, which did not follow the German model of obligatory insurance, introduced by Otto von Bismarck in 1884, and instead followed the Belgian and French model of a private insurance subsidised by the state. The Royal Decree regulated the companies insuring workplace accidents in industry, not in agriculture. The latter would have to wait until 1931, even though agrarian workers constituted the majority in the country. Notwithstanding the clear influence of French legislation, the social and economic situation was different in both countries. Spanish companies were smaller than the French companies, so their financial capability to cover the risks was also smaller (Silvestre and Pons, 2010). A comprehensive regulatory system for insurance companies was finally introduced by the Law of 1908.

The 1908 "*Ley reguladora de las Compañías, Sociedades, Asociaciones y cualquier entidad que tenga por fin realizar operaciones de seguros*", normally referred to as the Insurance Law, imitated the legislation of leading insurance nations such as France (1905), Germany (1901), Britain (1870), Switzerland and others. The law represented a clear intervention by the state in the entire industry. This began with the requirement to compile a full list of the companies operating in Spain, specifying which were Spanish or foreign. The level of control was very extensive because it included all aspects of the business, specific products, price, technical reserves, etc.

The purpose of the 1908 law was to improve the quality of the industry by developing control by the State in the face of the obvious inadequacies of self-regulation. Even if the majority of companies operated efficiently, greater control was considered, as in other countries at the time, necessary. Fiscal policy was partly behind this. All companies were now required to provide accounting information on a quarterly basis, which resulted in the tax revenue from the companies increasing. A state supervisory apparatus was set up, with systematic company inspections being carried out by specialized and highly qualified civil servants.

The law of 1908 initially resulted in the growth of insurance, however in 1919 there was a decline due partly to the withdrawal from Spain of several important foreign companies, particularly American life offices, that balked at the new controls, particularly the requirement to keep half of a company's reserves in Spain. From the perspective of the Spanish Government it was not acceptable that Spanish savings were leaving the country in the form of premiums, as the country had a great need of savings. The impact was enormous because two American companies, the Equitable Life and the New York Life, accounted for 40 per cent of the life insurance business in the Spanish market. The Equitable ceased issuing life insurance in Spain in 1916, while the New York Life sold its business to La Equitativa (Fundación Rosillo) in 1921.<sup>322</sup> An important British company, the Standard Life, also left Spain in this period. These exits can to some extent be blamed on the strict controls that had been recently developed by the Spanish administration.

In the case of the Equitable Life it was immediately clear that uncertainty about the new law of 1908 was a major issue, in particular the fear that all the company's deposits would be required to be retained in Spain. The New York headquarters was at first firm that the Equitable should not even apply for registration. Its General Manager in Spain, Juan Ángel Rosillo, opposed this decision because it would mean the end of the company in Madrid. Together with James C. Rocquet, the Secretary General for Europe, both men argued the case in New York for the company to stay. Eventually their arguments were accepted and the company registered in Spain. In the end, however, the obligation, introduced at the start of the

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<sup>322</sup> After World War One, the enormous financial problems in Europe, higher mortality rates, the greater controls imposed by law and high tax rates also convinced Equitable to withdraw from operations there (Pons, 2008).

war, to hold 50 per cent of the company's deposit in the Bank of Spain, together with the serious internal problems had arisen since the Armstrong Investigation of 1906 made the Equitable's directors reverse their decision in December 31, 1916. Spain was not the only country that the Equitable left. It also withdrew from France and Russia. In Spain, the withdrawal was gradual, beginning with the decision to cease writing new life policies. The company was finally officially liquidated there in 1947, at a difficult moment for the Franco regime, which in December 1946 had been excluded from United Nations (Huerta, 2007). Over the following decades the situation was more or less stable with regard to legislation and regulation. A new insurance bill was developed in 1954 but it never came into force, so the Spanish insurance industry continued largely to follow the regulations of 1908.

In France World War One had a terrible effect on the general economy and on the insurance industry. A Law of 15 February 1917 focused on regulating reinsurance, which had been operating during the first years of the war as if there were no hostilities. A large number of French insurance companies, however, were bound by treaty with reinsurance companies from enemy countries and there was mounting concern that sensitive information from French companies could be passed on to the enemy by company staff through reinsurance slips. The law subjected to supervision reinsurance operations underwritten or executed in France. In the field of direct insurance, the same law introduced the principle of discretionary authorization for foreign insurers, regardless of the branch operated and the possibility of requiring special guarantees by application of the principle of reciprocity. The law of 15 February 1917 also established one of the fundamental principles of French control: that risks located in France must be insured by companies with an office in France.

After World War One the sector in France was subject to the negative effects of the depression, and exactly how it overcame these difficulties requires an explanation. The main cause of the difficulties was competition among the domestic companies. Although this was not a new element, it was exacerbated by the crisis. In a shrinking market, companies tried to maintain their levels of production. In motor insurance, adventurous insurers started offering rates that were clearly insufficient, and in the other lines agents who were working hard to get even more contracts signed sometimes with large risks assumed and agreed to large rate

discounts. Some were even willing to insure the risks of war without requiring the payment of any additional charge. This reckless policy forced some insurance specialists to cease operations, but the effects of this increased competition created difficulties for the profession as a whole. The insurance industry responded by strengthening its organization. The action of the *Comité Général des Assurances*, created in 1927, with regular meetings between the directors of the major companies, strengthened the solidarity of the insurers and enabled them to agree on common tariffs. In 1933 a tariff was drawn up for motor insurance, followed in 1935 by a tariff for occupational accident insurance, and the major fire insurance companies signed a non-aggression pact to end the practice of granting premium discounts and to adopt a common tariff for this line of business as well. Finally, in 1936, the General Insurance Committee, the Trade Union for fixed-premium companies, the assembly of directors of mutual companies, and the Trade Union of transport insurance companies, created the *Fédération Française des Sociétés d'Assurances* (French Federation of Insurance Companies), with the aim of coordinating the activities of all groups and trade union organizations to represent the entire professional body in dealing with the government. That meant that on the eve of the Second World War, all the unions came together in one organization, with one of its missions being to represent the entire profession.

More important, however, was the fact that the state increasingly intervened in this sector in agreement with the key officials in the profession in order to safeguard the security of policyholders and to ensure that companies were always in a position to “honor” their commitments. Excessive competition was seen as harmful for the insured, and so it was considered necessary to bring an end to this.

A series of measures between 1930 and 1938 led to the organization and regulation of insurance and the prohibition of abusive practices. During these years a range of measures was agreed that tended to limit and control competition. In 1930, a law on land insurance codified insurance law and made contracts less disparate, and a decree prohibited certain abusive practices, such as abandonment to subscribers who want to extract all or part of acquisition commissions or bonuses. A decree of 1931 imposed, from December 31st, 1932, a reduction from five to 4.5 per cent of the interest rate used for the calculation of life annuities, and in the same year a law and two decrees reinforced the capital requirements

regulation applying to companies. In 1935 a decree reduced the amount of brokerages allowed, and, after the failure of some small cases, a set of measures was introduced that reinforced the control of the State over various categories including automobile insurance.

The Legislative Decree of 14 June 1938, supplemented by an order in council of 31 December 1938, completed the structural reforms by coordinating and simplifying the existing control system while organizing close collaboration between the representatives of the professional body and government officials. As the columnist (Mirimonde) of the *Revue d'Economie Politique* wrote in 1939, this decree "co-ordinates and simplifies the previous control system while organizing between the representatives of the corporation, disciplining and supervising itself, and the agents of the administration, in charge of the control. Broad perspectives thus open to a better coordinated industry. It is this new organization which allows in the immediate time to raise from 35 to 25 per cent [sic] the premiums for accident insurance".

Thus, before the Second World War the French insurance industry had diversified, driven by new needs and the extension of the scope of insurable risks. It had become organized, in agreement with the state, and had made admirable efforts in its international expansion. While in 1880 French insurance locations abroad were still rare, with the exception of companies like *L'Union*, by the late 1930s, they had become numerous, following the shift in international trade and the construction of the colonial empire. Although the project of nationalization or a public monopoly of the insurance sector was included in the program of the socialist party (SFIO), the Popular Front did not increase the intervention of the state in the insurance business.

One of the major changes affecting the insurance industry in the twentieth century was the motor industry and insurance supervision of this branch in France commenced as early as 1935 with the Decree-Law of 8 August 1935. This decree-law and the texts adopted for its application provided for the control exercised over insurance companies insuring against accident risks or civil liability resulting from the use of motor vehicles of all kinds. In particular, Article 8 of the Decree of 3 June 1936 stipulated that the Minister of Labour could require these companies



to provide all relevant information on their general situation, on the conduct of their operations and in particular on claims payments and on reserves.

An institution of control over the automobile industry had been demanded by the *Entente automobile*, founded in 1931, an organization representing all the automobile insurers, which aimed to establish a tariff based on common statistics. Control was seen as protection against the abuses of competition, whereby some companies offered significant discounts on the rates established by the *Entente automobile*. Very soon it became clear that the generalized control over all the activities of insurance companies, laid down by the Decree-Law of 8 August 1935, could not be exercised effectively if the rules applicable to all branches of insurance were not specified. The system in place created different situations for insurance companies depending on whether or not they practiced one of the branches subject to supervision. Moreover, the several laws on the subject, without sufficient coordination, gave rise to the application of different control methods that were not always justified by the particular techniques of the companies under supervision or the operations they were aimed at.

The Decree-Law of 25 August 1937 was a first step in the much needed consolidation effort by establishing a control procedure for companies carrying out insurance operations not previously covered by special legislation. This generalization of state control was followed quickly by the decree-law of 14 June 1938, which replaced all the previous texts. This latter decree, and the public administration regulation of 30 December 1938 that supplemented it, remain the basic texts governing insurance supervision in France.

Another aspect to analyze is the regulation of insurance contracts, because the control over insurance companies and legislation on contracts did not appear simultaneously in France. As early as the seventeenth century, special rules had been laid down for marine insurance contracts. These rules were incorporated into the French Commercial Code. However, in other branches of insurance the contract remained governed solely by the rules of ordinary law. Some fragmentary provisions occurred at the end of the nineteenth and the beginning of the twentieth century: the law of 19 February 1889 regulated the award of compensation to the insured's creditors; the law of 2 January 1902 established jurisdiction in disputes

between insurers and insureds; the law of 8 December 1904 prohibited insurance in the event of the death of children under 12 years of age; the Decree of 8 March 1922 regulated termination after damage, the duration of the contract, and the tacit renewal clause.

After lengthy preparatory work, the law of 13 July 1930 was passed that contained general rules on insurance contracts and repealed the above-mentioned provisions. However, marine insurance contracts were excluded from the scope of this law. These were still governed by the French Commercial Code (Articles 332 to 396). River insurance, aviation insurance and credit insurance contracts were subject only to ordinary law and reinsurance treaties.

The law of 13 July 1930 essentially determined the conditions of validity of the contract (form case of invalidity); the information that must be included in the insurance contract; the rules relating to its duration (case of suspension of termination); the rules relating to its modification or transmission to other persons, in the event of death, bankruptcy or alienation of the insured item; the obligations of the insured (declaration at the time of subscription is in the course of the contract concerning the guaranteed risks, declaration of claims, payment of premiums, etc.); the penalties that may be applied if the insured does not comply with them (nullity of the contract, reduction of benefits, suspension of the guarantee, loss, indemnity, etc.); the insurer's obligations (rules for determining the compensation due in the event of a claim, risks that may be excluded from coverage, risks that cannot be excluded); rules relating to procedure (limitation of actions, rights of third parties against the insurer, subrogation) and the competence of judicial authorities.

The provisions of the ordinary law (Civil Code) relating to contracts of nature remain applicable to insurance contracts for all matters not covered by the law of 13 July 1930. Among the essential texts relating to the insurance contract is the law of 15 February 1917 under which all contracts concerning a person or a liability in France must be concluded with an insurance company authorized in France. There are various other legislative texts concerning special cases (destroyed or stolen contracts, contracts in foreign currency and termination of contracts in the event of requisition of insured property or in the event of war). However, texts establishing an insurance

obligation generally specify the scope of the obligation and, consequently, the guarantees that the insurance contract must contain.

What were the basic concepts of control? The essential purpose of supervision was defined in Article 1 of the Decree-Law of 14 June 1938: "State supervision shall be exercised in the interest of insured persons, subscribers and beneficiaries of insurance and capitalization contracts". It aims to ensure the successful completion of the contract and therefore covers various aspects. From a legal point of view, the task of supervision is to monitor the application of the legislation defining the mutual obligations of the two contracting parties, the insurer and the insured, and possibly the insurer's obligations towards third parties who are interested in the coverage provided for in the contract. The state legal protection was equally available to all. One of the purposes of the latter is to ensure that insurance contracts are concluded in accordance with national legislation executed in good faith, whatever the personal situation of the subscribers. Another purpose is to ensure the application of the rules governing the constitution and administration of companies, especially when members of the company are at the same time the insured persons, as is the case for mutual companies.

In terms of business management, the state controls the accounting field, by ensuring that the companies establish a true and fair accounting of their operations. In the technical field state supervision is essential for examining methods for estimating commitments. In the financial field, the state lays down rules for the coverage of company liabilities by assets of certain value and by determining the amount of guarantees which constitute what is known as the insurer's solvency margin (share capital and guarantee reserve) and which make it possible to offset errors made in the valuation of liabilities. State control is also concerned with the economic aspect of the insurance industry and in particular seeks to avoid the inconveniences that could result either from certain obstacles to competition (agreements) or from abuses to which this competition may give rise.

If we refer to the form of control, we must point out that one of the essential characteristics of French supervision is that it covers all the activities of insurance companies. In this respect, there has been an evolution since the beginnings of state supervision. The audit first focused on certain specific lines of insurance

considered to be the most important. Experience, however, showed that such a design did not protect the interests of policyholders sufficiently. Currently, state control covers all branches operated by the same company. As a result, all insurance companies are subject to supervision even if they operate in a category of transactions of less social interest. It seemed essential that insurance companies carrying out the same category of operations should be placed in an equivalent situation and that policyholders should enjoy the benefits of supervision regardless of the company with which they insure.

Another important feature of control is that it does not limit its ambition to sanction mismanagement but to prevent it. This concern is revealed in a number of provisions providing for prior agreement (approval of the general terms and conditions of contracts, amendments to the Articles of Association for certain categories of companies, tariffs for certain categories of transactions) and above all in the emphasis given to regulation and the calculation of commitments, and in the regulation of authorized investments. However the concern to carry out preventive control has not ruled out the need for companies to retain the initiative and responsibility for their own management. Obviously, French insurance regulations exclude any arbitrary intervention by state authorities. Intervention must always be carried out within the framework of the regulatory texts. The supervisory authority can only act, with very few exceptions, by means of general regulations applicable to all companies, and not by taking individual decisions applicable to a particular company. That is why the entire set of regulations appears above all as a code of rules of prudence and sound management to which a company must comply.

## **CONCLUSION**

Insurance companies in their different organizational forms – state, stock companies or mutual – have a long history in France and in Spain. Insurance was already developing in the Middle Ages, but the substantial growth of the industry in France was in the nineteenth century and this opened up a debate about the role of public insurance. State control was crucial for the industry both during and after that century. The year 1898 was the starting point in France for a more specific kind of

control, for example of workplace accident insurance, and of the rules concerning the foundation and operation of all insurance companies. In the particular case of mutual companies even greater regulation was developed. In the twentieth century regulation became both broader and more specific to each branch of insurance.

In Spain state control of insurance companies developed at the end of the nineteenth and beginning of the twentieth centuries in a successful way. It helped reduce irregular activities in the industry and gave support to Spanish insurance companies, probably contributing to the departure of some foreign insurers from Spain such as the Equitable Life, the New York Life and the Standard Life. Up to the end of the Second World War under the Franco regime Spain experienced the greatest differences with France. This was the period in which the fewest foreign companies were operating in Spain and ensured, as it was said, that "Spain was different".



## CHAPTER 7. SWEDISH INSURANCE INSTITUTIONS AND EFFICIENCY 1920-1980

Mikael Lönnborg, Peter Hedberg and Lars Karlsson

### INTRODUCTION

This chapter addresses two intimately related fields of research. The first regards the literature on the relation between institutional change and market conditions, while the second regards the effects of market regulation on market efficiency. We place our focus on the conditions of the insurance market in 1920-1980 but focus on post-war Sweden. Insurance played a key role in the compensatory systems that developed in close relation to the Swedish welfare policies after World War Two.<sup>323</sup> From a public perspective, attaining economies of scale in insurance was considered a prerequisite for ensuring the efficiency and stability of the insurance market. For this purpose, from the 1930s onward, new regulations were introduced successively. Eventually, the insurance industry became both protected and concentrated and during the mid-1960s it developed distinctive features of an oligopoly market. As a result, a number of insurance companies were reorganised into a few large and financially strong business groups. The impact of this increase in market concentration on the efficiency of the insurance industry is, however, unclear. On the one hand, improved economies of scale have been regarded as one of the factors behind the remarkable post-war economic boom, especially in small and late industrialised countries like Sweden. On the other hand, according to the industrial organisation literature, oligopoly markets have been associated with numerous problems, such as low cost-efficiency in production and services, rent-seeking strategies,

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<sup>323</sup> Lundberg (1985); Baldwin (1990); Larsson, Lönnborg and Svärd (2005), p. 57; Lönnborg and Olsson (2010); Esping-Andersen (1985); Katzenstein (1985); Dixit (1996).

misallocation problems and so on, which might well entail market inefficiencies.<sup>324</sup> Problems of this sort did, eventually, become one of the main arguments for the wave of market deregulations in Sweden after the 1980s.

From the 1930s to the 1980s, the institutional environment for Swedish insurance was drastically altered by rigorous changes in market regulation. In this chapter we provide new empirical evidence on the impact of these institutional changes on the market structure, efficiency and profitability of the Swedish insurance industry. The empirical analysis is presented more closely below, in section III. In section II, the regulation of the Swedish insurance market is outlined in brief before the analyses are presented. In section IV, we look more closely at the difference between joint-stock and mutual insurers and in section V, we conclude the chapter.

## **THE CHANGING POLICIES AND THE REGULATION OF THE INSURANCE MARKET**

One of the guiding principles of the overall post-war policies in Sweden was to avoid conversion problems and cyclical fluctuations and to organise the economy in accordance with the Keynesian policy goal of full employment. Fiscal instruments and structural rationalisation were considered to be efficient policy tools. Accordingly, market concentration became an important post-war feature. Increasing ownership concentration, especially within the Swedish bank groups, encouraged the channelling of investments as well as the clustering of companies that aimed for a strategy of mergers and structural rationalisation in order to improve efficiency. According to Schön, this was part of the explanation behind the extraordinarily fast growth rates in Sweden during the post-war years.<sup>325</sup>

In this chapter we place special focus on the insurance market regulation that was introduced in 1948 and onwards, and that sought to ensure that the insurance

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<sup>324</sup> See, for instance, chapters 1 and 2 in Baumol (1986); Vives (2001); Scherer and Ross (1990); Feenstra and Levinsohn (1989); Dixit and Stiglitz (1977); Nishimura and Ogawa (2002); pp. 185-190; Childs (1936); Child (1980); Notermans (1998); Forsyth and Notermans (1997).

<sup>325</sup> Schön (2010); Rothstein (1996); Hägg (1998); Hadenius (1999); Landes (2003).



market functioned in accordance with the official policy objectives. Even though the regulatory regime shift began already during the 1930s, in order to coordinate domestic interstate policies in concert with the low fixed interest rate policy principles, the real watershed occurred after the war. From 1948 and onward, market regulation was successively extended, drawing on six basic policy principles in the insurance market which became instructions for the Insurance Inspectorate (*Försäkringsinspektionen*), namely the 'principle of solvency', the 'principle of equity', the 'principle of need', the 'principle of separation' (between life and non-life operations), the 'principle of insured's influence' and the 'principle that an insurer could only conduct insurance business'.<sup>326</sup> Several novelties were incorporated in the new legislation. The 'principle of need' meant that a company was obligated to demonstrate an actual need in order to receive a license to enter the market. This principle, which raised the barriers to entry, gave the supervising authority, e.g. the Insurance Inspectorate, the power to determine the structure of the market. In reality, this protected the incumbent insurance companies from competition from new companies, while the remaining companies expanded horizontally and vertically. During the first ten years of the new legislation, not a single new company was established in the life insurance field, since the Insurance Inspectorate considered the market to be in equilibrium. Even when non-life insurance companies did get a concession, it was mainly to enable combination insurance as a measure for improving market efficiency.<sup>327</sup>

The so-called 'principle of equity (fairness)' only applied to life insurance companies when it was introduced in 1948 (a decade later a softer version was introduced for non-life insurers). The purpose of this principle was to protect customers from paying too high premiums. The 'principle of equity' primarily aimed at underlining how the government gave priority to constant cost reductions among private companies. However, the principle was also a way of sustaining artificial competition and counteracting cartel agreements on the market, which reduced competition.<sup>328</sup> While the 'principle of equity' was a typical institutional device for

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<sup>326</sup> Jungerhem and Larsson (2013); Bergström *et al.* (1994); *Private Insurers in Sweden* (1954).

<sup>327</sup> *Statens Offentliga Utredningar* (1946): 34, (1949): 25, and (1983): 5, pp. 75-77; Larsson and Lönnborg (2016).

<sup>328</sup> Grip (1991).

