briefing note
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Aug 2019

Death Benefits

In her latter years the author of To Kill a Mocking Bird*, Harper Lee, obsessively followed the case of a rural preacher, Reverend Willie Maxwell. The case gripped Alabama. Maxwell was accused of murdering five of his family for insurance money in the 1970s. With the help of a savvy lawyer, Maxwell escaped justice for years until a relative shot him dead at the funeral of his last victim. Despite hundreds of witnesses, Maxwell's murderer was acquitted – thanks to the same attorney who had previously defended the Reverend.*

*Lee had the idea of writing a true-crime classic like the one she had helped her friend Truman Capote research (*In Cold Blood*). Casey Cep's book,* Furious Hours*, details this history and that of the book that was never written. This extract provides a short history of insurance.*

"Before Lieutenant Henry Farley fired the first ten-inch mortar at Fort Sumter, there was not much of a life insurance industry *in* the United States. There was property insurance, of course, for ships and warehouses, and, appallingly, for slaves, but even the most entrepreneurial types in an entrepreneurial young nation had not figured out a way to make money from insuring lives. To know how much to charge people until they died, you had to know how long they were likely to live, which was impossible because companies lacked actuarial data; to maintain consumer confidence, you had to have enough money on hand to cover all death benefits, no matter how early or unexpected someone's demise, which was difficult because capital was hard to raise. The Civil War solved both of those problems, changing not only the way Americans died but how they prepared for death. By the time that Union soldiers had taken all the souvenirs they could from the house at Appomattox where General Lee surrendered, Americans were insuring their lives at record rates.

Although it took hold in the United States over the course of four short years, the life insurance industry was, by then, thousands of years old. Its earliest incarnation, however, looked less like companies selling policies than like clubs offering memberships. During the Roman Empire, individuals banded together in burial societies, which charged initiation and maintenance fees that they then used to cover funeral expenses when members died. Similarly, religious groups often took up collections for grieving parishioners to cover the costs of burial and to provide aid to widows and orphans. It was centuries before these fraternal organizations came to operate like financial markets, and it took one city burning and another one crumbling for them to do so.

The city that burned was London. One Sunday morning in 1666, at the end of a long, dry summer, a bakery on Pudding Lane went up in flames. The houses around it caught fire one after another, like a row of matches in a book, and strong winds carried the blaze toward the Thames River, where it met warehouses filled with coal, gunpowder, oil, sugar, tallow, turpentine, and other combustibles. By Monday, flames and embers were falling from the sky; by Tuesday, the blaze had melted the lead roof of St. Paul's Cathedral and the iron locks of the city gates. On Wednesday, the winds shifted, and the breaks made by demolishing buildings at the edges of the disaster finally held. By then, though, the Great Fire of London had destroyed more than thirteen thousand structures and left one hundred thousand people homeless.

One of the men who made a fortune rebuilding the city after the blaze was a medical doctor turned developer with the appropriately fiery name of Nicholas If-Christ-Had-Not-Died-for-Thee-Thou-Hadst-Been-Damned Barebone. (The hortatory name had been given to him by his father, the millenarian preacher Praise God Barebone. With his considerable profits, Dr. Barebone founded an "Insurance Office for Houses" that employed its own team of firefighters to protect the buildings on which it held insurance—five thousand of them, eventually. In an apt abridgment, the doctor became known around London as "Damned Barebone," not only because of the ruthlessness with which he ignored housing regulations and local opposition to his construction projects, but also because of the soullessness with which his firefighters responded exclusively to fires in homes where a small tin plaque indicated that the owners were clients. Barebone's "firemarks" soon proliferated in first-floor windows around the city, and the practice of paying a little money now to insure against larger risks later became more popular. Within a decade, Barebone had come up with another innovation in the field, one that paved the way from fire insurance to life insurance: he created a joint-stock company to finance his policies. The first of its kind, it allowed investors to buy and own stock in an insurance company, the way they already could in mills, mineral mines, and spice trades.

Newly able to attract investors, insurance companies could finally raise capital. But the value of any given life was uncertain—far more so, even, than the fluctuating prices of saffron or gold. Say a banker in Dover bought a policy and then lived another four decades; by the time he died, he would have paid premiums for forty years, and his policy would have matured enough for the insurer to provide the full benefit to his widow and still make a profit. But say the same banker went straight from buying his policy to visiting the White Cliffs and promptly drowned in the English Channel. In that case, the banker's wife would get the full benefit at a fraction of the cost, while the insurer, far from making a profit, would take a substantial loss. The success of insurance companies depended on being able to guess which scenario was more likely, dying of old age or falling off a cliff—in the utter absence of any actual information about aging, falling, or all the other myriad ways that people die.

Part of the reason that information didn't exist was theological. Devout Christians were not meant to concern themselves with the details of their deaths. Like the timing of the Second Coming, as Christ proclaimed in the Gospel of Matthew: "Of that day and hour knoweth no man, no, not the angels of heaven." God, who kept watch even over the sparrow, would provide, and to doubt those provisions by making one's own end-of-life preparations was thought to reveal a lack of faith. Thus was the life insurance industry caught between a math problem and God.

