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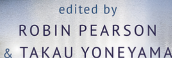
Corporate Forms and Organizational Choice in International Insurance

edited by

ROBIN PEARSON

& TAKAU YONEYAMA



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Robin Pearson and Takau Yoneyama

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1

Corporate Forms and Organizational Choice in International Insurance

An Overview of the History and Theory

Robin Pearson and Takau Yoneyama

The association of individuals to prevent or mitigate risks, or to compensate for losses caused by risk events, is an ancient impulse. Such associational or cooperative activity includes the burial clubs of the Roman Empire, medieval Europe, and Tokugawa Japan; the mutual aid associations of the Philippines, which rebuild barrio houses and dams after typhoons and floods; or the sea-rescue clubs of Senegalese fishermen.[1] Most mutual, non-profit, and non-probabilistic efforts at risk mitigation were private, voluntary, and informal. Sometimes, however, such efforts were organized, managed, or sanctioned by state-governing bodies. Examples include the public grain reserves of Chosun Korea and Imperial China, or the armed convoys protecting merchant caravans in medieval Europe.[2]

Given the infinite variety of risks and their contingent circumstances throughout history, it is perhaps unsurprising that insurance, from its infancy, also developed an extraordinary range of vehicles through which it was delivered. Yet we know little about how and why different insurance vehicles were chosen in the past, or why they survived or disappeared. Although there has been extensive research on the coexistence of contemporary mutual and stock company forms, the few historical studies in this area sometimes point to conclusions that confound economic theories or modern empirical results.[3]

[1] Platteau 1997; Pearson 2003a; Bankoff 2008.

[2] Sun et al. 2007, 598; Pearson 2010a, 2; Kim and Lee 2012.

[3] One example is the uncertainty raised by the history of mutual life insurers in the US about the influence of regulatory factors on the development of company forms. See Zanjani 2007. This and other examples of insurance history supporting or contradicting modern organizational theory are discussed in the following sections.

This book represents the first attempt to explore the foundation, survival, and performance of multiple organizational forms in the history of insurance, to situate these forms in an international comparative context, and to relate the results of historical analysis to modern organizational theory. The following section provides an overview of the development of organizations in insurance from the origins of the industry to the present day. The second section summarizes the theoretical and empirical literature on this topic. The final section describes the research project that underpins this book, outlines the contributing chapters, and points to some conclusions that have a wider relevance for modern theory.

THE HISTORY OF ORGANIZATIONAL FORMS IN INSURANCE

Modern insurance first developed in the Mediterranean trade of the late middle ages, although it had antecedents in the ancient world.[4] Individual merchants with surplus cash acted as underwriters for other merchants, while notaries were employed to draw up the contracts. By the early fifteenth century there were hundreds of notaries working in this field in Genoa, Pisa, Florence, Marseille, Milan, and Barcelona. Over time they helped to standardize underwriting practices in marine insurance, practices which were also adopted in northern European ports. By the early eighteenth century there were 150 specialist marine underwriters in London, fifty underwriters and several hundred brokers (not all broking insurance) in Amsterdam, and up to a dozen underwriters and brokers each in other Dutch towns.[5] Insurance underwriting and broking also came to be regulated and taxed by state and municipal authorities in Spain, Italy, Flanders, England, and the United Provinces.

This organizational form—with a merchant seeking insurance, a broker acting as intermediary, and a merchant or banker as underwriter—was in part dependent upon the nature of the risk. In the maritime trades each risk was relatively large, discrete, and short term—weeks for coastal tramping and for sea routes around Europe, up to eighteen months for transatlantic and African voyages. Few individuals had the financial capacity, or were willing, to undertake such liabilities entirely on their own account. Thus, the coinsurance of one risk by several merchants, each underwriting part of a ship and its cargo,

[4] Pearson 2003a.
[5] Spooner 1983, 27, 55–9; Cockerell and Green 1994, 5; Go 2009, 89, 130–1.

became the predominant form of marine insurance in the major European and American trading centres.[6]

The character of the risk, however, cannot have been the sole factor determining the form of early marine insurance, for there was already plenty of organizational variance. In England between 1720 and 1824 two joint-stock corporations had a monopoly of corporate marine insurance, but competed with the brokers and underwriters working out of Lloyd's and the Royal Exchange. In the coal, timber, and fishing trades of northeast and southwest England, numerous small mutual clubs for hull insurance were established by shipowners. These clubs did not breach the legal monopoly of the London corporations because each member underwrote a share in the risk for which he was individually liable.[7]