Sweden, the Insurance Inspectorate never defined the term 'equity' (fairness) in any proper way, and it was therefore dependent on subjective judgements of the Inspectorate. By referring to the 'principle of equity', the Insurance Inspectorate gathered information about how the costs developed for different companies, which were published continuously in the annual official statistics. This open publication was considered as a means of keeping the premiums down and underpinning a constant rationalisation among companies.<sup>329</sup>

Another feature was the so-called 'principle of mutuality', which in practice meant that the profits in every life insurance company – regardless of ownership structure – were to be returned to the policyholders. However, this was not a formal rule; rather it was inspired by previous traditions on the market. Fierce competition on the life insurance market before World War II induced a development where most of the profits were returned to policyholders. However, as a part of the 'principle of equity', the 'principle of mutuality' meant an informal ban on dividends among life insurance companies, and thus even joint stock corporations were forced into acting as mutual insurers. Eventually it was suggested that the 'principle of equity' should also apply to non-life companies, and this was duly implemented through an amendment to the law in 1950.<sup>330</sup> The wish to ban dividends among life insurers was supported by the so-called "principle of separation", which stipulated that the life operations of mixed companies must be transferred to a separate company, either existing or newly founded, without any compensation to the shareholders.

The 1945 state commission, that investigated whether the life insurance industry should be nationalized and also suggested new legislation for the entire industry, supported the idea of strengthening the position for those insured in managing the companies that insured them.<sup>331</sup> The influence of the insurance co-operative idea was to become one of the cornerstones in building mutual companies. The commission wanted this influence to increase and was willing to give priority to the founding of mutual enterprises. The commission was also in favour of

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<sup>329</sup> Larsson *et al.* (2005), pp. 75-76.

<sup>330</sup> Grip (1987); Lewin (1967).

<sup>331</sup> Statens Offentliga Utredningar (1949): 25.

representation for the insured and in 1951 a new law was passed that guaranteed representation on the board for policyholders in both mutual and joint stock companies.<sup>332</sup>

The insurance companies were not particularly supportive of regulations that limited their freedom of action. At the same time, however, the changing policy occurred against a backdrop of threats of even stricter regulations – and in the worst case nationalization – a threat that some recognised as very real. However, not all rules in the new law were negative for all companies, especially not for the larger corporations. One particular objective of the law was to make the market more efficient through mergers. It was argued that larger companies could more easily implement effective routines and develop new low cost insurance products. The larger companies gained an advantage mainly because the threshold of entering the market was raised (the market considered the ‘principle of need’ in the new legislation as a pretty effective barrier to entry) and because of a rising minimum efficient scale due to, for instance, the “principle of solvency”.<sup>333</sup>

In sum, the new legislation departed from international standards and considerably constrained private insurers regarding, for instance, entry into the market, setting premiums and making profits on life insurance, while also relaxing the previously existing rule that every different non-life insurance branch had to be organised as one specific company. The intention was to facilitate higher efficiency and, as a consequence, a market concentration process commenced.

### **The empirical analyses**

In the following, we examine the insurance market in Sweden between 1920-1980 with regard to its structure and composition. In 1920, the first year of our time period, the structure of the Swedish insurance market was relatively dispersed, consisting of a large number of companies, joint stock and mutual, with different kinds of operations nationwide (and indeed international), as well as at the

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<sup>332</sup> Larsson and Lönnborg (2015).

<sup>333</sup> Larsson, Lönnborg and Svärd (2011).

regional or county/parish level. In table 7.1 below, the total number of private insurers in Sweden is shown for ten-year intervals between 1920 and 1980, for four subgroups of companies. The number of companies declined across the four groups in general, but there was a considerable variation between the groups. The reduction in the number of companies between 1920 and 1980 ranges from 33 per cent in the case of joint-stock life insurers, to close to 70 per cent in the case of mutual non-life insurance companies. For both groups of mutual insurers as well as for the joint-stock life group, there was a long-run trend towards a reduction in the number of companies throughout the examined period, which seems to have accelerated in the 1950s and 1960s. The concentration process of joint-stock non-life companies, on the other hand, seems to primarily have taken place in the 1960s. All in all, the number of companies in the industry was reduced from 115 in 1920 to 46 in 1980, or a reduction of 60 per cent, with two thirds of this reduction occurring in the 1950s and 1960s.

Table 7.1. The Structure of the Swedish Insurance Market: Number of Insurers, 1920-1980

		1920	1930	1940	1950	1960	1970	1980
Joint stock	Life	9	7	7	5	5	4	6
	Non-life	35	31	32	34	31	16	16
Mutual	Life	17	14	12	13	10	8	7
	Non-life	54	52	47	39	32	20	17
Total		115	104	98	91	78	48	46

Source: *Official Statistics of Sweden, Private Insurance Companies, 1920-1980.*

Figure 7.1 below displays the development of the level of market concentration within the Swedish insurance industry for the same four groups of companies. The level of market concentration has been measured in the form of a Hirschman-Herfindahl index (HHI), using data on the total turnover for all Swedish insurance companies in the period 1920-1980. The HHI is calculated by taking the sum of the squares of the market shares of all firms within an industry, yielding a ratio that may vary from 0 to 1.0, where values close to 0 indicate low levels of market concentration, while values close to 1 indicate high levels of market concentration. An index value of  $>0.25$  is commonly interpreted as signifying a highly concentrated market. Looking at figure 7.1, the patterns are roughly similar across the four groups, with low to moderate levels of market concentration

prevailing for most of the period, followed by a significant rise in the HHI after 1948, when the regulatory shift began. When the regulation was extended, the market concentration increased. This was especially distinctive during the 1950s and 1960s, when the HHI rose up to levels representing highly concentrated markets. The group mutual non-life companies stood out somewhat from the other groups in several respects. It was the only group for which a clear downward trend in the level of market concentration is discernible during the early part of the period; from the 1920s up to the early 1940s.<sup>334</sup> During the latter part of the period, the HHI for mutual non-life companies was characterised by a steady upward trend, but it did not exhibit the same sharp upward shifts as did the other groups, nor did it rise to the same high levels as the HHI of the other groups. Finally, in the case of joint-stock (life and non-life), as well as mutual life insurance companies, there was a clear trend towards a lower market concentration taking place from the early to mid 1970s, while no such trend is discernible for mutual non-life companies.

The sharp upward shift in the HHI for joint-stock companies during the mid to late 1960s was mainly due to a series of mergers initiated by the rapid expansion strategies of Skandia, which increased its market share of the non-life segment from nine per cent in 1964 to just under 20 per cent in 1965 and over 40 per cent in the mid 1970s. The sharp rise in the HHI of mutual life insurance companies between 1970 and 1971 was caused by the merger between Trygg and Hansa, which left the merged company with a share of the Swedish life insurance market of around 34 per cent.<sup>335</sup> The subsequent downward trend of the HHI during the 1970's, in the case of joint-stock and mutual life insurance companies, was not primarily the result of new entry into the industry, but was mainly due to the convergence of market shares between incumbent companies. Overall, there were very few new entrants into this industry from the 1950s onwards, and it then mainly concerned reinsurance companies.<sup>336</sup>

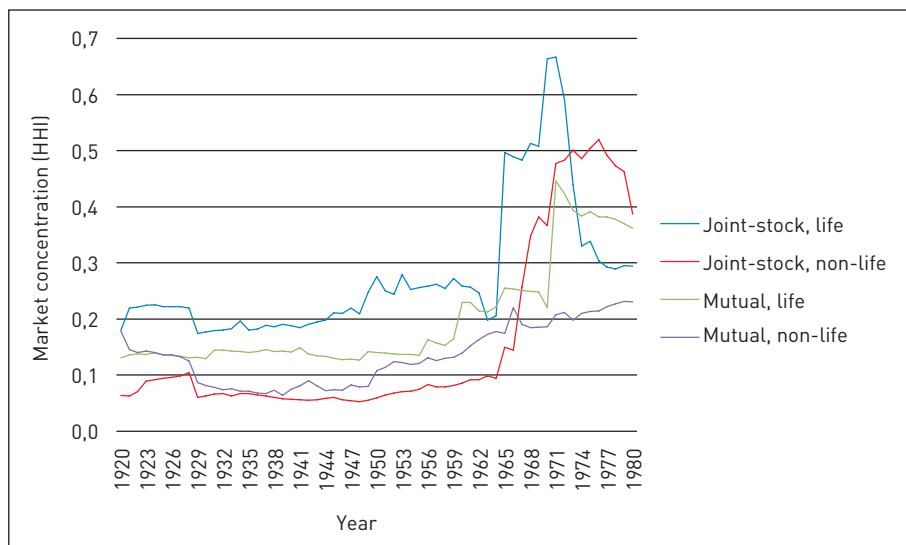
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<sup>334</sup> Lundberg and Molén (1958).

<sup>335</sup> Englund (1982); Kuuse and Olsson (2000); Fredrikson *et al.* (1972).

<sup>336</sup> Larsson and Lönnborg (2009); Larsson and Lönnborg (2014); Kader *et al.* (2010).

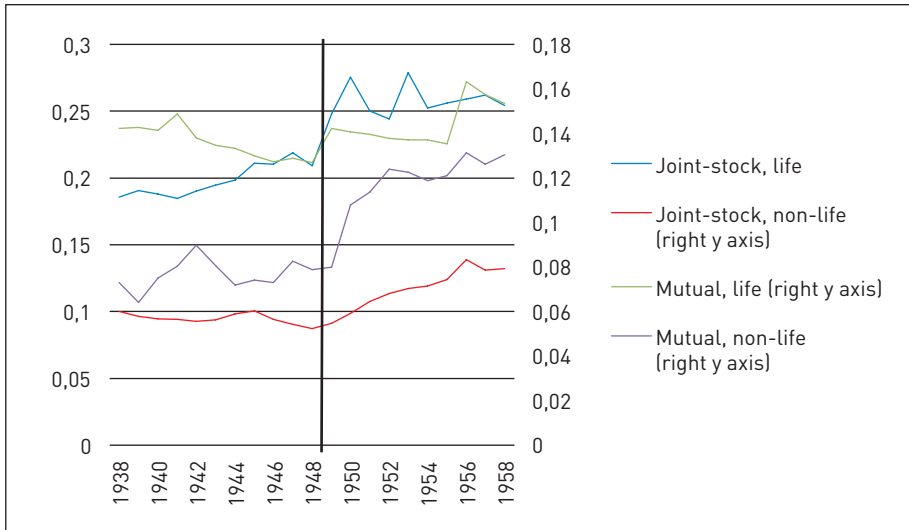
Figure 7.1. Hirschman-Herfindahl Index of Market Concentration, Swedish Insurers, 1920-1980



Source: Sweden Public Statistics, *Private Insurance Companies, 1921-1980*.

While not readily discernible in figure 7.1, there are signs of a shift in the level and/or trend of the HHI series in 1949/50, which can more easily be seen in figure 7.2 below. In the case of joint-stock life insurers, there was a weak trend towards increased market concentration from the late 1920s up to 1948, when the level of concentration increased significantly, which is displayed as a significant level shift in the HHI. The trend then continued up to a brief slump in the early 1960s, before the major concentration phase commenced in the mid 1960s. A similar level shift could be observed in the case of mutual life insurance companies. For non-life companies (joint-stock and mutual), there was an apparent shift in the trend of the HHI series from 1949 and 1950, respectively. These findings would seem consistent with the view that the regime shift, beginning with the introduction of the law of 1948, served to increase the level of market concentration in the Swedish insurance industry.

Figure 7.2. Hirschman-Herfindahl Index of Market Concentration, Swedish Insurers, 1938-1958



Source: Sweden Public Statistics, *Private Insurance Companies, 1921-1980*.

To formally test whether the Swedish insurance law of 1948 did, in fact, have an impact on the market structure of the insurance industry, we performed an interrupted time series analysis in the form of a panel regression. To estimate the effect of the 1948 law on market concentration (HHI), we included a dichotomous dummy variable (Law 1948 level) scored 0 for each year before 1948 and 1 for 1948 and after, as well as a dummy variable counter (Law 1948 trend), scored 0 for each year before 1948 and 1, 2, 3... for 1948 and after, and a simple time trend variable (baseline trend). These variables were included to capture a possible shift in the level (mean) and/or trend (slope) of the regression line from 1948 onwards. We used the natural log of total turnover for each of the four groups of companies as one control variable (ln Market size), and the average annual wage level in the Swedish insurance industry (ln Wages) as another control variable.<sup>337</sup> To control for endogeneity, we used fixed effects and included dummy variables for the

<sup>337</sup> Both control variables were expressed in real prices (1948=100). Data on total turnover was taken from Official Statistics of Sweden, *Private Insurance Companies, 1920-1980*, and data on wages was taken from Official Statistics of Sweden, *Yearbook of Wage Statistics in Sweden, 1920-1980*.

joint-stock life, joint-stock non-life and mutual life groups. The results, which can be seen in table 7.2 below, indicate that the law of 1948 did indeed have an impact on the market structure of the Swedish insurance industry, contributing to an increase in the market concentration (HHI) of around four per cent per annum from 1948 onwards. The OLS estimation tested positive for serial correlation and, for this reason, we also estimated the regression after having transformed all continuous variables using the obtained serial correlation coefficient. These results can be seen under the column GLS. This procedure removed the serial correlation, but left the Law 1948 trend variable statistically significant. There is thus a clear shift in the regression line from 1948 onwards, indicating that the law of 1948 did indeed contribute to the rise in market concentration in the Swedish insurance industry between 1948 and 1980.

Table 7.2. Regression Results: Market Concentration, Swedish Insurers, 1920-1980

	OLS	GLS
Ln real wages	0.55** (2.37)	0.16 (0.82)
Ln market size	-0.14** (-2.37)	0.05 (1.12)
Baseline trend	-0.01*** (-4.06)	-0.01 (-0.54)
Law 1948 level	0.03 (0.38)	0.04 (1.22)
Law 1948 trend	0.05*** (5.04)	0.04** (2.02)
Adj R <sup>2</sup>	0.80	0.27
D-W	0.26***	1.81
N	244	240

\*\*\* Sig. at 1 % level \*\* Sig. at 5 % level \* Sig. at 10 % level.

The insurance law of 1948 thus managed to accomplish one of its main objectives, i.e. creating a more concentrated Swedish market for insurance. As mentioned above, attaining economies of scale in insurance was considered by Swedish policy makers to be a prerequisite for ensuring the efficiency and stability of the market. Larger companies, it was argued, could more easily implement cost-effective routines and develop new low cost insurance products. For this reason, Swedish



policy makers pursued a policy of structural rationalisation which aimed at reducing the number of active insurance companies and concentrating market shares as a means of attaining economies of scale. To ensure that the expected rise in productive efficiency was not simply absorbed by the remaining companies – through rising profit margins – the so-called ‘principle of equity’, referenced above, was introduced in order to keep premiums at a level that was considered ‘fair’. These policies were, in combination, expected to maximize consumer welfare by enabling companies to provide better services at lower costs.<sup>338</sup>

Next we analyse the development of efficiency within the Swedish insurance industry over time, in an attempt to answer whether the 1948 insurance law did, in fact, accomplish the twin objectives of improving efficiency and maximizing consumer welfare. We use a simple partial productivity measure as a proxy for efficiency, with the sum of insurance claims paid and bonuses allocated to policyholders as output and the sum of administration expenses and net premium income as input.<sup>339</sup> However, it is important to note that this ratio is not only intended to measure the development of the productivity or the cost-efficiency of Swedish insurance companies. Rather, what we want to test is to what extent Swedish insurance companies became more cost-efficient as a result of the regulations that were introduced from 1948 onwards, *and* to what extent this improvement in cost-efficiency benefitted the average Swedish consumer of insurance, in the form of reduced prices (i.e. the effect that was anticipated by Swedish policy makers). If Swedish insurance companies did, in fact, become more cost-efficient after 1948, in the sense that more individual risk could be managed and redistributed using less input, and assuming that this improvement in cost-efficiency was not simply absorbed by rising profit margins, this should have caused our measure of efficiency to rise.

Figure 7.3 below shows the evolution of our measure of efficiency, for the same four groups of companies as before. Looking at figure 7.3, there are strong

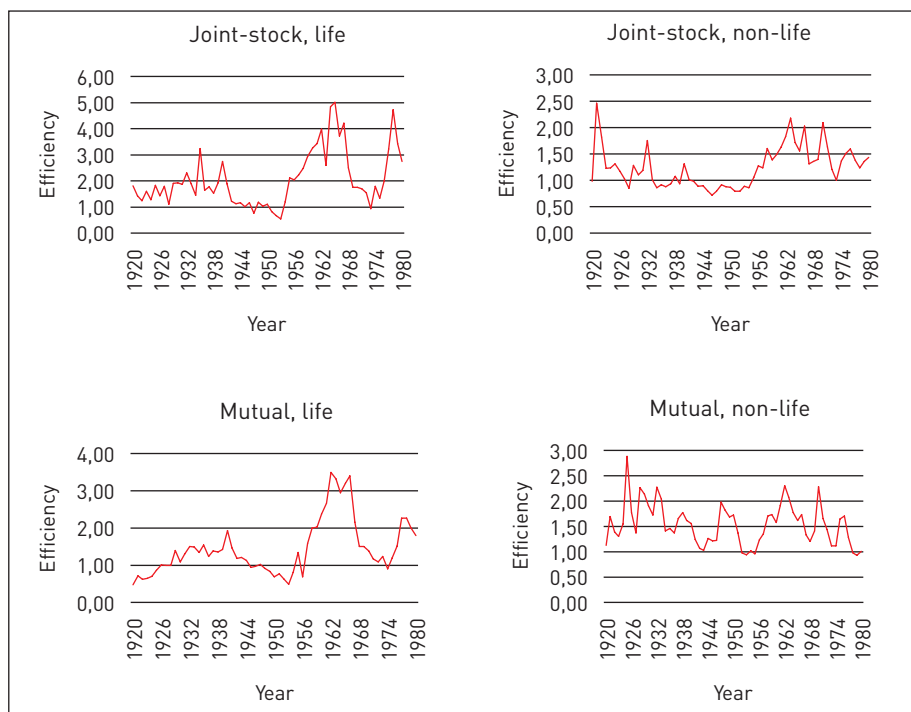
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<sup>338</sup> Larsson *et al.* (2005); Adams *et al.* (2012); Larsson (1998); Pearson and Lönnborg (2008); Allen and Lueck (1995).

<sup>339</sup> Net premium income is defined as premium income less insurance claims paid, bonuses to policyholders and administration expenses. Reinsurance claims and payments have been deducted from the calculations.

indications that the efficiency of Swedish insurers did, in fact, improve following the implementation of the 1948 law. In the case of joint-stock insurers and mutual life insurers, there is a sharp improvement in efficiency from the early 1950s to the mid 1960s. After around 1965, the efficiency starts to deteriorate, but once again improves from the early 1970s in the case of life insurers. In the years that follow directly upon the implementation of the 1948 law there is evidently, an equally sharp deterioration in efficiency. Moreover, this trend seems to have started already in the early 1940s in the case of life insurers, and even further back in the case of joint-stock non-life insurers. In the case of mutual non-life insurers, the variance in the efficiency ratio is quite high, and there is no discernible trend over any longer period of time. The improvement in efficiency during the 1950's is, however, evident also within this group of companies, but the trend is significantly shorter in duration as compared to the other groups.

Figure 7.3. Efficiency of Swedish Insurers, 1920-1980



Source: Sweden Public Statistics, *Private Insurance Companies, 1921-1980*.

In order to test the hypothesis that the insurance law of 1948 caused the efficiency of Swedish insurance companies to increase, we once again performed an interrupted time series analysis, with the natural log of our measure of efficiency as the dependent variable. The same dummy variable and dummy variable counter were included to measure the effect of the 1948 law (Law 1948 level and Law 1948 trend in table 7.3 below). We also included the natural log of our measure of market concentration (HHI) and the variable market size as additional predictor variables, along with one control variable: wages (i.e. the same control as in the previous regression). If the insurance law of 1948 had the anticipated effect, we should expect both HHI and market size to be positively associated with our measure of efficiency, in addition to the Law 1948 level- and/or the Law 1948 trend variables. Rising market concentration was, as mentioned previously, anticipated to improve the efficiency by making it easier for the incumbent companies to attain economies of scale. An increasing market size could be anticipated to improve the efficiency for the same reasons, i.e. enabling companies to spread costs over a larger volume of business. Increasing wages, on the other hand, can be expected to have had a negative impact on efficiency by raising the administrative costs.

The regression results are presented in table 7.3 below. The analysis shows that the insurance law of 1948 did, in fact, have a positive impact on the efficiency of Swedish insurance companies, as indicated by the positive sign of the coefficient for the Law 1948 trend variable. The effect size was reduced after removing serial correlation, but the coefficient in the GLS column still indicates that the regulation contributed to an increase in efficiency of around 1.4 per cent per annum.<sup>340</sup> Contrary to the expectations of Swedish policy makers, however, this effect was clearly not due to increased market concentration enabling companies to exploit economies of scale. Rather, in accordance with the industrial organisation literature, the results in table 3 show that increased market concentration (Ln HHI) had a strong negative impact on the efficiency of the insurance industry, a result that is strengthened when serial correlation is removed (see the results under the GLS column). An increasing market size similarly seems to have had a negative impact on efficiency; a one per cent rise in total turnover is estimated to have caused a 0.44 per cent decline in efficiency. We also ran the regression after including an

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<sup>340</sup> Baseline trend (-0.0086) + Law 1948 trend (0.0226) = 0.014.

interaction term between the annual change in HHI and the level of HHI in order to test whether an increase in market concentration could have had a positive impact on efficiency at low levels of concentration, turning negative only at higher levels of concentration. The interaction term was not statistically significant.

Table 7.3. Regression Results: Efficiency of Swedish Insurers, 1920-1980

	OLS	GLS
Ln HHI	-0.25*** (-3.14)	-0.26** (-2.37)
Ln real wages	0.25 (0.89)	0.02 (0.06)
Ln market size	-0.57*** (-7.94)	-0.44*** (-5.09)
Baseline trend	-0.02*** (-4.41)	-0.01*** (-2.64)
Law 1948 level	0.10 (1.07)	0.11 (1.52)
Law 1948 trend	0.06*** (5.38)	0.02*** (3.50)
Adj R <sup>2</sup>	0.39	0.15
D-W	0.65***	1.81
N	244	240

\*\*\* Sig. at 1 % level \*\* Sig. at 5 % level \* Sig. at 10 % level.

