

This is the outline of a presentation on the history of insurance given by Gary Simon at the Stern School on Sunday, March 5, 2000. The larger type face was shown on the overhead transparencies. A reference list appears at the end.

Insurance: Risk sharing

Many people pay to cover the losses of a few. This idea only works because losses are unpredictable.

Insurance has often been used as an investment. This is not a good idea.

Basic problems of insurance:

Fraud

- Fake losses

- Exaggeration of losses

- Criminal activity to create claims

Adverse selection

- Insurance companies will try to sell only to the low risk part of the population.

Group insurance

- Equal or unequal premiums within a group?

- Unintended consequences of grouping

Basic problems of insurance:

Failure of coverage

If insurance is accurately priced (premiums proportional to loss probability) then

- (1) Very low risks contribute little money to the pool.
- (2) Poor people who are low risks will not participate.
- (3) Poor people who are high risks will not participate, as they cannot afford the premiums.

Moral hazard

People alter behavior after getting insurance, unfairly increasing their risks.

Insurance is a contract, possibly long term

Requires

Stable government

Stable currency

Legal system

Earliest instances appear to be from Babylonia

Maritime shipments were insured

Supported by Code of Hammurabi, about 2250 BC

Egypt and China apparently were not innovators of insurance

Trener, pp 50-53

Insurance contract form spread

Babylonia → Phoenicia → Greece → Rome

Evidence of Greek contracts from about 350 BC

Greek contracts show details of security, loan period, interest rates

Greek insurance was considered risky, and it was illegal to invest money of orphans

Trener, p 10

Romans had the governmental structure to make complicated insurance

“Wager” insurance set up as a straight bet

“If my ship shall perish, will you pay me 10,000?”

Trener, p 17

Some specific dates:

215 BC Roman government insures merchants

49 BC Cicero had a contract with private persons to ensure the safe arrival of goods that he was shipping home

58 AD

Emperor Claudius
indemnified shippers against
storm loss

Trenerly, pp 130-131

Mutual aid societies handled costs of burials, 0 - 400 AD.

Trener, pp 18-28

Romans dealt with life insurance and annuities. Suppose that part of an estate is an annuity. How should this be valued relative to other items in the estate?

The jurisconsult Macer left a *responsum* advocating the use of a table by Ulpian for such purposes.

Trener, pp 150-151

ULPIAN'S TABLE

Age (years)	Expectation of Life, Years
Birth to 20	30
20 to 25	27
25 to 30	25
30 to 35	22
35 to 40	20
40 to 41	19
41 to 42	18
42 to 43	17
43 to 44	16
44 to 45	15
45 to 46	14
46 to 47	13
47 to 48	12
48 to 49	11
49 to 50	10
50 to 55	9
55 to 60	7
60 and up	5

Dublin et. al., p 31

Lorenzo Tonti, an Italian physician and banker, devised the tontine policy in the 1660s. The last survivor collects all the money. This is really not a very useful form of insurance, as almost everyone loses.

Kessler, p 187

This was modified into a governmental survivor's annuity. Each person pays and collects interest, but as people die out, the money going to those remaining will grow.

The first State Tontine was done in 1689 under Louis XIV in France.

Disappointing to most subscribers.

Last survivor, Charlotte Barbier, was drawing an annual income of 73,500 livres when she died in 1726 (at age 96); this was 245 times her investment.

Shulman pp 59-60

The first actual (term) life insurance contract.

1583 in London

Insured: William Gybbon

Employed as a salter (salting meat and fish)

Beneficiary: Richard Martin, relationship unknown

Gybbon died during the year

Underwriters refused to pay Martin on the grounds that the contract was for a year of 12 lunar months.

The courts ruled otherwise, and Martin was paid.

Kessler, pp 186-187; Shulman, pp 57-58

In England, it was legal to insure the life of anyone, even if the beneficiary had no link to the insured. The object of life insurance *did not even have to know* that his life was insured.

Shulman, p 64

Parliament in 1774 prohibited the issuance of insurance policies on people wherein those insuring had no legitimate interest in the insured.

Shulman, p 67

American Elizur Wright witnessed in 1844 the “selling” of life insurance contracts on old people in England who could no longer pay their premiums. Speculators paid the elderly, took over their premium stream, and became the beneficiaries.

Wright agitated for insurance reform in the US. In 1861 Massachusetts made a law requiring some form of term coverage for those with lapsed policies. In 1880 Massachusetts passed a cash surrender law.

Shulman, pp 73-76

Here is Wright’s quotation:

I had seen slave auctions at home. I could hardly see more justice in this British practice. If I should ever become old myself, I thought, I should not like to have a policy on my life in the hands of a man with the slightest pecuniary motive to wish me dead. This then is what has disgusted the sweetest songwriter in England [referring to B.W. Proctor] with life insurance. I soon found there was a reasonable act of Parliament against the issue of a policy in the absence of insurable interest on the part of the policyholder in the life of the insured, but no law whatever against the continuance of one, after all insurable interest had ceased; on the contrary, a judge-made law allowing it. I resolved, if I ever returned to America, it should be otherwise here, if my voice could avail.

INSURANCE IN THE UNITED STATES

Equitable

Started in 1859 by Henry Hyde

Innovation was high commissions to sales people

Passed control to son James Hazen Hyde

James Hazen Hyde, January 31, 1905, held party at Sherry Hotel (\$200,000).

James Hazen Hyde was bought out. He retired to France, and eventually he created "Poached peach à la James Hazen Hyde."

