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'FREEDOM WITH PUBLICITY' — THE ACTUARIAL PROFESSION AND UNITED KINGDOM INSURANCE REGULATION FROM 1844 TO 1945

By P. M. Booth

ABSTRACT

From 1870, in the United Kingdom, a generally liberal legal framework for life insurance existed which commanded wide support, particularly from the actuarial profession. Despite its apparent liberalism, however, it is likely that the regulatory framework impeded market entry, particularly of mutual companies. The liberal framework broke down in a number of incremental steps from 1946. This paper traces the development of U.K. life assurance regulation for 101 years from the mid-Victorian period, analyses contemporary reflections on the legal framework within the actuarial profession, and examines the appropriateness of the legal framework for achieving specific economic objectives for long-term insurance regulation.

KEYWORDS

Insurance Regulation; Actuarial Profession; Actuarial History

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1. Introduction

In the main the attitude of the State towards insurance companies was to impose as little regulation as was possible. During the last half century, however, the activities of the State generally have taken on a more positive aspect than would have been thought right or proper in the individualistic Victorian period. Raynes (1948)

There is a general presumption that, until recently, the United Kingdom life insurance industry operated in an environment of 'freedom with publicity'. Indeed, this has been the phrase used to describe the U.K. regulatory system to generations of actuarial students (see Abbott, 1984, for example), as well as at professional meetings. The phrase 'freedom with publicity' implies an environment where insurance companies can act with complete business freedom as long as they publish their financial positions in such a way that it can be verified by independent actuaries and other interested parties.

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This paper traces the development of life insurance regulation in the 101 years up to the end of the Second World War, and evaluates more precisely its character in the context of the general framework of legislation which surrounded businesses and corporations. The paper also seeks to demonstrate the extent of the support within the U.K. actuarial profession for the system of regulation which developed, and analyses the debates which took place within the profession, and with actuaries operating overseas, on the efficacy of different systems of regulation.

We conclude from our analysis that the period from 1844 to 1945 was a period of very liberal life assurance regulation, though it was not *laissez-faire*. In particular, new entry into the market was impeded. The relatively free insurance industry environment had deep philosophical support from the actuarial profession and in wider political society. From the limited evidence which we consider, it appeared to provide a more conducive background for business than the much more restrictive regulation which existed in many parts of the United States of America. Also notable is the extent to which actuaries, at the professional meetings of the time, were very well versed in the principles of political economy expounded by contemporary writers. It is difficult to date the breakdown of 'freedom with publicity' definitively. There is further discussion of this issue in the Appendix. However, in 1946, for the first time, statutory minimum solvency margins were required if a company were to be allowed to trade.

We restrict our analysis to the business of ordinary life insurance companies — not including friendly societies or industrial assurance business. We also concentrate on regulation relating to the authorisation of insurance companies and the regulation of their solvency (generally known today as prudential regulation). Special regulation relating to the sales process, so prominent today, was absent during the relevant period. We ignore special laws relating to insurance contracts, such as the concept of insurable interest, trust law and tax regulations.

2. Life Insurance Regulation before 1870

The beginning of a new era in life insurance regulation arose from the 1841 Select Committee on Joint Stock Companies, which was appointed to examine 'bubble' companies, including those formed to carry on annuity and assurance business. The Committee reported in 1844. Before 1844, proprietary life insurance companies could only be incorporated through the passing of a specific Act of Parliament or by Royal Charter. The conditions for Parliamentary approval of companies were onerous. However, non-incorporated mutual societies and proprietary companies were established and partnerships could be set up. The Equitable Society, for example, was established in 1762. Ogborn (1962, Chapter 2) describes

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the society's unsuccessful attempt to obtain parliamentary approval for incorporation, including the expression, by Parliament, of the view that the business should make a financial contribution to the Exchequer in exchange for approval.

The Select Committee on Joint Stock Companies proposed that legislation be brought forward that would, on the one hand, encourage the development of life insurance companies, but, on the other hand, promote such regulations which were necessary to ensure that their obligations were met. This led to the Joint Stock Companies Act 1844, which required the registration of all companies, including assurance and annuity companies, and the registration of every balance sheet. Nicoll (1898, p186) and Ogborn (1962, p234) suggest that its provisions were evaded by insurance companies, because there was no specified form of the accounts and because there were insufficient powers available to the Board of Trade to ensure compliance: "forty-eight (companies) were formed in the four years 1845-1848 ... their average life was less than ten years." (Ogborn, 1962, p234) Furthermore, there were no penalties for disregarding its provisions (Walford, 1867, p402). The Select Committee's report which preceded the 1844 Act discussed the particular problems of assurance and annuity companies. For example, it stated that there should be prescribed: "such reasonable precautions as may be requisite to insure the faithful observances on the part of such Companies of the extensive obligations into which they enter with the public," (see Nicoll, 1898, p186). The Committee also took evidence from a number of actuaries (see Ogborn, 1962, pp232-233, and paragraphs 633 to 667 of the minutes of the Committee referred to below). Despite this, there were no special provisions in the 1844 Act relating to assurance companies.

2.1 *1853 Select Committee on Assurance Associations*

In 1852, a Parliamentary Committee on Friendly Societies looked at some particular issues relating to assurance companies. These issues were taken up further and in more detail by the 1853 Select Committee on Assurance Associations.

Walford (1887) discusses the events leading up to the formation of the 1853 Select Committee. Robert Christie, later described by Walford as the 'self-constituted champion of Insurance interests, in effect of the older Insurance Offices' (Walford, 1887, p443) had asked the President of the Board of Trade for "thorough scrutiny and investigations into the affairs and responsibility of every Life and Annuity Institution in the United Kingdom, with a view to such enactments as shall protect extensive public interests from the alarming prospective evils of fraud and of ignorance" (Walford, 1887, p443). In fact, Walford notes that, in the following 35 years, only one of the offices identified by Christie had a 'disreputable ending'. Nevertheless, Walford suggests that the holding of a Select Committee enquiry became

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imperative after a letter from the editor of *Post Magazine* (J. Hooper Hartnill) was sent to the President of the Board of Trade (Rt. Hon. E. Cardwell, M.P.), containing details of activities of life insurance companies which its author regarded as disreputable.

In its report, the 1853 Select Committee did not accept these pessimistic views of the insurance industry, stating: "With regard to the general condition of existing companies as far as any evidence has been laid before your Committee, they feel it their duty to report, that it is more satisfactory than they had been led to believe before they entered upon their enquiry" (Select Committee, 1853, Article VI). The report went on to say that, insofar as impropriety did take place, it was of the form of 'swindling', which was already in open violation of ordinary law.

In its report, the Select Committee summarised views for and against special life insurance regulation. In favour of regulation, the committee said:

> "On the one hand, even admitting the general wisdom of the principle of non-interference on the part of the Government in matters of trade, it has been contended that the question of life insurance differs so materially, in its general character, from ordinary trading transactions, that it may fairly be considered as an exception to that rule."
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> (Select Committee, 1853, Article VIII)

Two of the reasons given for that exception were that: "obligations undertaken by such associations have reference to a very remote and uncertain period; ... that, unlike any ordinary transaction of trade, a contract once entered into cannot be discharged or abandoned, if doubts about the stability of the Office should arise ..." (Select Committee, 1853, Article VIII).

Those arguing against government regulation, when giving evidence to the Committee, pointed to the 1844 Act, which, it was suggested: had done more harm than good; had provided legitimacy to offices which would not otherwise have been able to perpetrate fraud; and had undermined private prudence and vigilance (see, for example, Select Committee Report, Article IX). Indeed, the Select Committee (Article VII) recognised that it was valid to suggest that the 1844 Act might have done 'too much', and thus 'weakened individual vigilance', just as it was valid to suggest that the Act might have done 'too little'.