Similarly, in the Netherlands private joint-stock corporations were founded in Rotterdam in 1720 and Amsterdam in 1772, while in Groningen the guilds of skippers of peat-carrying smacks operated mutual hull insurance boxes. Box members' contributions were fixed according to the destination or the value of their ships and payments were made both to cover ship damage and loss, as well as illness and pensions to skippers and their families. The boxes remained competitive for over 150 years until the first private underwriters and brokers appeared in the Groningen region during the later eighteenth century.[8] Elsewhere, private joint-stock marine insurance companies emerged. At least eight were established in Trieste between 1766 and 1803, and thirty-seven in Hamburg between 1765 and 1807.[9] They coexisted with individual brokers and underwriters, with mutual organizations, with small insurance partnerships—as formed, for example, by British merchants in China—and with public monopoly corporations, such as those established, often for fiscal or mercantilist reasons, in Copenhagen (1726), Genoa (1742), and Naples (1751).[10] Some of the private companies combined marine with fire insurance and also wrote inland transport insurance on Europe's waterways. In Philadelphia, the first marine insurance company in the United States, incorporated in 1794, emerged out of a failed life insurance tontine.[11] The ease of state incorporation in the American republic led to thousands of such stock companies being formed in insurance and other sectors after 1790.[12]

[6] Ruwell 1989, 42–5.

[7] Raynes 1948, 186–7. On organizational forms in UK marine insurance, see Chapter 3 by Pearson and Doe.

[8] Go 2009, 54–8.

[9] Hamburger Feuerkasse 1976, 16; Rohrbach 1988, 172–9.

[10] Spooner 1983, 43–6; Rohrbach 1988, 234–9. On the first marine insurance companies in China, commencing in 1805, see Le Pichon 2006.

[11] James 1942.

[12] Between 1790 and 1860, 22,419 business corporations, including 2,121 insurance companies, were chartered by state legislatures in the US. Sylla and Wright 2013, 654–5.

This early variety of organizational forms was also found in other branches of insurance. From the late seventeenth century fire insurance developed via three basic types of organization—public, proprietary, and mutual. The Great Fire of London, which destroyed 13,000 houses in 1666, gave rise to all three forms. There were also many local cooperative or collective schemes, such as 'briefs', official letters authorizing *post-hoc* collections, sometimes compulsory, for the relief of victims of fires. Collections were organized at a county level in Denmark, for instance, and at a parish level in Germany and England. In England the collections died out with the rise of private fire insurance companies. In Europe they came to be regarded with antipathy, not least because they could be a means of fraud.[13] Rural mutual insurance unions also became widespread across northern and central Europe, in which villagers helped their neighbours with materials, labour, and money to rebuild houses and farm buildings in the aftermath of fires. On some landed estates, membership was compulsory for all tenants, with contribution rates graded according to the size of their holdings. In Austria, at their peak in the late 1880s, there were around 300 farmers' insurance unions with 320,000 members.[14]

In some early modern towns residents voluntarily combined to draw up 'fire contracts', written agreements between groups of property owners. Members, whose property fell victim to fire, received compensation from a mutual fund accumulated from *post-hoc* flat rate calls on members for losses incurred, calls that were not proportionate to the sum insured by each.[15] The difficulty of spreading risk in a confined area led Hamburg's senate in 1676 to combine all the private agreements in that town into one new insurance fund, the *Feuercasse*, to be administered by council officials. This was the world's first public association for the insurance of buildings. The new fund was accumulated from *ex ante* payments at fixed rates, but if this proved insufficient to cover payments for losses, members were liable for further calls at rates proportionate to the sums they had insured.[16]

During the following century similar public insurance societies, some with compulsory membership, were formed across northern and central Europe. They were essentially extensions of state bureaucracy and revenue, managed by civil servants. They had no corporate identity, the business often being administered from a desk in a government office as one of several public funds. No actuarial calculation or profit seeking was involved. The societies mostly charged flat fees regardless of the type of property or its location.[17] They usually excluded large and hazardous risks and restricted their business

[13] Briefs were banned, for instance, in Saxony in 1729, in Mainz in 1780, and in Bavaria in 1845. Arps 1965, 24–30.

[14] Rohrbach 1988, 145–52, 221.

[15] Zwierlein 2011, 226–8.

[16] On the Hamburg Feuercasse, see Chapter 6 by Pearson.

[17] A primitive risk classification was introduced by the *Hamburger Feuercasse* in 1753 and later by other associations.

to buildings, leaving owners and occupiers to insure goods and contents with private companies. Accumulated funds were used to pay for the rebuilding of property and to supplement other welfare expenditure. As towns expanded and the value of urban property increased, however, the public societies increasingly suffered from a lack of funds. As mandatory buildings insurance in the public societies began to be abolished by many states during the nineteenth century, private mutual and stock companies attracted an increasing share of this business.

