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# The Purpose of Insurance Regulation: A Preliminary Inquiry in the Theory of Insurance Law

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# The Purpose of Insurance Regulation: A Preliminary Inquiry in the Theory of Insurance Law

*The author of this Article ambitiously undertakes to articulate those imperfectly perceived human aspirations which, having given rise to the institution of insurance, also give impetus to the regulation of that institution. Professor Kimball begins with an examination of the internal structure of the insurance enterprise, first discussing the implications of the policy holder's basic need for security and then considering the sometimes countervailing demands for reasonable, fair, and equitable treatment of policyholders. He then shifts his focus from structure to superstructure, from the essential to the expedient. Here, we are led to appreciate the impact of general public policies—political, economic, social, moral—upon the institution of insurance. The author concludes that it is difficult if not impossible to formulate a general theory of insurance regulation and that such a formulation may never be possible; although we can isolate common goals, the multiplicity of possible paths to those goals would seem to defy a definitive statement.*

Spencer L. Kimball\*

## INTRODUCTION

In the past half century, both private and governmental insurance have increased rapidly in importance in the western world. Though the substantial origin of the modern insurance system is found centuries ago in the economic renaissance of Europe, it has

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\*Professor of Law, University of Michigan. The research for this Article was made possible by funds from the W.W. Cook Endowment and the Ford Foundation Grant for International Legal Studies. Grateful acknowledgement is made to both. Neither assumes any responsibility for the views expressed here.

come into its own only in the twentieth century. With the passing of time, the institution has expanded from narrow beginnings in maritime commerce to serve a wide variety of needs, many of them not directly connected with economic activity. In our day a variety of insurance services is indispensable to commerce of any sort; it is even difficult to find noneconomic activity of modern man which has no insurance implications.<sup>1</sup>

The rapid recent growth of the insurance enterprise has been accompanied by the elaboration of governmental machinery to control the enterprise in the public interest. Meaningful regulation is much newer than the insurance business. In the United States it is scarcely a century old, and in most countries it is younger. Its significant growth is still more recent, and can be measured in a few decades, in even the most advanced parts of the world.

Insurance regulation was not created full-blown, it evolved. Supervision did not begin with the establishment of a board of insurance commissioners in New Hampshire in 1851,<sup>2</sup> in Massachusetts and Vermont in 1852,<sup>3</sup> in Rhode Island in 1855,<sup>4</sup> or with the appointment of a single superintendent in New York in 1859,<sup>5</sup> though it was by the creation of such independent regulatory agencies that insurance regulation became effective and comprehensive.<sup>6</sup> Some regulatory powers had existed for decades before the

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1. I have summarized this development in KIMBALL, *INSURANCE AND PUBLIC POLICY*, ch. 2 (1960). Some statistics from *INSTITUTE OF LIFE INSURANCE*, [1960] *LIFE INSURANCE FACT BOOK* may serve to throw the rapidity of growth into bolder relief. While the population doubled in the half century from 1909 to 1959, from about 90 million to about 180 million, ordinary life insurance in force in the United States increased from 11 billion dollars to 316 billion dollars, *id.* at 23; group life insurance began about 1912, and there was 160 billion dollars in force in 1959, *id.* at 25; credit life insurance began about 1920, and there was 26 billion dollars in force in 1959, *id.* at 30; in 1909 about three billion dollars of industrial life insurance was in force, in 1959 nearly 40 billion dollars, *id.* at 28; annual income of life companies increased from less than one billion dollars in 1911 to nearly 22 billion dollars in 1959, *id.* at 51; and assets of American life insurance companies increased from 3.6 billion dollars in 1909 to 113.6 billion dollars in 1959, *id.* at 62. Similar growth could be shown in other long-established lines of insurance, not to speak of the enormous size of lines scarcely known half a century ago, such as automobile and disability.

2. N. H. Laws 1851, ch. 1111.

3. Mass. Acts and Resolves 1852, ch. 231, Vt. Laws 1852, No. 45, § 15; Vt. Laws 1852, No. 46, § 16.

4. R. I. Laws 1854 (Oct. sess.), p. 17, § 17.

5. N. Y. Laws 1859, ch. 366, transferring to the superintendent powers given the state comptroller by N. Y. Laws 1849, ch. 308, §§ 7, 11, 13. The New York department celebrated its hundredth anniversary in 1960. See [1960] *SUPERINTENDENT OF INSURANCE*, 101ST PRELIM. REPT. 11-12.

6. PATTERSON, *THE INSURANCE COMMISSIONER IN THE UNITED STATES* 536 (1927).

creation of these independent agencies. Thus in the 1820's both New York and Massachusetts required certain insurance companies to make reports to the state comptroller or to the state treasurer.<sup>7</sup> Even that was not the beginning. Before they assigned regulatory tasks to existing state officials, the legislatures themselves sometimes exercised supervisory powers over insurance companies.<sup>8</sup> Before that, the process of incorporation by special charter, without more, gave the state some power over the insurance business. One can summarize the development of insurance regulation in the United States by saying that from an early date there were occasional regulatory efforts by the legislatures; that in the 1820's regulatory powers began to be concentrated in the hands of an existing state official, acting *ex officio*; that in the 1850's and 1860's many states concentrated insurance regulatory powers in the hands of a special board or an individual designated primarily to control insurance; and that ever since the creation of such an insurance department or agency, insurance supervision has been rather steadily extended and systematized.<sup>9</sup>

In Europe there was a similar development. From very early days there were scattered regulatory efforts. In the late fourteenth century and in the fifteenth century, statutes regulating insurance were enacted in Genoa, Florence, and Barcelona.<sup>10</sup> In the sixteenth century there were occasional efforts at control in England.<sup>11</sup> For the most part, however, European insurance came into the modern era an enterprise free from close regulation. Systematic control came even later to Europe than to the United States.

It is no more possible to provide a precise date for the beginning of systematic insurance regulation in Europe than it is in America. In Germany, for example, there was already some substantial insurance supervision in the nineteenth century in such important states as Bavaria, Prussia, Saxony, and Württemberg.<sup>12</sup> The location of that supervision at the individual state

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7. N.Y. Rev. Stat. 1829, vol. 1, p. 714; Mass. Laws 1827 (Jan. sess.), ch. 141.

8. See, e.g., Mass. Laws 1807, ch. 66, p. 13.

9. A brief but useful account of the early history of American insurance regulation may be found in PATTERSON, *op. cit. supra* note 6, at 519-37. A detailed summary of the development of the Wisconsin department is provided in KIMBALL, *op. cit. supra* note 1, at 174-208.

10. Holdsworth, *The Early History of the Contract of Insurance*, 17 COLUM. L. REV. 85, 93-96 (1917).

11. *Id.* at 98.

12. The summary of German development is based largely on Büchner, *Die Entwicklung der deutschen Gesetzgebung über die Versicherungsaufsicht bis zum Bundesgesetz vom 31. Juli 1951*, in 1 FUENFZIG JAHRE MATERIELLE VERSICHERUNGS-AUFSICHT 1, 7-15 (ed. Rohrbeck, Berlin 1952). By "substantial" I mean something akin to the German expression "ma-

level, coupled with the lack of an effective expert agency, made such regulation inadequate. As early as the 1860's there were some demands in Germany for federal regulation of insurance, and the foundation for legislation was laid in the constitutions of 1867<sup>13</sup> and 1871,<sup>14</sup> which gave the requisite power to the Bund (or Reich). Until the turn of the century, development toward a federal regulatory agency was gradual and difficult, but inexorable. Finally, in 1901 a statute established a regime of systematic and thoroughgoing control over private insurance, with some supervisory powers remaining in the agencies of the individual states, but with most powers going to a federal agency, the *Kaiserliches Aufsichtsamt für Privatversicherung*.<sup>15</sup> From that time to the present, except during the collapse at the end of World War II, German regulation of insurance has been continuous and effective.<sup>16</sup>

National regulation came earlier in Austria, where a statutory order in 1880 provided for regulation of insurance companies.<sup>17</sup> Switzerland had comprehensive regulation from 1885.<sup>18</sup> Sweden established a regulatory agency in 1903, though for decades there had already been lesser efforts to control insurance companies.<sup>19</sup>

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terelle Staatsaufsicht," used by the Germans to describe their own system and ours, in contrast to the English system, which they call a "Publizitätssystem." *Id.* at 5; BOSS, SYSTEME DER STAATSAUFSICHT UEBER VERSICHERUNGSUNTERNEHMUNGEN 31 (Berlin 1955)

13. Verfassung des Norddeutschen Bundes vom 26. Juli 1867, Art. 4, Ziff. 1, in [1867] Bundesgesetzblatt 1, 3 "Der Beaufsichtigung Seitens des Bundes und der Gesetzgebung desselben unterliegen die nachstehenden Angelegenheiten:

(1) die Bestimmungen über den Gewerbebetrieb, einschliesslich des Versicherungswesens"

14. Verfassung des Deutschen Reichs vom 16. April 1871, Art. 4, Ziff. 1, in [1871] Reichsgesetzblatt 64, 65. The 1871 terms are the same as those of 1867, set out in note 13 *supra*.

15. Gesetz über die privaten Versicherungsunternehmen vom 12. Mai 1901, in [1901] Reichsgesetzblatt 139 (Ger.)

16. For the occasion of the fiftieth anniversary of the German regulatory agency (the *Bundesaufsichtsamt für das Versicherungs- und Bausparwesen*), a three-volume collection of essays was published, dealing with the processes of insurance regulation in Germany. Collectively these essays provide some of the most perceptive analysis available in any language on insurance regulation. See FUENFZIG JAHRE MATERIELLE VERSICHERUNGS-AUFSICHT (ed. Rohrbeck, 3 vol. Berlin 1952-1955)

17. Verordnung der Ministerien des Innern, der Justiz, des Handels und der Finanzen vom 18. August 1880, in [1880] Reichsgesetzblatt 398 (Austria); followed by Verordnung der Ministerien des Innern, der Justiz, des Handels und der Finanzen vom 5. März 1896, in [1896] Reichsgesetzblatt 63 (Austria)

18. Bundesgesetz, vom 25. Juni 1885, betreffend Beaufsichtigung von Privatunternehmen im Gebiete des Versicherungswesen, in 8 Amtliche Sammlung der Bundesgesetze und Verordnungen der schweizerischen Eidgenossenschaft 1874-1886, at p. 171 (Bern 1887)

19. FOERSAEKRINGSINSPEKTIONEN, ENSKILT FOERSAEKRINGSVAESEN

Everywhere the development was much as in the United States, with unsystematic experiments during the nineteenth century, and at the turn of the century or in the early decades of the twentieth century a movement toward thoroughgoing and comprehensive supervision of the industry.<sup>20</sup> In the case of the federal states, the movement was also one toward federal rather than state control of insurance activity.<sup>21</sup>

Despite its comparative youth in most countries, insurance regulation has almost everywhere attained substantial dimensions and complexity, and the trend toward strengthening it seems to be continuing.<sup>22</sup> Among the older and larger supervisory agencies, both in Europe and in the United States, are some with well-established traditions and considerable expertise.

Notwithstanding the firm establishment of insurance regulation in the twentieth century, it has grown with little clear sense of purpose. At least in the United States, and probably in most countries, its detailed patterns have come mainly as specific responses to particular felt needs of the moment. Sometimes these needs were felt as the result of dramatic revelations of scandal. For example, the public disclosure of unsavory life insurance company practices that resulted from New York's Armstrong Committee hearings in 1905<sup>23</sup> led quickly to sweeping changes in the regula-

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11-12 (Stockholm 1954). This booklet (pp. 9-20 of which provide a summary of its contents in English) was published by the Swedish regulatory agency on the occasion of its fiftieth anniversary. For the 1903 Swedish statute, see [1903] Svensk Författningssamling Nr. 94.

20. For a study of European regulation as it stood in the 1950's see Boss, *op. cit. supra* note 12. My illustrations will be drawn almost exclusively from American, Swedish, and German materials.

21. American state regulation is often contrasted with German regulation, which is largely at the federal level. The comparison is only partly apt, for the United States is a continent. For further discussion of the federal problem, see text accompanying notes 136-43 *infra*.

22. Sweden in 1960 was considering a government committee's recommendations for stricter regulation of private insurance. STATENS OFFENTLIGA UTREDNINGAR 1960: 11, OEVERSYN AV LAGEN OM FOERSAEKRINGSRORELSE (Stockholm 1960). In 1954 the Netherlands began to regulate insurance marketing. Schreiber, *Die niederländische Versicherungswirtschaft*, [1959] VERSICHERUNGSWISSENSCHAFTLICHES ARCHIV 51, 55. In the United States, one recent innovation of importance is the regulation of credit life insurance, which began with Wis. Laws 1957, ch. 321. Other American moves toward strengthening insurance regulation are at once apparent to the most casual reader of the trade press.

23. See STATE OF NEW YORK, TESTIMONY TAKEN BEFORE [AND REPORT OF] THE JOINT COMMITTEE OF THE SENATE AND ASSEMBLY APPOINTED TO INVESTIGATE AND EXAMINE INTO THE AFFAIRS OF LIFE INSURANCE COMPANIES (10 vols. 1905). For a good summary of this investigation, see 1 PUSEY, CHARLES EVANS HUGHES 140-68 (1951). See also JAMES, THE METROPOLITAN LIFE 139-65 (1947); CLOUGH, A CENTURY OF AMERICAN LIFE INSURANCE 215-32 (1946). A muckraking account is given in HENDRICK, THE STORY OF LIFE INSURANCE (1907), first published in 27 McCLURE'S MAGAZINE 36, 157, 237, 401, 539, 659 (1906).

tion of insurance.<sup>24</sup> It also led to important alterations in the structure of the industry, such as the mutualization of many large companies,<sup>25</sup> the formation of many new companies in the West and South,<sup>26</sup> and the formation of the American Life Convention.<sup>27</sup> There were other kinds of pressure, too. For example, when the United States Supreme Court decided that insurance was commerce subject to the federal anti-trust laws,<sup>28</sup> Congress acted quickly to permit continued state regulation and taxation of insurance.<sup>29</sup> This was followed by the vitalization and extension of rate regulation at the state level, in order to preclude further federal intervention.<sup>30</sup>

As with legal growth generally, the development of American insurance law has been much influenced by the factors of inertia and drift.<sup>31</sup> It has moved forward only under considerable pressure, and then with little conscious planning—and certainly without the articulation of an integrated theory. It may be that such a theory is impossible in a pluralistic society with widely dispersed decision-making powers. However, only if the objectives of regulation can be systematically stated and the conflicts among them understood can insurance regulation be made fully to serve the public interest.

American writing on insurance regulation is largely concerned with purely practical problems, and little of it has value for our present purpose. The one significant American study of insurance regulation—Patterson's book<sup>32</sup> of thirty years ago—makes little effort to deal systematically with the *substance* of regulation, seeking only incidentally to isolate purposes or objectives.<sup>33</sup> The

24. For a summary of legislation in New York resulting from the Armstrong investigation, see STALSON, *MARKETING LIFE INSURANCE: ITS HISTORY IN AMERICA* 551-52 (1942). Investigations in other states also produced significant changes. *Ibid.* The developments in Wisconsin are explored in KIMBALL, *op. cit. supra* note 1, at 110, 155, 163-71, 173 (1960).

25. MAGEE, *LIFE INSURANCE* 86-88 (1939), Dawson, *MUTUALIZATION OF LIFE INSURANCE COMPANIES*, 70 *Annals* 62 (1917).

26. I BULEY, *THE AMERICAN LIFE CONVENTION 1906-1952: A STUDY IN THE HISTORY OF LIFE INSURANCE* 247 (1953).

27. *Id.* at 248, 264-65 *passim*.

28. *United States v. South-Eastern Underwriters Ass'n*, 322 U.S. 533 (1944).

29. 59 Stat. 33 (1945), 15 U.S.C. §§ 1011-15 (1958).

30. See generally Kimball & Boyce, *The Adequacy of State Insurance Rate Regulation: The McCarran-Ferguson Act in Historical Perspective*, 56 *MICH. L. REV.* 545 (1958), and materials cited therein.

31. See generally HURST, *LAW AND SOCIAL PROCESS IN UNITED STATES HISTORY* (1960).

32. PATTERSON, *op. cit. supra* note 6.

33. I have attempted to relate the law to underlying public policy in the historical development of a single state, Wisconsin, in KIMBALL, *op. cit. supra* note 1.