The major concerns of the Committee, expressed through their questioning of witnesses, related to whether there should be regulation requiring a deposit to be provided by companies, whether companies should have paid up or subscribed capital, and what form of accounting information should be published by companies. There were other discussions regarding the qualifications of actuaries,[1] and whether there should be actuarial supervision

[1] See, for example, questions and answers 3706-3732 which dealt with witnesses' views about the desirability of entrance examinations to join a professional association of actuaries and the role of government in that process. See also Section 4.

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by the Government, with government appointed actuaries having the power to investigate the financial affairs of a company.

The Committee concluded that life assurance companies should have special legislation applying to them; that the Registrar should be able to enforce the legislation, something which was not provided for under the 1844 Act; that all life assurance companies should be covered by the Act; that a deposit should be required of all new companies; and that a full quinquennial actuarial investigation should be performed and published and, in the intermediate years, that key financial statistics be registered.

It is worth noting that there was no suggestion that a particular solvency margin should be kept by insurance companies. It is also notable that there was no suggestion that investment policy, valuation techniques or premium rates should be regulated. This stands in contrast to the approaches taken to regulation, both in the U.S.A. and in continental Europe, as their markets developed.

2.2 *Developments from 1855 to 1870*

In 1855 an Act of Parliament was passed, amending the 1844 Joint Stock Companies Act and allowing limited liability joint stock companies. However, in 1856 a further Act was passed which specifically excluded insurance companies from its scope. Furthermore, this Joint Stock Companies Act of 1856 repealed the 1844 Act and the 1855 amending Act, thus creating considerable legal confusion and effectively preventing insurance businesses from incorporating as limited liability companies. The passing of a brief Act in 1857 restored the 1844 Act for assurance companies, but for companies formed between 1856 and 1857 the pre-1844 situation effectively prevailed. Furthermore, life assurance companies could not enjoy limited liability status whilst being registered as a legal corporation until the passing of the 1862 Companies Act, which applied to all companies[2] (see Macgillivray & Browne, 1937; Fitzgerald *et al.*, 1914). The proposals of the 1853 Select Committee, however, were not implemented at this stage. It is worth noting that the provisions of the 1862 Companies Act, as they applied to banks, insurers and related companies, required *limited companies* to make certain information relating to accounts public (see Walford, 1867). The tendency for bubble companies to form did seem to reduce in the 1860s, though it is difficult to ascertain whether this was due to the effect of the 1862 Act.

A proposed Bill relating solely to insurance business was put before Parliament in 1857, but it was deferred, because it was so close to the end of the parliamentary session. The Bill was discussed by the editor of the

[2] Because the 1844 Act, which was restored for insurance companies, did not allow for limited liability, unlike the 1855 and 1856 Acts.

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Journal of the Institute of Actuaries in 1859.[3] In the discussion it was suggested that there had been a remarkable improvement in the financial position of life insurance institutions in the last few years, which had tended to allay the desire for new regulation. It was further suggested that, whilst the 1857 Bill could have been improved, many were satisfied with the Bill, and its adoption would certainly have prevented the passing of a more detrimental Act. The editorial implied that a further Bill, presented in 1858 and also deferred, was, in fact, rather detrimental compared with the Bill proposed in 1857. Much of the 1857 Bill followed the sentiments of the 1853 Select Committee Report, including Part VI of the Bill, which required all life insurance companies to provide a range of valuation information to the Registrar of Joint-Stock Companies.

With the failure of these Bills, there was, in effect, no special legislation pertaining to the operation of life insurance companies during the early and mid-Victorian period. The 1853 Select Committee's recommendations had not been enacted. If this were, as is suggested in the *Journal of the Institute of Actuaries* editorial (*ibid*), because of financial calm in the industry, then this period was to come to an end with the failure of the Albert Life Assurance Company in 1869. The Albert was 31 years old, and had absorbed, at the time of its demise, 26 other life offices. The failure is reviewed in Walford (1887, pp453-454) and Nicoll (1898, pp206-207). When the Albert's original manager died, there was an investigation into its financial affairs, which discovered that, two years earlier, a large deficit had developed.[4]

The Government took action as a result of this failure and the failure of another office, the European Life Assurance Company, which suffered from similar problems to those of the Albert. However, Nicoll's later comment is worth noting (Nicoll, 1898, p207) that the wind-up of the companies was completed: "at very moderate cost, and apparently satisfaction to all parties". However, in the context of our later discussion, it is also worth noting that the legal structure to facilitate the winding up was incomplete. A special Act of Parliament was necessary to give an arbitrator (Lord Cairns) power to adjudicate on the financial rights of all parties in the case of the Albert. Had the special Act not been passed and the normal Court processes which had to be used before the 1870 Life Assurance Companies Act been followed, then a lifetime of litigation would likely have ensued (Walford, 1887, p254). A similar process to that followed in the case of the Albert was followed with the European.[5]

In a sense, the period 1844 to 1870 was a period of both freedom with

[3] Editorial comment, *Journal of the Institute of Actuaries*, 1859, **8**, 101-102.

[4] The deficit arose from The Albert over-paying for companies with which it amalgamated.

[5] Three arbitrators, Lord Westbury, Lord Romilly and Mr Reilly, were necessary in this case, as the first two died in office.

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publicity and 'freedom of publicity'. Insurance companies had significant freedom as to how they publicised their financial affairs. However, until 1862 it was also a period of legal confusion. From 1862, a legal framework for incorporation and limited liability did, at last, 100 years after the formation of the first major life assurance societies, exist. However, notwithstanding the legal confusion surrounding the repeal of the 1844 Act in 1856, the legislation did not work effectively, because its provisions were not enforced. Indeed, the Act did not even allow for the enforcement of its provisions. As was noted by the Select Committee, this could have had the effect of lulling potential policyholders into a false sense of security, making it easier for fraudulent companies to be created. The Act passed in 1870 attempted to address these problems.

3. Life Assurance Companies Act, 1870

The basic framework for life insurance regulation was set out in the Life Assurance Companies Act, 1870. There were some changes in detail in both 1871 and 1872, and the amended and consolidated Act became known by the short title, 'The Life Assurance Companies Act, 1872.'

3.1 *Information Provision Requirements*

The Life Assurance Companies Act, 1870 required companies doing business in the U.K. to make annual returns of their receipts and expenditure, and of their assets and liabilities.

A periodic detailed investigation of the financial condition of the company by 'an Actuary' was also required, although the term 'Actuary' was not defined. The investigation was to be quinquennial for companies established after the Act, but only decennial for existing companies (Section 7 of the Act). The purpose of this part of the Act was to enable the liabilities of the company to be estimated by outside, interested parties. The Act set out schedules for the information which should be provided to the Board of Trade. In fact, four actuaries, including Arthur Morgan of the Equitable, had given evidence to the 1841 Select Committee on joint stock companies. They suggested, at that time, the publication of valuations to enable the public to detect unsound companies. Morgan handed over examples of the Equitable's published statements (see paragraphs 633-667 of the minutes of the 1841 Select Committee) and, in effect, they became the schedules introduced 29 years later by the 1870 Act.

The basis for the calculation of liabilities was to be made public, but there was to be no statutory basis. The objective of these provisions was to promote greater publicity of accounts and to increase the flow of reliable information to prevent individuals contracting for insurance with companies which did not have the means to meet their existing liabilities.

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These particular aspects of the Act can be regarded as addressing the problem arising in financial markets, often described as 'information asymmetry', which was highlighted, but not described using that phrase, by the 1853 Select Committee. The philosophy behind the part of the Act requiring the publication of information was to allow all companies to trade, even if their margins of solvency were very slim, as long as they revealed their financial position. This is the approach which became known as 'freedom with publicity'.

It is worth quoting, at length, the editorial comment on the Act in the *Journal of the Institute of Actuaries*:

> "In future, when an actuary is asked his opinion of the solvency of an Office, he will no longer be compelled in many cases to say that he knows nothing of it for certain, and can give no information except from general repute. He will have materials at command, from which to form his own estimate of the solvency and stability of any Office in reference to which he may be consulted; and the opinions thus formed on trustworthy materials will be gradually diffused through the length and breadth of the country. The inevitable result must be that public confidence and support will be rapidly withdrawn from those Offices — few in number, we trust they will be found — that do not show themselves worthy of that confidence and support."
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> Editorial Comment, *Journal of the Institute of Actuaries*, 1870, **16**, p2.