To make matters worse, the overall reputation of the insurance industry had been tarnished by the sale of speculative policies, a practice barely distinguishable from betting. You could buy speculative policies with payouts contingent on everything from whether a given couple got divorced to when a particular person lost his virginity—or, in one infamous case, if a well-known cross-dressing French diplomat was biologically a man or a woman. Such policies could be purchased in secret, and the purchaser did not need to have any connection to the "insured." These seedy practices, along with the obvious incentive to murder someone whose life you had insurance on, had led France, Germany, and Spain to ban life insurance outright. England, meanwhile, created the insurable interest standard, which mandated that an insurance policy could be sold only to the person being insured or someone who had an "interest" in his life—that is, an interest in his remaining alive. But not even those advances cleaned up the industry. They only encouraged a new kind of speculation, in which elderly, indigent, or ill policyholders auctioned their insurance policies to investors who bid based on how long they thought the seller would live.

Of these various obstacles to establishing a life insurance industry—spiritual, mathematical, reputational—the mathematical one was solved first. Everyone knew that death, while uncertain, was also inevitable, yet before the seventeenth century no one had even tried tracking it, let alone measuring life spans in particular populations or for specific professions. The closest thing to an actuarial table at the time was a Bill of Mortality, a grim British innovation that listed plague victims in various parishes around the country. In 1629, a quarter century after he commissioned a new translation of the Bible, King James I instructed his clergy to start issuing those bills for all deaths, not just the ones caused by plague. Later, around the time of the Great Fire, John Graunt, a London haberdasher who dabbled in demography, organized those bills, arranging twenty years' worth of death into eighty-one causes and making it possible to see when people were most likely to die and what was most likely to kill them.

Armed with population information for the first time, insurance companies began to get a handle on probability calculations, and soon enough a natural disaster helped ease their difficulties with religion. On the feast of All Saints in 1755, just before ten in the morning, one of the deadliest earthquakes ever recorded struck the city of Lisbon. When the shaking finally stopped—fully six minutes later, some records say—tens of thousands of people had died as homes and churches collapsed, and fissures up to sixteen feet wide gaped open in the earth. Not long after, the waters along the coast of Portugal drew back in a sharp gasp, exposing the bottom of the harbor. Throngs of amazed onlookers had flocked to see old shipwrecks newly revealed on the seabed when, nearly an hour later, the ocean exhaled and a tsunami washed over the city, killing thousands more. The scale of the tragedy was so vast that existing theodicies seemed inadequate, and all of Europe struggled to answer the existential questions raised by the Lisbon catastrophe.

In the course of that struggle, theologians found themselves competing with Enlightenment philosophers, who seized on the earthquake to offer a rival account of the workings of the natural world. If earthquakes were not divine punishments but geological inevitabilities, then perhaps insuring oneself against death was not contrary to God's plan but a responsible and pious way to provide for one's family. By the end of the eighteenth century, that idea had gained legitimacy throughout Europe. Once it took hold, religious groups, initially opposed to the entire notion of life insurance, became some of its strongest advocates, in some cases even starting denominational funds to sell policies to their members.

That practice eventually spread to the United States, where even today millions of Americans buy their life insurance through religiously affiliated companies like Catholic Financial Life and Thrivent Financial for Lutherans. But such developments were a long time coming. Unlike Europe, which had decades' worth of mortality tables by the eighteenth century, colonial America had little reliable information on life expectancy, making it difficult for insurers to set prices and underwrite policies. When companies did try to offer life insurance, there were often too many beneficiaries attempting to make claims at once and rarely enough money to cover them.

In addition, although most states required insurable interest, the American life insurance industry remained exceptionally vulnerable to fraud. Some policyholders lied from the start, fibbing about their age or forging their medical history. Others lied as they went along, violating the terms of their policies by traveling to restricted places (the malarial South, for instance) or by restricted means (by railroad, without the appropriate rider). Still others lied at the end, faking their own deaths or disguising their suicides as accidents. But calling out such lies was tricky. Contesting any claim was expensive, and litigation rarely resulted in denial of coverage, since jury members were far more likely to want to see their own policies honored than care about the profit margins of insurance companies. Moreover, whenever a company preserved its profits by denying a fraudulent claim—say, a father who had failed to disclose an illness, or a husband who had purchased arsenic a few days before he died—it risked damaging its reputation in the eyes of a skeptical public, who worried that their own heirs might be cheated, too.

As companies attempted to grow, they exposed themselves to even more fraud through their own lapses in judgment. Some of their agents approved policies too freely in an effort to earn larger commissions, while some managers invested assets too dangerously in an effort to earn larger returns. Spreading into new territories meant recruiting new agents, not all of whom were scrupulous, and the more geographically diverse a company became, the less it knew about the background, life, and likely death of its would-be customers, making arbitrage of any kind difficult. The expansion of the postal service in the second half of the nineteenth century enabled mail-based sales but also mail-based fraud, on both ends: nonexistent companies could market nonexistent policies by mail, while unscrupulous clients could send away for policies they might never have qualified for in person.

Individual states tried to protect consumers by setting deposit requirements for companies and restricting their investments. But those same protections slowed sales, because they required more due diligence at every stage of the process, and decreased investment returns, because they left firms with less freedom to take the kinds of risks that could make their stocks rise. Unable to sell as many policies, companies had to pool risks across a smaller population, which left them struggling to remain profitable. Eventually, however, an industry shift from stock companies, which were owned by investors, to mutual companies, which were owned by policyholders themselves, allowed insurance companies to free themselves from the capital game; instead of attracting investors, they needed only to recruit customers. That became possible due to the carnage of the Civil War, which did for the United States what earthquakes and fires had done for Europe: spread a sense of both dread and obligation around the country, creating a massive demand for life insurance.

The total value of policies increased from $160 million in 1862 to an incredible $1.3 billion in 1870. Within fifty years there were almost as many life insurance policies as there were Americans."