INSURANCE:
Facts and Problems

SELECTED LECTURES ON
BUSINESS ADMINISTRATION AND ECONOMICS

by

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HARPER & BROTHERS PUBLISHERS

New York *1938* *London*

Chapter VII

PREVENTION OF RISKS[1]

Far-reaching Prevention Work

The theory of insurance economics would not be complete without a discussion of prevention. Because insurance practice in nearly all its activities is more or less combined with efforts, often successful, to avoid the occurrence of the insured event, or at least is successful in diminishing it, the importance of prevention must be recognized. The classification of risks and the calculations of rates, whether in life or in fire, in marine or in social insurance, teach us how inseparably the coverage of risks and the effort to prevent them are united in the actual insurance.

This prevention work refers to all sorts of insured risks where the occurrence of losses would bring a real damage to a private household or to the nation's economy. Therefore it seems that only in such life insurance where the insured sum is to be paid out in case a certain age has been reached, does prevention not occur. There are policies to be paid out at a certain birthday or in case of military service or in case an insured child should marry. But in all other cases, life conservation plays an ever-increasing rôle because, in general, men are the most valuable capital of a nation.

Prevention is of principal importance, first of all, to social insurance. European social insurance, especially the German, taught the American insurance business the use-

[1] Lecture, Indiana University, Bloomington.

fulness and fitness of combining insurance with prevention. Now it is known that social measures, or at least a great many of them, tend to make business more profitable. To spend a substantial sum of money which brings about the speedy recovery of an insured who is suffering from some illness, which, in turn, will enable him to pay his premiums over a long period, is not only beneficial to humanity and society, but also profitable from the point of view of the insurer, whether the state or a private company.

A review of international prevention, justified particularly because it represents its world-wide evolution, gives us the following classification:

All actions which diminish or eliminate dangers and prevent damages insured by policies are:

1. Preventive, strictly speaking, if they are undertaken against the occurrence of a possible event; or
2. Diminishing the cost of coverage, if they anticipate the happening of an event, either too early, too strongly, or too frequently; or
3. Suppressing, if they make impossible the further extension of an event which has occurred.

Furthermore, the various means of prevention must be compared:

1. Prevention may have been ordered by the state or another public organization, country or town, etc.
2. It may be required by the insurer.

The accomplishment of the various preventive means may be through:

1. The insurer himself.
2. The consumer, either on his own initiative or at the request of the insurer.
3. A third person, but in accordance with the insurer.

Lastly, a comparison may be made between general preventive means and those which are ordered to apply in special cases.

The insurers' attitude in regard to prevention is similar to that of doctors in regard to the prevention of illness. An honorable doctor will not refuse vaccination or injections which will prevent illness merely because it will eventually be noticed in a decrease of his income. A conscientious insurer will not oppose the introduction of certified preventive measures because of the fear that the interest in insurance will wane considerably. However, all that is offered as effective damage prevention is not necessarily to be recommended.

In connection with this idea it must be mentioned that there are certain enterprises whose principal aim is to provide beneficial prevention of damages, as, for instance, suppliers of electric alarm apparatus, etc. Besides this, however, they also offer insurance as a guarantee to their customers. For the common good of all, special efforts should be made to bring about a peaceful and harmonious understanding between the prevention institutions and the insurance companies.

The idea of prevention is prevalent among the insurers perhaps more than they themselves will ever realize. This almost automatic tendency may be accounted for when the intensity and frequency of damages, which might be so great that the premiums would grow to be prohibitive, are taken into consideration. On the one hand, the consumer who is threatened most will be ready and willing to make use of insurance. This phenomenon is called the adverse selection of insured. On the other hand, the insurer prefers to find consumers who represent good risks, that is, who show a small possibility in regard to the occurrence of the insured event. This is the selection made by the insurer. It is therefore obvious that the insurer can help himself to get these good risks by furthering the preventive measures. To oppose these measures means that the insurers bring about their own ruin. For example, if the streets of a city of almost any size were more and more crowded with cars, the number of accidents would certainly increase. For this reason those car owners who are most exposed to danger will take out insurance policies, with the result that the damage ratio will be much higher, which, in turn, calls for increased premiums. But this does not mean an increase in the total number of consumers of automobile policies. On the other hand, a reduction in premiums would draw more policyholders. The number of insured could be increased by promoting the prevention movement, whereby the frequency of accidents will decrease.

Development of Prevention

The problem of insurance consists of its aim to reach the maximum of its beneficial effects, as well as to decrease to a minimum the disadvantages which might appear.

Yet there is a possibility that an insurance company may find itself in about the same condition with or without prevention. The costs which it will have to take care of, perhaps because of the lack of prevention in one case, may be equaled by the costs which a definite prevention program may entail. The whole idea of the calculation of rates is influenced by the efforts to diminish, if nothing else, all risks insured, because the premium rates are in proportion to the probability and the amount of losses. It is obvious, however, that the degree of prevention differs in the various branches of insurance, just as the probability and the amount of losses are not the same in every field. The opinion that prevention is exclusively the duty of social insurance no longer exists. This assumption is incorrect, even historically.