In the market to insure household contents and commercial stock against fire, and buildings where this business was open to entry, mutual non-profit associations were often successful early movers. These had no share capital and all policyholders were voting members who participated in a periodic division of surpluses. Funds were accumulated from initial deposits by members upon entry, together with *post-hoc* levies or calls on members to meet losses. Operating costs were low and agency commission payments few or none. Three mutual offices together accounted for over half of all fire insurance premiums earned in London during the first two thirds of the eighteenth century.[18] As losses from fires increased towards the end of the century, however, the burden of calls became more onerous and enforcement more difficult. The London mutuals suffered liquidity problems and lost ground to the stock companies. One of them, the Union Fire Office, responded by demutualizing in 1805, possibly the first corporate demutualization in history.[19] By the early 1820s the fifteen largest fire insurers in the UK were all stock companies.[20]

In the US the earliest fire insurance companies, beginning in Charleston and Philadelphia in 1731 and 1752 respectively, were also mutually owned.[21] They generally insured only select residential properties within their home towns. During the early nineteenth century, town mutuals became supplanted by stock companies as the dominant form of property insurance provider in the US. By 1810 over seventy stock companies had received state charters to write marine or fire insurance or both. As demand rose, mutuals were found to be too selective and too restrictive in the amounts they would insure on single risks. One advantage of US stock companies lay in their links to banks and their ability to lend to policyholders and shareholders. The capital resources of the mutuals, it has been claimed, proved too limited for such purposes.[22] By 1900, the seven mutual fire insurers based in New York state

[18] Pearson 2004, table 2.1. [19] Pearson 2002.

[20] Pearson 2004, table 5.1. The UK's biggest mutual fire insurer of the time, the Norwich Union, converted to a stock company in 1821.

[21] Baranoff 2003, 34–40. The Charleston office was wound up following a large fire there in 1741. Cf. Hart 2012, 244.

[22] Baranoff 2003, 41–6.

wrote less than $37m, compared to the $6.5bn insured by the fifty-five stock fire insurance companies there.[23]

Large private stock companies, however, never dominated most insurance markets everywhere and at all times. The one exception was reinsurance, a major innovation of the nineteenth century. The specialist reinsurance companies that first appeared in Germany from the late 1840s were all stock companies. As Kopper has pointed out, this was almost certainly due to the nature of their business. As organizations that underwrote the surplus risks ceded to them from other insurers, reinsurers could not have been formed as mutuals owned by their policyholders, for the latter were competing companies who would have gained access to confidential information about the business of their rivals.[24]

Even in the US, the foremost land of the joint-stock corporation, mutuals remained important in some markets. Beginning in New England, factory owners who had been refused insurance by the stock companies, or who disliked their high rates, joined together to form 'factory mutuals'. These pioneered safety inspection and fire prevention technologies and focused on the best large manufacturing risks. Consequently, they were able to offer low rates to members who complied with their rigorous safety standards.[25] Factory mutuals also appeared in Europe, for example the Kiev Union for the Insurance of Sugar Refineries that operated in Russia before the First World War. Towards the end of the century, to save on the cost of commercial insurance, large enterprises such as Standard Oil began to establish their own internal organizations to insure their property and employees. These captive insurers have rarely been studied before, so Chapter 4 on Mitsubishi by Hisaaki Kamiya in this volume is pioneering in its subject. Self-insurance by big business became commonplace during the twentieth century. It was the trend, for instance, in corporate group insurance in the US during the 1970s, helping large employers to reduce costs while also providing an investment income from their self-insurance reserves.[26]

In many countries mutual societies competed successfully with public insurance institutions and private stock companies. In Russia, Sweden, Finland, and Germany large regional or national mutuals and numerous small local mutual associations together held between 35 and 60 per cent of their respective national markets before the First World War.[27] Econometric analysis has shown that Swedish mutual fire insurers enjoyed on average lower loss ratios (claims paid as a proportion of premiums earned) than their

[23] Baranoff 2003, 201. On mutual and stock insurers in the US, see Chapter 6 by Pearson.
[24] Kopper 2012. [25] Wermiel 2000, 104–37. [26] Graham and Xie 2007, 37.
[27] Estimated market shares calculated for Russia, *Assecuranz Jahrbuch* 14, 1893, 404; for Finland, *Assecuranz Jahrbuch* 16, 1895, 368; for Sweden, Hägg 1998, table 14; for Germany, *Assecuranz Jahrbuch* 10, 1889, 278; Gesellschaft fuer Feuerversicherungs-geschichtliche Forschung 1913, vol. 2, table XIII, 590.

joint-stock rivals throughout the period 1889 to 1939. It has been suggested that mutuals attracted low-risk customers, who, as owners entitled to a share in their company's surpluses, had a self-interest to act responsibly, thereby reducing moral hazard, although this relationship was qualified by other variables such as firm size, age, and leverage.[28]