Given that the increase in market concentration that took place from 1948 onwards was so clearly negative for the efficiency of the insurance industry, many aspects of the 1948 insurance law cannot be expected to have exerted the positive impact on efficiency that was anticipated by Swedish policy makers. As previously mentioned, several of the regulations were in fact aimed directly at achieving a structural rationalisation of the industry, with an anticipated rise in the market concentration. These were, for instance, the so-called principles of 'need' and 'separation', which benefitted incumbent companies at the expense of new entrants, or the 'principle of solvency', which served both to raise the barriers to entry and favoured larger companies at the expense of smaller rivals. If anything, such aspects of the regulation would seem to have been self-defeating, if the aim was to improve efficiency.

The only aspect of the regulation that could plausibly explain the observed improvement in our measure of efficiency from 1948 onwards is the so-called 'principle of equity'. The 'principle of equity' only applied for life insurance companies when the 1948 insurance law was introduced, but was extended to non-life companies in 1950. It was not until 1953, however, that a supervisory authority was put in place. Looking back at figure 7.3, which displays the evolution of our measure of efficiency, it is interesting to note that there is no clear sign of a shift in the trend of the series until 1953/54 in the case of life insurance companies and non-life joint stock companies, and not until 1955 in the case of mutual non-life companies. From 1954/55, when the 'principle of equity' came into effect, however, there was a sharp improvement in our measure of efficiency across all four groups of companies lasting to the mid 1960s. As previously mentioned, the purpose of the 'principle of equity' was to safeguard insurance customers from paying too high premiums. If the implementation of the 'principle of equity' was the main factor that influenced our measure of efficiency, it would primarily have affected the net premium income of the insurance companies, while it is much more doubtful whether it would have exerted any influence on actual productive efficiency. To see whether this was the case, we estimated two final interrupted time series models, one with net premium income as the dependent variable and one with the ratio between insurance claims paid and administration expenses (as a proxy for productive efficiency) as the dependent variable. All other variables were the same as in the previous regression.

The results of this analysis can be seen in table 7.4 below. As expected, the analysis shows that the 1948 insurance law had a negative impact on the net premium income of Swedish insurance companies, as indicated by the Law 1948 level and the trend variables. In the case of productive efficiency, on the other hand, the OLS estimation indicates a negative level shift in productive efficiency of around 15 per cent after 1948, and a positive impact of market concentration, but both these effects disappear when serial correlation is removed.

The 1948 insurance law, in other words, had no discernible impact on the productive efficiency of Swedish insurance companies. The main impact of the law does instead seem to have been felt in the form of a reduction in the gross

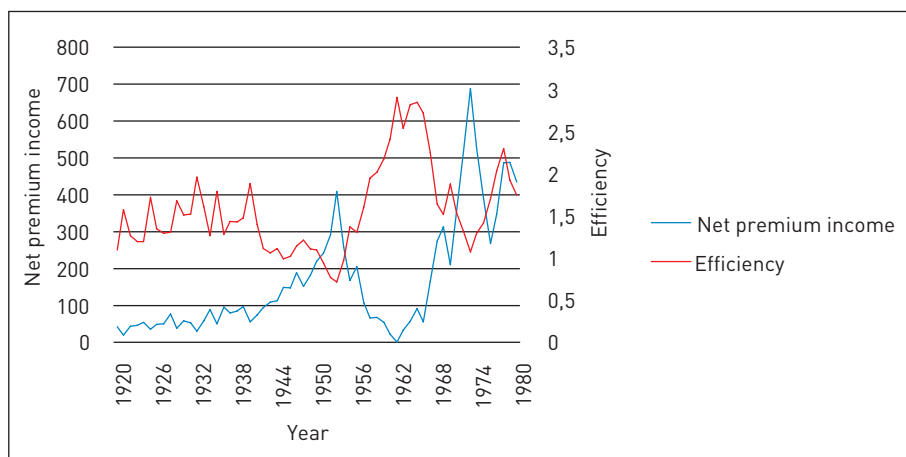
profitability of the industry, due to the restrictions on the level of premiums that were put in place through the 'principle of equity'. While the expressed purpose of the 'principle of equity' was to ensure that the anticipated improvements in cost-efficiency would not be retained by the insurance companies in the form of increased profit margins, but would instead benefit the consumers of insurance, in reality, it would seem that the 'principle of equity' was in itself the only aspect of the regulations that actually made a positive contribution to consumer welfare. Moreover, this contribution seems to have been short-lived. From the mid 1960s, our measure of efficiency (see figure 7.3), which is mainly driven by a renewed increase in net premium incomes within the industry, starts to deteriorate across all four groups of insurance companies. This can be better seen in figure 7.4 below which compares the arithmetic mean of our measure of efficiency for the four groups to the total net premium income of the companies (in 1948 prices).

Table 7.4. Regression Results: Net Premium Income and Productive Efficiency, 1920-1980

	Net premium income		Productive efficiency	
	OLS	GLS	OLS	GLS
Ln HHI	0.12*** (4.83)	0.12*** (3.44)	0.16*** (4.82)	0.04 (0.91)
Ln real wages	-0.15* (-1.77)	-0.14 (-1.22)	0.01 (0.08)	-0.22 (-1.41)
Ln market size	0.18*** (7.60)	0.17*** (5.80)	-0.06** (-2.04)	-0.03 (-0.99)
Baseline trend	0.01*** (7.03)	0.00*** (4.86)	0.01*** (5.05)	0.00 (0.60)
Law 1948 level	-0.17*** (-5.52)	-0.11*** (-4.87)	-0.15*** (-3.80)	-0.02 (-0.57)
Law 1948 trend	-0.02*** (-5.45)	-0.01*** (-3.36)	-0.00 (-0.85)	0.00 (1.58)
Adj R <sup>2</sup>	0.43	0.26	0.83	0.49
D-W	0.77***	2.00	0.58***	1.84
N	244	240	244	240

\*\*\* Sig. at 1 % level \*\* Sig. at 5 % level \* Sig. at 10 % level.

Figure 7.4. Average Efficiency versus Real Net Premium Income, 1920-1980



Source: Sweden Public Statistics, *Private Insurance Companies, 1921-1980*.

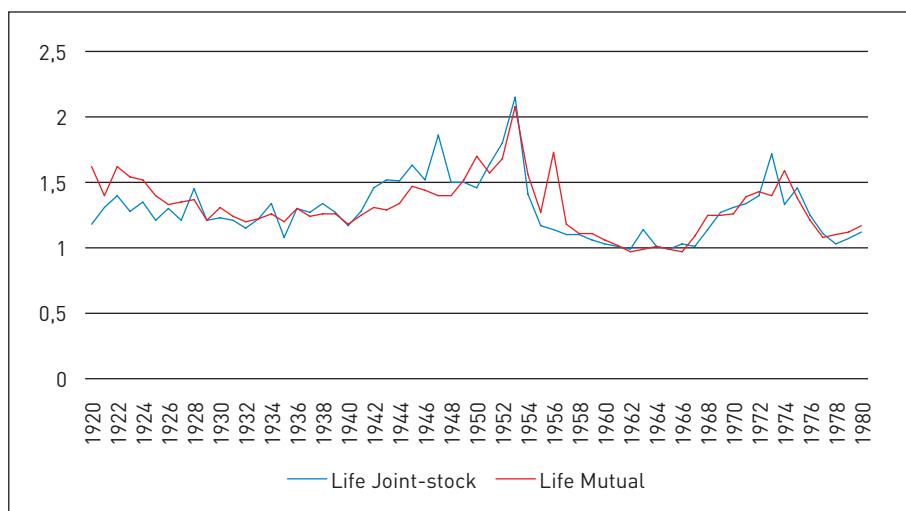
## DIFFERENCES BETWEEN JOINT STOCK AND MUTUAL INSURERS

Another question that has been discussed in the Swedish context – as well as in international literature – is whether it is possible to discern any differences as regards profitability among joint-stock insurers and mutual insurers.<sup>341</sup> In theory, the joint-stock corporations should be more profitable, in particular regarding the possibility to access external capital, but also and over time much more likely to outcompete the mutual organisations. However, in Sweden, the mutual organisational form has been regarded as successful and supported by the social democratic government, but the ownership forms during this time – 1920-1960 – joint-stock corporations were gaining market shares at the expense of mutual insurers. Comparing the combined ratio between joint stock and mutual insurers, it is possible to see whether the merger waves of joint-stocks in the 1960s and mutual insurers in the 1970s made any impact on their performance, and whether there had been any differences earlier.

<sup>341</sup> Larsson and Lönnborg (2018); Larsson and Lönnborg (2019a, 2019b); Wu (2002); Pearson and Yoneyama (2015).

In figure 7.5, it is shown that joint stock insurers were more profitable in the early 1920s than mutual ones; however, mutual insurers were relatively close at the end of that decade and during the 1930s. During World War Two the mutual insurers took the lead, but in the middle of the 1950s the joint stock insurers regained the position as most profitable. The merger wave of the joint stocks in the 1960s had no direct impact on profitability; as a matter of fact costs increased during the early phase of concentration. And as shown in the figures above, the early 1970s was a period when mutual insurers gained on the joint stocks while in the 1980s, the combined ratio was rather even between the two ownership forms. On average for the entire period 1920-1980, the life joint stock companies were slightly more efficient than the mutual companies (1.29 to 1.31).

Figure 7.5. Combined Ratio of Joint Stock and Mutual Life Insurers, 1920-1980



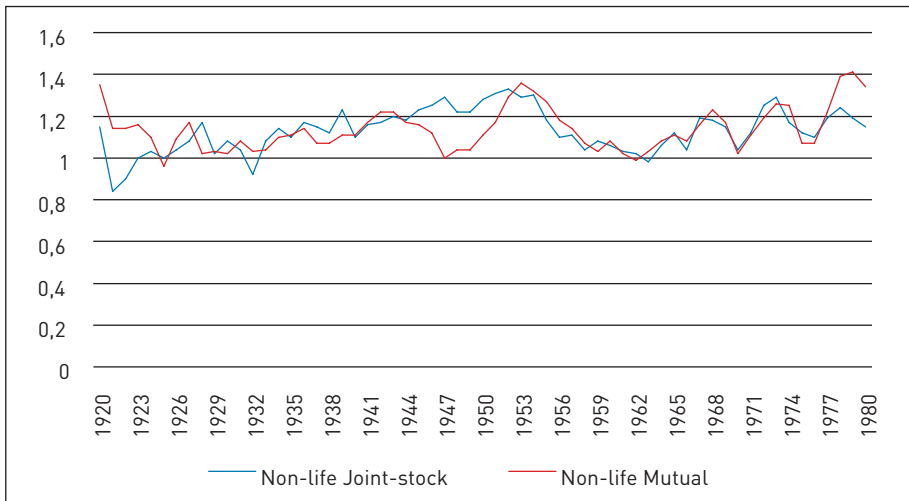
Source: Sweden Public Statistics, *Private Insurers 1921-1980*.

The combined ratio for non-life insurers has some resemblances to figure 7.5, i.e. that the joint stock insurers were more profitable during the early 1920s but that the mutual insurers caught up and during World War Two mutual insurers were much more profitable than the joint stocks. The main reason was likely the



joint stock presence on the international market that was associated with heavy losses, while the mutual insurers only conducted business in Sweden. One difference as compared to figure 7.5 is that it is not possible to see any impact of the mergers among joint stock insurers in the 1960s and no impact caused by the mutual insurers mergers in the 1970s. However, in the late 1970s, the mutual insurers demonstrated less profitability. On average for the entire period, the non-life joint-stock companies were more profitable than the mutual enterprises but the difference was surprisingly small (1.30 to 1.37).

Figure 7.6. Combined Ratio of Joint Stock and Mutual Non-Life Insurers, 1920-1980



Source: Sweden Public Statistics, *Private Insurers 1921-1980*.

Note: Measuring the combined ratio for life insurance annually is rarely executed, because that leaves out policyholders' saved capital, which is a substantial part of the total insurance sum.

## CONCLUSION

In this chapter, we have analysed the development of the Swedish insurance industry over the period between 1920 and 1980 in terms of the industry's market structure, efficiency, profitability and its contribution to consumer welfare. From the 1930s onwards, the institutional environment for Swedish insurance was

drastically altered by rigorous changes in the market regulations. There was an intense political debate in Sweden throughout the 1930s and 1940s concerning the perceived inefficiency of Swedish insurance companies, which fuelled a number of official investigations. In 1948, a comprehensive new Swedish insurance law was implemented, whose principal purpose was to bring about a structural rationalisation of the Swedish insurance market. From a public perspective, the market structure prevailing in the 1940s was considered to be much too fragmented, and characterised by over establishment and destructive competition. It was argued that a more restricted number of large-scale companies would be better able to implement cost-effective routines and develop new low cost insurance products. Increasing the level of market concentration was, therefore, considered to be the most effective means for safeguarding consumer welfare in the insurance market. For this reason, the new insurance law contained a wide set of regulations that raised the barriers to new entry and that favoured large-scale companies at the expense of smaller rivals, by raising the minimum capital requirements, facilitating mergers and acquisitions, and by placing new entry under administrative scrutiny.

In this chapter, we have provided new empirical evidence on the impact of these institutional changes on the functioning of the Swedish insurance industry. Our analyses show that while the 1948 Swedish insurance law did accomplish its objective of altering the market structure of the insurance industry, the rise in market concentration post-1948 did, in fact, have no discernible effect on the productive efficiency of Swedish insurance companies and was even detrimental for consumer welfare. The main effect of the law does instead seem to have come from an administrative restriction on the collection of premiums, which was put into place through the so-called 'principle of equity'. The 'principle of equity' was not a typical price regulation in the traditional sense, but constituted an administrative arrangement under which Swedish insurance companies were obligated to disclose financial information, so as to provide a basis for negotiations with the regulatory authorities concerning the level of premiums for different forms of insurance services. Nevertheless, the regulation seems to have been effective, judging from the fact that the net premium incomes started to decrease sharply from 1953/54, at the time when a supervisory authority was put in place to administer the regulation. It is possible that the increased level of transparency, in and

of itself, exerted a downward pressure on prices within the industry, in particular given the fact that the negotiations between insurance companies and the regulatory authorities took place against a backdrop of threats of stricter regulations – or even nationalisation – of the industry.

While the expressed purpose of the ‘principle of equity’ was to ensure that anticipated improvements in cost-efficiency would not be retained by the insurance companies in the form of increased profit margins, but would instead benefit the consumers of insurance, in reality, it would seem that the ‘principle of equity’ was in itself the only aspect of the regulations that actually made a positive contribution to consumer welfare. Moreover, this contribution seems to have been relatively short-lived. From the mid-1960s, our measure of efficiency (see figure 7.3 above) starts to deteriorate across all four groups of insurance companies, driven by a renewed increase in the net premium incomes. This may have been due to the fact that Swedish insurance companies started to expand into new markets during the 1960s and 1970s, such as labour market insurance, private pension insurance or international operations, which would have made it more difficult for the regulatory authorities to determine a ‘fair’ level of premiums. The highly concentrated market structure of the insurance industry would furthermore have added to such difficulties by increasing the informational asymmetries that already existed between the regulatory authorities and the companies.

Finally, the difference between joint stock and mutual insurers regarding the combined ratio was far smaller than expected, even before the introduction of the legislation of 1948, and even though it varied over time, the average differences were relatively small and this is partly evidence of the fact that we have earlier overestimated the competition power of joint stock insurers in both life and non-life insurance. This will be more closely investigated in the future, because the general assumption has been that joint stock insurers lost their market power in association with being taken over by foreign insurers at the end of the 1990s and the beginning of 2000s, but perhaps this happened earlier.



## **4. INSURANCE IN FINANCIAL CRISES**



## CHAPTER 8. REGULATORY OVER-REACTION TO THE GLOBAL FINANCIAL CRISIS: INSURANCE REGULATION IN SOUTH AFRICA

Grietjie Verhoef

### INTRODUCTION

In 2009 Alan Greenspan noted: “of all the regulatory challenges that have emerged out of this crisis, I view the TBTF (Too Big To Fail) problem and the TBTF precedents, now fresh in everyone’s mind, as the most threatening to market efficiency and our economic future”.<sup>342</sup> Instead of an improved regulatory framework proposed by Greenspan and other policymakers, however, the global financial crisis (GFC) prompted a global escalation of more extensive regulation of the different financial services. Two responses followed: increased state regulatory oversight, justified as ‘to protect consumers and improved market discipline’ as a means to promote prudence, safety and soundness in banking, insurance and other financial institutions.<sup>343</sup> The second response was an almost universal call for stronger risk management and supervision.<sup>344</sup> The mode of regulatory intervention changed fundamentally from a normative rule-based paradigm to a new generation of regulatory intervention based on a holistic, principles-based approach, which is ‘objective oriented’. The emphasis shifted to creating a regulatory environment in which management actions become more consistent with shareholder interests.<sup>345</sup>

Regulation of professional activities, such as securities trading, investment and professional services (accounting or legal) represented a deviation from self-regulation

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<sup>342</sup> Remark made at the American Enterprise Institute, 3 June 2009: quoted in Harrington (2009), p. 812.

<sup>343</sup> Harrington (2009), p. 812; Acharya *et al.* (2009).

<sup>344</sup> Ehling and Schmeiser (2010).

<sup>345</sup> Wallace, Krivogorsky and Ferris (2009).

so proudly advocated and defended by professions.<sup>346</sup> In the United Kingdom restrictive rules of trade and professional association constituted the regulatory framework defining the operation of professionals in financial services, such as equity trading, professional services such as accountants etc. In the USA formal statutes, such as the Glass-Steagall Act (1933) implemented legal regulation separating commercial and investment banking operations. Broad liberal market policies of the late 1970s and subsequent deregulation ended exchange control. Britain had to cope with a flood of international investments, equity operations and offers of equity participation in professional trading firms in London. A conflict of interest and duty developed, followed by abuses and ultimately questions about the effectiveness of self-regulation. In 1986 the United Kingdom introduced the first statutory regulation in the form of the Securities and Investment Board (SIB).<sup>347</sup> Once off the path of self-regulation, statutory regulation escalated rapidly, also affecting other related financial markets and geographies.

Globally deregulation stimulated the systematic blurring of clear distinctions in financial services between the banking and insurance sectors. The mutual contagion effects during the post-2007 years across financial services in the USA and subsequently in other global markets, illustrated the rapid spread of functional disaggregation in financial services. Gradual deregulation spread in international financial markets since the mid-1980s. Barriers of functional separation in financial services disintegrated, transforming operations into an operating environment of technological innovation, deregulation and globalisation.<sup>348</sup> The mutual form of organisation was questioned as market opportunities for capital rose, opening access to new sources of capital, credit and services.<sup>349</sup> Mutual savings or mutual insurance companies switched to listed stock companies, aiding the emergence of financial conglomerates, or diversified financial services companies, offering multiple financial services.<sup>350</sup> This dismantling of barriers between banks

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<sup>346</sup> Baumeister and Heatherton (1996); Gunningham and Rees (1997); Klein (1998); Vohs and Baumeister (2016).

<sup>347</sup> Gower (1988); Miller (1989); Martin (2017).

<sup>348</sup> Ferguson (2003), p. 235; Treptow (2006); Chugh (2006); Cummins and Venard (2008).

<sup>349</sup> McKnight and Gething (1996); Carson *et al.* (1998); Chaddad and Cook (2004); Meador and Chugh (2006); Treptow (2006).

<sup>350</sup> Gower (1988), pp. 3-4.



and insurance companies was apparent in the growing so-called ‘bancassurance’ phenomenon, more prevalent in Europe than the USA, Asian and Japanese markets.<sup>351</sup> In this blurred financial market, the former mechanisms of self-regulation became dysfunctional or disintegrated. The crisis of 2007/8, which originated primarily in the banking sector, therefore, was bound to have a profound impact across the wider spectrum of financial services – including insurance companies – on the regulatory paradigm.

The South African banking sector remained stable throughout the crisis years, with banks maintaining a capital adequacy ratio above the required 10 per cent (12.8 per cent in 2007, 13 per cent in 2008 and 14.1 per cent in 2009).<sup>352</sup> South African banks were not exposed to the securitisation risk which brought down the Northern Rock in the UK. Although South African insurance markets were not adversely affected by the GFC, ‘a myriad of regulatory changes’ affecting the long-term insurance industry followed.<sup>353</sup> Financial market deregulation in South Africa since the mid-1980s, prepared for far-reaching adjustments in the operations of domestic insurance companies. The capital adequacy cover (CAR) in the long-term insurance sector also contributed to financial sector stability.<sup>354</sup> The minimum CAR cover is one, but since 2006 the long-term insurance sector maintained a median of 2.8. Following the general economic slowdown caused by the GFC, the median dropped slightly to 2.5 in 2008 and 2009.<sup>355</sup> A strong capital position supported resilience in the wake of the GFC, but could not contain the exposure to systemic risks bound to affect local insurance markets. The deregulation of financial markets, as well as the re-entry of South Africa into the global world of business, exposed local financial enterprise to global financial market developments. This chapter analyses the systemic risk effect of the GFC on the South African insurance industry regulatory framework. The question is how the regulatory changes impacted on the domestic long-term insurance industry, and whether the regulatory response was justified?

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<sup>351</sup> Baluch *et al.* (2011).

<sup>352</sup> South African Reserve Bank (2007, 2008, 2009).

<sup>353</sup> PWC (2012).

<sup>354</sup> CAR cover in the long-term insurance sector is the times the assets exceeds liabilities.

<sup>355</sup> Financial Services Board (2007, 2008, 2009).