Prevention was well known centuries before social insurance existed. Its pioneers were the public fire insurance offices, which existed a long time before any private companies were even heard of. In Germany, for instance, these public offices spent a lot of money—and they are still doing so today—to promote the organization of fire brigades. However, it may be that the principles of the private companies' fire tariffs have been more effective. The introduction of highly specialized rates based on the inflammability of goods, etc., has educated the people economically in many countries. They were induced to build fireproof buildings, for the best fire brigades can do no more than diminish the losses after a fire has started; they cannot avert the occurrence of a fire as a fireproof building can.

The far-reaching combination of fire insurance with prevention is evidenced by the fact that in most countries premiums are reduced more or less, in favor of those insured who make use of sprinklers, automatic fire alarms, and other recognized preventive measures.

Prevention can be enforced by means of laws or similar public regulations such as are customary in social insurance, or through the addition of clauses to the insurance contract. In several countries there are, besides the policy conditions, special surety prescriptions which, if not observed, may make void the protection guaranteed by the insurer.

In the United States it is no longer necessary to teach that prevention is anything but the enemy of insurance, because experience has amply taught that no matter how much prevention there may be, the occurrence of losses is never completely eliminated. The United States is still leading in the highest accident figures.

The pamphlet "Accident Facts," published in 1937 by the National Safety Council, shows accidental death rates per 100,000 population as follows: Average of 16 European countries, 38; Australia, 51; Canada, 53; the United States, 78. There are many reasons for this. It may be that the application of technical measures which are sufficiently developed may be too expensive. There can never be anything more than a relative prevention of losses, a limitation; the exclusion of the occurrence of risks is impossible. It should never be forgotten, however, not even by the most enthusiastic supporter of insurance, that from the point of view of political economy it is always more important to avoid and suppress the occurrence of economic losses, than to let them occur and then distribute the payment of losses by means of insurance. The United States gives us the best example of the fact that a large extension of preventive work is no impediment to the expansion of insurance, which still continues all over the country. On the contrary, it has proved exactly the opposite.

Lloyd's of London offers another good example. From its beginning, centuries ago, this largest marine insurance organization, whose members are purely capitalistic, has furthered the surety of ocean-going ships by improving the news service, the classification of ships, the construction of boats, etc., besides the marine insurance business itself.

Just how much prevention can be applied to a certain case depends upon the nature of the cause of damage. Prevention is usually impossible in the case of events which are due to the elements, such as hail, rain, storm, earthquake and volcanic eruptions. But, nevertheless, even in these cases certain measures can be introduced to reduce the amount of losses. For instance, when possible, in districts where hailstorms are recurrent, crops which are less harmed by hail may be grown. Preventive measures are most possible in cases in which the action or inaction of men is the event insured against, such as crime on the one hand—burglary, robbery, embezzlement and forgery—and negligence on the other—for example, on the part of a driver.

In any case, the most important factor is that of economy. This means that there must be a reasonable relation between expenses for prevention of all kinds and the amount of the possible losses. If, for instance, the damage from hail could be prevented by firing a great number of guns in the belief that this keeps the hail away, this would not be employed very often, if at all, for the expense of the ammunition would be much greater than the possible damage payment necessitated by the hail.

Variety of Preventive Measures

The measures which may be applied to prevent the occurrence of insured events present a large variety; they begin with safety education and training in the elementary schools and go on to the use of the most complicated apparatus. These measures—fireproof buildings, careful driving, using lights in the streets, securing the safety of steamers and their passengers, prohibiting the sale of poison without medical prescriptions, etc.—are very often used, not only because they benefit insurance, but also for general reasons of safety, hygiene, etc.

Besides these measures which are introduced without specific application to insurance, interesting preventive measures have been initiated by the insurers, which are of importance not only to them but also to the community as a whole, as, for instance, the life conservation movement and extension service. Other examples worth mentioning are the Underwriter Laboratories in Chicago, the steam boiler inspections, the credit bureaus. All of these highly important combinations of prevention and insurance may be recognized as a new and progressive first-class protection for each community.

There are several questions in connection with this which may be mentioned. Sometimes it is pointed out that insurance companies do not have the obligation, or even the right, to spend money for matters other than the payment of losses of the insured. The correct answer to this could be given only by considering the problem from various angles, and no one conclusion could be reached for every country in all cases. If it is the policy of a state to take care of all hygienic and surety institutions, the answer would probably be different than if the self-help tradition is customary. For example, boiler inspection in Europe often is the duty of the state; in the United States it is a private matter.

Another dispute has arisen over the question whether fire insurance companies should spend money to assist the fire brigades, the point being that these brigades do not serve insured houses and property exclusively. The more generally insurance is used, the less important become such controversies.