Germans and the Swedes have gone further than we have in making a useful explanation of the reasons for regulatory activity,<sup>34</sup> but even they do not have any fully satisfactory statements. Nor would German or Swedish theories be altogether suitable for transplantation to American soil, where we have complicating factors of our own. Moreover, German writers tend to seek so assiduously for a single abstract principle that will comprehend a highly complex set of activities<sup>35</sup> that they lose contact with the diversity and raggedness that are the hallmarks of reality. Nevertheless, I shall draw on European materials, especially Swedish and German, to illustrate some of the ideas contained here. But I do not intend to make an exhaustive comparison of the systems in this essay.

In this Article my purpose is not to offer a general theory of insurance regulation; but to suggest in a preliminary way—hopefully for further discussion—some public policy objectives in the field of insurance regulation, together with some conflicts among them. A mature synthesis would require more extensive consideration than is fruitful until many people have discussed the subject from varying points of view. At this point in time, I can do no more than attempt to provide a reasonably clear articulation of the basic purposes of regulation, and of their relationships, in the hope that this will serve as a useful guide to legislative action and regulatory activity.

By regulation, in the present context, I mean all kinds of legal control over insurance, whether by judicial decision, by self-executing legislation, or by administrative activity of the insurance commissioner.

The major objective of insurance regulation is to facilitate the successful operation of the insurance enterprise itself. But other public policies reflecting pervasive attitudes in society influence the insurance regulatory pattern. They may channel or restrict the insurance enterprise, or merely change in a variety of ways the internal operation of the business.

The principal division of the subject, then, is between those objectives that relate to the internal working of the insurance busi-

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34. See Starke, *Die Entwicklungslinien der materiellen Staatsaufsicht in der ersten Hälfte des 20. Jahrhunderts*, in 3 FÜNFZIG JAHRE MATERIELLE VERSICHERUNGS-AUFSICHT 11, 57-74 (ed. Rohrbeck, Berlin (1955)). And see the elaborate Swedish studies in preparation for legislation, of which the report cited in note 22 is a good example; it contained over 500 pages of text.

35. E.g., Starke, *supra* note 34. Consider also the use of the almost mystical notion of the *Gefahrgemeinschaft*, or insured community, as a basic idea in insurance law. See, e.g., BRUCK-MOELLER, KOMMENTAR ZUM VERSICHERUNGSVERTRAGSGESETZ UND ZU DEN ALLGEMEINEN VERSICHERUNGSBEDINGUNGEN 96-97 (8. Auflage 1953).



ness, and those that derive primarily from its relationships to the world outside. Within the first class, one aim has overwhelming importance: the solidity or solvency of insurance companies. Supplementing and sometimes conflicting with that objective is an amorphous congeries of policy goals which, for want of a better term, we may call the objective of *aequum et bonum*. In a sense, solidity and *aequum et bonum* could be combined in a single aim, the protection of the policyholder. But it seems more fruitful to divide the all-encompassing purpose, by asking "protection for what?"

## I. INTERNAL WORKING OF THE INSURANCE BUSINESS

### A. THE PRINCIPLE OF SOLIDITY

Insurance performs important functions in social life, with both objective and subjective aspects. Objectively it provides a mechanism for solving many of the problems inherent in the unpredictable character of human life. It ensures that if a home burns another will take its place, that if a breadwinner dies prematurely his children will not starve or go without an education, that if a ship sinks its owner and the owners of its cargo may continue in business without the traumatic experience of bankruptcy. In short, it provides a degree of objective certainty in an uncertain world, it converts unpredictable risk to predictable cost, it smooths the path of economic activity. Subjectively insurance gives the buyer confidence that if his home burns he can build another, that if he dies prematurely his children can go to college, or that if his ship sinks he will not need to go through bankruptcy proceedings. In short, insurance also provides the policyholder with a *sense* of security, a *feeling* of confidence about the future, a freedom from *anxiety* about parts of the unknown. The more perceptive spokesmen for the industry recognize this dual role of insurance. One recently said.

My purpose tonight is to suggest the egregious error of assuming that our business rests upon a statistical foundation. It does not. It rests upon an emotional foundation. I cannot think of insurance as simply an arm's length business transaction. The public expects more of us than that. It expects security and peace of mind.<sup>36</sup>

The subjective and objective aspects of the needs met by insurance are closely related, but they are distinct. There seems no reason to doubt the legitimacy of either. One should not lose sight

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36. Morrill, "The Common Denominator", Address before the Casualty Actuarial Society, Nov 17, 1960, pp. 1, 3 of mimeographed text (also reported in National Underwriter, Fire and Casualty Edition, Dec. 16, 1960, p. 8)

of the *sense* of security given by the insurance institution, for supervision of insurance with a view only to enabling it to provide objective economic security may preclude its use to provide a *sense* of security. One might, for example, prohibit forms of insurance activity involving only very small claims that almost everyone can afford to bear, on the ground that the expense of handling such claims makes the insurance quite uneconomic in relation to the service rendered. Yet it is possible that attention to the subjective or psychic contribution of insurance would tip the scale in favor of permitting or even encouraging such insurance.

The needs for security and for a feeling of security seem universal, but the particular forms they take and the institutions that satisfy them are extremely varied and are culturally determined. In pre-capitalist forms of social organization, man achieved security, both economic and psychic, through a variety of interpersonal relationships which were central to the society and were highly institutionalized and often very complex. Thus in many primitive societies kinship was the basis of social organization, and one of the chief purposes of the network of rights and duties making up the kinship pattern was the provision of mutual aid to distressed individuals.<sup>37</sup> Mutual aid is a central aspect of culture—Leslie White even speculates that the universal incest taboo was a product of the need to provide a broader base for the mutual aid structure of kinship-organized primitive society.<sup>38</sup>

In more advanced cultures, functionally similar phenomena exist. Thus, in medieval society the reciprocal rights and duties which made up the feudal relationship provided both a feeling of security and a reasonable measure of actual security against many of the more pressing vicissitudes of life, for lord and man alike. And when the lord-vassal relationship did not provide the security, the Church or specially developed institutions like the medieval guild did.

The presence everywhere in pre-capitalist societies of insurance-like institutions led William Graham Sumner to the provocative suggestion that the insurance concept was a fundamental one which could be used with profit to explain much of social organization in all times and places. He even went so far as to describe religion as a species of the genus "insurance" which was, he thought—

a generic conception covering the methods of attaining security, of which the modern devices are but specific, highly elaborated, and scientifically tested examples. . . .

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37. HOEBEL, *MAN IN THE PRIMITIVE WORLD* 347, 355 (2d ed. 1958).  
38. WHITE, *THE SCIENCE OF CULTURE* 158-59, 313-27 (1949).

Insurance is a grand device and is now a highly technical process; but its roots go farther back than one would think, offhand. Man on earth, having always had an eye to the avoidance of ill luck, has tried in all ages somehow to insure himself—to take out a “policy” of some sort on which he has paid regular premiums in some form of self-denial or sacrifice.<sup>39</sup>

When the capitalist revolution swept away feudal society in Western Europe, it destroyed the structure that provided security through complex interpersonal relationships, and replaced it by the “cash nexus.” Men no longer had personal relationships comprehensive enough, or dependable enough, to provide the security and the feeling of security that are the final goals of much of the human struggle. Those goals had to be sought through new institutions. One ultimate consequence of the transition from feudalism to the market-oriented contemporary society—a consequence which is only now beginning to come into clear focus—was the development of a ubiquitous system of insurance, in the modern sense of a scientifically organized technique for the distribution of risks through an institution that has no other purpose. This institution provides security and the sense of security partly through commercial companies operating in the market and partly through governmental organizations operating in an analogous manner. In these ways modern man secures for himself all of the tangible security and a large part of the feeling of security that were lost when the old order was swept away.

This much has been said to emphasize the centrality of the “insurance” institution in both primitive and advanced societies. Insurance is one important modern way that man seeks security in a world in which it does not exist naturally. It is thus not surprising that all systems of insurance regulation regard the financial solvency of the insurance enterprise as the central aim, for if nothing else, insurance must *insure*. Some systems of regulation, notably that of Great Britain, seem to proceed little beyond that point. Other systems recognize additional goals, often only partly articulated.

The principle of *solidity*<sup>40</sup> is pervasive; it inheres in almost every corner of the regulator’s field of activity. Elsewhere I have dealt with the law governing the internal operation of the insurance business under three major headings: the creation of an adequate insurance fund, the preservation of the integrity of the insurance fund, and the distribution of the fund in order to satis-

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39 2 SUMNER & KELLER, *THE SCIENCE OF SOCIETY* 749, *passim*, (as indicated by index heading “Insurance”) (1927).

40. The Swedes speak of *soliditet*, the Germans of *Leistungsfähigkeit*, and the French of *solvabilité*. We speak more often of *solvency*, but *solidity* has the advantage that it does not now have a technical meaning.

fy the security needs for which it was collected.<sup>41</sup> In the first two headings the objective of solidity is central; all other objectives are no more than qualifications or limitations of it. But in the distribution of the fund, the principle of solidity is merely one of a pair of goals which contend with each other in precarious balance. In distributing the fund, a task supervised by the courts, the need to preserve the fund against unreasonable claims which threaten its existence must continually be weighed against the aim of ensuring that policyholders' reasonable expectations are fulfilled. In performing their task, courts have not always perceived the former.

The goal of solidity is sought in ways that are legion. The following description is not intended as a catalogue, but as an illustration of some of the principal controls reflecting this purpose.

At the very threshold of insurance activity, statutes exhibit the state's interest in solidity by control of the form of organization through which insurance is carried on. Though the law generally permits operation in a wide variety of forms—including mutual and stock corporations, interinsurance exchanges, and syndicates—there are often restrictions which make it impracticable for an individual entrepreneur or partnership to enter the business as an insurer, and which discourage the use of the Lloyds group.<sup>42</sup> Once the form of organization is chosen, the concern of the law to implement the solidity principle becomes more profound, and significant demands are made to ensure adequate capitalization of the new enterprise. Not enough thought about the role of capital in insurance lies behind the statutes, but the conceptual inadequacies do not alter the state's great interest in the question. In a going insurance business, capital plays a relatively subordinate role; the business operates on what is an essentially mutual basis, distributing risk among all participants, with capital serving merely as an added buffer against unpredictably high losses. But in the early days of any insurance company, capital plays a crucial role, until "the law of large numbers" enables the company to operate with assurance as merely a risk distributor. It is not surprising, therefore, that fairly substantial sums of paid-in capital are requi-

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41. See KIMBALL, *op. cit. supra* note 1, ch. 1.

42. *E.g.*, N. Y. INS. LAW § 43 requires that an insurer be either an individual or a corporation; it also requires an individual insurer to be a New York resident, to comply with the statutory requirements for capital, surplus, reserves, liabilities, investments, and deposits, to engage in no other business, and in general to conform to all corporate requirements except corporate existence. N. Y. INS. LAW § 425(4) prohibits subsequent organization in the state of Lloyds underwriters, and prohibits licensing of foreign or alien Lloyds underwriters. [The prohibition applies both to Lloyds of London and to American Lloyds groups.] The history of Wisconsin law concerning the form of private insurers is described in KIMBALL, *op. cit. supra* note 1, at 37-52.

site to the formation of a capital stock insurer.<sup>43</sup> Functionally similar requirements apply to the formation of mutual or reciprocal insurers, the statutes usually requiring that policyholders be assessable until designated surpluses have been accumulated, and forbidding any operation at all unless a prescribed number of participants have agreed to purchase the insurance.<sup>44</sup>

Concern for solidity has led American states to exercise control over the adequacy of premium rates in non-life insurance. The All-Industry laws, passed by the states to provide premium rate regulation sufficient to exclude federal power under the terms of the McCarran Act,<sup>45</sup> require that rates shall not be "excessive, inadequate, [or] unfairly discriminatory"<sup>46</sup> Though some state insurance departments have a tendency to focus too much on the requirement that rates not be excessive, losing sight of the greater need that they be adequate, that emphasis may be based upon an assumption that the insurance companies are capable of taking care of themselves. Up to a point the assumption is justified; the self-interest of the insurer is a powerful aid to the public imple-

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43. *E.g.*, N. Y. INS. LAW § 191 requires paid-in capital of at least \$300,000 and paid-in surplus at least equal to half its capital, for a stock life insurance company. Section 311 provides for various capital requirements varying from \$100,000 to \$500,000, with an additional surplus requirement of fifty per cent of capital, to write various forms of casualty insurance, with larger amounts required for combinations of lines; it also requires that the company maintain a surplus of \$1,500,000 if reinsurance is included. Section 341 provides similar requirements for fire and marine insurance. The Wisconsin history of capital requirements is treated in KIMBALL, *op. cit. supra* note 1, at 75-79.

44. *E.g.*, N. Y. INS. LAW § 196 provides for formation of a mutual life insurance company, requiring prior to incorporation 1,000 bona fide applications for life insurance in an amount not less than \$1,000 each, and payment from each such applicant of a full annual premium, in an aggregate of at least \$25,000. The company must have an initial surplus of \$150,000, as well. Section 197 forbids the issuance of assessable policies by mutual life insurance companies. *But cf.* § 58, which provides for the issuance of nonassessable policies by mutual companies, in most lines of insurance, only after those companies have made certain accumulations specified in the section. For the Wisconsin historical development, see KIMBALL, *op. cit. supra* note 1, at 79-82. It should be noted that these requirements make it difficult, if not impossible, to organize a new company as a mutual. HUEBNER & BLACK, LIFE INSURANCE 454 (5th ed. 1958).

45. Section 2(b) of the McCarran Act precludes application of federal statutes to insurance, unless the statutes specifically relate thereto, "Provided, That after June 30, 1948 the Sherman Act the Clayton Act [and] the Federal Trade Commission Act shall be applicable to the business of insurance to the extent that such business is not regulated by State law." 59 Stat. 33 (1945), as amended, 61 Stat. 448 (1947), 15 U.S.C. § 1012(b) (1958). This proviso has put heavy pressure on the states to develop adequate rate regulatory machinery.

46. *E.g.*, N. Y. INS. LAW § 180 proposes regulation so that rates "shall not be excessive, inadequate, unfairly discriminatory or otherwise unreasonable." A brief summary of the development of the model acts may be found in 1 RICHARDS, INSURANCE 216 (5th ed. 1952).

mentation of the goal of solidity. But self-interest is not always enough, as a melancholy procession of insurance insolvencies attests.<sup>47</sup>

The long-term character of the life insurance contract makes adequacy of premium rates even more important there than in the fire and casualty business, but in the United States there has been no direct regulation of life insurance rates. Instead, rates are governed indirectly by reserve requirements. The "legal reserve" is an amount that, together with future premiums, all accumulated at an assumed rate of interest, will suffice to satisfy the company's future obligations as predicted by specified mortality tables. So long as the company has assets to match this reserve liability, it is deemed solvent. Generally, rather conservative tables are used for reserve computation, and not infrequently a company can afford to (and does) collect from the insured gross premiums which are lower than the net premiums (*i.e.*, without expense loading) computed from the valuation tables used for reserves. When the gross premiums are that low, the legislatures have required the company to fund the difference between the company's actual gross premiums and the net premiums computed from the valuation tables, in a so-called "deficiency reserve." The company may continue to charge any premium rate it wishes, however; even here there is no direct regulation of the minimum level of life insurance premium rates.<sup>48</sup>

In Germany the situation is otherwise. In life insurance, in other personal insurance, and in automobile insurance there is direct regulation of premium rates; in other lines there is only indirect and casual control. Life insurance rate regulation is authorized by statute; the power comes from the requirement that an applicant for a license as an insurer must submit for administrative approval a *Geschäftsplan*, or plan for doing business, which must make clear how the future obligations of the company can be met on a continuing basis.<sup>49</sup> It must contain the company's schedule

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47. The harmful consequences of insolvencies would be greater were it not for the willingness of responsible companies, in the interest of the public image of the whole industry, to engage in rescue operations. For some cases where the self-interest of insurers was not enough to ensure an adequate rate structure, see KIMBALL & CONKLIN, *THE MONTANA INSURANCE COMMISSIONER: A STUDY OF ADMINISTRATIVE REGULATION IN ACTION* 30-33 (1960). It should be noted that regulation of rates reflects several different public policies. It will be discussed again in other connections.