## SYSTEMIC CHANGES IN THE FINANCIAL SECTOR

As the housing credit bubble burst in the USA in 2007, banks were first in the casualty line: Bear Stearns was acquired by J P Morgan, Lehman Brothers filed for bankruptcy, Merrill Lynch was acquired by Bank of America and the Federal Government bailed out AIG, the insurer, at a value of US \$85billion.<sup>356</sup> AIG through a London subsidiary had insured toxic assets thereby uniquely becoming part of the crisis. The AIG repaid the loan. The fundamental change in the long-term insurance business disclosed by the events was the interconnectedness of the insurance industry with other financial service providers, a consequence of market driven financial sector deregulation.

These events highlighted globalising tendencies of the early 1980s. Internationally, insurance markets diversified in services and products. Insurance risks became increasingly global, through the growing internationalisation of insurance operations as most insurance companies operate globally. Financial intermediaries' internationalisation escalated as they sought to spread risk internationally. Truly global insurance firms developed, such as ING, AIG, AXA and Allianz. Deregulation of the entire financial services sector mutually facilitated the internationalisation and cross-border competition in the industry.<sup>357</sup>

The global financial services industry grew more interconnected through the diversification of operations. New innovative financial services entered the industry. The AIG via a London subsidiary offered Credit Default Swaps (CDS). In the 1990s UK companies offered banks mortgage default cover that cost the insurance industry dearly. South African companies never offered these non-traditional insurance covers. AIG's high exposure to CDSs, was caught in the collapse of that market. Policy-holders starting to miss premium obligations, cashing in policies, and contracted an appetite for new policies. SwissRe confirmed that the growth in global life insurance premiums dropped by 3.5 per cent in 2008. 'Sales in unit-linked products linked to equity markets were severely impacted by falling stock markets ...causing life insurance premiums in industrialised countries to drop by 5.3 per

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<sup>356</sup> Harrington (2009); Acharya *et al.* (2009); Begg (2009).

<sup>357</sup> Cummins and Venard (2008), pp. 309-316.

cent'. The sales in non-linked savings products (fixed annuities) and traditional life savings sustained a steady rise but not one sufficient to offset the contraction in the demand for linked products.<sup>358</sup>

Fundamental changes to the structure and functions of insurance business inevitably mandated an adjustment in the regulatory environment. The bank sector suffered more from the money and banking crisis than the insurance industry, because their business models are fundamentally different. In short-term insurance, withdrawals are claim-linked and in long-term insurance other costs punish non-payment, such as lapse costs, or termination penalties. The core of an insurer's risk is underwriting long-term contracts. This 'liability portfolio' is diversified and largely uncorrelated with the asset side (and hence, to the capital markets in general).<sup>359</sup> Bank asset portfolios (outstanding loans) are directly linked to general economic conditions. An insurer's asset base usually includes substantial institutional investors on capital markets. If asset values show negative returns, institutional investors may seek other investment opportunities. On the liability side, insurers may suffer from exposure to the credit market, to reinsurance defaults or simply a general decline in demand for their products under conditions of economic downturn.

Regulation of the entire financial services sector impacted directly on insurance operations. Ehling and Schmeiser (2010) mapped out key consequences for risk management and supervision in the insurance sector. The first is that insurers had to take direct responsibility for risk and not delegate to a third party. This implies that the risk management function should be proactive, independent and endowed with adequate power of authority. The application of agency theory to hold risk managers accountable on behalf of potential victims of crises, is crucial to understand the responsibility of risk managers. Secondly, insurers must develop appropriate risk models, by taking care not to rely too confidently on underlying risk models. They may be incorrect because the historical observations on which they were compiled may have been too few. A third consequence is that the new generation risk management must be understandable. A well-functioning risk

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<sup>358</sup> Swiss Re (2009).

<sup>359</sup> Ehling and Schmeiser (2010).

model can facilitate a smooth process of risk management between risk management and managerial decision-makers. The fourth implication is that the right incentives must be in place to ensure a risk environment complicit with responsible risk. Cognisance is taken of Jensen and Meckling's theory of the firm, observing that ownership structure, management incentives and monitoring of managers constitute key determinants of the propensity for risk in a firm.<sup>360</sup> As a fifth consequence, portfolio theory, emphasises the positive relationship between risk and return, and the wisdom of diversification. For the insurance industry, high risk goes with high returns, but also high cost. Diversification of investments is wise. Insurance is called upon to adhere more to principles of risk management than on rules of regulation. Acting proactively, Ehling and Schmeiser suggest the establishment of an insurance guarantee fund to facilitate a controlled run-off. There is a higher cost to a guarantee fund, but the trade-off is between advanced solvency and a high degree of regulation, and the cost thereof. The argument is therefore in favour of closer agent oversight. Financial conglomerates should be supervised at group level and regulation arbitrage in financial markets avoided at all costs. As the financial services industry is integrated, the regulation of banks, insurance and other financial services should become 'globalised'.<sup>361</sup> This implies integrated regulation of all financial services in a specific market, but also between geographies globally. Better risk and solvency management finally boils down to transparency, market discipline and accountability.<sup>362</sup>

The South African financial services sector did not escape the effects of the GFC. The banking and insurance sectors experienced no substantive credit risks due to the GFC. The regulatory system separated banking from insurance since the 1960s, but functional convergence manifested gradually since deregulation. This chapter will now turn to an analysis of the regulatory environment of the insurance industry since the early 1900s.

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<sup>360</sup> Jensen and Meckling (1976); Fama and Jensen (1983).

<sup>361</sup> The lack of convergence between regulatory/supervision paradigms in Europe is also an issue that Begg noted as contributing to the vulnerability of European financial markets at the time of the crisis. Begg (2009), p. 116.

<sup>362</sup> Ehling and Schmeiser (2010).

## **SOUTH AFRICA INSURANCE REGULATION IN HISTORICAL PERSPECTIVE**

Before the formation of the Union 1910 the insurance market was dominated by UK insurance law and practice. The Cape passed the Life Insurance Act mimicking the UK Life Insurance Act. Insurers had to be registered, the payment of a licence fee and annual submissions of premiums and policies. The first South African insurance act was the Insurance Act of 1923, modelled on the British Assurance Company Act of 1909. Insurance business was regulated through statutory mandated registration, prescribed form and content of annual submissions and licence fees, and the deposit of £25 000 as security against insolvency.<sup>363</sup> This requirement was introduced in the UK with the passing of the Life Assurance Act following the failure of the Albert Insurance Company. In 1943 the Insurance Act, No 27 of 1943, replacing the 1923 Act differed from the UK legislation. For the first time, concern was raised about the security of savings in life assurance companies because of the lack of regulation of investment of funds or the valuation of assets or liabilities.<sup>364</sup> Spearheading the concern was Professor E. H. D. Arndt (Professor in Money and Banking at the University of Pretoria), who argued that 'an insurance contract is a mere piece of paper unless not only the actuarially determined funds are being held, but also unless funds have been wisely and safely invested'. Safety of investment would be enhanced by a 'desirable distribution of funds between (the) various types of assets'. Arndt called for explicit prescription of categories of debentures and qualifications to 'provisions in mortgages or notarial bonds, and minimum safety margins in the allocation of loans on mortgage'.<sup>365</sup> Compulsory deposits with the Treasury did not relate to the risk to which the insurer was exposed, but was a source of funding local industrial development.

These arguments had explicit implications for the operations of foreign insurance companies conducting business in South Africa.<sup>366</sup> All insurance companies were subjected to a more prescriptive investment environment. The act established a

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<sup>363</sup> Verhoef (2015), pp. 148-149.

<sup>364</sup> Arndt (1934).

<sup>365</sup> Arndt (1938), p. 48.

<sup>366</sup> Arndt (1941), pp. 15-16; Bernstein (1977), p. 6; Benfield (1987), pp. 150-156; Benfield (1997), pp. 575-577.

statutory position of a Registrar of Insurance. For a period of 45 years long-term insurers invested in prescribed asset categories. Long-term insurers had to invest 50 % of liabilities in South Africa in pension and retirement annuity funds, and another 30 % in government bills, bonds or securities. Insurers could invest the remainder of their funds in mortgages, policy loans, debentures, shares, property and related investments. The rationale of the state was to secure access to domestic capital for local industrial development, but as returns on government-linked investments failed to exceed market performance of securities and other investments, industry leaders voiced strong criticism against market interference.<sup>367</sup> Life offices believed that the statutory prescribed investments discouraged voluntary savings in life assurance.<sup>368</sup>

The rationale for the regulation of the insurance industry before the 1990s was not the protection of the policyholder, nor a potential systemic risk to the financial services sector, but the utility of premium income of the long-term insurance industry for domestic economic development. Although the concept 'financial repression' was coined only in 1973 by the economists from Stanford University, Edward S. Shaw and Ronald I. McKinnon, to describe state strategies to reduce state debt, the fiscal landscape on South Africa between the 1960s and 1980s indeed displayed elements of financial repression.<sup>369</sup> The state issued statutory prescribed investments to the insurance industry, exercised exchange control to prevent capital movement and the monetary authority practiced direct interest rate management.<sup>370</sup> The growing international adversity towards South Africa during the 1970s prompted further statutory changes constituting financial repression of the insurance industry. The Financial Institutions Amendment Act, No 101 of 1976, mandated domestic incorporation and majority shareholding of both bank and insurance company operations by 1 August 1979.<sup>371</sup> The 'domestication' of the

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<sup>367</sup> Frankel (1941), pp. 313-314; Beak (1973); Goedhuys (1994), p. 154; Spyrou (1955), p. 335; South African Government (1976); Goodall (1975), pp. 125-127; Bernstein (1977), p. 10.

<sup>368</sup> Spyrou (1955), p. 335; South African Government (1976); Goodall (1975), pp. 125-127; Bernstein (1977), p. 10.

<sup>369</sup> See McKinnon and Grassman (1981); Fry (1982); <https://www.investopedia.com/terms/f/financia-repression.asp> (accessed 1/4/2019).

<sup>370</sup> Jones (2002); Goedhuys (1994).

<sup>371</sup> South African Government (1970); Nicholson (1976); Verhoef (2010), pp. 160-162.

financial sector resulted in the unprecedented concentration of the local financial services sector.<sup>372</sup> As foreign shareholders sought to dispose of their shareholding in South African banks, the insurance companies were the only local corporations adequately capitalised to buy foreign shareholding. This gave the local insurance industry a controlling stake in the banks. This led to substantial concentration in the South African financial services industry, as the two largest long-term insurance companies simultaneously had either controlling or significant shareholding in two of the large banking groups. This development occurred at the same time as the strong global merger movement following deregulation.<sup>373</sup> The potential systemic risk to the financial service sector in South Africa became more pronounced when South Africa followed the global deregulation trend by implementing the recommendation of the *Commission of inquiry into the monetary system and monetary policy in South Africa*. (De Kock Commission).<sup>374</sup> The subsequent deregulation of the financial services industry allowed banks to perform service previously restricted to building societies, which resulted in the extinction of building societies and *vice versa*, and allowed insurance companies to own banks, and *vice versa*. The De Kock report displayed substantial resemblance to the report of the Australian Financial System Inquiry of 1979 (also referred to as the Campbell Inquiry), which ascribed inefficiencies in the insurance industry to financial market segmentation. Increased competition between banks eliminated barriers between markets and invited the influx of foreign banks.<sup>375</sup>

The reality of a systemic risk manifested as the AA Mutual short-term insurance company seemingly collapsed in 1986. A commission of inquiry into the reason for the collapse reported in 1988. The South African Commission of Inquiry into the winding-up of the Short-term Insurance Business of the AA Mutual Association Limited (Melamet Commission, under the Chairmanship of Judge D A Melamet) raised a number of regulatory concerns on the standardisation of the calculation of technical reserves, the solvency margin of insurers, and the method of

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<sup>372</sup> Verhoef (2009).

<sup>373</sup> Fazio (2003), pp. 225-227.

<sup>374</sup> South African Government (1984).

<sup>375</sup> Merrett (2002), pp. 279-281.

calculating unexpired risk reserves.<sup>376</sup> It took more than two decades to wind-up the AA Mutual, from which it appeared that the AA Mutual was solvent. The solvent company was returned to its shareholders. Meanwhile, the UK passed the Financial Services Act of 1986, bringing regulatory divergence between South Africa and the UK, The UK established the SIB. The Registrar of Insurance in South Africa called for more stringent regulation. This led to the Van der Horst committee, proposing a single financial services regulatory institution. The outcome was the formation of the Financial Services Board (FSB), in terms of the 1990 Financial Services Board Act, No 97 of 1990 to regulate compliance of financial institutions providing financial services.<sup>377</sup> The FSB integrated the regulatory functions of the following former statutory regulating offices: the Registrar of Pension Funds, Registrar of Friendly Societies, Registrar of Long-Term Insurance, Registrar of Short-Term Insurance, Registrar of Stock Exchanges, Registrar of Financial Markets, Registrar of Collective Investment Schemes and the Registrar of Financial Services Providers. The FSB gave effect to the emergence of an integrated regulatory framework. The following financial services fell under the auspices of the FSB regulation: all insurance (long-term, short-term, reinsurance), Lloyd's Correspondents, retirement funds, friendly societies, collective investment schemes, capital markets, financial intermediaries and financial advisers. Regulatory oversight began to display an integrated approach to financial regulation, but bank regulation remained with the South African Reserve Bank (SARB).<sup>378</sup>

The South African insurance regulatory landscape resembled global trends. The Deposit Taking Institutions Act, No 94 of 1990, introduced new prudential requirements to align the regulation of bank operations with the Bank for International Settlements' Basle requirements for risk management, primarily capital adequacy requirements. Concentration in the financial services industry rose. The HHI index of the four largest banking groups increased to 68 in 1997, and the four largest long-term insurance companies controlled the four largest banking groups.<sup>379</sup>

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<sup>376</sup> South African Government (1988).

<sup>377</sup> South African Government (1992).

<sup>378</sup> Financial Services Board Act, No 97 of 1990; Vivian (2007), pp. 684-685.

<sup>379</sup> The Herfindahl-Hirschman Index is an index used to measure concentration in banking. The HHI takes into account both the number and relative size of banks in the system. It is calculated by summing the squares of the market shares, so that if an industry consists of a monopolist, then



While 68 is a relatively low HHI, the fact that four institutions dominate the market, and their HHI is 68, is concerning. As South Africa followed global deregulation, systemic risk was a definite possibility because the insurance industry was regulated separately from the banks. In 1998 the regulation of the Long and Short term insurance sectors was split with the passing of two Acts, the Long-Term Insurance Act, No 52 of 1998 and the Short-Term Insurance Act, No 53 of 1998, securing functional separation between the long-term and short-term insurance business. Composite insurance business was prohibited, but systemic risk became a growing possibility as long term insurers controlled the major banking groups.

Baluch *et al.* (2011) pointed out that banks and insurance companies constitute a significant part of the capital market and that firm-specific exposure to volatility or risk inevitably transferred that risk to the entire financial system or capital market. This is 'systemic risk', defined by Csiszar (2002) as 'the risk that the failure of a participant to meet its contractual obligations may in turn cause other participants to default, with the chain reaction leading to broader financial difficulties'.<sup>380</sup> In 1998 and 1999 the two largest local mutual long-term insurance companies demutualised. This enabled functional diversification, thus enhancing the risk of systemic contagion. While the South African financial services industry did not suffer similar systemic contagion as a result of the GFC, the regulatory authorities (SA Reserve Bank and FSB) responded to this potential of systemic risk. The near collapse of AIG in the USA during the GFC alerted regulators to the formerly unanticipated credit risk of insurance companies and the interconnectedness between banks and insurers.<sup>381</sup>

The UK moved in a different direction by establishing the Financial Services Authority, a single peak regulator for all financial services.<sup>382</sup> In South Africa the Van der Host Committee proposed a similar single regulatory framework for the financial services sector – the FSB. The SARB insisted on relying on market forces for

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the HHI is  $(100)^2 = 10\,000$ , or if it is a contested market with 100 firms, each with 1 percent market share, then the HHI is  $(1)^2 \times 100 = 100$ . The higher the value, the less competitive the market. See Verhoef (2010).

<sup>380</sup> Csiszar (2002).

<sup>381</sup> Chen *et al.* (2013); Cummins and Weiss (2014).

<sup>382</sup> Miller (1989).

financial system stability, but considered a minimum level of intervention to 'contain systemic risk'.<sup>383</sup> The SARB supervised banks, while the FSB performed the regulation of all other financial services, including the insurance industry. In a 2011 National Treasury policy document 'A Safer Financial Sector to serve South Africa better', regulatory overhaul was motivated as measures to enhance financial stability (as part of an international corrective on the GFC, but then linked to the political economy of social transformation).<sup>384</sup> State intervention in the financial sector through market regulation had to secure consumer protection and financial inclusion.<sup>385</sup> At this point the South African political economy was imposed on international financial trends, which resulted in the indiscriminate subjection of the South African market to international regulatory developments.

Aligning regulation of the long-term insurance industry with international trends, based on the model of the European Parliament's Solvency Directive (generally referred to as 'Solvency II'), simultaneously became part of the state's socio-economic transformation agenda in the name of 'seeking to secure financial stability'.<sup>386</sup> The first steps to achieve this alignment, was the implementation of the Solvency Assessment and Management (SAM) framework. SAM introduced a new risk-based solvency regime comprising of three pillars. The first is, quantitative requirements on the valuation of assets, liabilities and capital. Second, qualitative requirements dealt with the processes of governance, risk management, internal controls and supervision. The third aspect was reporting and disclosure.<sup>387</sup> These new regulatory interventions went hand in hand with the so-called 'Treat customers fairly' framework of market conduct. This framework was also introduced in the UK.<sup>388</sup> The SAM requirements placed the domestic regulatory framework within the realm of the emerging twin peaks regulatory environment, which developed from the 1995 paper of Michael Taylor, 'Twin Peaks: A Regulatory Structure for the

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<sup>383</sup> South African Reserve Bank (2012), <https://www.resbank.co.za/regulationAndSupervision/pages/regulationAndSupervision-home.aspx>. accessed 9/04/2018.

<sup>384</sup> National Treasury (2011).

<sup>385</sup> *Ibid.*

<sup>386</sup> Financial Services Board (2009), p. 14.

<sup>387</sup> Financial Services Board (2011), pp. 48-52; Financial Services Board (2012), pp. 48-67.

<sup>388</sup> Miller (1989), pp. 352-353.

New Century'.<sup>389</sup> This approach to regulation received most attention in markets worst affected by the GFC.

The UK abandoned its single peak model by the late 1980s in favour of the so-called 'twin peaks' model. The prudential regulation of banks and other financial institutions returned to the Bank of England. The FSA, the one-time single peak regulator, morphed into the second peak as a market conduct regulator. South Africa followed suit. In 2017 the Financial Regulation Act, No 9 of 2017 essentially resembled the UK's twin peaks regulatory framework. This consolidated the regulation of all financial services under two regulatory frameworks. Prudential functions were passed on to the SARB and financial services' market conduct, to the renamed Financial Services Conduct Authority (FSCA). Despite market consensus that the South African banks and insurance companies did not suffer from exposure to the extreme adverse effects of the GFC, the state enforced a dual regulatory paradigm onto all financial services – pension funds, banks, insurance companies, collective investments, financial advisers and intermediary services.<sup>390</sup> Despite the soundness and solvency of the South African financial system, the state considered following international trends, desirable.

The long-term insurance industry in South Africa fell victim to the GFC inflicted anxiety over systemic risk to the broad financial services industry. Globally the impact on insurance business was uneven and in the UK as well as South Africa, the insurance sector was largely unaffected, or at least much less affected than banks.<sup>391</sup> While cross-holdings between banks and insurance companies was more prevalent in Europe than in the UK, and insurance markets in the UK were not dominated by a few large companies, as in Europe and South Africa, it was to be expected that the European regulatory model would find closer traction in South Africa. The tendency of insurance companies to pursue growing capital investments as a value driver to compensate for underwriting volatility exposed the insurance industry much more to market risk.<sup>392</sup> South African long-term

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<sup>389</sup> Taylor (1995).

<sup>390</sup> Parliamentary Monitor Group (2011), <https://pmg.org.za/committee-meeting/11873/>.

<sup>391</sup> Baluch *et al.* (2011).

<sup>392</sup> *Ibid.*, p. 132.

insurance companies held large to controlling shareholding in the major banking groups. This overlap paved the way for a similar potential systemic risk that had brought the GFC on in the USA.

The implementation of the twin peaks regulatory framework in South Africa was a contracted and drawn out process, from the first announcement to that effect in 2009 until the promulgation of the 2017 Financial Regulation Act. The SARB emerged as the sole oversight institution of prudential regulation for financial stability. The FSCA was the regulator of market conduct of all financial intermediaries. The prudential oversight function assigned authority for the supervision of the safety and soundness of financial institutions to provide financial products, market infrastructure and payment systems, with special attention to conglomerates in terms of systemic risk. The prudential authority also issued licences to deposit-taking institutions and long and short-term insurance companies. This authority sets the prudential standards in terms of liquidity, leverage, risk management and capital. The FSCA was made responsible for the management of market conduct and consumer protection.<sup>393</sup> Financial analysts and insurance academics criticised the introduction of the twin peaks regulatory model as being unsuitable to South African circumstances. The vision of securing financial soundness and consumer protection received acclamation, but the two vital conditions for the implementation of the framework in the UK, did not apply to South Africa. Taylor outlined two vital prerequisites for the success of the implementation of a twin peaks framework, namely the non-domination of banks in the financial sector, and the existence of a highly developed consumer protection regime. None of these conditions applied to South Africa.<sup>394</sup> In South Africa the banks dominated financial services since the early twentieth century and the consumer protection regime is only in its infancy.<sup>395</sup> The most serious objection is the market distortion introduced by the regulatory system of twin peaks. The cost of implementing the extensive

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<sup>393</sup> Dyasi (2017), <https://www.bowmanslaw.com/insights/banking-and-financial-services-regulatory/sa-reserve-banks-new-mandate/>, (accessed 12/3/2018); 'Financial Sector Regulation Act -EY Comments, <http://www.ey.com/za/en/newsroom/news-releases/news-ey-financial-sector-regulation-ac-ey-comments>, (accessed 12/3/2017).

