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CONTRIBUTORS TO THIS ISSUE

NORMAN KOGAN, A.B. University of Chicago; Ph.D. 1949, University of Chicago. Instructor, Department of Government and International Relations, University of Connecticut.

COST AND COVERAGE OF
INDUSTRIAL LIFE INSURANCE

Life insurance is necessary financial protection for people in lower income brackets. It offers not only family security in the event of the breadwinner's unimply death, but also a convenient method of building and investing savings. Not all types of life insurance, however, are within the reach of low-income earners. To obtain ordinary life insurance, they must purchase a policy with a face amount of at least a thousand dollars. Often they cannot meet minimum premium payments. Insurance coverage that can be bought in lesser face amounts and paid for with smaller premiums has a natural appeal to this income group.

Industrial life insurance has tapped this market. Policies can be purchased in any amount less than a thousand dollars; the average policy today has a face value of 300 dollars. Unlike premium payments in ordinary life insurance

2. See Huebner, Life Insurance 13-35 (1925) for an analysis of the family and personal uses of life insurance. The savings and investment function of life insurance is most clearly demonstrated by the purchase of endowment policies. Vance, Insurance 32 (3d ed. 1951); Meier & Osler, Modern Life Insurance 61-66 (1949). An endowment policy, in addition to coverage in the event of earlier death, provides the insured with the face value of the policy at a given maturity date. Maclean, Life Insurance 44-50 (1935). For further analysis of life insurance as an investment, see Timberg, Insurance and Interstate Commerce, 50 Yale L.J. 959, 978-94 (1941). Policy loans further demonstrate the savings function of a life insurance policy. The policyholder may borrow from the insurer at a specified rate of interest a sum of money equal to the cash surrender value of the policy. The policy is security for the loan. The loan need not be repaid during the life of the insured. Vance, Insurance 644-5 (3d ed. 1951).
3. Davis at 5-6. Some companies offer ordinary life insurance at face values as low as $500. Id. at 12.
4. Most ordinary life insurers require a ten dollar minimum premium payment. Davis at 12. Wage earners covered by group insurance have no problem meeting premium payments, for employers pay a substantial part of the premium. For the extent to which low-income workers are covered by group insurance, see pages 71-2 infra.
5. Davis at 4-7.
6. Industrial life insurance, often called weekly premium life insurance, takes its name from the industrial workers who typically are its policyholders. Gesell & Howe, Study of Legal Reserve Life Insurance Companies 254 (TNEC Monograph 28, 1940). For historical treatment of industrial life insurance, see Taylor, The Social Cost of Industrial Insurance 9-16 (1933) and Dryden, Addresses and Papers on Life Insurance and Other Subjects 19-43 (1909).

Industrial life insurance is defined in N. Y. Ins. Law § 201 as "that form of life insurance, either (a) under which the premiums are payable weekly, or, (b) under which the premiums are payable monthly or oftener, but less often than weekly, if the face amount . . . is less than one thousand dollars and if the words 'industrial policy' are printed upon the policy as a part of the descriptive matter."

insurance, the small weekly or monthly premium for the industrial policy is
typically collected at the home of the insured by the company's collecting
agent. Unlike ordinary life insurance, where policy amounts determine
fixed premium charges, industrial life insurance tailors face value to any
premium in a multiple of five cents that the insured wishes to pay. Instead
of the medical examination required in ordinary life insurance, most indus-
trial policies are issued on the basis of the soliciting agent's recommendation
and the applicant's own statements as to his medical history and present
condition of health.

Industrial insurance is big business today. 109 million policies are in force
in the United States. One insurer alone furnishes ten billion dollars worth
of industrial life insurance coverage. In the single year 1949, 212 million

9. Davis at 6-7.
10. The agent's recommendation is presumably based not only on the questions and
answers in the application and his observation of the applicant, but on an informal
investigation of the living conditions in the applicant's home, his and his family's general
health, his occupation, and information furnished by his neighbors or employers. Davis
at 107-9. Most industrial applications require the agent to state his personal opinion of the
insurability of the proposed risk. See, e.g., Part D of Metropolitan application form, id. at 105.
11. For a sample of questions asked, see application form of the Metropolitan Life
Insurance Company, reprinted in Davis at 104-5.