Shulman, pp 84-88, 98-105

Metropolitan Life Insurance Company

Started in 1863 insuring Union soldiers (bad idea)

Name Metropolitan, 1868

Marketed industrial insurance, 1879

Shulman, pp 95-96

Prudential

Started in 1875 by John Dryder

Sold industrial insurance

Took Rock of Gibraltar as its symbol

Kessler, p 68, 160

Kessler, p 160, notes the origin of the Prudential association with the Rock of Gibraltar. The motto "Prudential Has the Strength of Gibraltar" was devised in 1896 by Mortimer Remington, an advertising executive with J. Walter Thompson. He was inspired by rocks that he saw from his train window while travelling from Newark to New York.

United States insurance companies thwart regulation

William S. Manning published complete record of an 1877 investigation. The companies bought up the entire printing and gave Manning an annual retainer for the rest of his life.

Kenton, p 67

Armstrong commission investigated practices in New York, 1905. Charles Evans Hughes presided.

Shulman, pp 117-127

SBLI in Massachusetts, with urging of Louis Brandeis, 1907

Kessler, pp 234-235

Supreme Court found that insurance industry qualified as interstate commerce. Industry lobbied for McCarran-Ferguson Act, 1947. Insurance industry is exempt from Federal anti-trust laws; regulation is by states.

Kenton pp 67-68; Shulman, pp 168-176

Many anti-insurance diatribes were written in 1960s through 1980s. Examples: Gollin (1966), Shulman (1976), Kenton (1982), Kessler (1985).

HEALTH INSURANCE

Oldest instance in United States, US Marine Hospital Service, 1798

Field and Shapiro, p 57

Labor union insurance

US 1877 Granite Cutters Union (mostly income support)

US 1913 ILGWU had medical services (and a center in 1917)

Railroads hired physicians (issue was remoteness of work sites, not benevolence)

Field and Shapiro, p 54

Health insurance is not an ancient problem, as medicine was relatively cheap and quite ineffective.

Late 19th century concern was loss of income (or burial).

In Europe, this was by guilds, unions, mutual aid societies.

In US, there was a little by unions, but most was done by fraternal societies for burial (not sickness).

Government in health insurance

United States, 1885, first workmen's comp law
Alabama

1883 Germany starts government health insurance,

Bismarck, employer pays $\frac{1}{3}$ the premium

1911 Great Britain

Anderson, p 58

Serious effort in United States to get government health care, 1915-1920, failed.

Anderson, pp 59-80

US failure to get government health insurance

1915-1920 peak activity, AALL (American Association of Labor Legislation) led fight, not well managed as pure health and union issues got mixed
Government insurance was viewed as either Socialist (USSR, bad) or Germanic (also bad)

Insurance companies were of course opposed, but major opposition was AMA (American Medical Association)

Spurious argument by Frederick L. Hoffman

Anderson, p 80, gives some more about Frederick L. Hoffman, who resigned from the AALL in 1916. Hoffman really dragged out a lame argument. The suicide rate in Berlin (covered by Germany's socialized medicine) rose from 2.3 per 10,000 in 1900 to 3.8 in 1913. At the same time, it fell from 2.4 to 1.8 in Bronx and Manhattan. This is cited to Frederick L. Hoffman, *Facts and Fallacies of Compulsory Health Insurance*, Newark, New Jersey: Prudential Insurance Company of America, 1917, p 50.

Anderson, p 75, gives this quote by a New York physician:

Conceived in iniquity, nurtured in hypocrisy, struggling for deliverance at the frantic behest of socialist doctriners, compulsory health insurance should die a-borning. Nowhere has the swinish greed of the debasing propaganda of state socialism been more brazenly exposed than in this merciless attempt to steal the livelihood of the most unselfish profession in the world.

This is cited to W. P. Cummingham, "Health Insurance," *New York Medical Journal*, CVI, October 13, 1917, p 683.

There was opposition by Samuel Gompers, as it took away some union leverage. Anderson, p 77.

I am apprehensive that the attempts of government under the guise of compulsory social insurance for workers in cases of unemployment, sickness, and disability will result in every Government agent going into the homes and the lives of the workers as a spy. We have enough already of spies and detectives coming into the lives and workshops of the toilers. As long as there is one spark of life in me, of my mentality, whatever that may be, of my spirit, I will help in crystallizing the spirit and sentiment of our workers against this attempt to enslave them by the well-meaning siren songs of philosophers, statisticians, and politicians. [This was apparently his testimony before the House Committee on Labor.]

Franklin Roosevelt wanted health coverage, but opposition forced separation from New Deal legislation.

Harry Truman wanted health insurance

Anderson, p 113

Eventually Blue Cross eliminates the pressure for government health insurance

AMA came to terms with Blue Cross ideas (and doctors got rich).

Blue Shield plans for physicians were in all states by 1950. Blue Cross and Blue Shield used salesmen, but no commissions were involved.

Anderson, pp 120-121.

US government does do some health insurance

Medical care for veterans

Julia Lathrop's lobbying for Infancy and Maternity Bill (Sheppard-Towner), 1918-1921, was ultimately successful. Federal support for mother and child centers, passed 1921, was signed by President Harding. This expired in 1929 and not renewed.

Medicare started about 1967.

Group insurance in the United States

1912 Equitable had group life, group disability

1930 Baylor University Hospital Plan, Dallas

~1930 Community Hospital, Grinnell, Iowa

1934 Hospital plan, Associated Hospital Service of New York City

Big changes in World War II; group health was held to be a benefit not covered by wage and price controls.

HIP of Greater New York, 1946

Anderson, pp 157-163

Blue Cross in all states by 1950

Managed care, 1990s

FINAL CHALLENGE

In a brilliantly efficient capitalistic economy, why do we handle health insurance so badly?

Reference list

Not all the items listed below were used in the presentation.

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