<sup>394</sup> Vivian (2016); Mhango (2014).

<sup>395</sup> The National Credit Act, No 34 of 2005 and the Consumer Protection Act, No 68 of 2008, only came into effect in 2011. Both of these statutes are yet to establish a firm consumer protection regime.

bureaucratic regulatory system doubled from around R 1.3 billion in 2015 to R 3.8 billion by 2016, which is a cost to the shareholders of financial service companies. The state has therefore unilaterally imposed a 'tax' on shareholders thus escalating costs to the industry. This constitutes market interference/distortion, while the insurance industry displayed no tendency towards systemic risk.<sup>396</sup>

The stability of the South African long-term insurance sector was exposed to a growing global concern about a potential systemic risk in the financial services sector. The data in the following section illustrate the solvency and stability of the insurance industry, and the subsequent adverse cost implications of implementation of a twin peaks regime to the industry.

### **THE LONG-TERM INSURANCE INDUSTRY: SOLVENCY AND STABILITY, 2000-2016**

In examining the South African long term insurance market, it should be noted that South Africa has one of the highest levels of insurance penetration in the world. At a first glance, this is anomalous until one inspects the detail of the figures. Only about 14 per cent of life business is risk business; the rest is investment business related mainly to contractual pension savings. The landscape of the domestic long-term insurance sector was stable throughout the period of the GFC and thereafter. Previous research established the stabilising role of the long-term insurance industry in the South African economy during the last half of the twentieth century. The privately owned insurance companies (later insurance groups) performed this role, subjected to regulatory control by the Registrar of Insurance.<sup>397</sup> In the twenty-first century global systemic contagion resulted in an escalation of statutory regulatory intervention.

The long-term industry comprised of a growing number of companies and increasing functional diversification. In table 8.1 the number of long-term insurance companies shows relative stability. Since the mid-1980s, the number of local long-term insurance companies fluctuated between 52 and 44, after which the number

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<sup>396</sup> Vivian (2016); PWC (2013).

<sup>397</sup> Verhoef (2010).

increased steadily from 2000. This resulted from large life offices registering separate companies operating in different segments of the market. Market segmentation enabled operations through different business entities focussing on sharper alignment to specific needs. There were 56 primary long-term insurance companies in 2000, then another 22 entered the market by 2008, but by 2016 the number dropped to 74. The long-term reinsurance companies remained stable at seven throughout the period under discussion. This represents one dimension of stability in the long term market.

Table 8.1. Number of Long-term Insurance Companies in South Africa, 1985-2016

Year	Number primary lt	Number lt Reinsurance
1985	52	6
1986	52	6
1987	52	6
1988	49	6
1989	46	6
1990	46	6
1991	46	6
1992	47	6
1993	44	6
1994	44	6
1995	48	6
1996	48	6
1997	49	6
1998	53	6
1999	56	7
2000	56	7
2001	62	7
2002	66	7
2003	71	7
2004	71	7

Source: Financial Services Board (South Africa), *Annual Report: Registrar of Insurance* (1985-1990); idem., *Annual Report of the Registrar of Long-Term Insurance* (2000-2017).

The number of operating primary insurers fluctuated because of mergers and acquisitions, as well as market segmentation. This change in the number of life offices in the market had no significant effect on the stability of the long-term industry.

When a correlation analysis between primary long-term insurers and long-term reinsurance, as displayed in Table 8.1, is done, the following results were found:<sup>398</sup>

Correlation t-Statistic Probability	PRIM	LONG
PRIM	1.000000	
	-	
	-	
LONG	0.447941	1.000000
	2.651135	-
	0.0131	-

The correlation coefficient ( $r$ ) = 0.45; with a t-statistic of 2.65 and a probability of 0.013. This indicates that the correlation between the series is positive but weak (0.45) although it is significant at a 95 per cent confidence level ( $p=0.013$ ). Squaring the  $r = 0.20$ , which means that only 20 per cent of the variation in each series can be explained by the other.

Table 8.2. Premium Income of Long-Term Insurance Companies relative to the National Economy, 1985-2016

Year	Net Premium R'm (1)	Total income R'm (2)	Real Gross National Income R'm (at Constant prices) (3)	GDP at market prices (4)	1 as % of 3	1 as % of 4	2 as % of 3	2 as % of 4
1985	7 719	16 407	1 392 050	1 502 682	0.55	0.51	1.17	1.09
1986			1 402 509	1 503 950				
1987	11 817	20 622	1 446 943	1 534 523	0.81	0.77	1.42	1.34
1988	15 197	23 913	1 500 471	1 598 975	1.01	0.95	1.59	1.5
1989	17 258	31 165	1 517 927	1 637 267	1.13	1.05	2.06	1.90
1990	21 635	37 864	1 500 206	1 632 064	1.44	1.32	2.52	2.32
1991	24 689	39 840	1 488 327	1 615 446	1.64	1.52	2.61	2.46
1992	31 217	51 764	1 455 072	1 580 923	2.14	1.97	3.55	3.27
1993	38 378	52 415	1 476 338	1 600 424	2.59	2.39	3.55	3.27

<sup>398</sup> Correlation compiled by Prof Ilse Botha, Department of Accountancy, University of Johannesburg.

Table 8.2. Premium Income of Long-Term Insurance Companies relative to the National Economy, 1985-2016 (cont.)

Year	Net Premium R'm (1)	Total income R'm (2)	Real Gross National Income R'm (at Constant prices) (3)	GDP at market prices (4)	1 as % of 3	1 as % of 4	2 as % of 3	2 as % of 4
1994	46 079	62 244	1 526 473	1 652 184	3.01	2.79	4.07	3.76
1995	61 772	83 949	1 558 756	1 703 660	3.96	3.62	5.36	4.92
1996	74 279	97 600	1 640 371	1 777 032	4.52	4.17	5.94	5.49
1997	82 474	114 614	1 678 478	1 824 067	4.91	4.52	6.82	6.28
1998	114 517	153 401	1 680 188	1 833 504	6.81	6.24	9.12	8.36
1999	106 856	149 551	1 703 054	1 876 740	6.27	5.69	8.78	7.96
2000	147 747	191 967	1 763 909	1 954 710	8.33	7.55	10.88	9.82
2001	144 466	190 938	1 808 407	2 008 181	7.98	7.19	10.55	9.5
2002	174 901	225 122	1 897 022	2 081 837	9.2	8.41	11.86	10.8
2003	162 876	206 609	1957 912	2 143 232	8.31	7.59	10.55	9.64
2004	151 401	192 749	2 070 875	2 240 847	7.31	6.75	9.3	8.6
2005	163 751	213 118	2 187 361	2 359 099	7.49	6.94	9.74	9.07
2006	166 697	278 813	2 336 096	2 491 295	7.13	6.69	11.93	11.19
2007	225 634	412 191	2 447 776	2 624 840	9.21	8.59	16.83	15.7
2008	264 363	286 570	2 547 733	2 708 600	3.76	9.76	11.13	10.58
2009	294 873	383 541	2 571 088	2 666 939	11.46	11.03	14.91	14.38
2010	262 351	461 955	2 689 409	2 748 008	9.75	9.54	17.17	16.81
2011	283 242	429 415	2 816 169	2 838 258	10.06	8.39	15.2	15.12
2012	324 617	579 878	2 840 759	2 901 076	11.42	11.18	20.41	19.98
2013	373 687	686 304	2 905 055	2 973 176	12.86	13.37	23.62	23.08
2014	411 532	715 314	2 945 232	3 028 090	13.97	13.59	23.94	23.62
2015	447 623	669 958	3 066 836	3 066 836	14.87	14.59	22.26	21.84
2016	461 381	646 074	3 084 174	3 084 174	15.22	14.95	21.32	20.94
Annual Compound Growth %								
1985-2016	14.6	13.02	3.40	2.42				
1985-2000	23.13	19.2	1.7	0.88				
2000-2016	7.8	8.42	3.79	3.31				

Source: South African Reserve Bank, *Long-term Time Series Data* (1985-2016); Financial Services Board (South Africa), *Annual Report: Registrar of Insurance* (1985-1990); idem., *Annual Report of the Registrar of Long-Term Insurance* (1990-2016).



Table 8.2 demonstrates the sustained confidence of the investing or saving public in the long-term insurance sector. For the entire period between 1985 and 2016 annual compound growth of both net premium income and total income of the long-term insurance industry outstripped real national income growth and gross domestic product growth by more than three times. From 2000, seven years before the GFC, until 2016, net premiums of the long-term industry grew at a 7.8 per cent annual compound rate. Total income of long-term insurers rose by 8.42 per cent annual compound growth. This performance outstripped real national income growth and gross domestic product (at market prices). Real national income rose by only 3.79 per cent annual compound growth between 2000 and 2016, and gross domestic product at 3.31 per cent. In both premium and total income, industry growth was more than double that of the domestic economy. The rate of growth slowed down significantly after 2000, ascribed to both weaker macro-economic conditions and substantially increased regulatory requirements.

Table 8.2 illustrates the significance of the long-term insurance sector as net premium income constituted 15.22 per cent of real national income and total income 21.32 per cent of real national income by 2016. The important observation is that the South African economy sustained real growth throughout the GFC. At no stage was the domestic financial sector at risk of collapse, or any single bank or financial services company on the brink of failure that justified state intervention or stabilisation measures to rescue depositor interests.

When conducting a correlation analysis between Premium income, Total income, GNI and GDP, as displayed in table 8.2, the following transpires:<sup>399</sup>

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<sup>399</sup> Correlation compiled by Prof Ilse Botha, Department of Accountancy, University of Johannesburg.

Correlation t-Statistic Probability	PREM	INC_INS	GNI	GDP
PREM	1.000000			
	-			
	-			
INC_INS	0.977925	1.000000		
	24.76456	-		
	0.0000	-		
GNI	0.973095	0.965886	1.000000	
	22.34821	19.73600	-	
	0.0000	0.0000	-	
GDP	0.970514	0.960193	0.996834	1.000000
	21.30493	18.18887	66.34480	-
	0.0000	0.0000	0.0000	-

There are highly significant and positively strong correlations ( $r=0.96-0.98$ ) between these variables. This corroborates the importance of insurance industry income. These findings support the view that the local long-term industry was stable and unaffected by the GFC. The long-term insurance sector maintained a stabilizing role in the domestic economy.

The growth and distribution of assets of the long-term insurance sector also substantiates the fundamental stability of the long-term insurance sector.

Total asset of the long-term insurance sector rose from R714 050 million in 2000 to R 2,652,278 million in 2016, an annual compound growth of 27.2 per cent, compared to real national income growth of 3.66 per cent or GDP at market prices at 4.23 per cent (see table 8.2). There was no "AIG" in South Africa and the long-term insurance sector performed the stabilising role that had characterised its business since the mid-twentieth century up to 2000. Asset growth almost doubled between 2005 and 2010 – the period of the aftermath of the GFC – and by 2016 more than trebled. The rising relative portion of total assets to GDP at market prices confirms the strength of the sector and the confidence of the public. From 43.1 per cent of GDP in 2000, total assets of the long-term insurance sector rose to 85.9 per cent in 2016. No statutory prescription

from the early 1940s and 1960s with respect to the asset classes long-term insurance companies were required to invest, remained in force. The distribution of asset classes in which the sector invested remained relatively stable throughout the period under review. Around half of the assets were in securities/shares, and a balance of around one third each in fixed interest stock, deposits and cash, one third in loans and mortgages, and a third in foreign approved assets. The Long-Term Insurance Act, No 52 of 1998 abolished all statutory prescriptions on investments. Insurance companies balanced their asset portfolio as reflected in table 8.3 and thereby contributed to financial stability in South Africa.

Table 8.3. Total Assets and Asset Distribution of Long-Term Insurance Companies relative to Gross Domestic Product, 2000-2016

Year	Total assets R'm	Fixed Interest rate stock, Deposits + cash % total	Shares % of total	Fixed Property % total	Other assets, Loans, Mortgages % of total	Foreign Approved Assets % of total	Total Assets % of GDP At Market prices
2000	714 090	30	50	4	15	43.1	
2005	820 066	19	51	3	19	8	34.7
2010	1 530 478	24	49	4	13	10	55.6
2015	2 567 147	14	49	2	18	17	83.7
2016	2 652 278	15	50	2	18	15	85.9
Annual Compound Growth %	27.2						

Source: South African Reserve Bank, *Long-term Time Series Data* (2000-2016); Financial Services Board (South Africa), *Annual Report of the Registrar of Long-Term Insurance* (2000-2016).

The strong capital position of the industry also illustrates the inherent stability of the long-term insurance sector.

Table 8.4. Market Capitalisation, Capital Adequacy Ratio (CAR) and Contribution to GDP, 2000-2016

Year	CAR*	CAR cover
	% between 2 and 5 Times covered	Median
2000	**1.18	2.7
2001	87.3	2.6
2002	81.5	2.7
2003	80.5	2.8
2004	71.6	2.9
2005	70.4	2.93
2006	66.6	2.8
2007	64.2	2.7
2008	63.0	2.5
2009	69.9	2.5
2010	67.4	2.7
2011	60.5	2.4
2012	68.7	2.7
2013	73.3	2.8
2014	72.9	2.8
2015	66.2	2.7
2016	58.1	3.8

Source: Financial Services Board (South Africa), *Annual Report of the Registrar of Long-Term Insurance* (2000-2016).

Notes: \*CAR = Capital Adequacy Ratio, the number of times the CAR is covered by free assets; \*\* CAR not reported by FSB for 2000. The reported ratio here is total assets divided by total liabilities of long-term insurance companies for 2000.

The average CAR cover of the long-term insurance sector is an indication of the capital strength and solvency of a long-term insurance company. As reflected in Table 8.4, the median of CAR of the long-term insurance sector consistently exceeded the minimum cover of 1. The median cover rose steadily from 2.7 in 2000 to 3.8 in 2016. Although the ratio of insurers maintaining between two and five times capital cover dropped from more than 70 per cent to 58 per cent in 2016, the median CAR cover rose to 3.8 in 2016. Such a stable and strong capital position since 2000, throughout the GFC up to 2016, gave no indication of systemic risk. Confidence in the stability and growth performance of the long-term sector can also be derived from growing insurance penetration.

Table 8.5. Insurance Penetration: South Africa and Comparative Markets, 1992, 2016

Country	1992	2016
South Africa	10.3	14.27
South Korea	9.8	12.08
UK	7.3	10.61
Japan	6.3	9.51
Switzerland	5.0	8.85
Netherlands	4.5	10.39
Australia	3.9	6.52
Canada	3.0	7.49

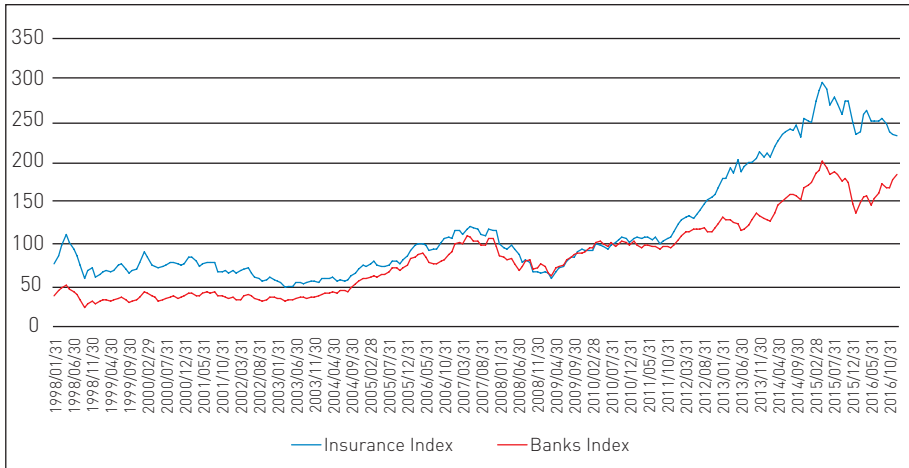
Source: Swiss Re (2017).

The only countries in the world with higher insurance penetration (insurance premiums as a percentage of GDP) are the Cayman Islands (22.60), Taiwan (19.99) and Hong Kong (17.60). South Africa's long-term insurance sector has therefore performed a consistent stabilising role both in the economy and the financial services sector. The leading African as well as emerging market level of insurance penetration, supports the view that the industry was well managed, significantly capitalised and embedded in consumer confidence. The behaviour of the share price of the listed long-term insurance companies during the period under review offers further support for the notion of stability in the insurance sector and subsequently investor confidence.

Domestic listed insurance companies consistently outperformed the banking sector, except for the period 2009 to 2010, when the two indices converged. Baluch *et al.* (2011) noted the sharp decline in global insurance indices, but the South African trading indices display a stronger performance during the GFC in 2008.<sup>400</sup> The slump in 2008 followed global scepticism about investment in banking and insurance investments, but not any systemic risk in either of the two sectors during the GFC. This is a direct consequence of the prudential behaviour of the entire financial services sector under SARB supervision. Local banks did not engage in CDS, which could potentially have compromised their capital requirements. In a similar fashion neither did the long-term insurance sector engage in the underwriting of credit risk in contravention of prudential behaviour.

<sup>400</sup> Baluch *et al.* (2011), pp. 128-129.

Figure 8.1. Bank and Insurance Indices on the Johannesburg Stock Exchange, 1998-2016



Source: Compiled from the Johannesburg Stock Exchange data on listed insurance companies and banks.

## CONCLUSION

The globalising effect of the GFC is most apparent in the massive escalation of regulation of financial services. Global contagion as a result of the systemic risk spreading in the USA and Europe, impacted differently in distant markets. In South Africa, the immediate impact of the GFC was almost non-existent. The South African economy was adversely affected by the effect of the GFC on European markets when the credit crisis effectively contracted demand for goods from emerging markets, and South Africa. The lag effect of the GFC on South Africa was a decline in demand from South Africa's leading trading partners, the European Union, the UK and the USA, for domestic exports. Furthermore the political 'systemic risk' caused by the endemically expanding corrupt presidency and ruling party since 2009, contributed to a slowdown of domestic activity, seriously collapsing demand and the weakening of the trade balance. Economic growth slowed down to barely one per cent. Despite the adverse political economy of South Africa, the long-term insurance industry succeeded in offering stability to its investors and policyholders. The growth in net insurance premiums and total income relative to the national economy, illustrated industry stability and consumer market confidence and trust.

In this volatile context, the long-term insurance sector displayed a high degree of stability. Two elements of the domestic industry shielded it from GFC global systemic risk. The first was the limited exposure to global markets, and the second was the inherent stability of the industry since the mid-1950s.<sup>401</sup> As displayed in table 8.3, foreign assets of the long-term insurance sector in South Africa comprised only 15 per cent of total assets in 2000, then dropped to eight per cent in 2005 at the beginning of the GFC, and rose to 17 per cent in 2015 and 15 per cent in 2016. Long-term insurance business was slow in internationalising and therefore minimised the risk of exposure to the global GFC systemic risk consequences.<sup>402</sup> This chapter has argued that the regulatory expansion following the GFC impacted adversely on the long-term insurance sector. The USA, UK and European responses to the systemic contagion of their long-term insurance markets affected the South African market adversely by adding excessive regulatory cost without justification.

In table 8.6 operating costs and other costs to the industry indicate the systematic escalation of cost of the regulatory overload since the GFC. Operating and other costs (together perhaps these expenditure items can be regarded as management and regulatory expenditure) are the expenditure items in total expenditure of the long-term industry excluding benefits and commission paid to policyholders and agents/brokers.

Table 8.6. Net Premiums and Costs, 2000-2016

Year	Net premium R'm (1)	Operating Expenses R'm (2)	Other Expenses R'm (3)	Total 2+3 (4)	Proportion 1 Of 4 %
2000	147 747	9 006	7 375	16 381	11.1
2005	163 751	13 848	2 532	16 380	10
2010	262 351	27 314	3 660	30 974	11.8
2015	447 623	36 171	9 794	39 965	8.92
2016	461 381	38 412	8 438	46 850	10.2
Annual Compound Growth %	7.8			7.25	

Source: Financial Services Board (South Africa), *Annual Report of the Registrar of Long-Term Insurance* (2000-2016).

<sup>401</sup> Verhoef (2010).

<sup>402</sup> Verhoef (2016).

The cost of managing the long-term insurance business escalated faster than the growth of the economy – both in real terms as well as at market prices. The cost escalation was just below the 7.8 per cent rise in net premiums. Reducing management cost through scale was substantially undermined by the implementation of the SAM reporting requirements in 2016. It can be argued that the soundness of the long-term industry in South Africa and the lack of the failure of any significant company in the long-term sector since the mid-1950s, begs the rationale to escalate statutory regulation since the GFC.

This chapter has substantiated the stability and financial soundness of the sector, as well as the compliance with global best practice capital requirements long before and in the aftermath of the GFC. Following global regulation trends to secure a long-term industry, which differed fundamentally from the South African long-term sector, was not justified by the performance of the industry in South Africa. No systemic risk manifested in the South African market. Extensive regulation escalated costs to the sector, and in principle, to policyholders and shareholders.



## **CHAPTER 9. REGULATORS AND VALUATION. DECOUPLING INSURANCE ASSETS FROM MARKET PRESSURE IN FINANCIAL CRISIS**

Luca Froelicher

### **INSURANCE COMPANIES AND FINANCIAL CRISIS**

In insurance history, the relation between the state and insurance business has been discussed manifold (Borscheid and Haueter 2012; Pearson 2010). Some authors have discussed the role of the state in creating insurance markets through law making, e.g., third-party liability or pension plans (Leimgruber 2008b). Others have discussed the role of insurance regulation as a way of crowding-out unsustainable business plans and supporting the international standardization of insurance practices (Borscheid 2006; Pearson and Lönnborg 2008). While many aspects have been discussed extensively, surprisingly, the state and insurance regulators have played a small role in recent insurance history literature in relation to safeguarding insurance companies' solvency in financial crisis.