Another distinctive feature of the industrial life insurance policy is the "facility-of-
payment" clause, designed to facilitate immediate payment of death benefits. Under it,
the named beneficiary in the policy must file a claim within thirty or sixty days after
the insured's death in order to preserve a vested interest in the proceeds. If the claim is
not filed within the time specified in the policy, or if the beneficiary predeceases the
insured, or is a minor or incompetent, the insurer has the right to pay the proceeds to a
relative by blood or marriage, or under some policies to any person it deems equitably
entitled to them. Possible recipients are friends, relatives, or persons who have incurred
expenses in behalf of the insured. See cases collected in Note, The Facility of Payment
Clause, 166 A.L.R. 10 (1947). During the twenties and thirties, the clause was a constant
source of litigation and often a source of insurers' abuse. See Fuller, The Special Nature
of the Wage-Earner's Life Insurance Problem, 2 Law & Contemp. Probs., 10, 29 et seq.
(1935). The typical abuse caused by payment to undeserving persons has been largely
corrected by giving the named beneficiary a vested interest for thirty or sixty days from
death of the insured. But since many industrial beneficiaries may be unaware of their
rights, the shortness of the period may still produce harsh results.
12. Life Insurance Fact Book 23 (1950). There are approximately 65 million
ordinary life insurance policies in force. Id. at 19. Since many industrial policyholders
own two or more policies, it is difficult to ascertain the exact number of individual policy-
holders. In 1943, there were 50 million. Davis at 3. Today the number is probably closer
to 60 million.

13. Communication to the Yale Law Journal from Malvin E. Davis, Actuary of
the Metropolitan Life Insurance Company, dated July 17, 1951, in Yale Law Library.
This is approximately one third of all industrial insurance in force in the United States.
Three companies, Metropolitan, Prudential and John Hancock, furnish about three-
fourths of all industrial insurance coverage. Davis at 6.
dollars were paid out in death benefits. An army of agents solicits sales and collects premiums. And each year’s business is greater than last.

For all its present vigor, industrial life insurance has had a checkered past. As early as 1906, Louis D. Brandeis pointed to grave abuses in the cost structure and selling practices of industrial insurers. Others raised sporadic protests for the next thirty years. Individual efforts culminated in the TNEC life insurance investigation in 1938. Summarizing exhaustive hearings and field investigation into all aspects of industrial life insurance, two monographs laid bare a long list of defects—enormous expense, low benefits, and high lapse rates for the insured; and predatory selling practices and huge profits for the insurers. Public reaction was aroused. Companies began to improve policy provisions, cost factors, and selling practices. State legislatures began hearings and enactment of regulations. But before reform had gathered momentum, the upward swing of the business cycle obscured the need. War production began—soon a boom was on—and public attention was diverted.

The High Cost of Industrial Insurance

The enormous cost of industrial insurance coverage is its most outstanding defect. The actual money costs of any given policy are small because face values are low. But per dollar of coverage, industrial insurance is vastly