3.2 *Deposit Requirements*

Section 3 of the 1870 Act required the deposit of £20,000 by every new Company with the Accountant-General of the Court of Chancery. The *Journal of the Institute of Actuaries* editorial (*op. cit.*) was highly critical of this provision of the Act. It suggested that it was a restraint on trade, and therefore did not follow the principles normally followed by Parliament on such matters. In particular, the editorial suggested that small societies, new societies and mutuals would be discriminated against. The requirement for a deposit was only for new companies, and the deposit was to be returned once the insurance fund reached £40,000. In the few insolvencies which arose, it became clear that the deposit provided little protection for policyholders of going concerns.[6]

The 1853 Select Committee had made clear their reasoning as to why a deposit was desirable. They believed that it was part of the process of establishing the *bona fides* intentions of the promoters of new companies *and* to provide security at the *early* stages of a company's existence. Nevertheless, there was a view held by many that the deposit should be used to help to ensure that obligations under contracts would be met. An Institute of Actuaries' resolution to this effect was passed in 1853, before the Select Committee met, and this resolution was put before the Select Committee (see Walford 1887, p445). Much later, the Board of Trade Committee set up in

[6] See the discussion of the National Standard Assurance below.

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1924 to review life insurance regulation made it absolutely clear that the purpose of the deposit was not, in any sense, to protect policyholders of long-standing going concerns, but to prevent speculative ventures (see Bateman, 1927). It was suggested in that report that the deposit would have to be 'enormously increased' if it were to meet the purpose of protecting the consumer in the case of insolvency (Bateman, 1927, p315).

3.3 *Separate Life Assurance Funds*

Section 4 of the 1870 Act required that a separate insurance fund was to be maintained in respect of life insurance liabilities. The life fund could not be used for purposes other than meeting life assurance liabilities.[7] The meaning of the phrase 'insurance fund' was ambiguous. However, it became clear that it related to an accounting concept (the accumulation of the balance sheet liabilities under the policies) rather than to a ring-fenced set of investments.

3.4 *Amalgamation and Winding Up*

Unsurprisingly, given the experience of insurance insolvencies arising from imprudent amalgamation, the Act also contained provisions relating to amalgamation and insolvency. The *Journal of the Institute of Actuaries* editorial (1870) suggested that these provisions would, in fact, be problematical to implement in practice.

Amalgamations under the Act would have to be approved by the Court of Chancery. The Court could not sanction an amalgamation or a transfer of business if policyholders representing one tenth or more of the total sums assured by a company involved dissented (Section 14 of the Act). It was argued at the time that: "There is, however, no doubt that the Act will place difficulties in the way of those legitimate amalgamations which are beneficial to all parties interested" (editorial comment, *Journal of the Institute of Actuaries*, **16**, p3). Strong insurance companies, for example, could have been prevented from taking over insurance companies which, despite being financially weak, were still solvent.

Courts were also to be involved in the winding up of insurance companies. In the case of most company insolvencies, a company is wound up when it is unable to fulfil contracts. Those who have contracts of value then have to make a case for compensation from the company's remaining assets, along with other creditors. Instead, with a life insurance company, under Section 22 of the 1870 Act, the court could order the contracts to continue at a reduced amount (reduced sum assured), instead of the company

[7] This provision was substantially unchanged until new composite insurance companies were prohibited under the First E.C. Life Directive, enacted in British law in the Insurance Companies Act 1982. Even this allowed the continuation of existing composite companies.

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being wound up. The company could then operate as a closed fund, perhaps after having been amalgamated with a financially sound company. If amalgamation happened, then the fund of the previously insolvent company would be a separate fund.

The *Journal of the Institute of Actuaries* editorial (*op. cit.*, pp3-4) suggested that there would be great difficulties for the court in determining whether a company should be wound up, and that actuaries giving evidence to the court would, no doubt, have different points of view. Nevertheless, this particular section of the Act seems reasonable. It is an arbitrary aspect of law relating to joint stock companies in general that, when a company is insolvent, contracts cease to exist unless agreement can be reached with all parties in a period of administration. This may be a reasonable provision for a company with predominantly short-term contracts, but not necessarily for a company writing long-term financial contracts, the beneficiaries of which may lose considerably if there is a full winding up of the company's activities.

These provisions for dealing with insurance companies which were in some financial difficulty or which wished to restructure resulted partly from the experience of the failure of the European. When the European became insolvent in 1869, significant legal costs were incurred in winding up the company (see Sprague, 1886) and in paying the policyholders' compensation. There was legal argument, for example, as to how to deal with the cases of impaired lives, who would find it difficult to find insurance elsewhere. Had the 1870 Act then been in existence, it would have allowed a court to reduce all sums assured proportionately, so that the business could continue as a closed fund. It is likely that such a course of action would have been to the benefit of all policyholders.

4. Contemporary Reflections on the 1870 Act

T. B. Sprague, Vice-President of the Institute of Actuaries, presented a paper to the Institute on 28 November 1870 (Sprague, 1871), and it is worth noting some of his comments on the Act. First, Sprague compared the system of regulation adopted in the U.K. favourably with the systems used in some states in the U.S.A. (for example, New York). Sprague suggested that the systems adopted in the U.S.A. were designed to prevent any insurance insolvency, something which he regarded as both inappropriate and impossible. In a trenchant defence of freedom of contract, quoting from J. S. Mill (Sprague, 1871, p83[8]), Sprague suggested that the U.S. approach would

[8] The lengthy quote from Mill's *Principles of Political Economy*, Book V began: "In all the more advanced communities, the great majority of things are worse done by the intervention of Government, than the individuals more interested in the matter would do them, or cause them to be done, if left to themselves ..."

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prevent innovation and competition from bringing many benefits to consumers. Sprague did not agree with the principle of the £20,000 deposit, and commented that it could prevent the entry of new and sound ventures (particularly mutuals[9]) and, far from discouraging fraud, the deposit would simply encourage those perpetrating a fraud to do so on a larger scale (Sprague, 1871 p93). Sprague welcomed the 'freedom with publicity' approach, but he did suggest that the Government could define certain standard contractual provisions (Sprague, 1871, pp91-92). He welcomed the suggestions of a German actuary Hopf (Hopf, 1870, p284), who had made proposals for restrictions on the investment of life insurance funds in Germany, and Sprague suggested that they could be applied in the U.K. It is difficult to see how such restrictions on investment freedom would have been compatible with the freedom of contract which Sprague trenchantly defended. No such limits on investment freedom have been enacted in the U.K.,[10] although they have long been a feature of German insurance regulation.

Sprague also commented that, by ensuring that insurance companies provided information to policyholders and to other interested parties, the state effectively absolved itself from any responsibility for losses made by life insurance companies.[11] This might contrast with a situation where the Government actually certified the solvency of an insurance company before providing it with a licence to operate.

Sprague ended his paper by saying that he felt that experience would only lead to changes in the details and not in the principles of the Act (p98). In this he was certainly correct, at least insofar as changes over the following 100 years were concerned.

In a paper presented to the Belfast Meeting of the British Association (Section F) (Sprague, 1874), Sprague suggested that the particular way in which contracts are valued should be made clear by insurance companies, and that it should be part of the contract that the reserve at particular ages should never be less than a specified amount. Interestingly, Sprague also commented: "The inconvenience ov the present state ov things, is that any person who, having satisfied himself ov the insolvency of a company, shoud be led by public spirit or other motivs to attemt to expose it, woud be

[9] There is evidence in the U.S.A. (e.g. Zanjani, 2005) that the popularity of the mutual form required discrimination in its favour in regulatory requirements. It is therefore possible that significant numbers of new mutuals would not have been formed in the U.K. after 1844, even if the deposit requirements had not existed. Many of the mutuals in the U.K. date from the time when incorporation of proprietary companies required a specific Act of Parliament.