48. For the actuarial theory of the deficiency reserve, see Actuarial Society of America, *Informal Discussion on a New Mortality Table*, [1957] *TRANSACTIONS* 212. Life insurance rate making and the deficiency reserve law are discussed briefly in KIMBALL, *op. cit. supra* note 1, at 110-12.

49. Gesetz über die Beaufsichtigung der privaten Versicherungsunternehmungen und Bausparkassen [hereafter abbreviated VAG] §§ 5 & 11,

of rates and its principles for computation of premium and reserve. For the most part informally, but sometimes quite formally, the German regulatory agency<sup>50</sup> uses its power to approve or disapprove the *Geschäftsplan* in order to exercise control over minimum rate levels in life insurance. For example, one nonparticipating life insurer proposed in its *Geschäftsplan* a gross premium loaded very slightly for expense, the company relying instead on mortality savings and excess interest earnings to take care of the company's expenses. The government agency declined to approve the premium calculations, insisting that the gross premium must contain a fair charge for expenses, in addition to the net premium, and that the company must not speculate on its future profits in this way<sup>51</sup>

The statutory sections specifying the contents of the *Geschäftsplan* do not require insurers in lines other than life and other personal insurance to submit rate schedules for approval. There are broadly phrased general powers enabling the regulatory agency to take action to alter the *Geschäftsplan*, even with effect upon existing contracts, where necessary for the protection of the policyholder's interests, but even this probably provides no control over minimum levels of premium rates in the non-personal lines of insurance.<sup>52</sup> Automobile insurance is a special case. Under powers that date from 1938,<sup>53</sup> the German Economics Minister (and not the regulatory agency), is empowered to set the premiums to be charged in automobile insurance. However, the continuing post-war German tendency to eliminate controls over business enterprise is illustrated by a 1959 statutory order relinquishing the power to set premiums. From the end of 1961, all automobile premiums will be made by the companies themselves—subject, however, to a continuing requirement of approval by the Eco-

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vom 6. Juni 1931, in [1931] Reichsgesetzblatt I.315 (Ger.) The *Gesetz* may be most conveniently studied, as subsequently modified, in PROBLSS, *VERSICHERUNGS-AUFSICHTSGESETZ* (München und Berlin, 2 ed. 1957)

50. I.e., The *Bundesaufsichtsamt für das Versicherungs- und Bausparwesen*.

51. Veröffentlichungen des Kaiserlichen Aufsichtsamtes für die Privatversicherung, 1908 at p. 114 (Geschäftsbericht 1907) The statutory sections that specify the contents of the *Geschäftsplan* are VAG §§ 11 & 12.

52. VAG § 81a. See also VAG §§ 81 & 89 And see Finke & Pfeifer, *Markt-, Preis- und Wettbewerbsordnung im Aufsichtsrecht und in der Aufsichtspraxis*, in 1 FUENZIG JAHRE MATERIELLE VERSICHERUNGS-AUFSICHT, *op. cit. supra* note 16, at 104, 123. For effects on premium regulation, see Fritz, *Beitragsgerechtigkeit in der Privatversicherung vom Standpunkt der Aufsichtsführung*, in [1958] *VERSICHERUNGSWISSENSCHAFTLICHES ARCHIV* 269

53. In 1938 the power was in a special officer, the *Reichskommissar für die Preisbildung*. Verordnung über die Versicherung von Kraftfahrzeugen vom 14. Februar 1938, in [1938] Reichsgesetzblatt I.200 (Ger.)

nomics Minister. After 1965, automobile insurance premiums will be as free from control as other non-life premiums.<sup>54</sup>

In all fields of insurance, the law expresses concern about the way in which the company's accounts are kept, compelling an accurate expression of the company's liabilities, actual and potential, so that the degree of its solvency or solidity is always clear. The need for this kind of control over reserves in a business in which income long precedes outgo is obvious. Even in a field where policies are sold for fairly short terms, such as fire or casualty, without proper accounting a company with an expanding volume of business could conceal indefinitely a condition of potential insolvency which would become at once apparent and threatening if the volume of business were stable. Only a realistic appraisal of assets and liabilities exhibits the true condition of the business, in the face of fluctuating volume. Thus the reserve laws go to the very heart of insurance regulation, providing reliable information for the protection of solvency.<sup>55</sup> The control is implemented by an elaborate program of examinations of the books of the companies.<sup>56</sup>

Another way in which the principle of solidity is implemented is by public control over investments. In the United States, this kind of control has been very strict for a long time, especially in life insurance. The life insurance company, whose liabilities are expressed in terms of a fixed number of dollars, has been compelled by law to invest very largely in fixed-dollar assets.<sup>57</sup> Investment in equities has traditionally been thought too risky in view

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54. Verordnung PR Nr. 15/59 zur Auflockerung der Preisbindung in der Kraftfahrversicherung vom 19. Dezember 1959, Bundesanzeiger Nr. 249 vom 30. Dezember 1959; Veröffentlichungen des Bundesaufsichtsamtes für das Versicherungs- und Bausparwesen, [1959/60] Geschäftsbericht 45.

55. *E.g.*, N. Y. INS. LAW § 73 provides for valuation reserves for life insurance policies; section 74 provides for unearned premium reserves in other lines; section 72 provides for loss or claim reserves. See also section 352 for loss reserves of fire and marine companies. These provisions do not exhaust the field; they barely scratch the surface of this kind of regulation. The German provisions are equally elaborate, with wide discretionary power to control forms given to the agency. See, *e.g.*, VAG § 55.

56. N. Y. INS. LAW § 28 permits the superintendent to examine the affairs of insurance companies as often as he deems it expedient, and requires him to do so triennially for some domestic companies and every five years for others. And see generally N.Y. INS. LAW §§ 26-32. The German system, while quite different in detail, provides the same kind of thorough control. See VAG §§ 56-65.

57. *E.g.*, N. Y. INS. LAW §§ 79-81. The history of investment regulation is illuminating. A quick impression for New York can be gained by tracing § 81 backward through its annotation in *McKinney's Consolidated Laws*. An exhaustive study of the history of Wisconsin's investment laws is provided in KIMBALL, *op. cit. supra* note 1, at 129-40. For the equally strict German rules, see VAG §§ 66-69.



of the long-term and inflexible nature of insurance obligations. Thus, over the past century life insurance company investments have been heavily concentrated in bonds, both government and private, and in mortgages.<sup>58</sup> With the increasing amount of money available for investment by insurance companies and by other institutions that are subject to similar restrictions, the implementation of the aim of solidity has come increasingly into conflict with other values or purposes, and the restrictions on investments have recently been modified in various ways. This conflict we shall explore further.<sup>59</sup>

Though these are the principal ways in which the goal of solidity is sought, they are by no means the only ways. The aim is ubiquitous and insistent, and may be seen throughout the field of insurance law. It would be unfortunate for the rational development of insurance law if any specific question were answered without explicit attention to its implications for the solidity of the enterprise. That is not to say that solidity is the only goal to be sought nor that it should always and everywhere prevail, but it is too important ever to ignore—though occasionally it seems to be ignored by judges or legislators, or even by insurance commissioners.

#### B. THE PRINCIPLE OF *AEQUUM ET BONUM*

Although it is hard to deny the propriety of utilizing legal controls to ensure the solidity of insurance companies, there is more disposition to question interference by the law on behalf of a congeries of objectives perhaps best expressed by the term *aequum et bonum*. This term is chosen precisely because it lacks precision, thereby reflecting the vague character of the objectives and at the same time adequately expressing their general thrust. The objective of *aequum et bonum* is present in some degree in most systems of insurance law and regulation. It has many facets: It is equity. It is morality. It is fairness, equality, reasonableness. It may even be efficiency, economy, parsimony. I shall seek to isolate and explore three principal components of this complex objective, after first illustrating its complexity and flexibility by looking at the history of the principle in Swedish law.

The most interesting development in Swedish insurance law since World War II has been the explicit recognition of a second objective of insurance regulation. The Swedes have long regarded

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58. Statistics on the distribution of life insurance assets for the last 40 years are given in INSTITUTE OF LIFE INSURANCE, *op. cit. supra* note 1, at 64-65. Detailed information about investment policy of a single, but very important, company is provided in WILLIAMSON & SMALLEY, NORTHWESTERN MUTUAL LIFE: A CENTURY OF TRUSTEESHIP (1957).

59. See text accompanying notes 164-69 *infra*.

*soliditet* as the major purpose of supervision. About the end of the war, the term *skälighet* (which the Swedes themselves translate as "equity") came into common use to describe a second objective.<sup>60</sup> The content of *skälighet* is uncertain, flexible, and growing.

The term seems first to have entered technical insurance law in 1948, as a legal standard applied to life insurance.<sup>61</sup> It received application to other insurance in 1950,<sup>62</sup> and the extension of its meaning to include new ideas was bruited about in 1960.<sup>63</sup> Long before its adoption in 1948, the principle was felt as a moral obligation of insurers, in some contexts, and was often a factor in the informal negotiations between the regulatory agency and the companies. Some explicit demand for *skälighet* as a legal standard seems to have existed as early as 1914, but it did not then find expression in the law. Some of the idea of *skälighet*, though not the term, was incorporated in the Motor Third Party Insurance Law of 1929.<sup>64</sup> Formal acceptance of the term in 1948 resulted from the deliberations of a series of government committees investigating the insurance business, beginning as early as 1937.<sup>65</sup> The 1937 committee suspended its work at the outbreak of war, but another committee, consisting of the chief of the regulatory agency, a professor of actuarial science, a member of the *Riksdag* (Parliament), and three insurance company directors, was appointed in 1942 by the Swedish Minister of Commerce.<sup>66</sup> The committee studied exhaustively the problems of the adjustment of insurance to the changing economic conditions. The committee's

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60. STATENS OFFENTLIGA UTREDNINGAR 1946:34, FOERSAEKRINGSUTREDNINGEN: FORSLAG TILL LAG OM FOERSAEKRINGSROERELSE M.M., II. MOTIV 33 (Stockholm 1946). A part of the lengthy report is translated into English under the title, ADJUSTMENT OF SWEDISH LIFE INSURANCE TO CHANGES IN THE ECONOMIC CONDITIONS, EXTRACT from an OFFICIAL REPORT (Stockholm 1946). See page 16 of translated extract. The French speak of *la moralité de l'assurance*. FOURASTIE, LE CONTROLE DE L'ETAT SUR LES SOCIETES D' ASSURANCES 259 (3 ed. Paris 1944).

61. [1948] Svensk Författningssamling Nr. 433, § 263. And see HELLNER, FOERSAEKRINGSRAETT 40-47 (1959).

62. [1950] Svensk Författningssamling Nr. 320, § 282, 2 mom.; APPELTOFFT, A SUMMARY ACCOUNT OF TWO REPORTS RENDERED BY AN OFFICIAL SWEDISH COMMISSION OF INQUIRY 18, 22-25 (Stockholm 1949).

63. STATENS OFFENTLIGA UTREDNINGAR 1960:11, OEVERSYN AV LAGEN OM FOERSAEKRINGSROERELSE 182-279 (Stockholm 1960); STUDY OF INSURANCE SUPERVISION, SWEDEN 30 (1960), a mimeographed statement in English prepared by the *Försäkrings Inspektionen*.

64. STATENS OFFENTLIGA UTREDNINGAR, 1946:34, *op. cit. supra* note 60, at 34 (translated extract at 16); [1929] Svensk Författningssamling Nr. 77, §§ 8 & 9.

65. FOERSAEKRINGS INSPEKTIONEN, ENSKILT FOERSAEKRINGSVAESEN 14 (Stockholm 1954).

66. *Ibid.* See also STATENS OFFENTLIGA UTREDNINGAR, 1946:34, *op. cit. supra* note 60 (translated extract at 5).

statement of the principles of regulation began with mention of *solidity* as the basic value. It then continued.

In addition to the above-mentioned demand, there is also the requirement that life insurance business should be conducted on a basis of *equity* or *fairness* towards the policy-holders. The demand for security renders it necessary to calculate the premiums to be paid by policy-holders at a higher rate than is actually expected to be requisite, as a safeguard against adverse deviations from the estimated proceeds of the business. Under normal conditions it may therefore be expected that the business will result in a surplus. This surplus reverts to the insured in the form of a return of premiums, and the real cost which the policy-holders incur for their insurances thus corresponds to the premiums paid minus a share in the profit earned. In order that a financial business of this kind shall be regarded as fair towards the policy-holders, it must therefore be demanded that the actual cost in question may be considered to be a reasonable price for the services rendered by the insurance company to the individual policy-holders.<sup>67</sup>

In this initial development, *skälighet* included only two notions—that the price charged to policyholders should be reasonable, and that the cost should be equitably distributed among the policy-holders.<sup>68</sup> These facets of the doctrine would naturally appear first because of their monetary character. They would predictably appear first in life insurance, where the long term of the contract and the principle of solidity require conservative operation (*i.e.*, that initial premiums be large enough to produce a surplus, often a large one) Perhaps beginning in the thinking about mortality savings, it early came to be generally accepted in Sweden not only that premium charges as adjusted by dividend payments should be reasonable, but that this end should be achieved by means of limitations on the profits available for distribution to stockholders.<sup>69</sup>

This principle received surprisingly early acceptance in company circles, facilitated perhaps by the fact that entrepreneurial motivation in life insurance in Sweden seems to have been concerned less with direct profits than with control of accumulated assets, and by a feeling that life insurance is less a part of the business system than an institution of social welfare operating in favor of the insured. Even before 1948, the important stock

67. STATENS OFFENTLIGA UTREDNINGAR, 1946: 34, *op. cit. supra* note 60, at 33 (translated extract at 16) If competition is vigorous enough, such surpluses may not develop, but one may then argue that the requirements of solidity are not being met.

68. FOERSAEKRINGSINSPEKTIONEN, *op. cit. supra* note 19, at 15.

69. STATENS OFFENTLIGA UTREDNINGAR, 1946:34, *op. cit. supra* note 60, at 64 (translated extract at 44-45) "To carry on insurance business without the participation of the policy-holders in the surplus is incompatible with the principle of equity" See HELLNER, *op. cit. supra* note 61, at 42 n.7 (1959)

companies were quasi-mutualized, in the sense that they became participating and they limited stockholders' profits to modest amounts.<sup>70</sup> Then the 1948 law enacted the principle of equity for life insurance and thus put strict legal limits on the permissible profit of life insurance companies.<sup>71</sup> Among the company people I interviewed in Stockholm in the spring of 1960, I discovered rather little feeling of injustice as a result of this limitation.<sup>72</sup>

The 1942 committee perceived another, much less important, dimension to the principle of reasonableness in price, for in several passages the committee talked about the need for limiting expenses:

It follows from the principle of equity that the company's costs must not be higher than corresponds to the services which the company renders. . . . [I]t seems reasonable to demand that the services rendered by the company in connection with its insurance business should be in good conformity with the real needs of its policy-holders, and that the costs therefore should stand in fair proportion to the value of those services. . . .<sup>73</sup>

This notion of economy, or *sparsamhet*, was fairly limited in the 1942 report, but by 1960 there seemed to be a slight tendency to give it a broader meaning. Thus, some people felt that companies had an obligation to be economical, even parsimonious, with respect to home office expenses, agency conferences, and amenities for employees and executives. But the companies have not yet acquiesced in a broader interpretation, as they have long since done with respect to the limitation of profits, and it is not yet clear that the tendency is of any real consequence.<sup>74</sup>

The widespread acceptance of *skälighet* in insurance circles in Sweden would be more surprising were it not for the immediate post-war political developments. In 1945 Social Democrats and Communists in the *Riksdag* made demands for an exhaustive inquiry into private insurance institutions.<sup>75</sup> The Communists proposed nationalization; the original post-war program of the Social Democrats also urged nationalization, though the specific Social

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70: The two preceding sentences are based on interviews in Stockholm in 1960 with various responsible and knowledgeable people connected with Swedish insurance. I do not read Swedish and have access to the Swedish insurance literature only when it is written in English or is translated for me.

71. See statute cited in note 61 *supra*; APPELTOFFT, *op. cit. supra* note 62, at 18.

72. I asked this specific question of a number of people.

73. STATENS OFFENTLIGA UTREDNINGAR, 1946:34, *op. cit. supra* note 60, at 39 (translated extract at 21) See also *id.* at 65 (translated extract at 45).