15. See table of amounts of industrial insurance in force by years in Life Insurance Fact Book 23 (1950). Since 1940, the yearly increase in industrial insurance in force has ranged from a minimum of approximately 400 million to over two billion dollars. Ibid.
16. The results of his findings were published in Brandeis, Wage-Earners' Life Insurance, Collier's, Vol. 37, No. 25 (1906), reprinted in Mason, The Brandeis Way 311 (1938).
17. See, e.g., Taylor, The Social Cost of Industrial Insurance (1933).
18. Davenport & Gesell, Families and Their Life Insurance (TNEC Monograph 2, 1940) ; Gesell & Howe, Study of Legal Reserve Life Insurance Companies 248-305 (TNEC Monograph 28, 1940).
19. Reforms included (1) earlier non-forfeiture benefits, Davis at 8-9, (2) restricting the operation of the facility of payment clause, see note 11, supra, (3) compensation to encourage sales of lasting policies, Davis at 225; U.S. Dept of Labor, Bulletin No. 688, Operation of Savings-Bank Life Insurance in Massachusetts and New York, 36 (1941) [Hereafter cited as Bulletin No. 688], (4) granting of direct payment premium discounts and reductions for monthly payment of premiums, see page 51 infra.
20. See pages 70-1 infra for some of the legislative results.
21. See Brandeis, op. cit. supra note 16 ; Taylor, The Social Cost of Industrial Insurance 160 (1933) ; Mason, The Brandeis Way 286-7 (1938) ; Gesell & Howe, Study of Legal Reserve Life Insurance Companies 283-9, 303-5 (TNEC Monograph 28, 1940). The TNEC noted that cost had changed little since 1905. Id. at 305. Between 1940 and the present, the yearly cost of protection has been lowered about 17 per cent. Compare figures in Bulletin No. 688 at 54 with figures in table on page 49 infra.
22. For example, a $276 industrial policy may cost as little as twenty cents per week in premiums. Bulletin No. 688 at 54.
more expensive than any comparable form of insurance. Comparison with Savings Bank and ordinary life insurance strikingly demonstrates the high cost of an industrial policy. Costs are most fairly and effectively compared on the basis of average yearly cost of protection. Premiums paid over a period of years, less dividends received and accrued cash surrender value, when divided by the number of years, yields the yearly net cost for comparison purposes. The following table, computed on this basis for a ten year period, compares the cost of industrial with an equal amount of Savings Bank life and ordinary life insurance coverage.

<table>
<thead>
<tr>
<th>Premiums Paid</th>
<th>Net Cost</th>
<th>Yearly Net Cost</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Savings Bank Life Insurance</strong>&lt;br&gt;(Averages of Mass. Banks)</td>
<td>252.40</td>
<td>27.37</td>
</tr>
<tr>
<td><strong>Ordinary Life Insurance</strong>&lt;br&gt;(Average of two insurers)</td>
<td>277.40</td>
<td>60.49</td>
</tr>
<tr>
<td><strong>Industrial Life Insurance</strong>&lt;br&gt;(Average of same two insurers)</td>
<td>392.60</td>
<td>169.40</td>
</tr>
</tbody>
</table>

(Based on $1000 straight life policy—age 35—1951 Rates, Dividends & Cash Values)

25. The table is based on figures in MASSACHUSETTS SAVINGS BANK LIFE INSURANCE COUNCIL, CHECK THE SAVINGS (1951). For similar 1941 comparative costs, see BULLETIN No. 688 at 50-55. In making the comparison, several factors must be considered. Industrial policies, unlike Savings Bank policies, provide disability benefits and double indemnity for accidental death. Ordinary policies may include these features, but usually at extra cost. BULLETIN No. 688 at 42-3. But the disability benefits of an industrial policy are narrow. They are payable only for a total and permanent loss of sight, loss of both hands or both feet, or one hand and one foot. DAVIS at 192.

In addition, the table was compiled before Savings Bank insurers were subject to the federal income tax. INT. REV. CODE § 101(2). Under the Revenue Act of 1951, a Savings Bank authorized to conduct a life insurance business is taxed on its insurance business at the same rate as life insurance companies. Revenue Act of 1951, § 313-a, 20 U.S.L. WEEK 29, 48 (U.S. October 23, 1951); RESEARCH INSTITUTE OF AMERICA, REVENUE ACT of 1951, 55 (1951). However, the tax exemption prior to 1951 and the exemption from state insurance department fees, BULLETIN No. 688 at 58-62, constituted an insignificant difference in operating costs. As of 1941, for example, the insurance companies paid about 2 per cent of their premium income in taxes and fees, while Banks paid about 7 1/2 per cent. BULLETIN No. 688 at 62.