[10] Some minor impediments to investment freedom did arise as a result of the U.K. adopting E.U. legislation in 1974, and the particular solvency regime in place from 2004 implicitly restricts investment freedom.

[11] "If persons, in the future, suffer loss as a consequence of insuring in unsound Life Offices, they will have nobody to blame but themselves; and the Government will be quite free from the moral responsibility to make good that loss ..." (Sprague, 1871, p98).

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liabl to an action for libel, which woud probably ruin him'' (*sic*)[12] Sprague (1874, p295). Sprague goes on to comment that *The Times* had lost an action for exposing the European, and had had to pay the European's costs: *The Times* was subsequently proven correct. The general point which Sprague is making here is that, with the U.K.'s libel laws, freedom with publicity might not have its maximum effect, because professionals would not always be able to pass an opinion on an office.[13] Nevertheless, the existence of a large amount of public information made it easier for insolvency to be detected and information about it to be disseminated than before the 1870 Act.

Whilst it is difficult to find then-contemporary calls from English actuaries for less liberal regulation, other than the thoughts above on investment regulation from Sprague, there were criticisms of various parts of the Act which were regarded as too restrictive.[14] The Institute of Actuaries' President in 1873, Robert Tucker (Tucker, 1873), in his opening address to members, stated that it was a pity that the English profession was not united, because, if it had been, it would have been able to make more effective representations to Parliament regarding the recent Bills. He described the Act as: "simply a nuisance to the sound offices, without being an efficient check upon the unsound ones'' (his remarks were followed by cries of 'Oh!' and 'hear, hear').[15] He was particularly critical of the returns to the Board of Trade under the fifth schedule.

Over the period 1870 to 1909, further comments were passed at various times upon the Acts of 1870 to 1872. At times the Acts were compared favourably with the situation which pertained in the U.S.A. In general, there was very little dissatisfaction expressed, although some particular practical amendments were proposed.

Sprague became President of the Institute of Actuaries in 1885. In his Presidential Address he said: "I think I may say, without fear of contradiction, that general satisfaction is felt with the working of the British Life Assurance Acts, and that neither the offices nor the public desire the introduction of a more paternal system of legislation on the American model'' (Sprague, 1885, p75). Some minor reforms to the Act were suggested by Sprague. The most

[12] Sprague was an advocate of a movement towards the standardisation of spelling on a more phonetic basis. He would use his own versions of spelling when allowed to do so in the *Journal of the Institute of Actuaries*.
[13] Sprague was not the only senior actuary to express concerns about the law of libel. In a paper read to the Institute of Actuaries, Cornelius Walford said: "laws against freedom of speech, more severe than those to be found in almost any other country, have been enacted here. The law of libel is essentially the rascal's paradise.'' (Walford, 1881, p26).
[14] Much earlier, Hendriks (1854), in a detailed discussion of the report of the 1853 Select Committee (together with an analysis of regulation elsewhere in the world), had been highly critical of a liberal approach, and had suggested that the 1853 Select Committee should have gone further in their regulatory proposals.
[15] Tucker (1873, p453).

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important of these was the suggestion that there should be more detail in the fifth and sixth schedules of the Board of Trade returns — the schedules dealing with the valuation of liabilities. Sprague did not believe that an external actuary could properly value the company without this further detail. Sprague believed that any amendment to the Act should be: "in the direction of requiring still greater publicity" (p76).[16] The purpose of more information provision, argued Sprague, should be to ensure that an external actuary could understand the solvency positions of a company, so that it would be possible for a court to identify, on advice, whether a particular company is insolvent and should, therefore, be wound up. He believed that the Act had led to the strengthening of life offices' financial positions and had increased public confidence in the industry (p76).

Deuchar (1891) showed statistics which illustrate a significant reduction in the number of companies discontinued after the 1870 Act. In the 18 years before the Act, 177 companies were discontinued. In the 16 years after the Act, 72 companies were discontinued (this number of 72 exaggerates the underlying number of companies with solvency problems for reasons explained below). However, there was an even greater reduction in the number of companies being founded (establishments falling from 78 to nine in the two periods, respectively, with only two establishments from 1877 to 1881). Deuchar suggests that this tendency can be attributed to the deposit requirement.

Whether Sprague's comment (Sprague, 1871) about the deposit being a restraint on trade was justified is not easy to judge in the light of this evidence, although the reduction in new companies being formed would suggest that this might well be so. Bailey comments in the discussion of King (1892) that: "in the present state of the law it was practically impossible for a new mutual life assurance company to be started" (p528).

Sprague also expressed concern about the impact of the deposit and the importance of new company formation in a letter to the *Insurance Record* (1 July 1873 — reproduced in Walford, 1887, pp460-461):

> "I believe I am right in saying, that all improvements in Life Assurance, of whatever character, have been originally introduced by new companies.... Speaking for myself, I say unreservedly, that I believe the system of Life Insurance, as at present practised in this country, admits of very substantial improvements ... and I shall view with pleasure the foundation and growth of a new company."

It is difficult to assess whether the deposit did prevent innovation in this way. There was certainly innovation and development within the life industry in the following decades, often responding to a very harsh investment climate (see Scott, 2002).

[16] This is also consistent with the comments in Sprague (1874).

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Deuchar (1891) commented favourably on the impact of the freedom with publicity regime: "and in that way, when an office gets into a bad condition, the truth soon becomes known." One comment is particularly interesting: "the full disclosure of the valuation basis required by the Act of 1870 has a decided tendency to favour the maintenance of high reserves by inducing offices to vie with each other in showing the safest basis rather than in declaring the largest bonuses." There was, it appears, no 'race to the bottom' in the freedom with publicity regime, something which is often feared when financial institutions have the freedom to set their own standards of solvency.

In an address to the Actuarial Society of Edinburgh in 1878, Deuchar (1886, p9) expressed concern about the way in which Board of Trade officials were using their powers under the Act. He accepted that the Board of Trade should be active "in pointing out to those offices which are considered defaulters in this respect [reserving insufficiently for future expenses], their duties and responsibilities," but then opined: "It is certainly to be deprecated, as contrary to the spirit of the Act, that a public department should express opinions on matters of principle connected with valuations on which competent authorities are not agreed." Deuchar (1886) also expressed concern that the absence of a provision for separated investments in respect of life policy assets meant that the security provided by the requirement for a separate fund was somewhat undermined (p22).

Calls for changes in the details of the returns provided to the Board of Trade were often made. King (1892), in a major paper on life insurance legislation, proposed a number of amendments to the returns to ensure more effective and earlier publicity of an insurance company's financial situation. In particular, King suggested that there was too little disclosure about assets in the returns. The President of the Institute of Actuaries, Newbatt, agreed with King in his contribution to the discussion of the paper (pp538-539). Nevertheless, the general approach of freedom with publicity was defended. For example, King criticised the approach of companies which treated new business acquisition expenses as an asset, but believed that, as long as it was clear in the accounts, this should not be a matter for regulation (King, 1892, p509). A modern defence of freedom in accounting matters is provided in Myddelton (2004), and it is interesting to compare the arguments of Myddelton and King, which are very similar.

There was criticism of the winding up procedures by King (*op. cit.*, pp520-526). Specifically, he suggested that the reduction of sums assured was being used to avoid winding up rather than as a method of winding up. This allowed shareholders to continue to have a positive financial interest in the company where insolvency and the reduction of the value of contracts did not lead to a winding up. In the discussion of King's paper, Bailey concurred with King's view (pp527-528), and there was no dissent.

Consistent with his belief in freedom with publicity, King was against

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imposing a uniform valuation technique and basis. King did, however, suggest that accounts should be certified by a qualified member of the Institute or Faculty of Actuaries and that the courts should have recourse to senior, independent, qualified actuaries when taking decisions about amalgamations and cases of winding up.