In some places mutual organizations were more trusted by governing authorities and supported accordingly. They were particularly successful in British settler colonies.[29] By 1900, for instance, there were more than 150 farmers' mutuals in Canadian fire insurance, competing effectively with the stock companies there.[30] In North Africa mutual societies were established to insure French settlers against drought, hail, locusts, and fire. In Algeria and Tunisia, the colonial authorities made it compulsory for the Muslim peasant population to join provident societies.[31] From the 1860s through to the interwar years mutual and cooperative organizations were established among citrus producers in Palestine, farmers in Mexico and Spain, and ethnic immigrant groups in Argentina to provide a range of cover against hail and fire damage to crops and buildings, funeral expenses, pensions, workplace accidents, and automobile damage.[32] Some governments, for economic, political, or ideological reasons, introduced differential regulation of stock and mutual companies that favoured the latter.[33] Following Spain's Workplace Accidents Act of 1900, for instance, tax exemptions for mutual insurance encouraged employers to set up their own mutual schemes. By 1935 there were 155 Spanish employers' mutuals and seventy-eight farm mutuals competing alongside thirty stock companies.[34]

Mutual organizations remained powerful players in many non-life insurance markets throughout the second half of the twentieth century. In Canada 20 per cent of property and casualty insurance was accounted for by mutual companies in 2003. In the same year mutuals held about one third of the business in France and the USA, a higher level than had been attained in 1850 when the markets were much smaller.[35] In the early 2000s about half the Japanese population were members of not-for-profit agricultural and consumer cooperatives called 'Kyosai' and the volume of their business was increasing, not least because they generally charged lower premium rates than the stock companies. In 2004 Kyosai accounted for 11 per cent of the total assets of all Japanese insurers (life and non-life).[36]

[28] Adams et al. 2011.
[29] See the Chapters 7 and 8 by Verhoef and Keneley, respectively.
[30] Macpherson 1977. [31] Saul 2012.
[32] Martel and Rabetino 2012; Del Angel 2012; Borscheid 2012a, 357; Pons Pons 2012.
[33] See Chapter 9 by Pons on Spanish mutual insurers under Franco.
[34] Pons Pons 2010, 160. [35] Bernier and Nathan 2007, 411–12.
[36] Yamori and Okada 2007, 189–90.

In other non-life markets mutuals have declined. In Spain, for example, following a law in 1941 that eliminated some of their privileges, many mutual insurers became for-profit companies, though a large number continued to operate through the Franco years, especially in occupational accident and automobile insurance. In 1950 there were 256 mutuals with a market share of 21 per cent. By 1970 numbers had fallen to 150, accounting for 11 per cent of premiums. By 2003, after demutualization, mergers, and concentration, just forty-six remained.[37]

Various forms of mutual organization were also common from the outset in life, health, accident, and other forms of non-property insurance. In the later Roman Empire, and among the guilds and fraternities of medieval Europe and Tokugawa Japan, burial societies provided compensation from a mutual fund to the relatives of deceased members. In medieval Germany and Austria *Knappschaften* were formed to provide miners with sickness, accident, and death benefits. By 1850 they had become compulsory in the German mining industry and survived well into the twentieth century.[38] Across Europe mutual societies were established to provide a widow and her children with a perpetual annuity upon the death of her husband. Some were confined to particular groups such as physicians, lawyers, or military officers. Some states—such as France from 1671, England from 1692, and Austria from 1727—also directly provided pensions and disability allowances for key groups of state employees.[39]

By contrast, early private for-profit life insurance often took the form of gambling on the lives of famous people such as kings and popes without a legal insurable interest and was regarded by many authorities as morally offensive. From the fifteenth to the eighteenth century it became prohibited in many European states. Where a profit could be made for the public purse, however, governments willingly endorsed life insurance in the form of the tontine, a contribution scheme in which annual payments were shared out among surviving members. The first, abortive, public tontine was devised by Lorenzo Tonti in 1652 to raise revenue for the French royal treasury. It was followed by other state and municipal tontines in France, England, Germany, and the Netherlands. In London a wave of private tontines, reversionary annuity and mutual contribution schemes was launched in the early eighteenth century. These coexisted alongside the outright speculative wagers that were later banned in England.[40] Most of the early London societies were short lived, but the tontine remained a popular, if controversial, product which was later

[37] Pons Pons 2012, 204, 210; Rubio-Misas 2007.

[38] Guinnane and Streb 2011; Rohrbach 1988, 65–7.

[39] The dates refer to the foundation, respectively, of Les Invalides in Paris, Greenwich Hospital in London, and the first of the military hospitals in the Austrian Empire.

[40] Clark 1999, 73–85. Wager policies demonstrating no insurable interest were banned in England by the Gambling Act of 1774.

sold by companies alongside other forms of life insurance. Between the 1870s and the First World War, the biggest American life insurance corporations wrote a large quantity of tontine policies across the UK and Europe, in the face of fierce hostility from competitors and regulators.