74. These observations stem from interviews conducted by the author in Stockholm in 1960. See note 70 *supra*.

75. APPELTOFFT, *op. cit. supra* note 62, at 5.

Democratic demands extended only to far-reaching control over most aspects of the private insurance business, not merely to ensure safe and fair operation of the business but also to effectuate other social policies. The special commission appointed for the investigation consisted of three representatives of the Social Democratic party and one each from the other four parties in the *Riksdag*, including the Communist party. The majority of the commission thus represented the two parties that had been highly critical of private insurance in Sweden. Unlike the 1942 committee, the 1945 investigating commission consisted largely of politicians, not of insurance experts. Its 1949 report resulted in the extension of the principle of *skälighet* to nearly all branches of insurance other than life insurance, so that reasonableness in premiums became an almost universal legal standard.<sup>76</sup> Indirectly, the very existence of the commission was important in inducing acceptance of the reforms of the 1942 committee, which were being discussed while the 1945 commission was sitting. The principle of *skälighet* is therefore regarded by many in Sweden as a political compromise between the advocacy of nationalization or far-reaching government intervention in the insurance business on the one extreme, and the advocacy of a laissez-faire policy on the other.<sup>77</sup>

Despite the lack of precision in the Swedish formulation of the notion of *skälighet*, and the lack of any explicit formulation of a similar principle in most other systems, it seems clear that the notion is in fact implemented in much of the law of insurance in all countries. In Germany, for example, one widely suggested, all-encompassing purpose of insurance regulation is the protection of the policyholder (*Schutztheorie*), which includes both the solidity principle and a complex principle of "equity."<sup>78</sup> In France a principle of *la moralite de l'assurance* is recognized.<sup>79</sup>

Let us attempt to isolate and describe the principal components of the principle we have designated *aequum et bonum*. The initial thrust of *skälighet* was reasonableness of the price paid for insurance. This objective is very widely espoused. Let us designate it the objective of *reasonableness*. It asserts that the cost of insurance should correspond to its value or, more generally, that the insurer should treat the whole body of policyholders in a reasonable and fair manner. In this more general form it is not limited to matters of price.

Swedish law also comprehended within the initial meaning of

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76. *Id.* at 7; [1950] Svensk Författningssamling Nr. 320, § 282. It is enforced with special emphasis in the automobile liability field.

77. See note 70 *supra*.

78. Starke, *supra* note 34, at 59.

79. FOURASTIE, *op. cit. supra* note 60, at 259.

the principle the notion that there should be a fair distribution of the costs of insurance among policyholders—that rate classification should be rational and appropriate. Let us designate this objective as one of *equity* among policyholders. It also is very widely accepted and is implemented in a variety of ways. Let us extend it, also, to include matters other than price. In this sense, it requires evenhanded treatment of policyholders.

Finally, there is a kind of *aequum et bonum* not included within either of the first two aspects. It is not a matter of reasonableness between the company and the policyholders as a body, nor of equity among various groups of policyholders, but is fairness as between the company and an individual policyholder. Let us call this the objective of *fairness*. It is implicit in many particular regulatory provisions but is seldom, if ever, recognized as such.

### *1 Reasonableness Between Company and Policyholders*

Two reciprocal aspects of this objective appear. On the one side, social policy requires that the premium charges should be reasonable so that insurance buyers pay only what the coverage is worth. On the other side, a complementary thrust of the objective would require the company to define its coverage in a way that is unambiguous and not unreasonably strict. This may be regarded as ensuring that the insured gets what he pays for, or—going somewhat further—as requiring the company to give the insured what he must have *assumed* he was paying for. The narrower interpretation would permit any constriction of coverage the company wished, provided only that the premium charges were appropriately reduced. The broader meaning would focus on the dangers of ambiguity, and might even place lower limits on the definition of coverage—quite irrespective of ambiguity or of correlative reduction in premiums—on the ground that such a limitation of coverage would be misleading. In this extended sense the goal of reasonableness might, in the short run, come into conflict with the principle of solidity. In the long run, premiums could be raised, in theory at least, to take account of any refusal of the courts, or of the insurance commissioner, to honor limitations in the policies.

The premium-limiting aspect of reasonableness is the principle thrust of the Swedish principle of *skälighet*. It is also a part of the American statutory rule with respect to premiums in insurance other than life, which prescribes that rates shall not be “excessive.” The insurance commissioner is charged to enforce the standard, and in fact makes an effort to do so, though there is some disagreement about the degree to which success is achieved.

In the United States, in contrast to Sweden, the principle of

reasonableness is sought by express legal controls in fire and casualty insurance but not in life insurance. Only in Wisconsin, among American states, is there an explicit statutory upper limit on life insurance premium rates.<sup>80</sup> No doubt the difference is more apparent than real, for competition in the United States is strong enough that any reasonable limitation on initial premium rates would be largely irrelevant. The Wisconsin limitation is so liberal that it is doubtful if it has ever had any effect. Moreover, the imperative demand for solidity, especially in the long-term life contract, ensures that any tenable maximum figure must be higher than premiums need to be for most companies. Secure operation of a life company requires premiums large enough to produce surpluses for distribution either to stockholders or to policyholders. If the objective of reasonableness is to limit premium rates to a reasonable figure, it can only be implemented, consistent with the demands of solidity, in the Swedish way—by a restriction of dividends to stockholders. No doubt this is not necessary so long as a highly competitive market continues to exist, but when control does seem necessary, a compulsory limitation on the amount of distributions to stockholders would achieve the objective of reasonableness far more effectively than does the Wisconsin law. No doubt such a solution would be vigorously attacked as “un-American” in some quarters, but it would only extend to the field of insurance a principle of control long accepted for public utilities. It is worth noting, at this point, that there is considerable demand in Sweden for the introduction of price competition into the life insurance market, thus making the Swedish control somewhat more like the American.

Premium rate limitations do not exhaust the possibilities of the principle of reasonableness, even with respect to monetary concerns. Thus, any statutory provisions which require non-forfeiture benefits on lapse and which set maximum surrender charges also constrain the companies to reasonable conduct in relation to policyholders as a group. It is possible, however, that when a company declines to give any benefits on lapse or when it charges excessive surrender fees, it is being reasonable with the whole body of policyholders but inequitable as among groups. Thus non-forfeiture provisions have their most direct thrust in the preservation of equitable treatment among groups of policyholders.

One facet of reasonableness has achieved explicit recognition to a very limited extent. There is some feeling that it is a proper objective of regulation to seek efficiency or economy in the in-

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80. See WIS. STAT. § 206.26 (1959). It should be noted that the German control over rate minima, through the *Geschäftsplan*, also provides control over rate maxima. See text accompanying notes 49–51 *supra*.

insurance market. This is not merely a matter of limiting entrepreneurial profits, but a matter of limiting economic waste. In the United States, for example, there have been occasional efforts to limit the salaries of insurance executives; large salaries are sometimes perceived as economically wasteful expenditure, and therefore unfairly burdensome to policyholders.<sup>81</sup> The recent Swedish development in which *skalighet* has come to include a notion of efficiency or economy,<sup>82</sup> has not proceeded very far, though there have been complaints about, or modest efforts made to prevent, wasteful expenditures for agency conventions abroad, for excessive traveling expenses, for special celebrations, for luxurious quarters, or for excessive amenities for employees and for executives.<sup>83</sup> In the United States, with its traditional wastefulness, there has been little desire to enforce a policy of austerity. In addition to occasional efforts (especially during the 1930's) to limit salaries there has been some control over commission rates in life insurance, but on the whole the notion of parsimony or austerity is not a part of our insurance law.<sup>84</sup>

Another aspect of reasonableness receives a great deal of attention, especially in the United States and in Germany. I refer here to the control of policy terms.<sup>85</sup> In the United States we have uniform fire policies, and standard provisions in accident and health insurance.<sup>86</sup> In general, however, we have less control over forms than the Germans, who have developed their technique for working out policy forms to a fine art and have made it one of the principal foci of the regulatory process. Control over terms ensures both that coverage will be more precisely defined and that restrictive clauses will not unfairly prejudice the policyholder, whether by making his bargain a bad one or by misleading him. As with us, approval of policy terms by the German regulatory agency is a prerequisite to their use.<sup>87</sup> But while with

81. See KIMBALL, *op. cit. supra* note 1, at 172-73. This effort may have a purely democratic objective instead. See text accompanying note 109 *infra*.

82. Though the notion of *sparsamhet*, or economy, is not strictly new, see text accompanying note 73 *supra*, it has recently received additional emphasis. See STATENS OFFENTLIGA UTREDNINGAR, 1960:11, *op. cit. supra* note 63, at 211, 259.

83. As yet there has been little concrete action with respect to *sparsamhet*, but I found it a topic which interested my informants in Stockholm in the spring of 1960, and the particulars I have listed were all mentioned to me in interviews.

84. For examples of statutes aimed at limiting expenses, see Wis. STAT. §§ 206.26-.31 (1959); N. Y. INS. LAW § 213.

85. In Sweden, the 1945 Commission was directed to consider this question. APPELTOFFT, *op. cit. supra* note 62, at 6.

86. See, *e.g.*, Wis. STAT. § 203.01 (1959) (fire policy); Wis. STAT. § 204.31 (1959) (accident and health).

87. Compare VAG § 5 with Wis. STAT. § 206.17 (1959).



us the immense variety of submitted forms tends to render the process of approval not much more than a formality in some lines of insurance in some states,<sup>88</sup> with the Germans it has led to an elaborate process of give-and-take between the industry and the agency before there is initial approval of the forms.<sup>89</sup> This leads to a much higher degree of uniformity of policies among the companies than exists with us, excepting those areas in which standard policies have come into vogue.<sup>90</sup> It also leads to policies which are better drafted than many of ours, and perhaps tends to decrease the amount of litigation.<sup>91</sup>

This strong drive toward uniformity of policies has shifted the area of competition from coverage—and especially from “gimmicks”—to price and service, concepts which the individual policyholder can better understand. This result the Germans regard as an objective in itself. They talk about the transparency of the market (*Markttransparenz*) as one of the purposes of insurance regulation.<sup>92</sup> With us the same tendency is manifested in quite a different way. While the Germans push hard for the development

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88. KIMBALL & CONKLIN, *op cit. supra* note 47, at 59. *But see* Kimball & Hansen, *The Utah Insurance Commissioner: A Study of Administrative Regulation in Action, Part II*, 6 UTAH L. REV. 1, 15 (1958).

89. This statement is based on extensive interviews with officials in the *Bundesaufsichtsamt für das Versicherungs- und Bausparwesen* in Berlin in the summer of 1960, together with examination of files involving the development of new *allgemeine Versicherungsbedingungen* (general terms of insurance contracts) for approval by the agency. *Finke, Werbung und Wettbewerb in der Versicherung* (Karlsruhe) is a two-volume loose-leaf service keeping various insurance law materials up to date for German lawyers. Most of this service relates to the approved stipulations incorporated in the policies.

90. See Bischoff, *Markttransparenz der AVB in der Sachversicherung als Aufsichtsproblem des § 8(1) Ziff 2 in Verbindung mit § 13 VAG*, in [1956] *VERÖFFENTLICHUNGEN DES BUNDEAUFSICHTSAMTES FÜR DAS VERSICHERUNGS- UND BAUSPARWESEN* 33. *Markttransparenz* seems to involve both the idea of comparability and that of uniformity. See also [1955] *id.* at 154; [1959] *id.* at 130; Knoll, *Die Hagelversicherung*, 2 *FÜNFZIG JAHRE MATERIELLE VERSICHERUNGSAUFSICHT* 245, 273 (ed. Rohrbeck 1952).

91. I have an impression that litigation over policy terms is less common in Germany than in the United States, even in relation to population, on the basis of conversations with people in the regulatory agency in Berlin. However, exact comparison would be very difficult and not very helpful. One could compare the number of American judicial opinions published in the law reports with German opinions listed and classified in *Übersicht über die Rechtsprechung auf dem Gebiete des Privatversicherungsrechts* (survey of decisions in the area of private insurance law), an annual feature of *Zeitschrift für die gesamte Versicherungswissenschaft*. However, in neither country are all litigated cases reported. Thus the comparison would be meaningless without much more information, which would be difficult to obtain. Moreover, if one found that there was much less litigation over the meaning of policy terms in Germany, it would still be uncertain what that proves.

92. See authorities cited in note 90 *supra*.

of contractual stipulations which are models of clarity and which require no litigation in the administration of claims, our less certain contracts are interpreted by the courts under a principle of construction which disfavors the companies (the *contra proferentem* principle).<sup>93</sup> Thus while our contracts are not unambiguous, any uncertainties in them tend to be interpreted against the company. The resultant of our approach is, therefore, much the same as the end product of the German method. However, the German method has the advantage of enabling the regulatory agency, in examining policy terms, to give attention to the need for solidity, a factor less likely to be considered by the American court construing an ambiguous policy term.

## 2. Equity Among Policyholders

The aspect of *aequum et bonum* that I have called "equity" is a notion that policyholders should be treated without unfair discrimination. It is best illustrated in American law by the explicit requirement of the All-Industry laws<sup>94</sup> that insurance premium rates shall not be "unfairly discriminatory." The requirement demands fair classification of policyholders for premium computation in order that each person need carry only the cost of his own insurance, so far as that can be worked out. No other objective of insurance regulation is so difficult to apply. In some sense every risk unit is unique and could be separately classified and rated. To carry refined classification to this extreme would be impossible for most lines, however. In the first place, an over-refinement of risk classification would increase administrative cost. In the second place, there is, in general, no way to measure risk directly; one can only measure risk indirectly through loss statistics which reflect experience with similar risks. Such statistics are valid only if they are "credible," a condition which exists when the collection of statistics is sufficiently large and dispersed that the effects of chance are eliminated. To give the quality of credibility to statistical data requires the combination in a single classification of a large number of risk units, categorized on some *a priori*

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93. For Wisconsin developments relating to contract interpretation, see KIMBALL, *op. cit. supra* note 1, at 210-12, 230-32 *passim*. The Germans use the *contra proferentem* principle too, using the term *Die Unklarheitenregelung*. Compare BRUCK-MOELLER, KOMMENTAR ZUM VERSICHERUNGSVERTRAGSGESETZ UND ZU DEN ALLGEMEINEN VERSICHERUNGSBEDINGUNGEN I:75-79 (8. Auflage 1953) with PROELSS, VERSICHERUNGSVERTRAGSGESETZ 18-25 (12. Auflage 1960).

94. *E.g.*, ILL. ANN. STAT. ch. 73, § 1065.1 (Supp. 1960); N.Y. INS. LAW § 180. The Germans have dealt extensively with these problems under the term *Prämien gerechtigkeit*. See, *e.g.*, a series of papers by Braess, Fritz, Giese, Reichert-Facilides, Steinlin, and Wünsche, in [1958] VERSICHERUNGSWISSENSCHAFTLICHES ARCHIV 257-333.

basis. Thus it becomes apparent that a reasonable compromise must be sought between refined classification and the need for credibility in order to measure risk.<sup>95</sup>

The danger of inequity resulting from *a priori* classification is easily illustrated. Not all categories for which considerable statistical evidence can be developed are in fact sound, since the defining characteristics chosen may have only a partial correspondence with the true causal factors. For example, Negroes have often been "rated up" in life insurance, based on the undeniable fact that mortality experience for *all* Negroes is less favorable than experience for *all* whites.<sup>96</sup> It requires little sophistication to appreciate the danger in using these categories, for such factors as a less favorable public health environment may well bias the statistics. While reliance on the race classification will protect the company, the classification is too crude, for it sweeps within the disfavored class many who should receive more favorable treatment. A desire to eliminate this particular inequity as in conflict with fundamental moral notions about equal treatment of races has led to statutes forbidding the use of race as a classification.<sup>97</sup> A more refined statistical apparatus which isolated and used the true causal factors would probably exclude it too.

Any number of possible inequities result from the classifications used in the gathering of statistics for rate-making. The discovery and validation of the appropriate categories which reach to the heart of risk variation is a difficult matter, especially since the search gets involved so easily in unrealized biases of the rate makers. For example, the grouping of all young drivers in the making of rates for automobile liability insurance undoubtedly leads to inequity against that large class of responsible youngsters who do not contribute at all to the bad statistics of the below-25 group.<sup>98</sup> To recognize the inequity of course is not to solve it; the problem is a complicated one with which many able people have struggled.