Teece (1885) comments on the 1870 Act from the perspective of a familiarity with U.S., Australian, New Zealand and U.K. law. In particular, a comparison with the very different system of regulation in the U.S.A. is instructive. It is worth quoting from Teece at length:

> "The leading principle of the English Act is in direct opposition to that to which I have alluded as the chief characteristics of American legislation. The latter, as I have shown, aimed at placing information in the hands of a State official, to whom the public were taught to look for protection. The English Act, on the contrary, aims at compelling the companies to make public this information, and then leaves the people to decide for themselves as to the solvency or otherwise of the corporations. America in effect declared that the people could not be trusted to discriminate for themselves; England, on the contrary, said, "give the people the information necessary to enable them to judge, and leave everything else to the force of public opinion, moulded by the criticisms of a free and unfettered press." (p355).

Teece then goes on to comment that he believes that most of the unsound companies have been 'weeded out' and the remainder are dying, and that the Act has justified the expectations of its authors.

Like Sprague, Teece did believe that more information should be provided in the Board of Trade returns. He also noted that the U.K. Act does not define what constitutes solvency — unlike the regulations in many U.S. states.

The paper by King (1892) and the subsequent discussion contained much debate on the relative merits of the U.K. and U.S. systems of regulation.[17] King, unlike some of the discussants, does not start from a position of principle.[18] He writes:

> "I cannot admit that any abstract principle, such as liberty of the subject, should be brought in ... If the Chancellor of the Exchequer was justified in his contention with regard to banks that the government may have, under certain circumstances, the right to interfere in the management, it can scarcely be denied that interference would also be justified in the case of life assurance offices." (King, 1892, p484)

Hardy, in the discussion of King's paper, then quotes, from newspapers of the time, sentiments favourable towards U.S.-style legislation. According

[17] A history of U.S. insurance regulation from its beginnings to 1945 is summarised in Shepherd (1948).

[18] Though, for someone who does not start from a position of principle, he has trenchant views on government officials! "To have a Government official who has, probably, been educated in red tape, interfering at every turn, would soon paralyse all energy and enterprise. He might be officious and fond of magnifying his office, or prejudiced and narrow-minded, or incompetent, or even corrupt ... At the best he would be narrow and ignorant compared with the aggregate of the profession outside the Government bureau ..." (King, 1892, p497).

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to Hardy, the articles suggested that, in order to be sure of the solvency of life insurance companies, it is essential that the state certifies their value. Hardy suggests that there are several other press articles of similar character, and that many people were crying out for government control. However, Hardy then comments: "The newspaper writers are often very far wrong in their facts." Furthermore, he states that: "In America, where Government supervision has been so complete, there are but few strong advocates of the system." He quotes several critics of the U.S. system, including Teece, who stated that, since the "introduction of Government supervision into the United States, more than 100 life offices, and nearly 400 fire and marine offices, have disappeared into the bottomless pit of bankruptcy." Hardy quotes a leading U.S. insurance newspaper at the time of a major bankruptcy: "We begin to fear that supervision of insurance companies by the state is a failure." In his response to the discussion, King noted that there had been only one failed U.K. insurance company in the 21 years after the passing of the 1870 Act that had not been known to be insolvent at the time of the publication of its first returns under the Act. He also notes that, of the 178 bankrupt companies mentioned in one of the newspaper articles cited by Hardy, only 27 of them ceased to exist after the passing of the Act; of the 27, 13 were closed almost immediately upon its passing; six transferred business; three were reconstructed or transferred with reduced contract values; and five (with aggregate premium income of £6,560) simply disappeared.

There was much further discussion of the merits of the U.K. and U.S. systems, which will not be presented here. However, it is worth noting two polarised points of view which illustrate the breadth of the arguments covered in the debates of the time. In the discussion of King's paper, Sheppard Homans from New York, first President of the Actuarial Society of America, defended the principles of the U.S. system, stating (discussion of King, 1892, p530): "There must be some interference [in the affairs of insurance companies by the government]. A life insurance company was the creation of the Government. It would surely be unsafe to allow any man or set of men to set up a company at will. It must have a charter, and it was only right and proper that some provision and control should be exercised by the Government."[19]

[19] Whilst Homans defended the *principle* of government interference, he was not in favour of the practical manifestation of that principle as it had developed in the U.S.A. In his obituary (*Journal of the Institute of Actuaries*, **34**, 144-147, 1898), Homans was described as "much opposed to the excessive Governmental supervision that obtains in much of the United States" (p146). In relation to insurance regulation in the U.S.A., it was stated in Homans (1897), in a paper which discusses very clearly some important general issues relating to the responsibilities of the states and the Federal Government under the U.S. constitution: "On the other hand, we have the stupendous interests of the life insurance companies — that is to say of policyholders and their future widows and orphans — which are hampered, perhaps even endangered, by numerous conflicting, discriminating, and unstable laws." (p335)

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Hardy, in his contribution to the discussion of King's paper, criticised the principles underlying Homans' view. Hardy strongly defended the 'freedom with publicity' approach. He suggested that existing common law could be used to deal with the situations of fraud which might arise in insurance companies. Invoking the sentiments of J. S. Mill, Hardy argued for the "support of the Institute for the principle of commercial liberty by which this country had largely achieved its present distinguished position, and which principle would carry it through many troubles, to which less happy and more bureaucratic countries were constantly exposed." (p534)

Calls for the amendment to some of the details of the 1870 Act continued. In his Presidential Address, Charles Higham (Higham, 1901, pp438-442) suggested a number of amendments. However, it is clear from his detailed discussion of the issues that such amendments related to technical issues (for example, the timing of the Board of Trade Returns and the application of the £20,000 deposit in particular circumstances), rather than to the principles of the legislation.

Unsurprisingly, many actuaries would have liked an 'actuary' to be defined in law, and for members of the Institute and Faculty of Actuaries to have a legally protected role in certifying certain valuations (see also Section 2.2). However, there was no desire for protection of the profession from competition. Nicoll writes thus:

> "From what has preceded, it would seem as if there had not been much in the way of aid or protection accorded by the State to the actuarial profession in the performance of its duties. Our Free Trade Government has, however, been rightly — as it seems to us — very chary at all times of seeming to favour any particular society, or set of individuals, more especially if that favouring was at all likely to be at the expense of other members of the community. It is really very doubtful whether the policy of non-interference is not, in most circumstances, the best for a Government to pursue; and, as regards the Institute of Actuaries, it is very questionable if it would have been so vigorous, or so surely founded as it is at the present day if it had depended, at its inception, on assistance or support in any form from the State." (Nicoll, 1898, pp169 and 170)

Nicoll then goes on to compare the vigour of the actuarial profession in the U.K. favourably with that in the U.S.A. which was, it appeared to Nicoll, crowded out by the state.

In summary, the contemporary reflections on the Life Assurance Companies Act, 1870 and subsequent amendments were largely favourable. There was little dispute about the principles underlying the Act, although not all views supported all major aspects of it. As would be expected, amendments to the details of the Act were proposed. Also, as would be expected, there was some discomfiture about the fact that an 'actuary' was not defined in law; the development of the legal recognition of an actuary with statutory responsibilities is discussed in detail in Daykin (1992). Views expressed on the Act from overseas were largely favourable, and the Act was generally compared favourably with insurance acts passed overseas —

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particularly in the U.S.A. At least as far as the actuarial profession is concerned, the overwhelming view appeared to be in favour of what was often described as the 'free trade' position. Some parts of the profession would have liked less intervention than that brought in by the 1870 Act. There were few calls for the kind of regulatory systems which existed elsewhere in the world.

5. An Evaluation of the 1870 Act

There are two main objectives of life insurance regulation which are outlined in the modern literature.[20] The first is to address the possible problem of information asymmetry.[21] The second is to address the potential problem of time inconsistency, leading to a lack of credibility of commitments made by long-term insurers.[22] This is related to a further issue, that of the difficulty of coordinating compensation to those to whom promises will not be kept at the time of a winding up. It is remarkable the extent to which the 1853 Select Committee intuitively understood these rationales for insurance regulation, as is clear from the statements in Article VIII of their report (see Section 2.1).