From 1721 life insurance was also sold on a premium basis by the two English marine insurance corporations, who acquired the right to sell fire and life insurance under additional charters.[41] These offered fixed-fee and fixed-benefit plans by which company profits were dependent on correctly predicting the future mortality of policyholders. This was a more risky business for underwriters than the older redistributive schemes, where price was determined a posteriori. Not until the mutual Society for Equitable Insurances on Lives and Survivorships was formed in 1762 were age-specific premiums introduced. The success of the Equitable encouraged a number of new premium-based life assurance companies to appear. Some were funded mutually, but the majority raised a joint-stock. In part this might be explained by the rapid growth in the UK gilt, share, and bond markets. The equity raised from investors by stock companies gave them a purchasing power in these markets that mutuals did not enjoy. When the stock market slowed down, however, as in the late 1820s and early 1830s, more mutual offices were formed.[42] By the late nineteenth century mutual life insurers in the UK were significantly more efficient than their joint-stock rivals, both in terms of costs and management. They distributed higher bonuses on with-profits policies, earned better returns on their investments, and enjoyed greater longevity.[43]

In the US, as in Britain, research suggests that there was a correlation between periods of economic depression and the attraction of mutual forms of life insurance. The latter became more popular during the early 1930s as consumer distrust of stock companies increased. Zanjani has found that when capital was expensive insurance entrepreneurs preferred those organizational forms that required less capital.[44] Furthermore, it has been argued that in times of economic uncertainty, mutual companies, being owned by their policyholders, prove more able than stock companies to deal with the growing problems of moral hazard and asymmetric information.[45] This may also have held for the nineteenth century. According to Murphy, the initial rise of mutual life insurance in the US was the result of the tight capital markets and lack of investor confidence that followed the bank panic of 1837. Whereas

[41] Drew 1949; Supple 1970.

[42] Alborn also explains the preponderance of stock companies by the continued inadequacy of mortality tables in nineteenth-century England. The latter, however, was a problem for both stock and mutual offices and, in any case, mutual insurers tended to follow the age-specific rates of their stock counterparts. Alborn 2009, 46.

[43] Johnson 2010, 175–6; O'Brien and Fenn 2012.

[44] Zanjani 2007, table 5. [45] Smith and Stutzer 1995.

the first life insurance companies had been mostly joint-stocks, by 1850 the ten largest were all mutuals.[46]

After the Civil War there was a boom in new life insurance company promotions. Competition increased, margins became tighter, claims more contested, and bankruptcies increased, resulting in a massive loss of consumer confidence. Some of the vacuum was filled by not-for-profit fraternal, benefit, and cooperative societies that developed a huge market in health, accident, and death insurance for the urban working class. By 1920 one in three adult male workers in the US was a member of such societies. Cooperative insurance was successful because there was little alternative state or employer provision at the time and because it was low cost and charged non-actuarial prices.[47] After the First World War, however, the fraternals rapidly lost market share. Some have attributed this decline to competition from industrial assurance sold by large private insurers and to the introduction of social insurance and consequent crowding-out effects.[48] Some have pointed to the imposition of burdensome solvency regulations that had previously applied only to commercial insurers.[49] The slowdown of immigration after the war, and the assimilation of the ethnic communities that had been the main recruiting ground of cooperative insurers, may also have been a contributory factor.

In sum, the growth of life insurance was accomplished through a great variety of organizational forms. Alongside the emergence of large premium-based stock companies, both premium-based and assessment-based mutual societies held their own or even expanded in markets such as Sweden, Japan, and the Netherlands. In the US the share of mutuals fell to 50 per cent of life insurance in force in the 1890s, before recovering to 75 per cent in the 1910s with the mutualization of the three leading stock companies. This high level was sustained until the 1950s when decline began. By 1975 market share was again at 50 per cent. Thereafter decline was precipitous, driven by a collapse in the number of new mutual company formations and waves of demutualizations. By 2000 mutuals accounted for less than 10 per cent of life insurance in the US, their lowest share for nearly 200 years.[50]

Life insurance became the first branch to be widely subjected to regulation and state intervention during the nineteenth and early twentieth centuries, amidst concerns about protecting the public from fraudulent joint-stock promotions, from mutual offices with a weak financial base, or from industrial assurance companies with exorbitantly high administrative expenses and a high drop-out rate of policyholders. Regulation could seriously affect the organizational structure of the industry. In France the restrictions on share

[46] Murphy 2010, 168–72, 207–37. US life insurance before 1914 is further discussed in Chapter 6 by Pearson.

[47] Gottlieb 2007.

[48] Kantor and Fishback 1996.

[49] Zanjani 2007.