Other practices may lead to discrimination against groups of policyholders. For example, whole groups may be excluded from coverage. If the company exercises a sound underwriting judgment one cannot regard this conduct as discriminatory, but the company's standard of exclusion may not always be justifiable. Ex-

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95. The 1945 Swedish Commission urged a balance between "simplicity and equity." APPELTOFFT, *op. cit. supra* note 62, at 13.

96. See MAGEE, LIFE INSURANCE 262 (1939)

97. See N. Y. INS. LAW § 209(3), which dates from 1892. See also Wis. STAT. § 942.04(c) (1959) (automobile insurance), *Lange v Rancher*, 262 Wis. 625, 56 N.W.2d 542 (1952) (state life insurance fund may not make rate distinction on basis of race or color)

98. For a study of the general problem, see WILLIAMS, PRICE DISCRIMINATION IN PROPERTY AND LIABILITY INSURANCE (1959) And see Weekly Underwriter, Jan. 21, 1961, p. 18 (Carr speech)

clusion of applicants from consideration on the ground of race or color is one such standard that is of questionable validity. Moreover, when the companies think that rates are inadequate, as in automobile liability insurance in the 1950's, the resulting strict application of the company's selection criteria will drive large numbers of "clean risks" into the assigned risk plan, where they are surcharged. There are elements of unfair discrimination in this exclusionary practice, and in 1960 there was developing concern with the problem.<sup>99</sup>

Equitable treatment of policyholders depends not only upon a fair application of underwriting standards and classifications related to the characteristics of the individual applicant but also upon an absence of unfair discrimination among groups created in other ways than by underwriting classification. One situation where the problem arises is in the early development of a life insurance company. In order to develop surpluses and contingency reserves that satisfy all of the demands of solidity, it may be necessary to withhold money from distribution to the policyholders who contributed it. This treats the policyholders who come into the company early less favorably than those who come later. The inequity is exacerbated by the fact that early policyholders take some risk that the company may not succeed at all. Perhaps the need for surpluses and contingency reserves can at least be minimized, and thus solidity and equity made more compatible, by operation with high premiums and correspondingly high dividends. This would give the company its solidity through its recuperative power, rather than through surpluses.

Competitive pressures may create the reverse inequity in the early years of a new life insurance company. In order to facilitate the sale of policies by an unknown company, such companies sometimes issue "founders' policies" which give the early policyholders an interest in a designated portion of the premium income received from later policies. Though this has been supported on the theory that the earlier policyholders bear a greater risk

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99. The most extensive public statements of concern came from New York. See, *e.g.*, Address by Superintendent Thacher to the Insurance Law Section of the New York State Bar Association, reported in *Weekly Underwriter*, Feb. 6, 1960, p. 273. As a result New York developed new rules governing use of the assigned risk plan, in an effort to minimize the use of the plan and maximize the issuance of voluntary insurance. One method was the provision of credit against assignments to the company for the voluntary insurance of drivers falling within certain classes. The New York rules were announced in August, 1960. *Weekly Underwriter*, Aug. 13, 1960, p. 272. For reports on the problem, see *Journal of Commerce*, Oct. 3, 1960, p. 9, and *Weekly Underwriter*, Oct. 1, 1960, p. 612. For stories on efforts to control cancellation of automobile policies by legislative enactment, see *Journal of Commerce*, Sept. 30, 1960, p. 10, and *Weekly Underwriter*, July 30, 1960, p. 181.

of failure of a new company, that is certainly not the theory on which sales of founders' policies are based—most often the appeals made are to the get-rich-quick impulse of the buyer

The recent development of minimum deposit insurance (which is ordinary insurance with especially high early cash values, on which buyers generally borrow to the limit) has been perceived as inequitable treatment among various classes of policyholders. Thus the New York Superintendent has said that:

When two policyholders who at the same age and condition have bought essentially similar policies in the same amount from the same company, one a minimum deposit policy and the other a conventional type policy, surrender them at the end of the first policy year, a return of as much as 70% of the first year premium to one and a return of nothing to the other is inequitable. Such disparity is completely inconsistent with the basic principle that cash values of different plans should bear a reasonable and regular relationship to each other. Accordingly, high early cash and loan values on minimum deposit policies insofar as they result from departures from the company's regular pattern used for determining the cash and loan values of other essentially similar policies are considered unfairly discriminatory and lend themselves to unsound and inequitable practices.<sup>100</sup>

Even if such a plan were actuarially sound in itself, so that it would be hard to regard it as inequitable as against other groups of policyholders, there might still be inequity among buyers of this policy. The initial reserve needed to create the high cash value in the first year can be met only with difficulty from the first year premium. If part of it must be borrowed from surplus, then even if the plan is actuarially sound with respect to the whole group who participate in it, there is unfavorable treatment of the policyholders who remain in the plan until maturity when compared with those who die or allow their policy to lapse in early years.

A large number of subtle and difficult problems of equitable distribution of cost, especially in relation to distribution of surplus, exist in connection with the actuarial laws in effect in the United States and elsewhere. However, understanding of them depends too much on an understanding of actuarial science for us to explore them further here.<sup>101</sup>

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100. WEEKLY UNDERWRITER, [1959] INSURANCE DEPARTMENT SERVICE [for] NEW YORK 6-7

101. For a perceptive discussion of some of these problems, see STATENS OFFENTLIGA UTREDNINGAR, 1946:34, *op. cit. supra* note 60, at 63-79 (translated extract at 44-54). Another part of the insurance law project in which I am engaged will seek to explore these problems in considerable detail. Clearly, the problem of equitable treatment can exist in non-monetary matters, though it is less common there. The German law prohibits special advantages of all kinds, monetary or otherwise. See VAG § 81, Abs. 2, Satz 3. This provision seeks to prevent inequity among groups of policyholders; it also seeks fairness to individual policyholders.

### 3. *Fairness to Policyholders*

Whereas the objective of reasonableness prohibits the mistreatment of the whole body of policyholders, and that of equity the mistreatment of policyholders in groups, the remaining objective of fairness prohibits mistreatment of policyholders as individuals. One of the most common examples of unfairness is in the handling of claims. Some companies make a practice of being unduly strict in claims payments or repeatedly insist on unmeritorious but available technical defenses. Likewise, some agents make misrepresentations to individual policyholders or induce them to replace existing policies. Individualized misconduct presents difficult problems of control, especially by a restructuring of the system of operation. Instead one has to rely, in general, on unwieldy administrative systems of enforcement akin to those developed for enforcement of the criminal law.

There seems to be no inherent conflict between the objective of fairness and the other objectives we have discussed so far. In practice, however, there may be conflict with the objective of solidity whenever a legal agency such as a court loses sight of the objective of solidity in seeking to implement the objective of fairness. Thus the construction of the insurance policy *contra proferentem* (against the company) can lead in an individual case to an extreme decision in favor of the policyholder that creates real difficulties for the security of the insurance fund. For example, if an agent has made misrepresentations to a policyholder under circumstances that induce the court to hold the company responsible for the misrepresentation, the consequence may be to make the company pay a large sum outside the boundary of the coverage upon which its premiums are based. Of course it is not abstract fairness that produces this conflict, but its misapplication. Likewise, a decision reversing a line of previous decisions may bring a whole class of occurrences within the policy coverage and create difficulties for the fund. But if the company is making proper use of reinsurance and has the resilience resulting from appropriate contingency reserves and surpluses, then the conflict is less with solidity than with equity, for subsequent rate increases will redress the balance between the company and the whole body of policyholders, while putting later policyholders at a disadvantage in relation to those who have already benefited from the unanticipated coverage.

Thus far we have dealt with policy objectives intimately related to the internal operation of the insurance business. Without reasonable implementation of these objectives, the business does not operate well. We move now to the discussion of objectives

that are essentially irrelevant to the proper operation of the insurance business but are imposed upon the business from without.

## II. OBJECTIVES NOT NECESSARILY INHERENT IN THE INSURANCE ENTERPRISE

Pressing in upon the insurance enterprise from without are all of the goals of society at large. For the most part the insurance business would work equally well whether these objectives were implemented or not. This is so far true that regulatory officials do not always recognize clearly that national economic policy, or other general public policy, has any relationship to supervision. Many officials in the German regulatory agency, for example, responded to that specific question by asserting the irrelevance of general economic or social policy considerations to problems of regulation. There is no doubt of the sincerity of this belief; it is especially noteworthy, therefore, that German regulatory officials have applied such considerations in a number of situations.<sup>102</sup> Nor is this surprising, upon reflection, given the intensity with which certain social needs are felt. Some of the officials put it differently, not saying that general economic and social policy is irrelevant, but rather that it is for the Economics Minister or other officials in Bonn to consider, not for the regulatory agency. No doubt this is true, speaking generally. In fact the Economics Minister could determine policy for the regulatory agency, allowing general national considerations to override the ordinary supervisory principles normally applied by the agency. However, it does not seem quite accurate to say that *only* Bonn officials can or do consider such factors, as the illustrations in the preceding footnote demonstrate—and as otherwise must be clear upon reflection, for insurance supervision does not exist in a vacuum but in a complicated twentieth-century state.

These general societal goals are pervasive demands which have as much validity within the insurance institution as they have any-

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102. For example, during World War II the *Reichsaufsichtsamt* (Reich supervisory agency) sought to exclude coverage of the unborn offspring of animals from slaughter-animal insurance (*Schlachtversicherungs*), the theory was that such coverage would encourage the slaughter of animals carrying young and was, therefore, contrary to the national food policy. *Veröffentlichungen des Bundesaufsichtsamtes für das Versicherungs- und Bausparwesen*, [1939–45] *Geschäftsbericht* 34. Similarly the introduction of insurance covering the enhanced value of property resulting from inflation (*gleitende Neuwertversicherung*) was resisted during the war on the ground that it might lead to a loss of confidence in the Reichsmark. *Id.* at 44–45. See also text accompanying notes 164–69 *infra* for the effect of national policy on insurance investments, both in the United States and in Germany. And see text accompanying notes 153–59 *infra* for a description of the “need test.”

where else. They are many and various, and it is difficult to classify them. For present purposes, I divide them into three groups, though with an understanding that there are interrelations which make this division somewhat artificial. One set of demands derives mainly from our political structure and attitudes. A second comes from economic and social policies that are not purely political. A third group, in some sense more fundamental than either of the first two, seeks to implement certain basic moral values. Let us look at them under these three headings, recognizing that other classifications may be equally useful. The present listing does not exhaust the possibilities. Any motive or attitude that becomes widespread may have an effect on insurance law, under appropriate circumstances.<sup>103</sup>

#### A. GENERAL PUBLIC POLICIES—DEMANDS DERIVING FROM POLITICAL STRUCTURE AND ATTITUDES

The policies suggested here are numerous, complex, and sometimes subtle. For some purposes it would be important to define them far more precisely than is useful here, and perhaps even to subdivide and differentiate them further. Without any effort to attain precision, however, let us discuss the impact on insurance law of four aims: democracy, liberty, local protectionism, and federalism.

##### 1. *Democracy*

If it seems curious to name democracy as one of the objectives of insurance regulation, let it only be remembered how pervasive is this ill-defined goal as a human aspiration. As used here, the word refers primarily to egalitarian ideas, both in the social and in the political sphere. The democratic or egalitarian purpose has spilled over into insurance regulation, not only in a multitude of subtle and indirect ways, but also in some rather explicit ones.

An egalitarian motif runs through much legislative action respecting local mutual insurance companies in the United States. For many decades the Wisconsin legislature had repeatedly to consider bills proposing to change the voting rule in town mutual fire insurance companies from one based on the amount of insurance carried to one in which each policyholder would have a single vote.<sup>104</sup> There was also a related effort, through legal limitations on the use of proxy votes, to discourage domination of local mutuals by management cliques and thus to preserve democratic

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103. Holmes, J., dissenting in *Lochner v. New York*, 198 U.S. 45, 76 (1905): "Every opinion tends to become a law."

104. KIMBALL, *op. cit. supra* note 1, at 71.



values.<sup>105</sup> In the big commercial mutuals, the problem of democracy arose because management tended to become self-perpetuating, aided by the difficulty of organizing opposition among innumerable policyholders, widely scattered.<sup>106</sup> As a result of the investigations in 1905 and 1906,<sup>107</sup> various statutes were passed which sought to assure democratic control by policyholders, by requiring the company to give certain types of assistance to dissident groups seeking to overturn management, and by other means.<sup>108</sup> It is doubtful that this statutory policy was ever implemented very effectively—or that it could have been implemented without making management too insecure, thereby threatening the value of solidity. Finally, there was an element of egalitarian thinking in the efforts occasionally made to restrict executive salaries in the larger insurance companies.<sup>109</sup>

No doubt one would find the egalitarian motif running through insurance law in many other countries as well, but let one specific illustration suffice. In Sweden, one purpose of the 1945 commission's inquiry into insurance was "to safeguard a democratic and social influence on all insurance activities."<sup>110</sup> By a "democratic influence" the commission seems to have meant, among other things, that control of insurance organizations must not be based solely upon property conceptions—that joint stock life insurance companies must provide policyholder representation on their governing boards, and that mutuals must give reality to policyholder control. The commission felt that for stock companies "the insured, or some organ representing them, *should be entitled to appoint one or more directors* in addition to those elected by the shareholders," as a "natural democratic claim."<sup>111</sup> The companies were to be given an opportunity to work out the method of providing such representation, subject to the government's power to intervene when necessary to protect the interests of the insured.<sup>112</sup> The government has in fact intervened, and has made much use of its power to appoint directors to represent the policyholders, with very little objection from the companies.<sup>113</sup> To some

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105. *Id.* at 72.

106. *Id.* at 72-74.

107. The Armstrong investigation in New York was only the best known of the investigations. For accounts of the Armstrong investigation, see authorities cited in note 23 *supra*. For the Wisconsin and other investigations, see authorities cited in note 24 *supra*.

108. KIMBALL, *op. cit. supra* note 1, at 73. See also authorities cited in note 24 *supra*.

109. See note 81 *supra* and accompanying text.

110. APPELTOFFT, *op. cit. supra* note 62, at 5-6.

111. *Id.* at 17. And see generally *id.* at 15-18.

112. *Id.* at 17-18.

113. FOERSAEKRINGS INSPEKTIONEN, ENSKILT FOERSAEKRINGSVAESEN 16 (Stockholm 1954).

extent, there has been a tendency to use this power as a means of providing increased income to government officials serving in positions for which the prevailing salaries are felt to be inadequate; of course this does not mean that the appointees cannot make as important a contribution to the companies as other directors. However, many of the appointees have been Social Democrats, a fact not likely to make the most conservative among the insurance men happy.<sup>114</sup>

Despite the fact that the power of control remains in the board members selected by the stockholders, there seems little doubt of the impact of this move for "democratization" of insurance company management. Regular board members will naturally be wary of suggesting company action that would lead to demands for further reform, a possibility ever-present in the minds of insurance men who contemplate the presence of a government-appointed member of the board.<sup>115</sup>

## 2. Liberty

For present purposes, this heading includes all attitudes that result in restraints on government interference with companies or individuals in the insurance business. It has many facets, including those restraints on official action that are substantive in character, as well as those that are procedural. Some of the restraints—particularly those that are procedural—are constitutionally imposed, while many others merely reflect current attitudes about the proper limits of governmental action. I shall merely illustrate a few of the implications of libertarian ideas for insurance law, without making any effort to deal with them exhaustively.

At the level of pure procedure, it seems clear that insurance regulation would be more effective if the insurance department were free to act on the basis of probability and to refuse licenses to company or agent without the apparatus of notice and hearing. Although that statement would be applicable to the regulation of any business, it is particularly true in the insurance business, which consists of a multitude of individual transactions, most of them very small. Though the sacrifice in supervisory effectiveness resulting from the requirements of notice, hearing, and adequate

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114. The last two sentences are based on interviews in Stockholm in May, 1960, with various responsible and knowledgeable people connected with Swedish insurance, supplemented by later correspondence.