A third factor relevant to the comparison is the differing methods of premium payment in industrial and ordinary insurance. Industrial payments are weekly and current, while ordinary are at least quarterly and often semiannually or annually, and are payable in advance. The ordinary insurer has at the beginning of an investment period a comparatively larger sum of cash to invest. In this way, more favorable investment returns may result.
The cost of an insurance policy is a function of three factors—mortality, rate of return on the insurer's investments, and loading or operating expenses. Since investment opportunities are presumably equally favorable for insurers of comparable size, the higher cost of industrial insurance per dollar of coverage must be the result of the other two factors. The mortality rate of industrial policyholders is indeed 20 per cent higher than that of ordinary life insurance policyholders. But since industrial costs almost three times as much as ordinary, a small part of the cost differential is traceable to this factor. Loading expenses—sales and collection commissions, administrative and bookkeeping expenditures, and lapse costs—account for the bulk.

Sales and Collection Costs

To push sales of new policies, industrial insurers pay their agents a promotional first year commission amounting to twenty to forty per cent of the first year premiums. Other insurers pay a commission based on the weekly or quarterly net increase of premiums collected. Premiums not only reflect these sales commissions, but also include continuous commissions on the agent's weekly collections. The clerical and administrative cost of 52 rather

27. Companies which transact both ordinary and industrial life insurance combine funds for investment. Davis at 122. Interest earned on policy loans to ordinary insurance policyholders is credited to that branch exclusively. Rarely are loans granted to industrial policyholders. Ibid.
28. In 1940-41 mortality among industrial policyholders was 120 per cent of that among ordinary policyholders. Davis at 119.
29. Gesell & Howe, Study of Legal Reserve Life Insurance Companies 287-89 (TNEC Monograph 28, 1940); Bulletin No. 688 at 57; Mehr & Osler, Modern Life Insurance 202-4 (1949). In 1939, for example, the ratio of salaries and commissions to premium income of four companies selling industrial insurance was more than twice as high as the same ratio in the same companies on sales of ordinary policies. Bulletin No. 688, table at 57.
30. Davis at 66-7. See note 31 infra.
31. See Gesell & Howe, Study of Legal Reserve Life Insurance Companies 255-58 (TNEC Monograph 28, 1940). More recent information was obtained by a questionnaire sent to thirty industrial insurers in the United States. Fourteen replies were received. Represented were (a) smaller Southern insurers, (b) insurers with more than 100 million dollars of insurance in force, and (c) two of the three larger insurers, those with over a billion dollars of insurance in force. The various questionnaires [hereafter cited as Questionnaire] are on file in Yale Law Library.

The questionnaires indicated two methods of compensation for sales of new policies. Some insurers base compensation on the weekly net increase in premiums paid and collected. The commission is equal to the net increase in the amount of premiums, multiplied twenty or thirty times. Other insurers pay a percentage—ranging from twenty to forty per cent and averaging thirty-five per cent—of the premiums paid in the first year of the policy.
32. Never less than 12 per cent of the premium collected weekly was allocated to the agent's collection commission. Some insurers pay as high as 25 per cent of the
than 12 or 4 collection transactions increases district office expense. Taken together and averaged over a normal life insurance span, these loading factors substantially increase the cost of an industrial insurance policy.

Some insurers offer to policyholders several cheaper alternative forms of insurance and methods of payment. Ordinary life insurance may be available on a monthly-payment basis for policies of $1000 or more face value. On industrial policies, some insurers give a ten percent rebate if premiums are paid directly to the branch office and a reduction in premiums when they are collected on a monthly basis. No company, however, offers greater reductions for a combination of monthly-directly paid premiums, and many companies offer neither monthly ordinary life nor cheaper methods of industrial premium payments. Where the company does offer the direct payment discount, it is often buried in legalistically worded policy provisions likely to be overlooked. Monthly payment discounts are not advertised in the application or policy at all. The agent is an unlikely proselytizer, for any savings to the policyholder are almost a total loss to the agent. Rarely encouraged

premium. As a general rule, the smaller the insurer, the larger the collection commission. Questionnaire. See also Geisel & Howe, op. cit. supra note 31, at 256 n.46.

33. Davis at 146. To obtain the rebate, the policyholder must pay premiums to the branch office for 52 consecutive weeks. At the end of the year, the company refunds ten per cent of the total premiums paid. An alternative method gives 52 weeks credit for 47 direct payments. Questionnaire.