[50] Zanjani 2007, figure 2.

transfers, imposed on stock companies by a law of 1867, gave mutuals an advantage that they enjoyed well into the following century.[51] By contrast, deposit requirements introduced by many US states suppressed the formation of mutual companies.[52] In his study of US life insurance between 1900 and 1949, Zanjani found that the regulatory impact on organizational forms differed according to the nature of the regulation. Mutuals were formed most frequently in states with low capital requirements and with differentially higher ones for stock companies. As regulation increased capital requirements over time, and as the differential between the requirements for stock and mutual companies decreased, the mutuals' inferior access to capital markets became a handicap for start-ups.[53]

Direct state participation in the market has also affected the organizational structure of the industry in major ways. We noted above the abundant examples of this in early modern Europe. From the late nineteenth century many governments either set up mandatory schemes for unemployment, accident, health, and pensions insurance, invested in joint ventures with private companies, or established fully state-owned corporations with a partial or complete monopoly. Compulsory contribution employment-based social insurance first emerged in Germany in the 1880s with national health insurance, accident insurance, and state disability and old age insurance and this provided a model for many countries, although programmes varied greatly in terms of their coverage, organization, finance, and method of delivery. Some countries, such as Denmark (1892), Sweden (1891), and Belgium (1894), began with voluntary rather than compulsory schemes. In some places private health insurance providers who submitted themselves to state regulation received government subsidies.[54] Some state insurance schemes, such as the statutory pensions in Denmark (1891), New Zealand (1898), and the UK (1908), were initially non-contributory, means-tested, and funded through tax revenue. By contrast, statutory workmen's compensation insurance was generally sold by private companies, or, as in the case of the German scheme, by newly created, state-supervised mutual associations to which firms paid their premium contributions.[55] As the work of Guinnane and Streb has shown, in these types of state-mandated and supervised, but privately delivered, schemes, the nature of regulation could directly affect performance. The German miners' insurance associations before World War One found

[51] Straus 2012. [52] Murphy 2010, 117–20.

[53] Zanjani 2007. Others have also pointed to the costs of raising capital as a determinant of organizational choice in insurance; see, for instance, Harrington and Niehaus 2003.

[54] Winegarden and Murray 1998.

[55] Guinnane and Streb 2012. Similarly, in 1894 South African mine owners established the Rand Mutual, in response to legislation introducing compulsory compensation for mine workers. The Rand Mutual supplied the insurance while the state collected the funds from a levy on employers. Vivian 2007.

that their incentive structure was distorted by administrative processes and the rigid requirements of the Imperial German Insurance Bureau.[56]

During the twentieth century many public-private joint ventures appeared with widely varying levels of state investment. In Mexico, for instance, a life insurance company, *Seguros de Mexico*, was founded in 1935 with 60 per cent state ownership.[57] Fully state-owned enterprises also competed directly with the private sector. Uruguay established a state accident insurance company in 1911, the *Banco de Seguros del Estado*, which enjoyed a virtual monopoly in the country from 1926.[58] In Japan from 1916, and in colonial Korea from 1929, the government introduced a compulsory state-run industrial life assurance for workers, known as *Kampo*, delivered via the post office on a non-profit basis. It became hugely popular. In 2004 *Kampo* accounted for nearly one third of the total assets of all Japanese insurers.[59]

Reinsurance also became an object of mandatory state participation or control in numerous countries between the 1920s and the 1970s, often driven by the autarchic policies of military or nationalist regimes, and by monetary and exchange concerns and a desire to limit the flow of premiums abroad to foreign-domiciled companies. The usual procedure was to establish a national reinsurance corporation, either in whole or partial public ownership, and to pass legislation requiring private insurers to cede a certain percentage of their surplus risks to that corporation. Such a scheme was discussed in Russia as early as 1890.[60] The first state reinsurance vehicle appears to have been launched in Chile in 1927. Others followed in Turkey (1929), Iran (1935), Brazil (1939), France (1946), and Argentina (1948), and from the 1950s in many countries across North Africa and Asia. Most commenced with a partial monopoly, though this was often subsequently extended.

Full nationalization of other branches of insurance was debated in several countries during the nineteenth century, but it only occurred extensively during the twentieth century, particularly in communist and nationalist states, in dictatorships, and in countries newly liberated from colonial rule. Life insurance was nationalized in Italy in 1912, India (1956), Ceylon (1963), and Pakistan (1972). State monopolies for all lines of insurance were introduced in Russia (1918), Costa Rica (1924), China (1949), Syria and Burma (1963), Iraq and Cambodia (1964), Algeria (1966), Libya (1969), Yemen (1970), Afghanistan and Bangladesh (1972), and Laos (1975)—this list is not exhaustive.[61] The reasons given for outright nationalization derived usually from a mixture of autarchic economic policies and public welfare concerns.

[56] Guinnane and Streb 2011. See also Guinnane and Streb 2012.

[57] Borscheid 2012c. The Irish Life Assurance Company was formed in 1939 with the state taking an 18 per cent stake that increased to 90 per cent by 1947. Greenford et al. 2007, 573–4.

[58] Borscheid 2012c. [59] Borscheid 2012b, 526.

[60] *Insurance Times* 23, 1890, 20.