115. The development of the principle of *skälighet* would seem to indicate that these men have some basis for fearing further governmental intervention. See text accompanying notes 75–77 *supra*. In Wisconsin, in the wake of the insurance investigation of 1906, there was a proposal that the Governor appoint one director of domestic mutual life companies. Nothing came of it. See KIMBALL, *op. cit. supra* note 1, at 74.

proof is considerable, and though there is a very high probability that an unfettered administrator would not be wrong very often, the sacrifice seems a small price to pay for freedom from arbitrary action by a public official. There is even some doubt whether we have gone far enough in devising controls over the procedures in the insurance departments. Liberty ranks so high in our scale of values that we willingly suffer—and should suffer—many limitations on the effectiveness of our control machinery rather than acquiesce in official arbitrariness.<sup>116</sup>

The objective of liberty has other facets than mere insistence on procedural restraint. There is, for example, a widespread notion that compulsion itself is an evil, and that we should only suppress action widely regarded as undesirable and of considerable moment. It is better for society to suffer slight harms than to suppress them forcibly. In part this is probably a result of a feeling that it is immoral to compel, but it also reflects a wise skepticism about the capacity of human beings to make sound decisions, and a judgment that that society is sounder which provides for a very broad dispersion of decision-making power. This element of the liberal democratic faith seems a sound principle to apply to insurance. It takes maximum advantage of the wisdom, the integrity, and the sense of responsibility of persons in the industry, mainly

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116. See Kimball & Jackson, *The Regulation of Insurance Marketing*, 61 COLUM. L. REV. 141-200 (1961) for a discussion of some such problems. The Scandinavian institution of the *Justitieombudsmannen* is an interesting contribution to the science of controlling official discretion. The *Ombudsmannen* is a parliamentary commissioner whose specific job it is to seek out and punish arbitrary action by public officials, thus protecting the citizen against the government. The institution dates back to 1810 in Sweden. Although the *Ombudsmannen* has apparently never had to take action respecting the insurance inspectorate, the extent of his activity can be judged by the fact that in Sweden in 1959 he received 780 complaints and initiated 223 actions of his own. Out of these, 5 prosecutions were begun, 8 recommendations were made for changes in the law, and 247 admonitions were administered to officials. Press release prepared by Swedish Royal Ministry for Foreign Affairs, June 1, 1957, supplemented by typed information dated June 1, 1960. Another important factor in controlling official action in Sweden is the fact that most documents and letters of an agency are accessible to the public.

German regulation provides for a considerable measure of control over official discretion. Most decisions of the *Bundesaufsichtsamt* are considered to be *Verwaltungsakte* (administrative acts), subject to review in the *Bundesverwaltungsgericht*. See, e.g., PROELSS, *op. cit. supra* note 49, at 579. The areas of free discretion are strictly limited, and even there the systematic character of German regulatory practice tends constantly to narrow the range of discretion by establishing precedents within the agency itself. The sections of the VAG which in terms provide wide discretionary power, such as §§ 81, 81a, 89, tend to be viewed rather restrictively by the officials in the agency. Interviews with regulatory officials in Berlin, summer, 1960.

relying on nonlegal rather than legal means to provide control over them.<sup>117</sup>

There are elements of both the wisdom of procedural restraint and the benefit of wide dispersion of decision-making power in the fact that in insurance regulation a serious effort has been made to bring representatives of the regulated industry into even the official decision-making process. This is sound, though it must be done in such a way as to avoid industry domination of the supervisory agency. All systems seem to do this informally; in some systems there are also formal efforts to achieve participation. For example, the Germans have the *Beirat*, an advisory body established by the basic statute, to bring experts representative of the insurance industry, of insurance buyers, and of other social and economic groups into the regulatory process.<sup>118</sup> New York has an insurance board, appointed by the governor, which has at times been a useful adjunct to the regulatory process.<sup>119</sup>

Control of conduct often involves creation of an elaborate administrative mechanism, which is expensive and cumbersome and may have collateral consequences violative of other important objectives. There is no sound argument against trying to solve serious problems, but there is an unanswerable argument for trying to anticipate the consequences of all proposed solutions. One may suggest, for example, that a requirement of prior approval of premium rates may tend either to compel a perfunctory (and therefore wasteful) process of approval or to make adjustment of rates difficult and slow, thereby threatening the solidity of insurers—or making it difficult to equalize the burdens among groups of policyholders, and thus challenging the very values it sought to promote. In Germany, where the regulatory agency must usually give explicit approval to the purchase of real estate, I learned from interviews in one city that some real estate brokers often refrained from offering available land to insurance companies because of the inevitable delay consequent on the requirement of official approval of the purchase.

The English carry the distaste for compulsion and for cumbersome administrative machinery as far as anyone. They rely very heavily on self-regulation by the business, on a sense of moral responsibility in the English business community, and on publicity.

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117 STATENS OFFENTLIGA UTREDNINGAR, 1946:34, *op. cit. supra* note 60, at 35–37 (translated extract at 17–19), has some perceptive comments.

118. VAG § 92. See PROLSS, *op. cit. supra* note 49, at 57–62 (and index under *Beirat*). See also GESAMTVERBAND DER VERSICHERUNGSWIRTSCHAFT E.V., 12. GESCHAEFTSBERICHT [1959/60] at 119–20, for a discussion of the activity of the *Beirat* from the industry viewpoint.

119. See N.Y. INS. LAW § 19.

A mere handful of people in the Board of Trade, no more than a score at most, regulate insurance in one of the world's most important insurance markets.

Thus far we have seen some of the procedural aspects of libertarian attitudes. But liberty goes to substance as well. Notions of freedom of contract and of vested rights sometimes create difficult problems for the regulation of a business so complex as insurance. For example, if a mutual company has been operating on an actuarially unsound basis, the idea that policyholders have vested rights in the benefits promised by the contract—irrespective of the state of the company treasury—makes it difficult to adjust to a sound basis without a reorganization, because to do so violates vested rights in the contracts. This was a serious problem with fraternal insurance companies in this country during the early decades of this century, for they had begun in the nineteenth century on an actuarially unsound basis and only later desired to convert to a sound basis of operation with as little formality as possible.<sup>120</sup> Perhaps some European countries do not feel these values so strongly, or perhaps they appreciate more fully the difficulties created by an extreme emphasis on the sanctity of vested rights. The willingness in Sweden to limit life insurance profits to a percentage of original investment is one illustration of the European attitude.<sup>121</sup> Another is the German willingness to permit unilateral alteration of contracts, not only during the inflationary period of the early 1920's, but even more generally, in the name of the *Versicherungsgemeinschaft*, or insured community.<sup>122</sup>

Altogether it seems clear that our attitudes toward liberty do have considerable impact on insurance law and regulation, and should have. There is no reason to isolate insurance from the rest of society

### 3 Local Protectionism

In its most important aspect, insurance is a handmaiden of commerce, and as such is essentially national or even international in the scope of its activity. Yet the operation of the insurance enterprise has been severely handicapped at times by localistic restrictions on its activities. By localistic restrictions I mean something other than the diversity of regulatory systems. I mean essentially a policy of subjecting foreign companies to disadvantages in relation to domestic companies. Such a policy is especially

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120. See KIMBALL, *op. cit. supra* note 1, at 156-62.

121. Interviews in Stockholm in May, 1960.

122. See Büchner, *supra* note 12, at 21-24; VAG § 81a. The principle of equity requires such adjustment. On *Versicherungsgemeinschaft*, see note 35 *supra*.

incongruous in the United States, the prototype of all continental customs unions, where historically there has been only a minimum of apparatus for the harassment of economic enterprise at political boundary lines. Yet in the United States there have been many manifestations of this kind of local public policy, inconsistent though it may be with the larger interests of the insurance business and even of the local communities themselves.

Among innumerable illustrations of a policy of localism, perhaps the most striking is the Robertson law, enacted in Texas in 1907<sup>123</sup> and then unsuccessfully proposed very widely in the United States.<sup>124</sup> The Robertson law was intended to discourage the outflow of capital from the state by requiring life insurance companies to invest at least 75 per cent of the legal reserve for policies on Texas citizens in Texas securities and real estate. The Robertson law led to the withdrawal of about two dozen insurance companies from Texas.<sup>125</sup> One cannot be confident about the economic consequences of such a statute, and they may be much less than insurance men have supposed, but industry spokesmen made strong assertions that the Robertson law and industry reaction to it diverted capital from Texas to Oklahoma and Louisiana.<sup>126</sup> In any case the statute probably was not necessary, since capital tended to be invested in the state in larger amounts than the statute required.

It was not only American states that had such a policy. The Northwestern Mutual Life Insurance Company is said to have withdrawn from Canada in 1878 because of similar investment restrictions.<sup>127</sup>

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123. Tex. Laws 1907, ch. 170, now TEX. INS. CODE, art. 3.33 (1952).

124. Robert L. Cox, a vice-president of the Metropolitan Life Insurance Company, stated in 1924 that since the 1907 legislative session, when the law was passed in Texas, 104 bills had been introduced in 33 legislatures in 18 years, all proposing the Robertson law. All had failed. Cox, "Statutory Direction of Life Insurance Investments with Special Reference to the Robertson Law of Texas," Address to Association of Life Insurance Presidents, Dec. 12, 1924.

125. *Ibid.*

126. See, e.g., Alfred Hurrell, Attorney for Association of Life Insurance Presidents, "The Call for Investments," Address to South Carolina Bankers' Association, July 5, 1912; Robert L. Cox, General Counsel and Manager, Association of Life Insurance Presidents, "A Trial Test of Compulsory Investment Legislation, Economic Results under the Robertson Insurance Law of Texas," Address to Texas Welfare Commission at Dallas, May 16, 1912; Cox, "The Geographical Distribution of the Investments of Life Insurance Companies," Address to Association of Life Insurance Presidents, April 2, 1909; Cox, *supra* note 124. The foregoing addresses are all available in the Library of the Insurance Society of New York.

127. WILLIAMSON & SMALLEY, NORTHWESTERN MUTUAL LIFE: A CENTURY OF TRUSTEESHIP 74 (1957). The law was 40 Vict. c. 42, § 7 (1877) (Can.).

Discriminatory taxation also manifests local protectionism.<sup>128</sup> But there are limits to the advantages a state can give its domestic companies by tax differentials. If the state has important domestic companies, they will seek to gain a share of the national or at least the regional market. There the domestic company will meet retaliatory statutes which impose on it any burdens imposed by its domicile on out-of-state companies. The universality of retaliatory statutes ensures that the domestic company will pay taxes in other states at least as high as the tax burden imposed on out-of-state companies by its domiciliary state. If the domiciliary state is a high-tax state, the domestic company will be put at a competitive disadvantage, for it will pay those high taxes everywhere, while its competitors from low-tax states will pay the high taxes only in those states where they are directly imposed. This curious problem sometimes leads to protectionism of an inverse sort. For example, the Northwestern Mutual Life Insurance Company, domiciled in Wisconsin, has been a leading national company for nearly a century. During the last third of the nineteenth century, Wisconsin was a fairly high-tax state. In order not to prejudice the Northwestern Mutual in its national aspirations, the state followed a policy of taxing domestic companies (*i.e.*, Northwestern) more heavily than it taxed foreign companies. It did this with the acquiescence of the company, which only ceased to be willing to undergo discriminatory treatment at home (in order to avoid retaliation abroad, while providing the state with needed revenue at home) when Wisconsin ceased to compare so unfavorably with most other states on premium taxation.<sup>129</sup>

Local protectionism on occasion rears its head in the international sphere, especially with respect to ocean marine insurance. Often this is related to, or is consequent upon, important national defense or foreign relations policies. The Merchant Ship Sales Act of 1946, for example, pointed to the necessity for "efficient American-owned facilities for marine insurance" in order to attain national security and develop our foreign commerce.<sup>130</sup> In 1946 the Maritime Commission promulgated a rule requiring ship operators who get a subsidy from the United States, and operators of vessels acquired under a United States mortgage, to place "not

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128. In *Prudential Ins. Co. v Benjamin*, 328 U.S. 408 (1946), the Supreme Court upheld a South Carolina tax of three per cent on out-of-state insurance companies, though domestic companies did not have to pay a similar tax. The extent to which discriminatory taxation is possible under the authorization given the states to tax insurance by the McCarran Act is not entirely clear from this case. Presumably there are some limits.

129. The history of this problem is treated in detail in KIMBALL, *op cit. supra* note 1, at 259-70.

130. 60 Stat. 41 (1946), 50 U.S.C. §§ 1735-46 (1958)

less than 75 per cent of the required hull insurance in the American market."<sup>131</sup> This rule was modified but extended in 1956.<sup>132</sup> Serious criticism of the protective rule, expressed in the 1960 report of the O'Mahoney committee investigating ocean marine insurance,<sup>133</sup> seems to underestimate the importance of other public policies besides the reasonableness in price sought by the committee through the preservation of a highly competitive market. While all instances of local protectionism, whether domestic or international, are suspect and should be supported only after the most careful and skeptical examination, in the international sphere the overriding importance of national security and other values may make it desirable to place some artificial restrictions on the insurance market.<sup>134</sup> At least a policy of retaliation may be necessary to protect the *right* if not the duty of American shippers to buy insurance in the American market, as against *foreign* localizing restrictions.<sup>135</sup>

#### 4. Federalism

If the question were still undetermined, it is quite possible that American insurance regulation would develop at the federal level. Certainly during portions of our history, insurance company spokesmen and others have urged regulation at that level, partly on the ground of simplicity and partly on the ground of effective-

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131. The Insurance Industry, *Hearings pursuant to S. Res. 57 before the Subcommittee on Antitrust and Monopoly of the Senate Committee on the Judiciary*, 86th Cong., 1st Sess., 5637-43 (1960); Subcommittee on Antitrust and Monopoly of the Senate Committee on the Judiciary, *The Insurance Industry*, S. REP. No. 1834, 86th Cong., 2d Sess., 102-03 (1960).

132. *Hearings*, *supra* note 131, at 5640-42; REPORT, *supra* note 131, at 105.

133. REPORT, *supra* note 131, at 108.

134. One interesting possibility, the effects of which would be too small to weigh very heavily, is suggested by the recent proposal of an American insurance man urging localistic restrictions as a measure to slow the gold outflow from the United States. N. Y. Times, Jan. 9, 1961, p. 62, col. 7. See also McHugh, "The Challenge to State Regulation of Insurance," Address to South Carolina Insurance Forum, Feb. 1, 1961, at p. 12 (mimeographed text).

135. At the end of 1960, American marine underwriters were protesting to the State Department a threatened Venezuelan Government action to prohibit importers from placing marine insurance with non-Venezuelan underwriters. See, e.g., Journal of Commerce, Dec. 2, 1960, p. 2; *id.*, Dec. 9, 1960, p. 9. For further discussion of localism as a factor in insurance law, see KIMBALL, *op. cit. supra* note 1, at 270-80.

All manifestations of local protectionism are abhorred in insurance circles in London. Complexities in regulation are also disliked, for English insurers are subject to difficulty because of the variety and cumulative impact of measures that, taken alone, seem reasonable and modest. A requirement of a security deposit as a condition to doing business is one illustration. Security deposits are usually reasonable enough, taken individually, but in the aggregate they are very burdensome.



ness. Half a century and more ago, the prevailing opinion seemed to favor federal regulation.<sup>136</sup> With the passage of time, insurance men generally have shifted their views and would now favor the present system of state regulation by an overwhelming majority, despite the complexity and cumbersomeness of that system.<sup>137</sup> They often put their preference on ideological grounds (*i.e.*, states' rights), but one is entitled to wonder if behind the change in viewpoint is the spectre of the wide-ranging and generally effective twentieth-century federal agency. The opinion favoring state control persists despite the *South-Eastern Underwriters* case, which made it clear that insurance regulation was within the sweep of the commerce power.<sup>138</sup> An added factor now is the existence of well-established insurance departments in every state, each with a continuing vested interest in state regulation. There has also grown up a national association of state insurance departments which exerts every effort in favor of continued state jurisdiction.<sup>139</sup>

This is not the place to reach a conclusion on the merits of state versus federal regulation of insurance. That question is not an easy one to answer, for there are strong arguments on both sides. A federal agency would probably be more effective than most of the state departments, though perhaps not more effective than the best. To the extent that state regulation is ineffective in any state, that state's citizens are subjected to risk of loss from inept or venal management of insurance companies. It is probably no accident that one of the stronger recent statements in favor of federal regulation came from an attorney who supervised the liquidation of one of the most seriously mismanaged insurance companies of our day.<sup>140</sup> The smaller state departments are incapable of detecting dangers in the structure or operation of such companies, even if the laws under which they operate give them sufficient power. A possible solution to the problem within the framework of state regulation is for the smaller states voluntarily to rely much more than they do upon the services performed by the larger states. Unfortunately there is reluctance to do so. Of course, federal control gives no absolute assurance of superior effective-

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136. See Huebner, *Federal Supervision and Regulation of Insurance*, 26 ANNALS 681, 682-86 (1905)

137. See, *e.g.*, 2 NAT'L ASS'N OF INS. COMM'RS, [1959] PROCEEDINGS 460-61.

138. *United States v South-Eastern Underwriters Ass'n*, 322 U.S. 533 (1944)

139. See, *e.g.*, the activities of the Preservation of State Regulation Committee of the National Association of Insurance Commissioners, reported in 2 NAT'L ASS'N OF INS. COMM'RS, *op. cit. supra* note 137, at 457-63, and in other volumes *passim*.