One reason might be that insurance companies are still considered relatively stable during financial crises. The nature of insurance companies' balance sheets makes insurance companies less vulnerable to liquidity panics. Furthermore, insurance companies are independent from business cycles, making them one of the few net-buyers during financial crises. Insurers have therefore a stabilizing effect on financial markets (The Geneva Association 2010, p. 3; International Association of Insurance Supervisors 2011, pp. 25–26). It is a common understanding in literature that insurance companies have failed during a financial crisis only because of so-called non-insurance products, e.g., banking-like activities (Baluch *et al.* 2011; Cummins and Weiss 2014, p. 491; Acharya and Richardson 2014). This was the case for example for German FAVAG and Austrian Phönix (Feldman 2002; Eggenkämper *et al.* 2004; Lembke 2016) in the interwar years and for the recent failure of AIG in the United States (Peirce 2014). Insurance regulators therefore

should take an active role in challenging non-insurance activities of insurance companies, although the dividing line is far from easy to find (OECD 2011, pp. 55–57). However, the academic literature in insurance history is still scarce in relation to instances in which regulators are actively involved in safeguarding the insurers' solvency and ensuring public trust during financial crises.

This is surprising for two reasons. First, insurance companies have been in history more affected by financial crises than is generally assumed in the literature (Capie 2016; Froelicher 2019). A heavy decline in asset prices, as is typical during a financial crisis, has a significant impact on the insurers' balance sheets and their solvency. For insurance companies, the financial market risk is considerable. Recent literature has shown that during the financial crisis of 1931, the actual internal reported losses from financial market depreciation was much higher than reported. One of the largest reinsurance companies, Swiss Re, was near bankruptcy due to a heavy write-off on its financial assets. Only the existence of hidden reserves allowed the company to absorb the shock from financial markets and to report a positive result (Straumann 2014). It was the state that enabled through its law the creation of hidden reserves and therefore contributed to the resilience of insurance companies (Froelicher 2019). Second, recent academic literature has shown that liquidity crises affect insurance companies as well. Rose demonstrates the resolution of a systemically important US insurer, the National Surety, which had become the object of a bank run. Policy holders asked for a payback of unearned premiums when the unsound financial situation of the insurance company became public (Rose 2017). Interestingly, Huertas *et al.* (1984) have shown that insurance regulators had been actively involved in creating an "insurance holiday" in 1933. Policy holders of American life insurers approached their insurance companies in their search for liquidity when bank withdrawals were limited and a "banking holiday" was announced. The policy holders were enabled to receive policy loans according to their contracts, but life insurance companies were running into serious liquidity problems when they had to liquidate assets in times of depressed asset prices. Only the intervention of the regulators and the prohibition of a further issuing of policy loans could safeguard the solvency of life insurers.

Regulation authorities in financial crises can play a vital role for insurance companies when they allow less transparent financial reporting. Therefore, the way US

regulation authorities decoupled financial assets from market pressure in the middle of the financial crisis in the 1930s is demonstrated in this paper.

## **VALUATION OF FINANCIAL ASSETS**

The question of the valuation of the assets of financial institutions is an ongoing discussion since the Great Financial Crisis (Plantin *et al.* 2008; Laux and Leuz 2009; Ball and Haldane 2015). One of the main missions of insurance regulation authorities is to ensure the solvency of insurance companies. Insurance companies are required to provide a market-consistent assessment of the value of their assets and liabilities. An insurance company's solvency is adequate if it is likely to be able to meet all its obligations to insured persons even under unfavorable conditions. Assets on insurance companies' balance sheets are financial assets, such as loans, shares, and bonds that are tradeable and priced on financial markets, or other tangible assets, such as real estate. The way the assets of insurance companies are valued is therefore essential. Regulation authorities play a crucial role in defining the method of valuation, giving the state a considerable responsibility in ensuring the insurance market's functioning and public trust. The way an insurance company's assets are valued has a significant influence on the insurer's calculated solvency and on its standing. It is therefore not surprising that the debate on the valuation of securities is regularly discussed, especially during financial crises.

During the financial crisis of 2007-2009, many accused today's accounting standards, known as fair value accounting (FVA), of aggravating the financial crisis. FVA means that the valuation of assets in a financial institution is based on market prices (mark-to-market accounting) rather than historic costs. Critics of FVA have argued that it has significantly contributed to the financial crisis and has exacerbated its severity for financial institutions: FVA is procyclical and can cause a downward spiral in financial markets (Amel-Zadeh and Meeks 2015, pp. 197-198). Furthermore, FVA can provoke contagion in financial markets because financial institutions must sell assets at a price below fundamentals, and this is a price signal to other institutions to mark their assets to market (Laux and Leuz 2009, p. 829). Whereas most of the criticism originated from banking institutions,

insurance companies were among the skeptical voices as well. Among the critics were Claude Bébéar, chairman of the French insurance giant AXA, and Denis Kesler, CEO of the reinsurance company SCOR. Both talked of the destabilizing effect of the mark-to-market rule, which aggravated the financial crisis and increased volatility unnecessary (Uhlig 2008).

Regardless of what the stabilizing or destabilizing role of FVA might be – the scientific discussion continues – historical research can contribute to this debate. Insurance regulators discussed the valuation of securities during the Great Depression and developed specific solutions to the question. They intervened with acts that are not according to today's practices, which believe in the superiority of market mechanisms.

## **DECOUPLING ASSET PRICES FROM MARKET PRESSURE**

It was in December 1931 that a participant at the American Convention of Insurance Commissioners asked the crucial question: What is a fair market value for the assets of insurance companies? (National Convention of Insurance Commissioners 1932, p. 10). Worldwide, stock markets and bond prices had fallen significantly in the past months prior to the convention. The collapse of Central Europe's banks and states was a major shock to the financial markets, followed by another shock when Great Britain went off gold and devalued Sterling in September 1931. Insurance companies' financial assets were under pressure, their solvency – at least with some companies – in question. For the insurance commissioners, it was clear that this shock on the investment side of insurance companies would cause serious issues for many companies. As was normally the case, insurance companies could value their assets based on market prices on December 31. The insurance regulators concluded that this rule was not to be followed for the year 1931. Instead, they decoupled insurance balance sheets from market pressure. In fact, between 1931 and 1934, the official insurance balance sheets were far from actual market prices. The financial assets of US insurance companies over these four years reflected the situation of the financial markets on June 30, 1931 (Easo 1959, p. 27). This was the last date when – in the eyes of the insurance commissioners – markets were still functioning “well” and when prices were “true” (National Convention of Insurance Commissioners 1932, p. 10).

Similar interventions took place in other countries as well, most notably in Germany. Observers in the 1930s have written about this (Magrath 1933; Ullrich 1934), but few have taken notice of these actions in recent academic literature (Werner 2016, p. 28, accessed 4 January 2016). While Werner values the interventions in the US as successful, the reasons for the intervention remain unclear.

This chapter includes a discussion of the insurance commissioners that led to the creation of such an intervention in the market. The main questions are: how was the intervention justified, and what does that indicate regarding the relation between the state and the functioning of the insurance market? The discussion is traced in the respective bodies on the basis of the minutes of the National Convention of Insurance Commissioners (NCIC). The convention was a voluntary association for the interchanging of views among state officials charged with supervision of the insurance business, but it was more than simply a voluntary association. It was a place where insurance regulation among the states harmonized and synchronized actions to regulate US insurance markets. The minutes are supplemented by the investigation of reminiscences of the leading insurance commissioner of that time, George van Schaick. He was appointed Superintendent of Insurance in New York State, one of the most important insurance markets in the US. He was one of the leading figures of the intervention and justified it later in his reminiscences, which were included in a larger oral history project in the 1970s that attempted to collect memories of leading figures of the Roosevelt-era and can be found in the Columbia University Archives. Next, the results are discussed, and lessons regarding the relation between the state and insurance companies are presented.

## **VALUATION OF SECURITIES IN THE UNITED STATES 1931-1935**

Insurance companies in the US were regulated differently in each state. There was no national regulation authority (Kobrak 2012, pp. 276-277; Patterson 1927). Among the states, New York was considered to have the most and the strongest laws regarding insurance companies because it was also one of the most important insurance markets (Gudmundsen 1960). Nevertheless, the different state insurance regulation authorities met on a regular basis at the National Convention of Insurance Commissioners (Cunneen 1926, p. 44).

Among the features of regulation was the so-called authorized valuation of investments on the asset-side. Each state could issue such a list, which was the basis for the valuation of securities. The list contained the maximum price for valuating a specific asset that was traded on the financial market, and there was a specific price. An insurance company was allowed to present its assets as valued under the market or convention price (historical method) but not above it. Insurance companies should not be allowed to state fantasy prices for their assets because it would provide incorrect information regarding their actual solvency. Historical costs were allowed.

The authorized price was normally equal to the market quotations of December 31. The list was compiled by a sub-committee of the National Convention of Insurance Commissioners. After adopting the list, the NCIC issued the "Convention Book of Security Values", which nearly all states required the companies to use. It was rare for an insurance commissioner to prescribe security values differing from the convention's basis, although of course any commissioner would have had the right to do so. As Howard Dunham, Commissioner of Connecticut, explained, the list was not mandatory but generally accepted de-facto: "Its decisions are binding on no commissioner, yet they have the broad basis of nation-wide opinion and carry the prestige of the Convention" (Dunham 1938, pp. 4-5).

When in the second half of 1931 the stock exchanges and bond prices dropped significantly, the Commissioners discussed the valuation list exceptionally early. In September 1931 the convention committee on the valuation of securities reviewed the conditions of the financial markets and appointed a sub-committee to continue to study and to make recommendations for the upcoming December meeting (Magrath 1933, p. 282).

George van Schaick summarized the early action of the Committee. He had just been nominated Superintendent of Insurance in the spring of 1931 by the then-Governor of New York State, Franklin D. Roosevelt. Van Schaick was a former attorney at law and did not have any insurance background. Nevertheless, Roosevelt appointed him superintendent.

Van Schaick reported that from October 1931 chief examiners of the insurance department in Albany and in New York came to his office to tell him that several

insurance companies would experience trouble. One reason was that a large amount of investments by fire and casualty insurance companies was held in common stocks that were depreciating heavily. Van Schaick remembered that “executives of companies began to sense the situation and began to come in to talk about their problems” (Van Schaick 1950, pp. 60-71).

It is difficult to review this statement because most of the documents from the insurance department during this time have been lost; however, because not only common stocks but also a considerable amount of bonds were affected by the financial crisis of 1931, there is strong evidence that insurance companies faced massive write-offs on financial assets when market prices fell under book prices. The security markets between September and December continued to fluctuate violently. The bond price index that was accessible to the committee had dropped from 98.7 to 68.5 and ended at 72.5 points. The stock price index of the committee had shown a free fall from 109.2 in April to 57.7 points in December. The committee therefore recommended at the meeting of its body on December 8, 1931 to find another basis for the valuation than the usual market quotations (Magrath 1933, p. 285).

It was not the first time that the NCIC recommended a deviation from market quotations. It had taken this action in 1907, 1914, 1917, 1918, 1919, 1920 and 1921 – seven times in the last 30 years. The reasons for this are obvious. The financial panic of 1907 was viewed as an extraordinary event by the insurance commissioners. Thus, the valuation was based on a rather strange method: market quotations as of the first day of each month and the last day of the year, totalled and divided by 13. In 1914, 1917 and 1918 it was the Great War that had disruptive effects on financial markets. Thus, in 1914 it was possible to use values as of June 30, when the war in Europe had not begun yet. In the years following 1917 it was the volatility of the financial markets resulting from abandoning the gold standard in many countries. At this time, insurers were able to value their investments on the basis of the previous year (ending date) and to add the ending date of the year divided by two. This was meant to bring less volatility and some kind of average value to the insurance companies’ balance sheets because insurance companies were considered long-term investors that did not have to liquidate all their investments at the same time (Magrath 1933,

pp. 281–282). Thus, when the discussion at NCIC regarding the authorized values of securities took place in 1931, the committee could refer to a regularly used act to decouple prices from market pressure.

### **Discussions about a “Fair Value” for Insurance Companies Assets**

This act was viewed as an extraordinary measure in extraordinary times. In the resolution of the committee, some remarkable statements – even from today’s perspective – can be found. It stated that “exceptional fluctuations of value of stocks and bonds as reflected on the exchanges have led to the inquiry as to whether the market price quotations for stocks and bonds on any particular day are indicative of the fair market value of such securities” (National Convention of Insurance Commissioners 1932, p. 6). The Committee believed that under these conditions, the market price did not reflect a so-called “fair market value”. Therefore, the committee resolved that a fair value was approximately the closing price of June 30, 1931, a date that reflected the state of the financial markets before the great rupture. Insurance companies were allowed to value their financial assets according to this authorized price with the exception of securities of issuers that had defaulted in principal or interest since that date. For these assets, the values of December 31, 1931 should be used (National Convention of Insurance Commissioners 1932, p. 6).

George van Schaick, the president of the valuation committee of NCIC, explained the views of the majority. In the discussion at the convention, he argued that “there is no magic in the day of December 31 of any particular year”. Taking December 31 market quotations was thitherto a “matter of custom, and as a matter of convenience,” and he concluded that there would have never been any reason why the precise valuation on that particular day should be taken or of any other particular day. One would agree, he stated, that stock would “only reflect a standard that under normal circumstances we can properly use”. There would be occasions when this was not a proper standard. For the insurance interests of the US, it would be wrong “to be tied up to a false standard and to say because we have in normal times adopted one standard, in abnormal times we should not correct it by discarding a standard which for the time-being is not right” (National Convention of Insurance Commissioners 1932, p. 10).



There was some need to discuss the resolution at the convention. The speaker of the minority that opposed such rules was Howard P. Dunham, Insurance Commissioner of the State of Connecticut. He told the Convention about his reasons to oppose the resolution. He said that it would be a dangerous precedent to take these "drastic actions". It would be unsound for State Insurance Departments to recognize for annual statement purposes a valuation for securities on any other basis than the true market value at the end of the year. Especially for fire and casualty insurance companies, which might at any time be called upon to pay out large sums of money, it would be "seriously misleading to assume that their resources represented any more in value than could be produced by the conversion of securities into cash at current market values". The insurance departments would have a definite obligation to their respective states and to the insuring public to carry out their duty to report to the public the facts in respect of insurance companies that were under their supervision. This would not be the case if the departments allowed deviation from the mark-to-market principle. The annual statements would be misleading, and by such action, "we would lay ourselves open to criticism and perhaps legal action in the case of policyholders who are misled by statements approved by the insurance departments and who suffered loss due to inability of the companies to pay". He proposed that it would be best to adhere to true market values because many unsound insurance practices and companies would be excluded from the market. He feared that insurance departments would be placing themselves in an "unsound and inconsistent position of bolstering up weak companies through the medium of approving fictitious and inflated valuations of securities; and by such action would be deterring the accomplishment of the improvement of the insurance business which these departments have so earnestly recommended". He concluded that companies that would be legitimately engaged in the insurance business and that were not organized for speculative purposes would not need help. "Artificial values" would be for the "weaklings" only. A report would be required to be a "true" report, and no financial statement of a corporation is true unless the values both of the assets and the liabilities are correctly stated according to his statement (National Convention of Insurance Commissioners 1932, pp. 12-21).

After the two statements, there was an extended discussion, after which a vote was taken. The motion was carried with only three dissenting votes, a success for

Van Schaick and the Committee (National Convention of Insurance Commissioners 1932, p. 21). In the views of the majority, it was legitimate to decouple authorized values from market prices, therefore leaving the mark-to-market-paradigm. The argument in favor was that market prices themselves did not reflect inherent prices. They believed that market prices would recover over time, and because insurance companies were considered long-term investors, they should not liquidate their assets in a short period because this was viewed as no threat to solvency. Insurance companies were therefore allowed to issue annual statements regarding their solvency that were based on artificial prices and that did not reflect their actual status.

Interestingly, 1931 was not the only year with this extraordinary measure. In the years following, the NCIC adopted similar resolutions. Until 1934, the annual statements of insurance companies tended to use "convention values" in place of market values as of the last day of the year because until 1933 the market prices had only slowly recovered. Some modifications were introduced for 1933 statements. Stocks and bonds other than government, state, and political subdivisions could be valued at the average of the December 1932 convention value and the market value as of November 1, 1933, with some exceptions. These exceptions included bonds that were amply secured and not in default, which could be valued on an amortized basis. Purchases of bonds and stocks after June 30, 1931, were to be valued at market values of November 1, 1933. For the December 1934 statements, bonds and stocks were to be valued at market quotations of December 31, 1934 with two exceptions (State of New York 1935, pp. 18-19). The first was that all bonds amply secured and not in default were to be valued on an amortized basis. The second was that bonds issued by the states and political subdivisions and not eligible for amortization were to be valued at the December, 1933 convention values with a different formula for those in default over two years (Easo 1959, pp. 261-264).

### **DID IT HELP THE INSURANCE COMPANIES?**

The effect of the regulator's intervention is difficult to measure. To achieve this, corporate archives should be visited to examine internal balance sheets and to compare the book values to actual market prices. Not many have done this, but

there is some evidence from at least two previous studies. Guthmann *et al.* (1935) compared the book and market values of two large insurance companies between 1929 and 1933. They showed that the market values of Sun Life Insurance Company dropped to 56.9 per cent of book values in 1931, recovering to only 61.7 per cent in 1933, whereas authorized value by the convention was 96.5 (1931) and 97.5 per cent (1933) of book value. Taking into consideration the entire amount of assets of \$ 338 Mio. (1931), where the actual market price dropped to \$192 Mio. (-146 Mio.), the shock absorbing effect of convention values is evident (Guthmann and Dauer 1935, p. 241).

This depreciation, if reflected on the official statement, would have practically exhausted Sun Life's total capital. Huertas *et al.* (1984) concluded from this study that, on the surface, insurance companies were far from failure during the Depression. Official statements of the companies showed asset values comfortably in excess of policyholder reserves during the entire period. According to these documents, insurance companies were in robust condition, even at the nadir of the Depression; however, Huertas *et al.* concluded that these reports did not present a completely accurate picture of the insurance companies' conditions. At the Metropolitan Life Insurance Company, the country's largest insurance company with nearly one-fifth of the nation's insurance in force, the market value of the bond portfolio was only 82 per cent of its book value. If mortgages had also been valued at what they could be sold for rather than what they had cost, Metropolitan would almost certainly have been insolvent at the end of 1932 (Huertas and Silverman 1984, p. 110).

Easo (1959) also concluded that if market values had to be used, "quite a few companies might have found themselves technically insolvent". Thus, the convention values insulated the statements from the full effects of market decline in the value of securities according to Easo. Insurance companies were viewed as long-term investors with some choice in timing their sales. It was assumed that they would not face emergency liquidations at market prices on any large scale and that the collapse of the market was a temporary phenomenon. Easo then pointed to the fact that not all insurance companies adopted the convention values at the same time or without modifications. Some had set up valuation reserves and had reduced the value of assets from convention to market. Some had set up surplus reserves, anticipating future market declines (Easo 1959, pp. 261-264).

Although such practical issues were a large concern, there is strong evidence that the convention values played a significant role in giving the insurance companies room to maneuver. By eliminating market pressure, insurance companies were given some flexibility, and their resilience was strengthened. In the words of Superintendent Van Schaick, as he told insurance company officials, “oxygen which was being administered here to get us all over the trouble” (Van Schaick 1950).

## **THE ROLE OF THE REGULATION AUTHORITIES**

It was the regulation authorities who pushed such interventions in favor of the insurance companies. In fact, it was a high-risk game. With this act, the insurance commissioner misled the public regarding the actual solvency and made a significant trade-off. It weighed the interest of the stabilization of insurance companies higher than the interests of shareholders or policy holders; however, no one could predict with certainty whether depressed market prices would actually recover. Van Schaick later reported that it was simply the only solution for this situation: “It was one of those things one couldn’t go into too carefully. It had to be done, as I viewed it”. After many years, Van Schaick seemed to be amused by the fact that the convention values were simply a spontaneous result because no one presented a better solution: “I was a little ashamed of it, to tell the truth. It didn’t sound scientific”. Still, he was convinced that the measure provided “a breathing spell during which the companies could put their houses in order” (Van Schaick 1950, pp. 60-71).

Interestingly, the use of convention values was made official to the public. The New York State Insurance Department informed the public about the way the financial reporting of insurance companies took place from 1931 to 1934. It was stated that insurance companies used a specific resolution for their market values, and the resolution was printed in the annual report of the department. “Practically all insurance companies, societies and associations use values given in the Convention Book of Security Values in preparing their annual statements”, the department informed the public (State of New York 1932, pp. 18-21); however, this did not lead to panic, either because the reports were published with a huge delay or because the reports were only read by experts. The experts had already noticed the difference between the convention values and the market values.

## **CONVENTION VALUES VS. MARKET PRESSURE**

By defining the valuation technique for insurance companies, the state encouraged the deviation of the mark-to-market principle, and thus a deviation from transparency standards; however, it was precisely the loss of transparency that enabled the insurance companies to recover from the worst influences of the financial crisis. Considering the current discussion of fair value accounting, this historical example proves to be an interesting contribution to the discussion.

The role of insurance regulators in softening the market powers on insurance companies is evident. The question of accounting standards, therefore, is a question of how the state shapes the market and market behaviors. Currently, valuation methods for multinational insurance companies have become global standards: IFRS or GAP are the accounting principles and are based on the Fair Value standard. It is much more difficult to deviate from this standard during a financial crisis on a national level, as was the case in the 1930s.