The 1870 Act (and subsequent amendments) broadly addressed these economic objectives of regulation. However, two criticisms of principle can be levelled at the Act, if the objectives of the legislators were, indeed, those suggested. The first criticism is that the deposit was only required for new companies, and was, in fact, returned when the company grew to a particular size. Secondly, and notwithstanding the above point, it also seems likely that the deposit was an impediment to market entry. If regulation is addressing the potential problem of commitment to long-term contracts, it would seem reasonable for the deposit not to be limited to new companies. It would also seem reasonable that it should be related to the size of the liabilities or the sum at risk of a company: if this had been done, it would have been an impediment to new entry to a lesser degree.

[20] See, for example, Morrison (2004). The literature on the rationale for life insurance regulation is very sparse compared with that in the banking area, although much has been written about information asymmetries more generally. See also the recent book by Plantin & Rochet, 2007).
[21] See, for example, Akerlof (1970) for the original theoretical exposition of this problem in a different context.
[22] This problem has particularly sparse treatment in the literature. Cochrane (1995) and Hendel & Lizeri (2003) provide good treatment of the problem of the insured not being able to commit to the assurer (for example, a healthy life leaving a pool of insured lives, so that the pool deteriorates from the perspective of the assurer). However, the commitment problem works in the other direction, as discussed by Morrison (2004). How does the insured know that the assurer will deliver its long-term promises? How does the insured distinguish, at the time when a policy is bought, between those companies which will break their promises and those which will not?

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However, the 1870 Act certainly had many qualities. Without interfering unduly with the freedom of contract, it addressed the problems in life assurance markets which had been analysed by the 1853 Select Committee. The Act did not prevent life insurance markets from thriving, even though new entrants may have been discouraged.

The appropriateness of the roles of the court in winding up and amalgamation is debatable. Their role in winding up can be regarded as a mechanism of ensuring the commitment of insurers to their long-term contracts. The court would ensure that contracts would be honoured as far as was possible, given the financial position of the company. For reasons explained above, this may be preferable, in a long-term insurance operation, to cancelling the contracts and requiring the insured to rank with other creditors. The role of the courts in amalgamation could, though, be regarded as an impediment to the development of the market — including markets in arbitration and private law. On the other hand, the court could be regarded as a third party protecting the contractual interests of policyholders, in a situation where commitments and contracts could be implicitly undermined by financial restructuring. The requirement of the Act for separate insurance funds for life assurance business could also be regarded as a minor inhibition on companies' freedom of action, yet it is also something which could strengthen the quality of insurers' commitments.

The success of financial regulation is not indicated by whether or not insolvency of financial institutions actually occurs. Policyholders may be content to take risks, even risks which they cannot evaluate, if they are appropriately rewarded. However, it is noteworthy that the 1870 Act was precipitated by the insolvency of major insurers, as was the discussion about life insurance regulation which took place in the 1850s. It is therefore of interest that virtually no insurance insolvencies occurred in the 45 years after the passing of the 1870 Act. Collins (1925) reflected on this fact:

> "Eight years ago when the author was asked to undertake the valuation of the policies in the National Standard Life Assurance Corporation, Ltd., which had been ordered to be wound up on the 6 June 1916, there were virtually no precedents to be found as a guide to the application of the rules contained in the sixth schedule of the above [1909] Act. This is really a cause for congratulation. It proves conclusively that, since the passing of the 1870 Act, no important failure has occurred. This bears out the dictum of the late Professor De Morgan that there is no commercial institution so safe as a well-managed Life Assurance Company." (pp152-153)

It is, indeed, quite remarkable that insurance insolvency was so rare in a period when solvency margins, or capital, were not, in any sense, regulated. Even the power of courts to reduce the value of contracts under the 1870 Act was rarely used. The first example of contracts being reduced (the case of the Great Britain Mutual Life Assurance Society) did not occur until 1880

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(see Regina versus Great Britain Mutual Life Assurance Society, 16 CD 246).[23]

Comparing the U.S. and U.K. systems of regulation in 1874, Sprague (1874) noted:

> "it is contrary to the spirit ov British legislation to interfere in any way with the internal management of trading companies. In the United States much more is don in this way than woud be tolerated in this contry ... This law certainly has the effect ov preventing the scandals in America, which we hav seen in England; but it may be douted whether this advantage is not too dearly purchast." (*sic*)

Sprague was hinting at a trade off between the costs of regulation and the potentially lower probability of insolvency. However, when this paper was republished in the *Journal of the Institute of Actuaries* in 1877, the author added a note qualifying his statement about scandals in the U.S.A. and the U.K.: "This was written in 1874. Subsequent events have causd (*sic*) the statement in the text to be no longer true." Failures in U.S. life insurance companies continued throughout the nineteenth century, despite the degree of regulation. Indeed, particular life insurance products were banned in the U.S.A. For example, after the Armstrong investigation (1905-06), tontines were prohibited (see North, 1954; Ransom & Sutch, 1987, for a discussion of this policy).

Indeed, insurance companies in the U.K. adapted effectively to the differing and sometimes harsh economic climates which existed between 1870 and 1946. A prolonged period of falling prices, the First World War and subsequent inflation, the Great Depression and the Second World War caused difficulties for insurers, but rarely caused insolvency. Indeed, some contracts will have been written around 1870 with an insurer, having survived *all* these adversities, and paying benefits close to the end of this period. One way in which companies adapted was by changing the orientation of their investment portfolios (see, for example, Scott, 2002).

Putting aside objections to the deposit requirement, in many respects the 1870 Act is the essence of good legislation. A small number of well-defined problems were identified and specific solutions to those problems were developed. No 'public choice' interest groups were created by the legislation which would attempt to spawn increased regulation. Government officials were not even employed to interpret the information provided on the returns — the information was merely made public. If the Board of Trade was dissatisfied with the returns, its officials could do nothing other than correspond with the company concerned and make the correspondence public. The principles of this legislation remained in place for at least 75

[23] Important legal clarifications arising from this case are discussed in Fitzgerald *et al.* (1914) and Macgillivray & Browne (1937).

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years. This is very different from the situation which pertains today, where a regulatory body has widely defined powers to achieve diverse objectives. The 1870 Life Insurance Companies Act can be regarded as a natural evolution of Gladstone's 1844 Joint Stock Companies Act, and the philosophy that underlays that Act, to meet some well-defined and specific attributes of long-term insurance business. It is also worth noting that the banking industry was treated very differently, being much more closely regulated than insurance companies.[24]

6. Developments in Life Insurance Regulation from 1873 to 1945

The next major development in life insurance regulation after 1872 was the Assurance Companies Act 1909. Besant (1925b) suggests that, from 1890, it had been felt in some quarters that amendment of the 1870 Act would be necessary. However, despite correspondence between the Board of Trade and various insurance organisations, including the Institute of Actuaries, as to how amendment might be effected, no specific legislation was developed. A House of Lords Select Committee sat in 1906, and reported on the position of British policyholders of foreign companies (see below). In 1909, an act relating to insurance companies was then passed. This repealed the 1870 Act. It brought all insurance, including non-life insurance, under the jurisdiction of one act. The changes to the provisions of the law as they related to life insurance companies were not substantial.

The 1909 Act extended the requirement for a £20,000 deposit to all life insurance companies. This included those hitherto not affected, because they were formed before the 1870 Act or because their funds had surpassed the £40,000 level. The 1906 Select Committee had noted that a deposit of £20,000 would provide little benefit to the policyholders of large domestic companies — for whom the deposit would not be great relative to the company's liabilities — but, if it were required for foreign companies writing British business, it would at least allow policyholders to take court proceedings against the company (Report of the House of Lords Select Committee on foreign insurance undertakings, paragraph 6[25]).