140. See *Journal of Commerce*, May 25, 1960, p. 10.

ness; federal agencies too can be weak, ineffective, subject to improper influence, or even corrupt.

Doubtless federal regulation would be less expensive than state regulation in the aggregate, for there is a large amount of duplication in the present regulatory effort among the states.<sup>141</sup> The German regulatory agency does an effective job of regulation for all of West Germany with a staff smaller than those of our larger state insurance departments.<sup>142</sup>

Yet one has not exhausted the arguments when he has discussed the relative economy and effectiveness of federal and state regulation. The values of federalism lie in the wide dispersion of decision-making power and in the probable enhancement of democracy and liberty by such dispersion of power, especially in a complex and diverse society such as ours. In part the decision on federal versus state regulation of insurance must turn on such abstract considerations of political theory; in part it must depend upon the concrete practical considerations of economy and effectiveness.<sup>143</sup>

#### B. GENERAL PUBLIC POLICIES—DEMANDS DERIVING FROM ECONOMIC AND SOCIAL POLICY

Insurance does not exist in a vacuum, but in a complex modern society with a developed and dynamic economy. The industrialization and urbanization of modern life, with the attendant deterioration of such social institutions as the extended family which were

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141. Companies must comply separately with the laws of each of the states in which they operate, and make separate reports to each. Moreover, they are subject to multiple examinations. The National Association of Insurance Commissioners has made great contributions to the simplification of this complex situation, by a system of convention examinations, by convention forms, and by the development of uniform laws and practices, but much complexity remains.

142. It is not entirely apt to compare the problems of the United States with those of Germany. If one compares the United States with the whole of Europe, the comparison becomes more favorable to the United States. In Europe, problems of diversity of insurance law and regulation are being attacked through committees of the Organization for European Economic Corporation (OEEC) and the Common Market, and in the EUROPEAN Conferences of Supervising Services of Insurance Companies. For the achievements of the OEEC on insurance, see *ORG. FOR EUROPEAN ECON. CO-OP., CODE OF LIBERALISATION* 33, 111-21 (August 1959). (For reservations to the code, see *id.* at 127-39.) And compare the Records of the Third European Conference of Supervising Services of Insurance Companies, Rome, October 1-5, 1956, with the Proceedings of the National Association of Insurance Commissioners for any year. Some current suggestions to ameliorate the diversity are central security deposits, or cautions, and reciprocity with respect to certificates of solvency.

143. Any evaluation of federal versus state regulation must inquire deeply into the German experience and compare it with the American experience.

of vital importance in generations gone by, have brought pressing social problems which cry aloud for solution. In many of them, insurance can be made to play a key role. If insurance is to be utilized in solving such problems, the impact on the law and regulation of insurance will be substantial. Let us outline public policy as it relates to socialization of risk, freedom of enterprise, and the process of capital accumulation.

### *I Socialization of Risk*

I have already suggested that insurance is a central institution in contemporary society, having replaced prior basic institutions as the way of providing for the pervasive security demands of the human being. One would expect considerable pressure from society at large to compel the insurance institution to do fully the job for which it exists.

If insurance is to carry out fully its role in our society—if it is to provide security and the *sense* of security on a broad basis—it must include almost everyone, at least in certain key fields. Pressure for the extension of insurance coverage is an aspect of what one may call, very loosely, the socialization of risk. The desirability of extending coverage may transcend purely economic considerations. As one Swedish observer has put it:

The frequently urgent social aims of insurance—especially of persons—urges its extension also to fields or groups of the population in which acquisition is uneconomical to the insurer. Social demands must then to some extent take precedence of financial motives.<sup>144</sup>

One needs only to point to some of the twentieth century developments in this field to make the point sufficiently for present purposes. The development of workmen's compensation, unemployment compensation, bank deposit insurance, the pressure for universalization of automobile liability insurance, as manifested by financial or safety responsibility acts, by unsatisfied judgment funds, by compulsory insurance, and by voluntary uninsured motorist clauses to forestall further development of compulsory insurance, all have the same underlying significance.<sup>145</sup> The insurance institution is being compelled, in one way or another, to do its job completely. The contemporary drive to expand social security to provide medical care for the elderly is yet another illustration.<sup>146</sup> The professional, conservatively oriented insurance man resents the solutions involving government participation and seeks to exorcise the demon by magical incantations—by denying

144. APPELTOFFT, *op. cit. supra* note 62, at 10.

145. See *id.* at 20–21 (obligatory insurance in Sweden)

146. See N. Y. Times, Jan. 11, 1961, p. 18, col. 3; N.Y. Times, Jan. 12, 1961, p. 28, col. 1 (editorial) Cf. Weekly Underwriter, Jan. 14, 1961, p. 5.

the use of the good word "insurance" to describe the bad development.<sup>147</sup> But insurance is the contemporary manifestation of man's search for security, which demands the extension of insurance to protect the whole society in the way that the primitive kinship system did. Though our pattern of development is much like that of Europe, the Europeans have either seen more clearly than we the social implications of insurance activity or are less disturbed by the change it foreshadows. The 1945 Swedish Commission said, for example:

A wide extension of contingency insurance appears highly desirable from the point of view of the community. This applies especially to contingencies that would otherwise cause insuperable financial difficulties to individuals, or permanently interfere with private enterprise. The responsibility not only for the security of individual citizens, but also for our economic life, rests with the community in general. An important duty in that respect must be to promote the sound and appropriate development of contingency insurance.<sup>148</sup>

The pressure for providing insurance solutions for complex social problems has had much impact on insurance law. Conversely, the existence and widespread use of insurance has had many consequences for other branches of law.<sup>149</sup>

If socialization of risk is viewed as an objective of insurance regulation, it at once alters the basic focus of the enterprise from one essentially private (albeit subject to control in the public interest) to one which is essentially public, permitted to exist in private form only to the extent that it fulfills society's demands. Despite all our predilections to the contrary, it seems a fact that the basic focus of the enterprise is changing—subtly and gradually, but inexorably—and the new and pervasive demands of society are becoming more influential.

Automobile liability insurance is a good illustration. It seems to be social policy to encourage or even to require that automobiles be covered by insurance, in order to provide a solvent defendant for victims to sue. Obviously, it then becomes necessary to provide an insurance market for all drivers whom the state permits to drive. This produces the assigned risk plan, and compulsion on the company to insure. At this point insurance begins to look like

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147. For example, in 1959 the National Association of Life Underwriters passed a resolution calling upon Congress to delete all insurance terminology from the Social Security Act, to change the name of the program, and to take steps to ensure that it is not represented to be "insurance." *Weekly Underwriter*, July 11, 1959, p. 49, 72.

148. APPELTOFFT, *op. cit. supra* note 62, at 20.

149. This is especially true in tort law. See, *e.g.*, 2 HARPER & JAMES, *THE LAW OF TORTS* 759-84 (1956) for an introduction to these complex problems.

a public utility<sup>150</sup> The consequences of this change are immense. If it is urgently required that insurance be available to all comers, it is more difficult to implement with the same degree of effectiveness the basic objective of solidity of the enterprise, or even the less crucial but important objective of equity among policyholders. Libertarian objectives are challenged. All must be qualified by the overriding needs of society. If solidity is endangered, public subsidies or public guarantees are not far behind. If subsidies are required, considerations of equity give way to convenience to the tax gatherer. The public policy with which we are dealing leads to serious conflicts of important values. The agencies that make and enforce public policy must reach a resolution of such conflicts by balancing the disparate demands which we seek to elucidate here.

## 2 *Freedom of Enterprise*

There is no reason that a cartelized insurance industry could not operate both safely and fairly, so far as policyholders are concerned, without providing freedom of access to the market for new insurers. Indeed it might operate with more stability and solidity than a highly competitive enterprise, though regulation might then be necessary to ensure reasonableness of prices to the insured. However, in American society at least, freedom of access to the market for new entrepreneurs is itself regarded as a value of considerable importance. As a result, it is characteristic of American insurance regulation to provide only general standards for admission to the market, standards difficult to meet in an earlier period of capital scarcity but modest in mid-twentieth century. New business units now come into the business easily and in large numbers.<sup>151</sup>

In many other systems a policy of freedom of access to the market either is given less effect or is repudiated. In Sweden, for example, the government concession or license which is necessary to do business in the country is granted only under rather restrictive rules. New institutions and foreign companies seeking a place

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150. See *California Auto Ass'n Inter-Insurance Bureau v Maloney*, 341 U.S. 105 (1951) (upholding constitutionality of compulsory assigned risk program), 2 LARSON, WORKMEN'S COMPENSATION LAW 450 (1952) (discussion of statutes forbidding rejection of applications by compensation insurers). See also *Aetna Cas. & Sur. Co. v. O'Connor*, 207 N.Y.S.2d 679, 170 N.E.2d 681 (1961).

151. See Cartwright, column in *National Underwriter*, Nov. 4, 1960, p. 43, talking in disparaging terms of the "continuing cascade of [new] promotions." *E.g.*, from the end of 1950 to mid-1959 life insurance companies in the United States increased in number from 650 to 1402. This was a net increase. INSTITUTE OF LIFE INSURANCE, *op. cit. supra* note 1, at 97-98.

in the market must show that they are needed and that they are likely to promote sound insurance practice. In general, new companies are not admitted to do business along traditional lines unless the particular field is unsaturated; companies advancing new ideas may be admitted, however. Moreover, there is a current trend (which has been encouraged by the regulatory agency) toward the merger of existing firms in order to minimize any untoward effects of excessive competition, such as the alleged increase in marketing costs.<sup>152</sup> One thing is clear—the tight control of entrance into the market makes it much easier to control other aspects of the market than is the case in the United States, where access is open and frequently utilized.

In Germany, a “need test” was enacted into law in 1937.<sup>153</sup> The determination of need was to be made by the regulatory agency in accordance with principles enunciated by the Economics Minister of the Reich. A set of instructions from the Minister in the same year gave a strict reading to the need test, with especial attention to be given to the needs of the total economy.<sup>154</sup> Since the war, the provision establishing a need test has continued to be expressed in the statute, just as it was originally stated in 1937.<sup>155</sup> The validity of the provision seems now to depend upon whether it has been impliedly repealed as inconsistent with Article 12 of the new German Constitution.<sup>156</sup> In the mid-1950's the German Federal Constitutional Court decided a series of important cases interpreting that article.<sup>157</sup> Many German lawyers, including the

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152. APPELTOFFT, *op. cit. supra* note 62, at 6. And see STUDY OF INSURANCE SUPERVISION, SWEDEN 8-9 (1960), a mimeographed statement in English prepared by the *Försäkrings Inspektionen*. Officials in the regulatory agency say they would stop the merger tendency before it resulted in undue restriction of competition. The 1945 Commission also favored a policy of restriction of access to the market. APPELTOFFT, *op. cit. supra* note 62, at 11, 18.

153. Gesetz zur Änderung des Gesetzes über die Beaufsichtigung der privaten Versicherungsunternehmen und Bausparkassen, vom 5. März 1937, art. I, § 2(b), [1937] Reichsgesetzblatt I:269 (Ger.). The original regulatory law had provided that granting of a license was independent of need. See § 5 of statute cited *supra* note 15.

154. Büchner, *supra* note 12, at 31; PROELSS, *op. cit. supra* note 49.

155. VAG § 8, as reprinted in PROELSS, *op. cit. supra* note 49, at 132.

156. Grundgesetz für die Bundesrepublik Deutschland, [1949] Bundesgesetzblatt 1, 2. See also PROELSS, *op. cit. supra* note 49, at 152-54. Before the new Constitution, there was a question whether the need test was ineffective because in conflict with the principle of free competition which was, in some sense, basic law in the western occupation zones. Büchner, *op. cit. supra* note 12, at 31. The earlier story of the need test in Germany is extensively treated in Finke & Pfeiffer, *supra* note 52, at 111-23.

157. See PROELSS, *op. cit. supra* note 49, at 152-54. The department's reaction to the development at the time it took place can be seen in Veröffentlichungen des Bundesaufsichtsamtes für das Versicherungs- und Bausparwesen, Geschäftsberichte [1952/53] at 25; *id.* [1953/54] at 15; *id.* [1954/55] at 14.

President of the regulatory agency,<sup>158</sup> now believe that the law is clear and that the need test no longer has any effect. Until its 1954–1955 report, however, the regulatory agency seems to have felt that the provision was still law, albeit somewhat qualified and to be applied with great restraint.<sup>159</sup> Even if the need test, as such, were no longer valid, the department felt it had some control over the admission of insurers because of the threat to solvency implied in an overcrowded market. It would only have exercised such power in extreme cases, however. Since 1955 the department has not mentioned the question in its official reports.

The “need test” is not the only place where varying attitudes about relative freedom of enterprise may manifest themselves in insurance regulation. For example, one of the requisites of safe and solvent operation of life insurance companies is the computation of reserves on a conservative basis. Arguing from this position, well-established life insurance companies have often urged the compulsory computation of the legal reserve on the “full net level premium” basis. By this is meant, for present purposes, that the contribution to the reserve of the first premium must be approximately the same as in subsequent years. However, the way the life insurance business operates leads to a very heavy concentration of expenses in the first year, including both the special expenses of getting the policy on the books and the largest part of the soliciting agent’s commission—ordinarily about half of the initial premium. The result is that the mortality or insurance cost for the first year, plus the first-year expenses, plus the full tabular reserve required by the full net level premium plan, is substantially in excess of the first year premium. This creates a problem of equity among policyholders which we have already discussed. It also creates a problem of solidity, perhaps not so great for large, well-established companies with big surpluses (for they can borrow the excessive expenditure from surplus and repay it in the future years of the policy) but very serious for new companies for which the drain on surplus may be too large to bear. The result of a statute prescribing the use of the full net level premium reserve is to give a competitive advantage to the established companies. Modified reserve plans are available which take account of the way the life insurance business operates and make it unnecessary to contribute such large amounts to the reserve in the initial year. All are actuarially

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158. Letter to the author dated Feb. 24, 1961.

159 See Geschäftsberichte, cited *supra* note 157. The changing view within the agency was paralleled in the postwar period by a general change in German public attitudes in the direction of a greater degree of economic freedom. One illustration is the recent enactment of an anti-trust law. Gesetz gegen Wettbewerbsbeschränkungen vom 27 Juli 1957, § 102, in [1957] Bundesgesetzblatt I.1081, 1100.

sound, in the sense that a company operating in accordance with any one of them is safe from risk of insolvency. They vary in many ways, and it is not important here to describe them in detail. They all remedy the imbalance between old and new companies, in greater or lesser measure, by reducing or eliminating the temporary drain on surplus resulting from the writing of new business.<sup>160</sup>

Thus, implicit in the most abstruse mathematical computations are policy judgments about the degree to which the value of freedom of access to the market is to be given effect. Changes in actuarial standards inevitably affect the "balance" between companies. It is most unfortunate that decisions are often made about actuarial standards on the assumption that they are merely scientific judgments operating without bias. It is interesting to note, in this connection, that in Sweden there is much discussion at the present time concerning the competitive implications of different methods of allocating costs. Insurance people feel keenly the broader implications of actuarial decisions.