[61] Dates of insurance nationalization are from Kwon 2010.

Deregulation and liberalization since the 1980s have reduced the dominance of state insurance institutions, even under communist governments, but this can be a slow process. As late as 1996, after ten years of liberalization, the People's Insurance Company (founded in 1949) still accounted for nearly three quarters of the insurance market in China.[62] Nevertheless, more liberal insurance markets have seen important changes in their organizational structures with, for example, waves of demutualization, the growth of corporate captives, the formation of mutual holding companies, and the rise of bancassurance.

The late twentieth-century trend of converting mutuals into stocks has provoked a large volume of research. The demand for capital features prominently in economic explanations of this phenomenon.[63] Mutuals, having no tradable capital, are protected from predatory takeovers and from the volatility of share values that stock companies are subject to. When supernormal growth needed to be financed, however, access to the buoyant capital markets of the 1980s and 1990s became more attractive and demutualization more tempting.

Changes in regulatory capital requirements and the search to improve managerial incentives and business efficiency have also been proposed as factors explaining demutualization.[64] None of these are fully satisfactory nor explain why many mutuals did not convert.[65] The modern evidence for the greater efficiency of former mutuals after conversion is inconclusive or contradictory.[66] Historical evidence, as we have seen, also does not point to mutual insurers being less efficient than their joint-stock competitors.

Legal reform, the search for structural flexibility, and the desire of some mutuals to build links with non-insurance financials such as banks have also been suggested as catalysts for recent mutual-stock conversions.[67] The deregulation of financial services in many countries during in the 1980s and

[62] Sun et al. 2007, 600–1; Faure and Köll 2012.

[63] For example, the study of the demutualization of forty US property and liability insurers 1968–87 in Fitzgerald 1990.

[64] Mayers and Smith 1986, 2004; Viswanathan and Cummins 2003; Zanjani 2007. Better remuneration for company managers was found to be an important incentive to demutualize from a survey of the executives of over 340 US mutual insurers conducted in 1999, Butler et al. 2000.

[65] MacMinn and Ren 2011, 108.

[66] Erhemjamts and Leverty 2010 found that US life mutuals achieved significant improvements in efficiency after demutualization. Cummins et al. 2004 and Jeng and Lai 2005, however, report similar efficiencies of mutual and stock insurers in the US, Spain, and Japan. McNamara and Rhee 1992 examined the demutualization of thirty-three US life insurers between 1902 and 1986 and found a significant increase in capital and surplus, but also an increase in management turnover following conversion. Cagle et al. 1996 found no great change in the profitability of twenty-seven US property and liability insurers following demutualization between 1972 and 1988 and describe these conversions as 'neutral mutations' driven by changes in marketing strategy. Jeng et al. 2007 found only ambiguous evidence of efficiency improvements among US life insurers after demutualization in the 1980s and 1990s.

[67] Butler et al. 2000.

1990s had important structural consequences for insurance markets.[68] In Canada, for instance, following legislative changes in 1997, the four largest mutual insurers opted to convert to joint-stocks. This was followed by global expansion, greater access to capital markets, and their participation in cross-border mergers and acquisitions. By 2003 only 6 per cent of the Canadian life and health insurance market was accounted for by mutuals.[69]

Demutualization carried the serious risk of exposing a converted mutual to a hostile takeover. The Mutual Holding Company (MHC) was developed, in part, as a solution to this problem. The first conversion of US mutuals into mutual holding companies took place in 1996, but the corporate form has been also adopted in other countries, as Chapter 13 by Caruana de las Cagigas shows. An MHC was 100 per cent policyholder owned. It could own other financial companies but, as a legal mutual, it could not be owned by anyone other than its policyholders. It functioned as the parent company holding the capital of a newly formed joint-stock enterprise that inherited the assets and liabilities from the original converting mutual. MHCs allowed the managers of mutual insurers to claim that they were preserving policyholder value and the mutual ethos of their company, while at the same time acquiring the benefits of the stock company form, including access to capital for acquisitions and expansion. In the US a total of fifty-three MHCs were created in the life and health insurance industry between 1996 and 2003, including four of the ten largest demutualizations.[70]

Some stock conversions were used to bring mutual companies into larger financial groups, whilst also increasing managerial compensation through payment in stock options. Deregulation allowed other institutions, especially banks, to enter the insurance market. The phenomenon of 'bancassurance' took off in some countries. In the US large financial services holding companies emerged, especially in life and health insurance. In the Netherlands insurance came to be dominated by 'all-finance' groups such as ING and Fortis. In France bancassurers had acquired 62 per cent of the life insurance market by 2003. In Spain eight of the ten largest life insurers became affiliated with banks and used bank branches to sell their products.[71]

In sum, the private insurance industry has continued to expand through different organizational vehicles during the twentieth century, notwithstanding the growth of social insurance and widespread nationalization. In addition, the modern state has played an important role in risk mitigation in ways that have helped the private insurer, for instance by interventions to protect the

[68] See Chapter 13 by Caruana de las Cagigas and the papers presented to this project on demutualization in South African and Australian life insurance that have been published elsewhere: Keneley 2010, 2012; Verhoef 2012.