[24] Justifications for such closer regulation are well known, relating to the potential for 'runs', the impact of the failure of one bank on the payments system and so on. The implicit understanding of the reasons for regulating life insurance companies were well articulated in the actuarial profession. However, King's assertion above (King, 1892) that, because the Exchequer regulated banks, it could scarcely be denied that it should regulate life insurance companies, seems misplaced, though it went unchallenged in discussions at professional meetings. In King's defence, it could be argued that he was referring to abstract philosophical principles rather than to detailed economic arguments.

[25] It was noted by the Committee (also paragraph 6) that many foreign companies already held such a deposit voluntarily, presumably because it made them more attractive to customers.

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Thus, under the 1909 Act, all foreign companies undertaking business in the U.K. had to deposit securities worth £20,000 with the Court of Chancery. The amount of the deposit was still invariant with the liabilities of the company, and was held so long as there was a single British policy outstanding.

The House of Lords Select Committee discussed whether all insurance funds in respect of British policies sold by foreign companies should be held in Britain. However, it had had strong representations that this should not be required. The objections, cited in the House of Lords Select Committee report (paragraph 2), included that it would violate the principle that all the funds of a life assurance company should be available for the claims of all policyholders; it also might imply that there was a government guarantee of policy benefits; and, furthermore, such action might invite reprisals from foreign governments.

The 1909 Act defined different classes of business, and required that the deposit be kept for each class. These classes are defined in Section One of the Act as: life assurance, fire, accident assurance, employers' liability assurance and bond investment business. Many of the provisions of the Act required different classes of business to be treated as if they were written by separate companies for many purposes (for example a separate deposit was required, separate funds had to be held, separate returns to the Board of Trade filed, and so on). It may be thought that the inclusion of life business as one category would mean that there would be few practical implications of this requirement for life assurance companies. However, some aspects of business transacted by life assurance companies might well fall under other classes (for example, bond investment business and accident business). Thus, there were costs incurred by companies as a result of this subdivision.

Whilst the 1909 Act required the subdivision of funds arising from different classes of business, it clarified that separate pools of assets did not have to be held for each class (Section 3).[26] However, the company could not create prior charges ranking above those of the particular class of policyholder for each of the insurance funds. This provided some security for each class of policyholder, that the insurance fund would be used to meet the claims of that class rather than being used to meet obligations to providers of capital or holders of insurance policies of a different class. This principle is still followed today, and is regarded as important in the supervision of financial services companies with both banking and insurance

[26] Nevertheless, the precise meaning of the word 'fund' was still the subject of legal dispute in later decades. Coe & Ogborn (1952) describe the concept of the fund as an 'ambiguity'. See also the discussion of the 1927 Board of Trade Committee.

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interests, as it protects the banking business from losses in the insurance business (and vice versa).

Under the 1909 Act, an actuary was required to sign off the Board of Trade returns and valuations. The Board of Trade had the power to determine the definition of 'an actuary', and chose to define the actuary as a Fellow of the Institute or Faculty of Actuaries. Some non-fellows were allowed to sign off returns and valuations on application to the Board of Trade. This restriction on the definition of an actuary was the first reserved role for members of the Institute and Faculty of Actuaries in life insurance.

The 1909 Act was reviewed by a Departmental Committee of the Board of Trade which was set up in 1924, but which did not report until 1927 (Board of Trade, 1927). The Committee was set up in the wake of the crash of the City Equitable and City Life. As part of its report, the Committee produced a draft insurance Bill (The Insurance Undertakings Bill). The Departmental Committee was asked to address the questions of whether the powers of the Board of Trade to intervene in cases of insolvency were sufficient; the separation of the assets of different insurance funds in the event of insolvency; and changes to the Board of Trade returns to dispense with unnecessary detail and provide more information regarding the development of and changes to business written by a company (Bateman, 1927).

In fact, no further Act was passed until the Assurance Companies (Winding Up) Act 1933, which implemented some of the proposals of the 1927 Board of Trade Committee — though not its proposal for 'ring-fenced' assets in the insurance funds. The 1933 Act, for the first time, allowed the Board of Trade, with the leave of the court, to petition for a winding up if an insurance company was regarded as insolvent. Under the Act, the Board of Trade could also, through the court, request information from a company in order to evaluate its solvency. If the company failed to comply, this would provide further grounds for pursuing a winding up. It became clear that the powers of the Board of Trade to request information could only be exercised if it had *evidence* of the company being insolvent. An amendment to the Act in 1935 allowed the Board of Trade the power to request information if it had the *suspicion* of insolvency, and then it could appoint inspectors to investigate the company. The 1933 Act and the 1935 amendment gave the Board of Trade a degree of discretionary power which had not previously existed.

7. Contemporary Reflections on the 1909 Act

The main published discussion of the 1909 Act in the actuarial profession took place at the presentation of a paper by Barrand (1911). Barrand (p261) wondered whether the provisions to protect British policyholders of foreign

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companies would be adequate, and recalled the fable of the mountain in labour which brought forth a mouse. In opening the discussion of Barrand's paper, Coutts suggested that the only way to protect British policyholders of foreign companies was to require that their reserves in respect of British business were deposited in Britain. This was necessary, he said, because policyholders could not apply to the court for a winding up in the same way as they could in respect of British insurance companies. Coutts suggested (abstract of the discussion of Barrand, 1911, p320) that the requirement for a £20,000 deposit would provide little protection for British policyholders. This point was reaffirmed in Marks' contribution to the discussion (p324). He suggested that British policyholders had no better than a second claim on the assets of foreign companies. The reasons why the approach of requiring insurance funds of foreign companies to be kept in Britain was rejected have been noted above.

Ryan (1911) discusses the provisions of the Act as they relate to life insurance. In particular, he noted the potential problems for British policyholders of foreign companies and suggested that the strengthening of regulation was desirable to ensure that foreign companies selling policies to British citizens were treated in exactly the same way as British companies. (pp18-21).

Ryan also regarded the subdividing of insurance funds into different classes as valuable. However, despite this generally favourable comment, he then says:

> "One sighs for the old simplicity of an Insurance Company's accounts, and wonders whether all this mass of information conveys much to the average shareholder or policyholder. I fear these minute separations and subdivisions tend to make our returns an object of dismay to the non-expert mind, invaluable as they may be to the specialist as a storehouse of facts." (Ryan, 1911, p22)

In the discussion of Barrand (1911), several speakers expressed concern that the 1909 Act would make beneficial transfers prohibitively costly, because of the increased cost of providing information to policyholders. This fear seems to have been realised in practice. Much later, Besant (1925a), in his Presidential Address to the Institute of Actuaries, comments: "It may be added that the machinery provided for carrying through any amalgamation or transfer has proved to be so cumbersome and complicated as to render any such procedure almost impracticable under the Act." (Besant, 1925a, p17) Besant also suggested that methods of valuing assets should be disclosed by insurance companies, and that assets in respect of life business should be held separately from other assets of the business. However, Besant noted that 15 composite companies already did this; if the principle of freedom with publicity, whereby companies make public their procedures and financial situation, is accepted, it calls into question why such a provision would need to be enacted in law. A further proposal of

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Besant was for increased powers of intervention to be given to the Board of Trade.[27]

Also, in the discussion of Barrand (1911), several speakers, as well as the author himself, expressed satisfaction with the framework of the 1870 Act, and regarded it as desirable that many of the provisions of the 1909 Act mainly involved updating the 1870 Act.

8. An Evaluation of the 1909 Act

If it is the case that the additional information required by the 1909 Act is not useful, then the extended regulations were simply a bureaucratic inconvenience imposing unnecessary costs upon insurers. If the information is useful, but over-complex, for policyholders and individual shareholders, whether it is appropriate for the Government to compel its production is a moot point. As is clear from the discussions of the 1870 Act, the point of compulsory information provision is to resolve information asymmetry problems by ensuring the provision of information which experts (intermediaries, independent actuaries, etc.) could interpret in order to assess the strength of an office. It was not intended that it should be directly useful to policyholders.