Freedom of access to the market has other dimensions as well. Mere legal freedom to start a new company means little if a small group of companies is able to dominate the market and put outsiders at a disadvantage. Freedom from undue domination of the market is a value the implementation of which has special importance for the regulation of rate making and of marketing practices, and in particular for the control of rate bureaus and industry advisory organizations.<sup>161</sup> One further aspect of entrepreneurial freedom appears. Concentration of insurance assets in a few companies might not, in itself, affect seriously the balance of political and economic power in the modern state. But if the aggregate power of the insurance enterprise were affiliated with the power of the larger financial institutions, and this combination were used to dominate industrial corporations, the consequences could be serious. Fear of the consequences of interlocking directorates between major insurance and banking institutions was one of the factors leading to the Armstrong and other investigations and to the resultant reforms.<sup>162</sup> It must be acknowledged that the impact of insurance practices on the balance of political and economic power in our society seems not to be a very pressing problem in mid-twentieth century, however it may have stood half a

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160. See KIMBALL, *op. cit. supra* note 1, at 167-70.

161. The current controversy over the standing of the rating bureaus and their affiliated companies to challenge rate submissions of independent companies will serve to illustrate this point. See generally Comment, 58 MICH. L. REV. 730-53 (1960) for an able examination of the question.

162. See 10 STATE OF NEW YORK, TESTIMONY [and REPORT], *op. cit. supra* note 23, at 385-89; KIMBALL, *op. cit. supra* note 1, at 133.



century ago. Nevertheless, freedom of access to the market and prevention of domination of the insurance market and of the financial and industrial world generally by coalitions of powerful entrepreneurs are values which have many consequences for insurance law<sup>163</sup>

### 3 *Objectives Related to Capital Accumulation*

The level premium basis for life insurance, now all but universal, results in the aggregation by the life insurance companies of enormous sums of money to be converted into investments in business enterprise.<sup>164</sup> The fact that the life insurance company obligations are largely of long-range and fixed-dollar character leads to a pattern of investment control which results in extremely conservative investments, traditionally heavily concentrated in mortgages and bonds. Nor are life insurance assets alone in this conservative tendency. The investments of other insurance companies, as well as of savings banks and trust companies, lead to palpable downward pressure on the rate of interest for trustee-type investments. Not only does any decline in the rate of interest for conservative investments (in comparison with risky investments) increase the cost of life insurance, but it also encourages a top-heavy debt structure in the financing of enterprise, with resulting rigidity in the face of economic reverses. No doubt it is easy to exaggerate the danger and to ignore corrective tendencies automatically operative in our financial system. Current social policy demands that legal rules protecting solidity must not unduly encourage excessive reliance on debt in the financial structure of enterprise or compel investment in unreasonably unprofitable assets. One of the results of this policy has been a steady liberalization for many decades in the investment requirements applicable to life insurance companies. New powers of investment include limited powers to invest in common stocks, in income-producing real estate, and in unrestricted investments. The overwhelming importance of the objective of solidity has kept the process to a deliberate pace, but investment powers have expanded inexorably<sup>165</sup>

The large capital accumulations of insurance companies bring yet other policies into play. Whenever new social problems re-

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163. Notably in investment regulation. See, e.g., N.Y. INS. LAW § 85.

164. In 1960, life insurance company assets approached 120 billions of dollars. INSTITUTE OF LIFE INSURANCE, *op. cit. supra* note 1, at 62.

165. See, e.g., Bell & Frane, *Legal Framework, Trends, and Developments in Investment Practices of Life Insurance Companies*, 17 LAW & CONTEMP. PROB. 45-85 (1952), Comment, *Statutory Regulation of Life Insurance Investment*, 57 YALE L. J. 1256-75 (1948). The history of investment regulation in Wisconsin is treated in detail in KIMBALL, *op. cit. supra* note 1, at 129-43.

quiring large capital investment become pressing, insurance assets appear important as sources from which to draw the funds. Thus, if insurance companies had not acquired government bonds in enormous quantities in the early 1940's, it would have been more difficult to finance the war effort. In 1939, life insurance companies owned five billion dollars in U. S. Government securities, or about 18 per cent of their assets; in 1946, the amount had increased to nearly 22 billion dollars, or 45 per cent of assets.<sup>166</sup> The liberalization of investment regulation to permit investment in income-producing real property has helped solve housing problems born of war and depression. In these circumstances, it was only partly the need to relax investment rules for the sake of profit that produced the result; in part the result was produced by the social need to tap new reservoirs of capital to solve the pressing housing problems. Similarly, in post-war Germany the social role of insurance company accumulations has been clearly recognized in so-called special programs.<sup>167</sup> These basically voluntary arrangements between the life insurance industry and the German Economics Minister have helped to channel funds into the reconstruction of dwellings in devastated areas of West Germany and into the reconstruction of the more vital parts of the German industrial machine.<sup>168</sup> In the more difficult days of reconstruction there were even compulsory measures such as a capital levy to help channel capital funds into the areas of most pressing need.<sup>169</sup>

Thus, to the extent that life insurance assets constitute a major part of the liquid capital available for new investment in our economy, the life insurance companies must meet the social needs or bow to compulsive demands of society in the form of law. It is in vain to denounce such demands as immoral or as destructive of freedom of enterprise. The heavy concentration of new capital in institutional hands ensures that the institutions will frame policies to meet the social needs, either voluntarily or by compulsion.

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166. INSTITUTE OF LIFE INSURANCE, *op. cit. supra* note 1, at 67 Depression investments in government bonds were important too. As recently as 1930, the companies had only 319 million dollars, or 1.7 per cent of assets thus invested. *Ibid.*

167. See Veröffentlichungen des Bundesaufsichtsamtes für das Versicherungs- und Bausparwesen, Geschäftsbericht [1952/53] at 21.

168. See also FRITZ, DIE VERMOEGENSANLAGEN DER VERSICHERUNGSWIRTSCHAFT IN AUFSICHTBEHOERDLICHER SICHT 19-21 (Berlin 1958.) *Das Freie Vermögen der Lebensversicherungsgesellschaften*, [1958] ZEITSCHRIFT FUER VERSICHERUNGSWESEN 155-57.

169. See, *e.g.*, Gesetz über die Investitionshilfe der gewerblichen Wirtschaft, vom 7. Januar 1952, in [1952] Bundesgesetzblatt I. 7

### C. GENERAL PUBLIC POLICIES—DEMANDS DERIVING FROM BASIC MORAL VALUES

It is much more difficult to isolate the demands falling under this rubric, for aside from those so obvious as to be trite, most of the effects of moral attitudes are very subtle. It will suffice here to illustrate by three examples the implications for insurance law of basic moral values.

#### 1 *Gambling*

Insurance is an aleatory contract, with a certain payment on one side equated to a much larger but uncertain payment on the other. In the gross disparity of amounts and in the uncertainty of payment it is much akin to gambling. The Anglo-American public policy that has frowned on gambling contracts in recent centuries<sup>170</sup> has had impact on the insurance institution, helping to create the doctrine of insurable interest to distinguish permissible contracts of insurance from illegal wagers. Rationally considered, the insurable interest doctrine merely provides a way to test whether an insurance contract has a proper purpose. In borderline cases, where a decision is difficult to make, it has been important that a strong moral attitude lay behind the doctrine, giving it intense support. Otherwise there would surely have been a much stronger inclination to let the parties themselves make the relevant decisions about the validity of transactions of doubtful purpose.

The same objection to wagering has been one of the factors leading to the outlawing, in substantially all American states, of the tontine policy in all its forms.<sup>171</sup>

This moralistic attitude is by no means so strong everywhere, as is made evident by the combination of insurance with a lottery in post-war Austria and Spain and by the earlier use of this combination in the Saar.<sup>172</sup> The Austrians have explained their use of the lottery as an effort to bring the propensities of the people to gamble to aid in the re-establishment of the life insurance situation, after the weakening of popular confidence in it brought on by the currency depreciation consequent upon two world wars.<sup>173</sup> The European Conference of Supervising Services of Insurance Companies expressed disapproval of the combination

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170. The development is summarized in PATTERSON, *CASES ON THE LAW OF INSURANCE* 112-14 (3d ed. 1955)

171. See N.Y. INS. LAW § 216; KIMBALL, *op. cit. supra* note 1, at 164-67

172. See Records of the Third European Conference of Supervising Services of Insurance Companies, Rome, October 1-5, 1956, at pp. 741-47

173. *Id.* at 746, 963-64.

in its 1956 meeting,<sup>174</sup> and the German spokesman said that the proposal had been made often in Germany, too, but had been rejected there.<sup>175</sup> A number of other countries specifically prohibit the junction of lottery and insurance.<sup>176</sup>

## 2. *Risk Control and Prevention of Loss*

Insurance is mainly concerned with the distribution of risks; its safe and fair operation does not depend at all upon elimination or control of risks. A life insurance company can operate as effectively in a country with bad mortality experience as in one with good; a fire insurance company can serve as well whether there are many fires or few. Indeed, from the entrepreneur's point of view a higher loss rate means more premium income as well as higher loss payments, and thus a chance of a higher profit on larger volume. It also means more fear of the threatened loss and an increased use of insurance.

There is, however, an underlying policy objective of reducing economic and human waste which operates on the law governing the insurance institution.

This objective is at once evident in doctrines limiting the applicability of the insurance institution, particularly in the doctrine of insurable interest. Part of the thrust of the insurable interest doctrine is that it limits the sale of insurance to those situations in which the existence of a contract will not significantly increase the risk of loss. Thus, incentive to murder is repeatedly said to be one danger thwarted by the doctrine of insurable interest in life insurance, and incentive to arson by that doctrine in fire insurance. Likewise, discussions about the valued policy law in Wisconsin and elsewhere turned largely on the question whether the existence of such a law increased the likelihood of loss through carelessness or through deliberate arson.<sup>177</sup>

A wide variety of insurance industry activities, aided and supported by the law, seek to reduce the economic and human waste in insurable losses.<sup>178</sup> Here it is enough to say that the reduction or elimination of such loss is a pervasive aim of the law, and that no consideration of a new proposal in the insurance field is complete without an inquiry into the probable effect of the measure on the incidence of loss. This is not to say that the effect, even if it is considerable, is necessarily decisive. Moreover, the effect of novel proposals on the loss ratio is traditionally exaggerated by

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174. *Id.* at 747

175. *Id.* at 743.

176. *Ibid.*

177. KIMBALL, *op. cit. supra* note 1, at 240-46.

178. *Id.* at 288-300.

insurance men, who tend to rationalize opposition to novel proposals on the basis of danger to the loss ratio. For example, it has never been shown conclusively that the Wisconsin valued policy law had any adverse effect on the loss ratio, nor has the showing been made for comparative negligence statutes.<sup>179</sup> Nevertheless, insurance men continue to make the assertions. One can regard a policy of risk control as always relevant, without being influenced too much by facile assertions of drastic effect on the incidence of loss.

### 3 *Avoidance of Corruption*

It hardly requires mention that honesty in public and private life is an explicit policy of the law, reflected in many fields. This policy has impact on insurance law, too.

Corrupt relationships between insurance company executives and the New York legislature were among the reasons alleged for the Armstrong investigation.<sup>180</sup> Squandering of funds for which there was limited accountability under prevailing reserve laws, if not downright dishonesty with respect to such funds, was another reason for the investigation,<sup>181</sup> and led to the abolition of the tontine policy after the investigation was complete.<sup>182</sup>

An ever-present problem is the handling of insurance on public property or activities, for the distribution of the state's purchases constitutes a natural field for graft and corruption. Such dishonesty is not unknown in the distribution of the public insurance business.<sup>183</sup> Possible solutions to the problem, aside from closer policing, are creation of a state insurance fund to provide the insurance, and development of a plan for distributing the business so widely that all incentive to corruption is eliminated.<sup>184</sup>

## CONCLUSION

In the United States and Germany, and to a lesser but considerable extent in many other countries, insurance is subject to close regulation. Interference with free activity in the insurance market is especially noteworthy in a business which is highly competitive, which is generally well-run along conservative lines, and which presents no striking problems of domination of economic life or subversion of political processes. It is perhaps not easy to justify

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179 *Id.* at 242; Peck, *Comparative Negligence and Automobile Liability Insurance*, 58 MICH. L. REV. 689 (1960). No doubt the frequent assertions about the effect of direct action statutes are equally incapable of proof.

180. MOWBRAY & BLANCHARD, *INSURANCE* 462 (4th ed. 1955)

181. *Ibid.*

182. *Id.* at 463.

183. See KIMBALL & CONKLIN, *op. cit. supra* note 47, at 67-71.

184. *Id.* at 71.

such extensive regulation, at least in comparison with the freedom enjoyed by most other businesses of similar importance. If one seeks reasons, he is told that the parties to an insurance contract are not negotiators of equal weight in the marketplace, that insurance is an exceedingly complicated business selling a product which is difficult for its votaries to understand and impossible for most of its buyers, that the contract has long duration in many instances, that the uncertain payment coming at the end of the long delay is likely to be of crucial importance in the life of the policyholder. Although all of these things are true, it must be conceded that each of them is true of some other businesses as well. However, there is probably no other business to which so many of these characteristics apply in such large measure, and perhaps in the aggregate these factors justify the deep-probing supervisory activities of the modern insurance department.

All of these factors are in reality variations of the first, the disparity in bargaining power. This suggests that regulation exists to protect the weaker contracting party. It is not surprising, therefore, that marine and transport insurance and reinsurance have generally been subjected to much less control than other lines of insurance, for here the insurance buyer is likely to be as large as the seller, as expert, and as adept in the marketplace.

While protection of the weaker of two contracting parties explains the intervention of the state in the insurance transaction, it does not explain the myriad forms taken by that intervention. Beginning with the most obvious, the requirement of solidity is imposed because without it the business does not work at all, does not *insure*. This purpose is the first to be perceived after the decision has been made for government intervention; indeed, threats to solidity were the *raison-d'etre* of the early insurance departments. Once intervention has begun, new purposes begin to emerge, and the goals of reasonableness, equity, and fairness become explicit. Finally, as the insurance enterprise becomes more and more crucial to the social fabric and as regulation acquires more sophistication, the manifold purposes of society at large come to have more and more implications for the processes of insurance regulation.

There is nothing inevitable about the growth of insurance regulation from a simple focus on the solidity of the enterprise to a wide-ranging concern for many purposes. English regulation, for example, seems to have gone little beyond the purpose of solidity. Clearly, in the case of England this reflects neither an undeveloped state of the insurance enterprise nor an undeveloped sense of responsibility for the welfare of the people. In part it reflects a greater emphasis than we place on certain of the objectives we

have described, for the objectives are not all consistent with one another. In part it may reflect also an entirely different pattern of solutions which seek and achieve roughly the same ends. Thus the ease of access of new entrepreneurs into the American insurance market presents the American insurance departments with difficult problems of control—problems that do not exist in the English market, where few new companies are formed. Moreover, there is said to be a quality of sober restraint in English economic life that may make various kinds of regulation less necessary than here. Another relevant factor is the degree of self-regulation of the business. One may justifiably suggest as a hypothesis that the English pattern of regulation seeks the same goals as the American, but that the English social and governmental structure permits it to achieve the same goals with a lesser expenditure of effort than does ours. This would not be the first time that English society had managed to do a large job with a small investment in central government machinery. In its early centuries, the royal judicial machinery in England operated quite successfully with an investment in judicial manpower that was a mere tithe of that used on the continent of Europe.<sup>185</sup> Before one concludes that the English are less effective in achieving most of the goals we have described, or are uninterested in some of them, one needs to make a close comparison between the English insurance system and the American or German systems—and in considerable depth. The differences one thinks he perceives between the purposes of English insurance supervision and those of either American or German supervision may be more apparent than real. The difference may instead be a difference in the extent of the need for particular governmental controls. But this question requires much exploration before one can venture an answer.

It is usually assumed that the purpose of insurance regulation is single and simple. In reality it is neither. There are many purposes, and they are in considerable conflict with one another. Insurance is a small world that reflects the purposes of the larger world outside it. It is not easy, therefore, to state a theory of insurance regulation in which every activity will neatly fit. Perhaps it is even impossible. It seems likely, however, that more attention directed to the purposes of insurance regulation would illuminate the field and render it more meaningful, not by making it simple but by explaining the objectives in all of their complex interaction and in all of their conflict. Only thus can a theory of insurance regulation be developed as a meaningful guide to practical, everyday activities in the insurance departments of the world.

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185. See DAWSON, *THE HISTORY OF LAY JUDGES* 69–72 (1960)