It was during the financial crisis of the 1930s that American regulators decided to weigh the interest of stability higher than the public interest of transparency. As it turned out, leaving the mark-to-market accounting standards between 1931 and 1934 gave the insurance companies some room to maneuver because they were allowed to set fantasy prices for their assets on their balance sheets. With this measure, they seemed more solvent and were not subject to general public panic. The regulators legitimized their action based on an extraordinary situation. The stock markets and bond prices did not – in their understanding – represent a fair market value at this time. In particular, it was argued that for long-term investors, such as insurance companies, that did not have to liquidate all the assets at one time, the convention values were the correct values upon which their solvency should be judged.

Whether this would have helped withstand the recent financial crisis remains an open question; however, it has been shown that the discussion regarding what constitutes a fair value is not new and can have different outcomes.



## CHAPTER 10. BANCASSURANCE AT THE HEIGHTS: THE BANESTO-LUYEFE CASE (1879-1993)

José L. García-Ruiz

### INTRODUCTION

The 'bancassurance' concept, which arose in France in the second half of the twentieth century, covers three types of relationship that go further than simple distribution agreements: i) strategic alliances between financial intermediaries in various sectors; ii) joint ventures, which entail the shared ownership of products and customers and require strong and long-term commitments; and iii) financial groups, where the degree of integration is greater and there is active participation by the bank in the insurance business (Montijano 2001; Ricci 2012). This latter type characterises the bancassurance relationship that the large Spanish banks established with their insurance subsidiaries in the middle decades of the twentieth century, in connection with the consolidation of a 'mixed banking' (universal) model. As they were universal banks with a focus on manufacture, the insurance subsidiaries coexisted with the industrial ones, and it became commonplace for an industrial subsidiary to be co-financed by the parent bank and co-insured by the insurance subsidiary, in operations which required other participants but that the universal banks clearly headed up.

The key Spanish banking institutions prior to the oil crisis were based in Madrid, represented by *Banco Hispano Americano* (BHA or Hispano) (1900), *Banco Español de Crédito* (Banesto) (1902) and *Banco Central* (1919) (Tortella and García-Ruiz 2013, chapters 6, 7 and 8). Each had their own insurance subsidiary: Hispano had *La Estrella* (1901), arduously controlled between 1903 and 1946; Banesto from the beginning had *La Unión and El Fénix Español* (Luyefe) (1864), thanks to the connection with the Pereire family; and Central took

control of *Banco Vitalicio* (1880) from 1957, as part of the takeover by the Madrid bank of the business group created in Barcelona by the Marquis of Comillas (García-Ruiz 2007a; García-Ruiz 2007b; Tortella 2007). Spanish legislation allowed banks to have holdings in insurance companies, and also allowed insurance companies to have holdings in banks, but always maintaining corporate independence. This situation has remained the same to the current day. In addition, a bank cannot act as an insurance company and vice-versa, as they are activities subject to different regulations and impossible to consolidate in the accounts.

Compared to just one famous case of a bank run by an insurance company (*Banco Mapfre* in the 1990s, whose unsuccessful trajectory is studied in Tortella *et al.* 2009, pp. 270-277), in Spanish financial history there have been several cases of insurance companies being controlled by banks, a process which intensified in the twentieth century. In the early 1990s, when we stop our research, close to 70 per cent of all premiums were collected by companies linked to banks (Montijano 2010, p. 265). As a hypothesis, Francisco Montijano, one of the greatest Spanish experts on bancassurance, has pointed out that 'the banks have for a long time seen the sense in establishing and exercising control over the resources captured by the insurance activity and, at the same time, as secondary interest, in covering their risk activity. This interest has arisen from a position of dominance' (Montijano 2010, pp. 263-264).

In the twenty-first century, insurance companies fully integrated into the financial groups of the large Spanish banks dominate the rankings, mainly in the life insurance branch. Due to their very nature, bancassurance companies have always had, and still have, a greater presence in life than in non-life. A study by Swiss Re showed that, in 2006, the distribution of life insurance policies through bancassurance companies was very high in Portugal (88.3 per cent), Spain (71.8 per cent), France (64 per cent) and Italy (59 per cent), while it was less relevant in Germany (24.8 per cent) and the United Kingdom (20.3 per cent) and was practically unheard of in the United States (two per cent) (Swiss Re 2007, p. 11). The question that immediately arises is whether the strong presence of bancassurance in countries such as Portugal or Spain is related to their poor position in terms of making insurance products and pension funds appealing for the



savings of families (on financial savings, see the Inverco reports, which offer data since 1985). If there has been a 'position of dominance' for the banks over the insurance companies, as Montijano suggests, it is clear that through this path we will be able to find an explanatory factor (although certainly not the only one).

If banks and insurance companies compete to attract financial savings, it is not far-fetched to think that the bancassurance relationship contains dangers for the weakest party. The study by Swiss Re (2007) points out that, for this reason, bancassurance has faced many legal limitations in the Anglo-Saxon world, where the financial system has not been as dominated by the banks as it is in mainland Europe. Until recently there have even been some restrictions in this geographic area: for example, in Italy, until the Amato Act (1990) the banks could not hold shares in insurance companies (as in the US Glass-Steagall Act of 1933, which was abolished in 1999). And in Asia, bancassurance pacts were viewed with distrust until the early years of the twenty-first century (Swiss Re 2007, p. 11). It can be argued that bancassurance did not turn into a worldwide reality until the neoliberal winds of the Second Globalisation blew strongly, and even so, its presence today is only noticeable in Latin Europe (particularly, in Spain, due to its traditional liberal stance on this issue).

In a previous study, the domination hypothesis was confirmed for the Hispano-Estrella relationship (García-Ruiz 2017). This study aims to test the hypothesis for the Banesto-Luyefe case over the long term, paying particular attention to the banking crisis years between 1977 and 1993. This crisis saw the end of the supremacy of the Madrid banks, which within a few years ended up being controlled by Banco Santander. Following the government intervention in Banesto in 1993, Santander took control of this bank in the following year, and in 1999 it would absorb *Banco Central Hispano* (BCH), established in 1991 by the merger of Central and Hispano. Based on the research conducted by the author in the Banesto and Luyefe archives, we will describe the essential aspects of the relationship and try to evaluate their behaviour during the debacle (for the study of the Spanish banking crisis, see Cuervo 1988, and Tortella and García-Ruiz 2013, chapter 9).

## BANESTO AND LUYEFE (1879-1977): THE GOOD TIMES

### Under the influence of the Pereires (1864-1923)

In 1857 a company called *La Unión* was established in Madrid with French capital, which would operate in the branches of marine and fire insurance. The company would have offices spread along the Spanish and Portuguese coasts. Soon afterwards, in 1864, the well-known *Pereire Frères*, Émile (1800-75) and Isaac (1806-80), founded *El Fénix Español* as part of the corporate empire they were creating in Spain, which included *Crédito Mobiliario Español* (bank) and *Compañía de los Ferrocarriles del Norte de España* (railways) as key elements. The Pereire brothers were descended from a Spanish mathematician and philologist, of Jewish origin, who had emigrated from Berlanga (Badajoz) to Bordeaux in the eighteenth century, acquiring French nationality and changing his surname from Pereira to Pereire (*La Unión y El Fénix Español* 1946, pp. 65-66; Autin 1984).

*El Fénix Español* also operated in marine and fire insurance, but from the beginning also added scientific life insurance. It had its main offices in Madrid and Paris, from where it controlled a broad network of agents and a branch in Portugal. The link with France was damaged by the suspension of payments of the well-known *Crédit Mobilier* in 1867, created by the Pereires to channel investments during the French Second Empire, which was dealt a deathblow by the Franco-Prussian War (1870-1) (Tortella *et al.* 2014, p. 116). *Mobilier* was one of the many victims of the international crisis of the 1860s.

The prestige of the Pereires collapsed in France and the brothers decided to focus their investments in Spain, although the political situation was not easy there either and the Treasury crisis made it very hard to earn a return on *El Fénix Español's* large portfolio of public debt. In 1874 the reinstatement of the Monarchy, in the figure of Alfonso XII, brought back optimism, which explains the merger, in 1879, of *El Fénix Español* with the other insurance company of French origin, to create *La Unión y El Fénix Español* (Luyefe). The merger was mainly based on the complementarity of the businesses: *La Unión* was strong in marine and fire insurance, while *El Fénix Español* was strong in life insurance. Ernesto Polack, head of *El Fénix Español*, led the negotiations successfully and, in late 1879, the new company

was formed, with *Crédito Mobiliario Español* holding a third of the capital (Tortella *et al.* 2014, pp. 118-119).

Only Isaac Pereire took part in the foundation of Luyefe, as Émile had passed away some years earlier. Gustave Pereire (1846-1920), Isaac's son, would take over and witness the progress of Luyefe until well into the 20th century. The Spanish Restoration (1874-1923) and the French Third Republic (1870-1940) were periods of strong prosperity. Luyefe took advantage of this, making interesting investments in buildings, both in the Paris renewed by the Baron Haussmann (a friend of the Pereires) and in the Madrid that was able to build *La Gran Vía*. In 1904, Luyefe announced the construction of what would become its most emblematic building, located at the junction between the streets Alcalá and Caballero de Gracia, which would be crowned with the figure of the Phoenix along with the pageboy Ganymede (today, the building belongs to Metrópolis). The building was inaugurated in 1911.

In 1908, the Insurance Registration and Inspection Act was passed, which created the first official register for insurance companies. Luyefe registered as a Spanish company, even though the majority of its shareholders were French. Luyefe easily dominated the Spanish market, which was very small, which led them to also have a presence in other nearby markets, namely the French and Portuguese ones, even in direct insurance. These characteristics, so unique in a Spanish insurance company, would remain until the end of its history. Shortly before Spain entered the European Union in 1985, 96.7 per cent of the premiums for direct insurance underwritten abroad by Spanish companies corresponded to Luyefe (Martínez 1987).

At the beginning of the twentieth century, Gustave Pereire was also behind the foundation, in 1902, of *Banco Español de Crédito* (Banesto), to which *Crédito Mobiliario Español* contributed 30 per cent of the capital, while *Banque de Paris et des Pays-Bas* (Paribas) led the operation, contributing 40 per cent. The new Spanish bank would have a Board of Directors in Madrid and a Committee in Paris which, according to the bylaws, would have to be consulted for strategic decisions. Banesto succeeded *Crédito Mobiliario* in all its operations, even buying its headquarters on the Paseo de Recoletos street for half a million pesetas. The chairman was a

Spanish politician from the Conservative Party, but the CEO was French, Léon Cocagne, with very broad powers (so broad that in the Board Meeting held on 13 November 1902 he even asked for them to be cut back).

In the climate of growing nationalism that was so characteristic of the Restoration, the Spanish and French directors soon disagreed on the nature of the new bank (for everything related to this conflict, see García-Ruiz 2007c). The Spanish, led by José Gómez-Acebo Cortina, Marquis of Cortina since 1908, believed that the best strategy would be to turn it into a deposit bank, with branches across the country, as Hispano was doing. The French, led by Cocagne, preferred the company to settle for handling French interests in Spain, in the style of an investment bank. In 1912, a politician from the Liberal Party, who was very close to Cortina, was named chairman, and Cocagne started to come under pressure. He tried to resign in 1915, but was convinced to remain in his position until November 1919. From 1917, Cortina was chairman of Banesto.

In the General Meeting of Shareholders held in July 1919, a capital increase of up to 50 million pesetas was approved. Spanish shareholders were favoured by the strengthening of the Spanish peseta against the French franc (during the First World War, Spain had prospered thanks to its neutrality, while France had suffered greatly from being involved). In 1920, Banesto bought the magnificent building on the junction of the streets Alcalá and Sevilla, which had belonged to a major American insurance company (The Equitable), which was now abandoning Spain, leaving the business in the hands of *La Equitativa-Fundación Rosillo*. In 1922, the new headquarters were inaugurated in an act presided over by King Alfonso XIII.

### **In the years of the consolidation of Spanish capitalism (1923-1939)**

The euphoria of the First World War era was coupled with a severe social conflict due to strong inflation, which reduced the lowest wages to a pittance. Between 1920 and 1923 there was serious banking unrest, with the director Pablo Garnica Echevarría standing out due to his firmness in tackling the problem at Banesto. In recognition of his work, Garnica would be named CEO in December 1923. By then, since September, Spain had been under a dictatorship, with General Miguel Primo de Rivera at the forefront, and this regime would last until early 1930. The

Banesto of Cortina and Garnica, two men linked to the Liberal Party, did not want to collaborate with the dictatorship in political affairs, but did so in the economic realm as they believed in the protectionist, nationalist and interventionist model of the Restoration, which would be continued and increased by Primo de Rivera. In the General Meeting of 1927, Banesto showcased itself as the champion of the 'repatriation' of a large number of companies, including the bank itself. The Committee in Paris disappeared after 25 years.

From 1927 Banesto could start being the great universal bank that Cortina had dreamed of since the beginning. A bank with branches across Spanish, a retail bank, but also with a large portfolio of shares in railways, various companies and, of course, insurance companies, where the investment was concentrated in Luyefe (Garnica would also be CEO of Luyefe between 1923 and 1929). The 'enemy' of Cortina was not so much the Pereires, who were comfortable with their Spanish origins, but Paribas, which, for example, refused to support the purchase of Soviet naphtha on behalf of Campsa, a commercial monopoly fostered by the dictatorship, when this was the sole alternative given the blockade of the Western oil companies that had been ousted from the market. In 1928, the Paris branch of Banesto, which operated as *Banco Español y Francés*, was liquidated. The resources would be concentrated in the domestic market.

In 1930, the dictatorship was followed by a 'soft dictatorship', a transition period towards a return to the democratic regime, with which the men at Banesto showed a willingness to collaborate politically (to understand what ensued, see García-Ruiz 2013). Three directors held ministerial positions, most notably Manuel Argüelles, who would be the Chancellor of the Exchequer. Cortina's bad health led him to transfer his responsibilities to Garnica, paving the way for the succession which took place in December 1932 when the chairman passed away. The company was in such good health that it was the only one among the large banks that did not have to create a share price fluctuation fund to deal with the stock market crisis at that time, brought on by the start of the international Great Depression and the fall of the Monarchy in April 1931.

Banesto was closely linked to the Monarchic regime of the Restoration, which is why Garnica accepted Epifanio Ridruejo, a man of merit who had a good

relationship with the new republican authorities, as CEO. Garnica and Ridruejo managed to ride out the economic and politic difficulties of the time, and steered the bank towards new industrial sectors, such as the car industry. Banesto continued being the banker of Hispano Suiza, but was also the main source of financing for the commercial subsidiaries of Renault and Fiat in Spain, along with the manufacturer of Tudor batteries and the tyre manufacturer Firestone. The outbreak of the Civil War in July 1936 caught Garnica by surprise while on holiday in Cantabria, where his family was from. The banking sector, of liberal affiliation, was not involved in the coup that had clear fascist features.

How did Luyefe perform during the crucial period between 1923 and 1936? In the Board Meeting held on 20 November 1922, the CEO Francisco Setuain declared that under his leadership the company had grown in all branches between 1907 and 1921, to the extent that total assets had more than tripled, but that there was no cause for satisfaction because the company still suffered from being 'small' compared to its counterparts in Paris, London and Berlin. In his opinion, the way to grow quickly was to create trusts, in the style of the English companies or the Spanish banks, looking for an expansion across Latin America through subsidiaries (*Fénix Hispano-Argentino*, *Fénix Hispano-Mexicano*, etc.). The strength of the peseta would make this investment process possible, starting with the fire branch and then extending to the other branches (Tortella *et al.* 2014, p. 257).

The expansion of Luyefe in the following years would not be along the path planned by Setuain due to the difficulties imposed by the dictatorship on foreign companies wishing to operate in the Spanish market and also to the establishment of minimum capital requirements in 1927, which opened new opportunities in the internal market to insurance companies such as Luyefe. French capital had stopped being dominant in Luyefe during the First World War times, as in Banesto, but the company still had a noticeable presence of Frenchmen on the Board of Directors and many competitors stated that Luyefe was not 'truly Spanish'. Luyefe had difficulty gaining admittance to the *Federación de Compañías Españolas de Seguros* (association for national companies) (1928), which openly challenged the *Agrupación Española de Compañías Extranjeras de Seguros* (association for foreign companies) (1926) in years of growing nationalism.

The Federación, run by Fermín Rosillo (*La Equitativa*), did not stop until it had persuaded the Minister of Labour, who oversaw the insurance companies, to demand, by royal decree of 27 December 1929, that 'national companies' should have two thirds of their share capital owned by Spaniards, a ratio which increased to three quarters in the case of joint-stock companies. This had to be demonstrated by way of nominative shares that were non-transferable to foreigners. Furthermore, the royal decree stated that managers, executives, directors, CEOs and representatives had to be Spanish, except in joint-stock companies, where up to a third could be foreign directors, 'but they cannot be in charge of chairing the board or managing the company'. In the Luyefe's Board Meeting held on 27 January 1930 the decision was made to protest because the provision would cause problems for the numerous French shareholders in the company, and the directors managed to obtain the royal decree passed in 28 March 1930 that annulled the measure due to it being unnecessarily interventionist (Tortella *et al.* 2014, p. 148).

The rankings tell us that Luyefe was market leader at all times, at a noticeable distance from *La Catalana* (Fire) and *Banco Vitalicio* (Life). One advantage Luyefe enjoyed was its diversification, holding a prominent position in workplace accident insurance. For this reason, a manager of the company in the republican years, Rafael Iparraguirre, distinguished himself by challenging the insurance reform implemented by the socialist Minister of Labour, Francisco Largo Caballero, who intended to turn it into a compulsory and social insurance, where the mutual companies would be favoured over the joint-stock companies as collaborating entities (Iparraguirre, 1934). Luyefe succeeded, and in the ranking for the work accident branch of 1935 this joint-stock company appeared in fourth place.

During the Civil War, a man linked to the powerful businessman Juan March, Ernesto Anastasio, who had been CEO since 1929, took on all the executive duties of Luyefe for the rebel side of General Francisco Franco (whose coup March had prominently financed). The great concern of Luyefe and the other insurance companies during these years was how to cope with the high claim rate the conflict was causing. In 1938, the most respected actuary in Spain, Jesús Huerta Peña, suggested taking inspiration from what happened in Europe after the First World War and thinking about a cooperative solution for everything related to life insurance. However, in the turbulent republican years, riot insurance had been very

successful, covering damage to goods caused by civil unrest. The number of policies sold had increased following the high compensation paid for the damages suffered during the violent events of October 1934. To prevent a cascade of claims, insurance companies hurried to define what was happening in 1936 as a 'revolt', 'revolution' or 'war', but never as a 'riot' or 'unrest'. However, as we will see, the fascist New State that emerged from the Civil War would not see it that way.

### **A long dictatorship (1939-1975)**

General Francisco Franco won the Civil War (1936-1939) and, against the wishes of many of those who had supported him during the conflict, he refused to reinstate the Monarchy and imposed a totalitarian regime. The great Madrid banks would remain very critical of this regime, most notably in the case of Garnica, who in 1943 even signed the 'Manifesto of the Twenty-seven' to support the return of the Monarchy. Upon observing the limited success of this initiative, the attitude adopted during the Primo de Rivera dictatorship was replicated: opposition in politics, collaboration in economics, although during the 'First Francoism' (1939-1959) the interventionism became suffocating (on Banesto during Francoism, see García-Ruiz 2013).

Banesto was managed by an Executive Board, which included the chairman (Garnica), the vice-chairman (Argüelles), Jaime Gómez-Acebo Modet (Cortina's son) and José María Oriol Urquijo, a key man in the Spanish electricity sector, where Banesto was interested in increasing its presence. The decisions of the Executive Board would be put into practice by Epifanio Ridruejo, CEO from 1942. Another line of expansion for Banesto in these years was aimed towards Catalonia and the Basque Country, regions with a lengthy industrial tradition. In Catalonia they took over the bank *Arnús-Garí* (1941) and started a relationship with the bank *Garriga Nogués* (1952). In the Basque Country a special relationship was established with *Banco Guipuzcoano* (1942), with José María Aguirre Gonzalo as linkage, and Banco de Vitoria (1955). Similar operations in Galicia and Cantabria were not successful due to the strength of the local banks (*Banco Pastor* and *Banco Santander*, respectively).

The relationship between the banking sector and the First Francoism was complex. The Banking Regulation Act of 1946 was celebrated by the banking sector



and challenged by *FET y de las JONS* (Falange, the fascist single party), whose members believed that the sector should be nationalised. However, it soon became clear that the large banks could only maintain their independence if they acquiesced to the requests of the official *Dirección General de Banca y Bolsa* (a regulatory body, politically motivated). There was one point on which the new authorities and the large banks could agree: support for inter-bank agreements to limit competition. The first significant agreement on interest rates was signed on 19 November 1949 in the office of the director general, Luis Sáez de Ibarra, at the Bank of Spain, as he was also the deputy governor of the central bank and the vice-chairman of the *Consejo Superior Bancario* (a consultative body) (Tortella and García-Ruiz 2013, chapter 8).

The fifty-year anniversary of Banesto was celebrated in 1952. In the General Meeting of that year, Garnica reminisced about the company's history, highlighting how Spanish shareholders had achieved control during the First World War, not only of Banesto, but also of the railways, *Banco Hipotecario* (another great creation of Paribas) and Luyefe, among other companies. With Cortina, Banesto had fully focussed on opening branches, definitively ceasing to be an investment bank. Now, there were more than 9,000 shareholders and a million accounts open. Banesto was running smoothly and the Spanish economy would soon be too, thanks to the aid approved by the US government, as Franco had managed successfully to have his anti-communist dictatorship recognised in the context of the Cold War.