[69] Bernier and Nathan 2007, 411–12.

[70] Graham and Xie 2007, 75.

[71] Graham and Xie 2007, 39–43; Venard 2007, 296; Oosenbrug 2007, 489–90; Rubio-Misas 2007, 534–5.

public from insurer insolvency, or by disaster relief schemes that effectively subsidize areas that insurance coverage cannot fully reach. Among the former are the state guaranty funds in the US, first established in New York in the 1940s.[72] An example of the latter is the US Federal Emergency Management Agency, established in 1978, but with antecedents in federal, state, and municipal relief organizations earlier in the century.

The above survey has demonstrated that multiple organizational forms coexisted at an early stage in the history of insurance and, although some older forms declined or disappeared, others survived or revived and were joined by new forms of organization, or by adaptations of older forms such as captives, pools, holding companies, and fully nationalized or partially state-owned monopoly corporations. Two key questions about this phenomenon immediately arise, which several of the essays in this book address. First, why did this multiplicity of forms occur? What were the factors determining organizational choice in different places and at different times in history? Second, what was the impact on the insurance market, on its structure and performance, and on risk mitigation more generally, of diverse and competing forms of organization? The following section outlines the approaches taken and answers suggested to these questions by the modern economic and business literature.

THE ECONOMICS OF ORGANIZATIONAL FORMS IN INSURANCE

In the 1970s two main tracks, sociological and economic, emerged in the theoretical literature on organizations. The first proved largely to be a cul-de-sac. The second opened up diverse routes towards explaining the coevolution of different forms of business organization, especially in insurance. From the mid-1970s what appeared to be a paradigm shift in the sociology of industries occurred with the rise of so-called 'population ecology'.[73] Advocates of this approach aggregated companies into 'organizational species' and measured their distribution frequencies and density. They argued that the organizational population of an industry was the product of three Darwinian-type processes, namely variation, selection, and retention. The basic idea was that some forms of company were selected for survival or extinction according to their compatibility with the social environment that they operated in. Later, non-environmental predictors of survival or failure were added, such as the age

[72] Graham and Xie 2007, 34.

[73] Notable contributions include Hannan and Freeman 1977; Carroll 1984. The following draws on the useful summary provided in Budros 1989, 16–29.

and size of an organization. This ecological approach to organizations, however, eventually came under criticism for examining too narrow a range of variables and too few industries, and for the weakness of its empirical research. Indeed, one scholar writing in 1988 argued that population ecology theory had failed to contribute to a better understanding of organizations and should be abandoned.[74]

Despite such criticism, the population ecology approach has persisted in the form of 'community ecology' with a new focus on the relations between organizations and other social institutions within a particular place, sometimes with interesting results.[75] One recent work adopting this approach is by Greve and Rao on mutual business institutions in Norway.[76] They find that those communities that were the earliest to establish mutual fire insurance societies and mutual savings banks were the ones most likely (much) later to establish cooperative stores. They come to the interesting conclusion that an 'institutional legacy . . . amplifies variations in the civic capacity of communities', although the question is left open as to why certain communities and not others established particular types of institutions in the first place.

Economists writing about organizational forms have largely focused on a range of issues around the choice between mutual and stock forms of insurance.[77] These issues include the relative efficiency, performance, and ability of each form to resolve agency problems between owners, managers, and customers; second, the ability of each form to resolve adverse selection and asymmetric problems; third, the incentives to demutualize; and fourth, the impact of regulation on different corporate forms. The literature embraces several, often contradictory, models offering agency, uncertainty, and efficiency explanations for the coexistence of mutual organizations alongside joint-stocks, together with explanations of the reasons for conversion between the two forms.[78] The focus has usually been on insurance companies, but it has also been extended to banks and other financial institutions. Most attention has been paid to the agency problems that appear under conditions of asymmetric information, in particular moral hazards arising between customers, owners, and managers because of diverging interests.[79] According to agency theorists, mutual insurance arises in order to eliminate conflicts between owners and policyholders by doing away with the division between the two groups.[80] Intuitively, mutuals are free of the moral hazard to be found

[74] Young 1988. [75] Cf. Ruef 2000; Freeman and Audia 2006.

[76] Greve and Rao 2012.

[77] One notable exception is Hansmann 1996, who examined a range of ownership forms across all sectors, including manufacturing, banking, and insurance. The elements of Hansmann's model relevant to insurance are examined below.

[78] For a recent survey, see MacMinn and Ren 2011.

[79] The seminal article is by Fama and Jensen 1983.

[80] Fitzgerald 1986; Mayers and Smith 1988.