34. Questionnaire. See also, Davis at 266. Of thirty-one companies Davis lists, only 9 gave direct payment discounts. Some states require companies chartered or doing business within the state to offer the direct payment discount. See e.g., N.Y. Ins. Law § 163(1) (k).

35. For example, the policy of one large industrial insurer informs the policyholder of the direct payment rebate thus: "If, while premiums are not in default beyond the grace period, notice is given to any office of the Company which maintains an account for receiving direct payment of premiums, that premium will in future be paid directly to such an office, and if premiums are so paid continuously for a period of one year without default beyond the grace period, the Company will, at the end of such year, refund 10 per cent of the total of the year's premiums so paid..."

36. When an agent sells monthly ordinary life insurance, his sales commission is identical with weekly or monthly industrial. Davis at 67. But his collection commission is smaller, usually only five per cent of the size of the premium. Ibid. Industrial insurers were asked in the Questionnaire, supra note 31, how much larger over a twenty-year period the agent's total compensation would be on a weekly industrial policy than on an ordinary policy of identical size and type of coverage. One large insurer estimated that compensation on weekly industrial would be "seven per cent of the size of the premium" higher than for monthly ordinary. Other insurers estimated that the total compensation on weekly industrial would be from 50 to 75 per cent larger on the ordinary policy over the twenty year period.

When a policyholder pays premiums directly to an office of the insurer, the agent loses the entire collection commission. Since collection commissions constitute approximately 40 per cent of the agent's total weekly income, Davis at 69, encouraging direct payments is obviously not in his financial interest.

See also Taylor, The Social Cost of Industrial Insurance 172 (1933); Geisel & Howe, op. cit. supra, note 32, at 256 n.47, 289.
to take advantage of these savings, policyholders continue to rely on the agent's weekly collection of industrial premiums.  

But the need for weekly home collections is illusory. Low-income families are capable of saving for monthly premiums and taking the minimum affirmative action necessary to pay directly to a branch office. They pay utility bills this way. Industrial policyholders' reliance on weekly home collection is due more to ignorance of available savings than inability to take advantage of them. Many who do know of the savings may, without advice, fail to appreciate their significance. So long as home collection conveniently exists and the agent encourages it, policyholders tend to rely on the service. Nevertheless, a growing number of policyholders utilize direct and monthly payment savings. There is no reason to suppose they are atypical. And once policyholders take advantage of the discount, experience of the insurers indicates, they maintain payments on this basis.

To reduce collection and handling costs, wasteful and largely unneeded weekly home collections should be eliminated. Other incentives can relieve

37. The percentages of policyholders paying weekly collected premiums in two of the three larger insurers were 78.6 and 43.3 per cent respectively. Data on the third was unavailable. Questionnaire.

38. In 1933, a depression year, one thoughtful observer wrote: "There is growing evidence of the increased ability of people... to attend to payment themselves... to put money by for intervals longer than one week... to look ahead much further than [their] father or grandfather did or could." TAYLOR, THE SOCIAL COST OF INDUSTRIAL LIFE INSURANCE 168 (1933). Present economic conditions can only reinforce this belief.

But see DAVIS at 52-3: "The small size of Industrial premiums and the frequency with which they are payable make the... method of mailing premiums directly to the company impractical. The average weekly premium per family in one large company is 69 cents... Most [policyholders] have no checking accounts, and it would be highly inconvenient for them to mail these small sums directly to the company. The cost of postage alone... would in many cases be greater than the cost of having an agent call to receive the premiums... [M]any policyholders do not live or work in the immediate vicinity of [branch] offices. For them to make payments personally would usually cost carfare..." But this argument proves too much. If the average family's insurance costs are so low as 69 cents per week, policyholders in the family could manifestly pay on a monthly basis, directly or by collection.