Garnica's Banesto was a mixed or universal bank that did not ignore the direct involvement in industrial companies. In this regard, Garnica went much further than his predecessor in the position. In the General Meeting of 1950, Garnica said how proud he was of the Banesto's portfolio of industrial holdings. Following its traditional support for the car industry, Banesto was present in the spring of 1950 at the incorporation of S.E. de Automóviles de Turismo (Seat), which represented a curious coupling of foreign capital (Fiat) and private banking with the public holding *Instituto Nacional de Industria* (INI), a key piece in the Franco's autarchic mindset. Garnica passed away in December 1959, being succeeded by Cortina's son, the Marquis Consort of Deleitosa since 1927, who had been working as vice-chairman for several years.

As soon as he took over the role of chairman of Banesto, Deleitosa showed a willingness to continue with Garnica's legacy. Deleitosa was convinced that it was good for banks to take part in the management of the companies it supported with loans or holdings in the share capital. That is why Deleitosa felt profoundly disappointed when a decree of 1968 prohibited membership of the boards of related companies. Deleitosa saw these measures as 'an attack, or at least, severe censorship', when 'the continuation of banking representatives on the Boards of Directors of other companies generally gives the latter a sense of austerity, of seriousness in their administration and efficiency in their economic management which are hard to beat' (Banesto, Board minutes, 10 July 1968). In his opinion, Banesto had contributed in this way to the success of Luyefe and the bailout of *Valenciana de Cementos*, which was controlled while in a critical situation. The establishment of compulsory investment ratios in public funds, following that established in the Banking Regulation Act of 1962, also shocked Deleitosa.

In September 1970, Deleitosa felt his health was failing and he wrote a letter to the vice-chairman, José María Aguirre Gonzalo, submitting his resignation. The Board of Directors of Banesto agreed that Aguirre should succeed Deleitosa, despite his advanced age (he was 73 years old). Garnica Mansi was confirmed as CEO (he had held the position since 1964), also taking on the position of vice-chairman. He would be assisted in his duties by his son, Pablo Garnica Gutiérrez, as CEO. Deleitosa's son, Ricardo Gómez-Acebo Duque de Estrada, joined the Board of Directors. That ensured that the influence of the Banesto 'families' would continue being notable in the new stage that was starting.

During Francoism, Banesto fully respected the autonomy of its affiliate Luyefe, beyond the bona fide recommendations quoted by Deleitosa. In the First Francoism, the key man in Luyefe was Ernesto Anastasio, CEO in 1929-1942 and chairman in 1942-1967. In the early years, he stood out for his battle with the *Dirección General de Seguros* (regulatory body in insurance) and its determination to respond to the claims derived from the Civil War through riot insurance by way of a 'compensation consortium', that is, a transactional system whereby companies had to make a contribution. Anastasio's annoyance grew when, in 1944, the compensation consortium for riot risks was transformed into a compensation consortium for catastrophic risks, as a result of the complete destruction of the small

town of Canfranc due to a fire. In the General Meeting held on 23 May 1952, Anastasio would protest: 'To define a risk as catastrophic, it is not enough for the cause to be of an extraordinary nature. The simultaneous presence of the quantitative factor also seems necessary' (on the battle between Luyefe and the *Dirección General de Seguros*, see García-Ruiz 2015).

The interventionism of the First Francoism manifested itself in full when the Insurance Market Act of 1954 grouped the existing consortiums into the *Consortio de Compensación de Seguros*, which would enjoy a monopoly over the catastrophic risks until 1990, turning Spain into a very unique country in the worldwide insurance landscape. Only the *Caisse Centrale de Réassurance*, created in France on 25 April 1946 to handle the extraordinarily high claims related to the Second World War, had a similar development. In the General Meeting held on 29 May 1954, Anastasio would argue that 'when a national disaster takes place, governments have more than enough means to come to the rescue of the affected people using the Nation's resources', which is the most accepted solution to this problem worldwide.

The Second World War damaged Luyefe's relations with France, where, in contrast to Banesto, the founding Paris Committee was still operational. With the German occupation of France, Luyefe had two serious problems: i) Paris ceased being the world capital of reinsurance and ii) the presence of Jews in the Committee was not accepted by the German authorities. The first problem led Anastasio to create, in 1940, *Compañía Española de Reaseguro* (CERSA), one of the few pure reinsurance companies in the history of Spain. CERSA took on the duties of the French branch during the war and would consolidate its position when in the post-war era statist winds were blowing in France. The second problem affected Alfred Pereire, son of Gustave Pereire, and René Mayer, who had to resign in May 1942. The grandson of the founder declared that, despite his race, he was a 'fervent catholic' (he had worked for Pope Pious XI!), but that, being 'a Benedictine at heart', he would resign so as to not cause problems and would lock himself up in a 'personal monastery, engrossed in my scholarly works where all is peace and calm' (Luyefe, Board minutes, 12 June 1942).

CERSA had a strong start, taking advantage of the neutrality of Francoism during the Second World War, but was confronted between 1944 and 1948 by an

unexpected competitor in the form of the *Instituto Español de Moneda Extranjera*, (IEME), an official body which regulated the flow of currencies and which tried to control those linked to reinsurance, starting with maritime transport (Gutiérrez-González 2014). This interventionism also had its counterpart in post-war France where, following the step of the creation of the *Caisse Centrale de Réassurance*, the large companies were nationalised, along with workplace accident insurance, this being the main direct insurance business of the Luyefe subsidiary. Nonetheless, the branch and the Paris Committee remained as a reality still characterising Luyefe at the time of its centenary (La Unión y El Fénix Español 1964). Workplace accident insurance was replaced by car insurance, heralding what would soon happen in Spain.

It is worth noting that in some respects Anastasio and Francoism were on the same page. For example, the chairman of Luyefe backed the creation of a mandatory social insurance system, which should function on the basis of the principle of *reparto* ('pay as you go'). In the General Meeting held on 31 May 1957, Anastasio recommended that Spanish Social Security be created on the basis of the *clases pasivas* system, which civil servants and servicemen had been enjoying since the statute of 1926, which unified the complex legislation on their retirement, widowhood and orphanage pensions, which had been in place since the late eighteenth century. These pensions were paid each year directly from the State budget, in other words, through a pure distribution system, and there was no other option for Social Security, although, of course, 'excessive pension rights' were to be avoided.

Another connection with Francoism was the support for industrialisation as a preferred route for economic modernisation which, as we have already seen, was an opinion shared by the senior executives of Banesto. This made possible the 'effective support' which, in the Board Meeting held on 31 January 1947, Anastasio demanded from Banesto to deal with the competition from *La Estrella*, 'a company firmly supported by the organisation of *Banco Hispano Americano*, *Banco Herrero* and *Banco Urquijo*' (Herrero and Urquijo were very close to Hispano). In 1960, Luyefe was able to insure the Barreiros car factory for 100 million pesetas on its own, but it was common to use co-insurance, a formula frequently used with Banesto's subsidiary industrial companies, but also with many public companies (most notably Seat, where the participation in the co-insurance reached between

30 and 50 per cent), before the creation, in 1966, of the *Mutualidad de Seguros del INI* (Musini), which accounted for the majority of this type of activity.

Involvement in workers' accident insurance was also reserved for the mutual insurance companies in 1966, which is why, as had happened previously in France, Luyefe was forced very quickly to invest heavily in car insurance. The following year, Ernesto Anastasio handed the baton over to Jaime Argüelles, its vice-chairman for the previous 10 years. In the last Board Meeting he chaired, held on 24 January 1967, Anastasio stated that: 'The future of our business does not seem very clear. The accumulation of difficulties and requirements is ever greater and *La Unión y El Fénix Español* must bear the heavy burden of being the leading company among all others in Spain, which entails the duty to be totally earnest and serious with the commitments acquired because it must take responsibility for defending the general interests'. After taking on the role of chairman, Jaime Argüelles appointed François Pereire, Alfred Pereire's nephew, as vice-chairman. The Argüelles-Pereire duo would work well over the next two decades.

Car insurance had two components, one mandatory (since 1965), and another voluntary. The former had to conform to official rates which quickly became obsolete, while the latter did not develop much because of the low income levels of Spaniards. The chairman Argüelles said as much in the General Meeting of 20 June 1974: 'Global accident rates are holding up in car insurance with a constant upward trend since 1967 and there is a growing distancing from risk premiums, especially for mandatory insurance'. However, the expansion in the number of vehicles in use meant that operating in car insurance guaranteed a high market share, and for Luyefe it could be dangerous to lose the leadership (a bad signal to the market). The limited or non-existent technical profit obtained in this branch had to be offset by the financial returns from investments, but the rigidities of the Spanish capital market made that difficult. The solution seemed to be a greater focus on life insurance, which had been declining in the twentieth century until it represented around 10 per cent of all premiums. However, the most appealing branch, life-savings, meant competing with the large banks in attracting savings. How would Banesto react, having until then maintained a *laissez-faire* attitude?

## BANESTO AND LUYEFE (1977-1993): A SHARED CRISIS

### The mistakes of Aguirre and Garnica Mansi

The era of Aguirre as chairman began impeccably, with Banesto supporting the creation of Acerinox (1970) (with Japanese technological partners), progress in the transmission of data via telephone (1971) (with Telefónica) and a Spanish contribution to the budding world of credit cards, the 4B Card-Cheque (1973) (with Hispano, Central and Santander). However, Aguirre began to be questioned from December 1977 when a series of events took place which would end up dragging Banesto into a severe crisis.

The merger between *Banco Central* and *Banco Ibérico* was announced on 16 December 1977, placing the former ahead of Banesto in the ranking. Aguirre's reaction was to approve, days later, the takeover of *Banco Coca*, basing his decision exclusively on the personal guarantee given by the banker Ignacio Coca (see Banesto, *Annual Report*, 1986). The 75,000 million pesetas obtained in deposits allowed Banesto to recover the leadership, but it was also the beginning of a true nightmare as *Banco Coca* had lent almost 37,000 million pesetas to companies with little solvency linked to the owner of the bank (he held almost 84 per cent of the capital). The 'Coca case' led to the resignation of Ridruejo in 1980 and to Aguirre being replaced in 1983 by Garnica Mansi, who would retain the position of CEO, while Jaime Argüelles was promoted to vice-chairman.

In February 1986, the Bank of Spain began to worry seriously about the position of Banesto and, under the socialist government of Felipe González, triggered the entry of José María López de Letona, former minister and governor of the Bank of Spain, as vice-chairman and CEO, while the chairman Garnica Mansi lost his executive powers. Soon, Ricardo Gómez-Acebo and the director César de la Mora Armada (grandson of César de la Mora Abarca, director and friend of the Marquis of Cortina) objected to this intervention, but, in July, Letona was (hardly) confirmed in his positions and all the resources generated throughout the year (around 85,000 million pesetas) were allocated to restructuring (as well as the 'Coca case', which led Ignacio Coca to commit suicide in June 1986, there were severe problems with the subsidiaries *Banco de Madrid*, *Banco Catalán de Desarrollo* and *Banca Garriga Nogués*).

### **A false start: Mario Conde**

The constant divestments of Banesto did not go unnoticed by the public and, in June of 1987, a press campaign was orchestrated against the bank's interests. The share price fell until, in August, a mass purchase of shares began, which greatly concerned Letona. In late September it became known that Mario Conde and Juan Abelló were the buyers and they wished to join the Board of Directors. This was approved, and on 28 October they both took office, directly joining the Executive Board and envisaging that they would act as vice-chairmen when Letona took on the role of chairman in December (as had been agreed in June) (for what transpired, see García-Ruiz 2012).

In November 1987 *Banco de Bilbao* launched a friendly takeover bid for Banesto, which was unanimously rejected in the Board Meeting held on the 25th. Garnica Mansi said that accepting it would entail 'giving up everything Banesto has historically represented and represents'. Behind Letona's back, Conde met with the chairman of the Basque bank and on the 27th Letona submitted his resignation due to the 'alarming loss of authority' he had suffered since the arrival of Conde and Abelló, who even accused him of having prepared the *Banco de Bilbao's* operation. Immediately, Conde was promoted to vice-chairman.

With the friendly takeover having failed, *Banco de Bilbao* began a hostile takeover and on the 30th Gómez-Acebo proposed that Conde be elected chairman. Garnica Mansi, who was present, approved this, while staying on as honorary chairman. One of Conde's men was appointed as director to fill the Letona's position. Shortly afterwards, the *Juntas Sindicales* (self-regulatory bodies) of the Stock Markets of Madrid, Barcelona and Valencia did not approve the takeover and Banco de Bilbao gave up its efforts. In the early months of 1988 Conde took steps to streamline the industrial portfolio, de-centralise the organisation and implement a new computer system. Everything seemed to be on track until 17 May, when he made the surprise announcement that the bank would merge with *Banco Central*, a bank that shared a similar culture. Conde would be CEO of the new *Banco Español Central de Crédito*, sharing the role of chairman with the chairman of Banco Central until October 1991.

In February 1989 the Bank of Spain notified its opposition to the merger, as they were two banks with problems and the merger could not lead to a positive

outcome. The failure of the merger precipitated the departure from the Board of Banesto of Conde's partner Abelló, and also of the representatives of the Garnica, Argüelles and Herrera families, who had always been linked to the bank. Likewise, three independent directors who had been appointed in the previous October resigned. Conde barely managed to cobble together a group of loyal people with whom he would begin a new adventure full of irregularities and which would end with government intervention in the bank in 28 December 1993 and the indictment of its chairman and his closest associates (they were found guilty by the *Audiencia Nacional*, a court of special jurisdiction, in 2000 and by the Supreme Court in 2002).

The irregular actions by Conde were focused on Banesto's business holdings that were grouped in a new company, *Corporación Industrial y Financiera*, which represented around one per cent of Spanish GDP. The main companies added were Acerinox (with an equity holding on 11 April 1990 of 32.5 per cent), Agromán (50.2), *Asturiana de Zinc* (51), *Carburos Metálicos* (16.7), Petromed (36.7), Sansón (35.4), Sniace (25.4), Tudor (37.3), Luyefe (51.5), *Inmobiliaria Urbis* (72) and Isolux (61). *Valenciana de Cementos* was missing, as the Serratosa family did not trust Conde and took measures to be left outside the *Corporación*.

### **The Luyefe crisis**

In the early stages of the Banesto crisis, relations between the bank and its insurance company grew closer, to the point where the chairman of Luyefe, Jaime Argüelles, was named vice-chairman of Banesto when Pablo Garnica Mansi took on the role of chairman in late 1983. In that year, what Anastasio had always feared finally happened: the loss of leadership, which was taken over by the fast-growing Mapfre of Ignacio Hernando de Larramendi, completely independent from the banks (Tortella *et al.* 2009). The reaction was to make the most of the options offered by a new fiscal law on financial assets of 29 May 1985, which allowed 'single premiums' to earn profits without tax withholdings, which was a great advantage at a time when a modern taxation system was being implemented in Spain (it had not existed under Francoism).

In a short period of time, single premiums turned into the safe haven for money looking for fiscal 'opacity', until in late 1988 the Treasury intervened, requesting



personalised information, and the bubble burst. The proportion of total premiums accounted for by life insurance (life-savings) had increased from 14.2 per cent in 1985 to 65.3 per cent in 1988. The insurance companies controlled by banks were the ones which absorbed more single premiums, allowing Luyefe to temporarily regain the number one spot. The fact that Letona's Banesto reached an agreement with Luyefe on the commitment to pay the pension allowances of Banesto employees, which took effect on 1 January 1987, was also a contributing factor. However, when money quickly left single premiums, and the proportion accounted for by life-savings fell to 32 per cent in 1990, Luyefe was plunged into a crisis from which it would never recover.

In the Board Meeting of Banesto on 16 December 1987, Jaime Argüelles resigned as vice-chairman and handed his position as director to his son Jacobo, in a similar operation to that seen with Pablo Garnica Mansi and his son Pablo Garnica Gutiérrez. In February 1989, Jaime Argüelles would also leave the role of chairman of Luyefe in the hands of Mario Conde. As we have seen, this generational handover would not last long, as the Garnica and Argüelles families would break away from Mario Conde in the spring of 1989. On 16 June 1989 Jacobo Argüelles sent a letter to Conde accusing him of having launched the merger with Central for his mere desire to 'lead the transaction', without taking into account that 'this Company named him chairman mainly due to regarding him as the ideal person to prevent the takeover by *Banco de Bilbao*'.

In the letter, preserved in the Banesto Archive (today part of the Banco Santander Historical Archive), Argüelles decried that half of the profits from 1988 had been obtained thanks to loans awarded to a shell company at an interest rate of more than 70 per cent and the capital gains from the sale of over 40,000 million pesetas in securities to Luyefe, without consulting the insurance company's Board. Other problems were summarised as follows: 'Not only is the growth in expenses excessive, the expansion in loans disproportionate and their financing expensive and risky, but on top of that, company holdings from the most diverse national sectors have been purchased, when the bank needs a schedule to fully comply with the Bank of Spain's Circulars' (these circulars imposed a conservative strategy). Lastly, Argüelles was hurt by the break with 'the Banesto culture' which was reflected, for example, in disdain for the minority shareholders in the subsidiaries, contempt for employees who

had devoted their life to the bank and the parking of shares in 'the most exotic of places' (offshore operations). The next day, the director Argüelles was dismissed.

Through his position as chairman of Luyefe, Conde had used the insurance company to record a profit in the accounts of Banesto. François Pereire added his voice to that of Argüelles in criticising what was happening (he would pass away soon after, being succeeded by his son Marc). However, the irregular practices continued from mid-1989 to late 1993. In June 1990, Luyefe, in which Banesto had a 51.5 per cent holding, became part of *Corporación Industrial y Financiera*. Soon after, the Bank of Spain asked Banesto to decrease the risk of its subsidiaries, which led Conde to begin taking steps to sell Luyefe. As the company was very well known in France, with the help of Paribas, negotiations began with AGF, which soon demanded full control. On 10 December 1993, the creation of *AGF Unión Fénix* was approved, in which the French company would hold over 60 per cent of the capital. A few days later, on 28 December 1993, the Executive Board of the Bank of Spain approved government intervention in Banesto, which would not alter the path taken by Luyefe to become part of AGF (since 1997, part of the Allianz group, where Luyefe continues as *Fénix Directo*, a small subsidiary in the car insurance business).

## CONCLUSIONS

The history of the bancassurance relationship involving Banesto and Luyefe reveals the importance of the context and the personality of those in charge for the 'position of dominance' (Montijano) to be present in its starkest form. Unlike other countries, Spain is a country where bancassurance has never been regulated, something which explains its long-term prevalence. In a relationship characterised by competition to attract financial savings, as is the case with life-savings insurance, it is normal for the weak company (the insurance company) to take a secondary position compared to the strong one (the bank), which helps to explain the historical underdevelopment of the Spanish insurance sector.

The only case that had been analysed to date, the case of Hispano-Estrella (1901-1993), has similarities and differences with the case of Banesto-Luyefe (1879-1993). To begin with, in the case of Hispano-Estrella the bank had to fight for control of the

insurance company from 1903 to 1946, while in the case of Banesto-Luyefe the presence of the Pereire family provided an element of continuity and stability from start to finish. In the Banesto period from 1902-1927, the fight for 'Spanishness' led by Cortina and Garnica was waged against Paribas, not against the Pereires, who were even of Spanish origin.

There were similarities in the phase of greater prosperity, the decade of the 1960s (the 'Spanish economic miracle'), when Luyefe and *La Estrella* were leaders in industrial co-insurance and strongly involved in selling car insurance in Spain, with the financial backing of the two banks that were at the top of the Spanish ranking. When the industrial crisis of the 1970s hit Hispano and Banesto hard, both required government intervention (Hispano in 1984 and Banesto in 1986) as the monetary authorities detected serious management mistakes. Initially, Estrella and Luyefe retained their independence (Benito Tamayo managed Estrella between 1977 and 1987, while Jaime Argüelles managed Luyefe between 1967 and 1989), but both companies were involved in the boom of the 'single premiums' in 1986-1988, a very unorthodox type of life-savings insurance since its greatest appeal was fiscal opacity. This ended quickly and badly, as was to be expected.

The fact that single premiums were concentrated in companies controlled by banks suggests that these banks may bear some responsibility (Tamayo and Argüelles were also banking executives), although, at last, the greatest responsibility lay with the tax authorities which took three years to react. The truth is that the single premiums scandal prevented the insurance companies from adopting the promising modern life-savings formulas for many years. In the case of Banesto, one also has to consider the entirely irregular behaviour of its chairman Mario Conde, who recorded profits for the bank at the expense of the insurance company, breaking the traditional culture of Banesto of respect towards the subsidiaries.

In sum, the Banesto-Luyefe case represented an advantageous bancassurance relationship for both parties (leaders of their respective markets) for a century of 'good times' (1879-1977), but led to severe problems for the weaker party (Luyefe) in the brief but final 'crisis era' (1977-1993), as is to be expected in troubled times when there is a 'position of dominance'. The regulatory authorities should learn lessons from these historical experiences.



## **ABBREVIATIONS OF ARCHIVE REPOSITORIES**

ASA     Aberdeen Standard Archives, Edinburgh.

ELAS    Equitable Life Assurance Society of the United States records, Baker Library, Harvard Business School, Boston.

LMA     London Metropolitan Archive.

ZAZ     Zurich Insurance Company Archive, Zürich.



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In June 2019 the first world congress on Risk and the Insurance Business in History was convened in Seville. The organisers believed that this field of history had finally reached a critical mass of scholars and experts who would benefit from participating in a large conference that could generate new intellectual synergies. The essays in this volume, selected from the contributions to this conference, are illustrative of some of the best new research in the field, the variety of its methodological approaches and its broad geographical scope. Two essays explore, respectively, the issues confronting British and US life insurers trying to underwrite lives in foreign and colonial contexts during the nineteenth century. Two case studies of Canada and Switzerland examine fire and casualty insurance and state regulation in the long nineteenth century. Other essays examine the long-run impact of regulation on insurance markets and insurance industry and regulator responses to modern financial crises in Spain, France, Sweden, South Africa and the United States.

P.V.P.: 25 €

ISBN 978-84-9844-753-8



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