Levine (1929), reflecting on proposals for further changes to the Board of Trade returns in the draft Insurance Undertakings Bill (see above), made a further important point about compulsory information provision. He criticised the draft Bill's proposals, but then made a more general point:

> "If only people would realise that uniformity often leads to stagnation! ... Anyhow I would appeal to those of you who will be responsible in the coming years for the valuation of the life business of Insurance Companies not to be deterred from seeking and experimenting with modern and improved methods of grouping and of classification and valuation merely because of these schedules." (pp21-22)

It is of interest that serious criticisms were made by the Financial Services Authority (FSA) of insurance companies in general, and of The Equitable Life in particular, for shortcomings in the development of innovative valuation methods for complex policies, such as those containing options, after the Equitable Life's recent troubles at the beginning of the 21st century. The returns and schedules which had to be provided by The Equitable were very similar to those in operation in 1925, and they actively discouraged

[27] These three proposals were all adopted by the 1924 Board of Trade Committee set up to inquire into the workings of the 1909 Act (see above). Besant makes these proposals, and then suggests that discussion of them would be inappropriate at that time because the inquiry of the Board of Trade Committee was in process (p24). The Committee included three senior actuaries, Phelps, Trouncer and Allin, one of them (Phelps) an ex-Institute of Actuaries President.

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innovative methods of valuation. Arguably, it was regulation itself which fossilised the approach to valuation and disclosure.[28]

Seven years after the 1909 Act a substantial insurance failure occurred, that of the National Standard Life Assurance Corporation. The assets of the company were so small that a reduction in the value of policies or transfer of business to another company would not have been worthwhile. A detailed analysis of that failure by Collins (1925) led to a discussion of possible changes to the 1909 Act. Collins himself (p164) suggested that no significant changes would be appropriate, but proposed some changes to the detail of the schedules provided to the Board of Trade. He stated that: "It is doubtful whether any Act of Parliament will cure the evil effect upon public confidence of failures such as these. Unless legislation will really prove effective it is a pity to trammel legitimate enterprise.'' The National Standard was able to continue to transact business whilst insolvent, because its insolvency was not clear to the public because its Board of Trade returns had been inadequate (Collins, 1925).

As has been noted above, the Board of Trade had limited powers if returns to it were inadequate. Hooker, in the discussion of Collins, proposed that the Board of Trade should be allowed to petition the Court for a winding up if it suspected that a company was insolvent. Such a proposal would not have been inimical to the principle of freedom with publicity, and could be regarded as remedying a quite specific coordination difficulty which policyholders might have in petitioning for insolvency themselves. As has been noted, the Board of Trade was given such powers in the 1933 Act. One disadvantage of this approach is that the insolvency of an insurance company is a subjective matter, so that one could find sums assured being reduced and a company being wound up, on the petition of the Board of Trade, even though the company might have turned out to be solvent.

9. Conclusion

The development of the organised actuarial profession began in the mid-nineteenth century, at a time when the legal framework for insurance was still developing. Before 1844 the legal framework prevented the establishment of insurance operations which took particular corporate forms. Nevertheless, many insurance entities were formed — particularly mutuals. For most of the

[28] Ironically, the statutory information published by The Equitable in 1998 would have been very similar even to the schedules proposed to the 1841 Select Committee on joint stock companies by The Equitable itself. The schedules were published freely by The Equitable before 1841, became enshrined in legislation in 1870, and remained more-or-less unchanged until the 21st century.

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period from 1844 to 1870, relative freedom existed for insurers, within a defined legal framework, similar to that which existed for other corporations.

The 1870 Act required life insurers to make financial information public, required a deposit to enter the market, and brought about court involvement in winding up and amalgamation. This was an extremely liberal framework of law compared with, for example, that in the U.S.A. and continental Europe, and compared with any period in the U.K. since the principles of the 1870 Act broke down from the mid-twentieth century. The regulation which did exist was directed at well-defined problems which seemed to be understood clearly at the time, and which have justifications in modern-day economics. The 1870 Act was largely unamended for over 75 years, and some of its principles endured for 100 years.

The principle of freedom of contract was supported by the actuarial profession, though not always by the press. Indeed, it is clear that there was a strongly embedded culture of free trade within the profession which had deep philosophical roots.[29] There were few calls for reserved roles and no calls for significant protection for the profession. This cannot be simply passed off as the self interest of those in the industry. Indeed, particular key industry figures did, from time to time, call for more substantial regulation of, and protection for, the life insurance industry. It was these figures, rather than those who wanted more freedom from regulation, who were regarded as pursuing a self-interested course.

The period of relative freedom for life insurance companies was accompanied by relative stability. The industry flourished and evolved through two World Wars and serious inflation, as well as the Great Depression and substantial periods of falling prices. For long periods there were no insurance insolvencies at all.

There are issues worthy of further investigation. One such area is the impact of the deposit on market entry and corporate structure (particularly restricting the development of new mutual companies). On the one hand, it is possible that new mutual companies were inhibited by the deposit requirement. On the other hand, it is possible that the regulatory framework established in 1870 (and arguably that established in 1844) helped to nullify some of the benefits of the mutual structure, because of the improved security and transparency of proprietary businesses.

[29] Alborn (1994) discusses the place of the actuarial profession amongst statisticians in the nineteenth century. He concludes that they were an empirical and practical group, and compares them with economists at the time. The classical economists were themselves empirical, seeking to understand real-world phenomena resulting from subjective decisions, rather than to design a regular or perfect world. There are, today, constructive tensions within the actuarial profession between those who pursue a more theoretical and equilibrium orientated approach and those who wish to follow a more empirical and subjective approach to actuarial problems.

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APPENDIX

A NOTE ON THE END OF 'FREEDOM WITH PUBLICITY'

There was no further major legislation from 1933 until 1946, which is when we date the end of the 'freedom with publicity' period. However, it is worth discussing briefly when the period of 'freedom with publicity' could be regarded as having ended, as this is a moot point. Others might regard the system as having lasted longer than 101 years.[30] The 1946 Insurance Companies Act introduced minimum solvency margins (set at £50,000) (see Finsinger *et al.*, 1985). Thus, for the first time, the state attempted to protect customers from investing in companies which were barely solvent. In practice, this probably made little difference to the regulatory regime. However, the 1946 Act did breach the regulatory principles established in the nineteenth century.

In 1967, Part II of the Companies Act gave the Secretary of State at the Board of Trade the power to prevent unfit persons being associated with insurance companies, as well as the power to control investments and otherwise intervene in the affairs of companies in certain situations. The 1967 Act also gave the Secretary of State powers to impose regulations on the format of accounts and of forms to be deposited with the Board of Trade (see Abbott, 1984). Previously, the necessary forms had been incorporated in primary legislation and rarely changed. Finsinger *et al.*(1985) date the end of the freedom with publicity period as 1967, because it gave a monitoring role to government officials which had previously been undertaken by market participants.

The Policyholders Protection Act 1975 guaranteed policyholders 90% of their benefits if their insurer became insolvent, with the costs being met by solvent insurers. This Act had the potential to increase moral hazard and, arguably, reduce the benefits of private monitoring by intermediaries. U.K. entry into the European Community led to the adoption of extensive rules relating to the valuation of assets and liabilities and the holding of solvency margins. This was enacted through the Insurance Companies Act 1981, consolidated into the Insurance Companies Act 1982. The period of 'freedom with publicity' in life assurance certainly came to an end at this time, if it had not done so already, although it is worth noting that the Government of the time, as well as much of the actuarial profession, may have differed from this view; in the 1980s, insurance regulation in the U.K. was still regarded as being very liberal compared with regulation elsewhere in what is

[30] Though it could also be argued that the Insurance Companies (Winding Up) Act 1933 gave power to government officials which ultimately undermined free trade by opening the door to much wider-ranging use of arbitrary powers, without reference to a court.

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now called the European Union. The sale of insurance products remained largely unaffected by specific regulation until the implementation of the Financial Services Act 1986. By this time the framework of insurance regulation, which had remained largely unaltered for a century from 1844 to 1945, would have looked very different to somebody who had operated under the regime of freedom with publicity.

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