39. See DAVENPORT & GESSELL, FAMILIES AND THEIR LIFE INSURANCE 54 (TNEC Monograph 2, 1940).

40. In 1940, twenty-eight per cent of one large insurer's weekly industrial premiums were paid directly to the branch office. GESSELL & HOWE, STUDY OF LEGAL RESERVE LIFE INSURANCE COMPANIES 256 (TNEC Monograph 28, 1940). Today, in the same company, almost one third of the weekly industrial premiums are paid directly. Questionnaire. See also DAVIS at 15 for a chart demonstrating the increasing utilization of monthly premium and direct payment discounts. In view of the limited means by which policyholders learn of the savings, pages 51-2 supra, the development is impressive.

41. For example, every insurer offering direct payment discounts replied that once a policyholder utilized the saving, he continued payment on the same basis. Questionnaire.

42. "By the elimination of the agent's collection function, the greatest part of the expense [of industrial insurance] would be saved. Fewer agents would be necessary, because not nearly so many men would be required to solicit new business. Less business
pressures now inducing agents to discourage cost-saving forms of insurance and methods of payment. For example, a greater bulk of the agent's compensation could be based on the face value of non-lapsed insurance sold rather than on current or past premium collections. Moreover, all insurers might at least equalize sales commissions on industrial with monthly-ordinary sales commissions. In this way the desirable incentive to sell and maintain insurance is kept, but the agent no longer has a monetary interest in pushing higher-premium insurance or costlier payment plans.

Aside from elimination of high-cost factors and agents' undesirable selling methods, all insurers could more directly encourage policyholders to utilize cost-saving payment plans and alternative forms of insurance coverage. Direct payment rebates, monthly payment discounts, and even greater premium reductions for combined monthly-direct payments could be offered both in the contract and by directly mailed notice to policyholders. And, of course, simple language should apprise the policyholder of the potential saving. To provide service equivalent to home collection, insurers could contract for collection by willing employers through payroll deductions. This economical would very likely be done, but at least an equal amount would be conserved. The Industrial policyholder should be encouraged to assume more responsibility for the maintenance of his insurance, for it is an enervating process, which removes from him any mental or physical stimulus in the retention of it. He is in receipt of a service at too great a cost... There can be no material change in the cost of Industrial life insurance until there is a radical revision of the place of the agent in its conduct. TAYLOR, THE SOCIAL COST OF INDUSTRIAL INSURANCE 172 (1933).

43. Compensation from weekly collection of industrial premiums constitutes 40 to 50 per cent of the agent's total income. DAVIS at 69. Unless a smaller percentage of the agent's income is derived from collections, it is unlikely that he will encourage direct payments of weekly premiums or the purchase of monthly ordinary. If, on the other hand, compensation were based on face value of a persisting policy regardless of the type of insurance or method of payment, the agent would encourage the policyholder to take the cheapest form of insurance. Establishing a compensation based on face value equitable to company and agent should not be difficult. Some insurers stated that they were contemplating such a system. Questionnaire.

44. Some insurers equalize sales commissions today. Questionnaire. See also N. Y. INS. LAW § 213-a (7). Under this statute, compensation for sales of industrial policies cannot be higher than compensation for sales of monthly ordinary policies.

45. If an insurer altered the basis of compensating its agents, pages 52-3 supra, they more probably would inform policyholders of direct and monthly payment discounts. But directly mailed notice may still be necessary to guarantee widespread knowledge of the savings.

46. The legalistic language now used in the policy provision informing policyholders of the direct payment saving, note 35 supra, doubtless results from the insurer's desire to cover all conditions and requirements of the benefit. But the policy provision and direct notice need only inform the policyholder that a saving is possible, subject to the insurer's regulations. When the policyholder seeks to utilize the saving, he can then be informed of specific conditions and restrictions.

47. The greatest saving to policyholders would be achieved through coverage by an ordinary policy for which premiums are payable annually. Money for premiums could be accumulated through weekly deductions, or out of any yearly bonus. Since the employer
form of "home collection," could materially reduce costs while retaining any advantages of direct collection. More and better insurance coverage could be sold for the same price. Finally, conversion to one ordinary life insurance policy could be facilitated when the aggregate value of any one policyholder's industrial insurance reaches $1000. In this way the expense of collection and recording for each of several smaller policies in one home could be lowered.

High Lapse Costs.

An unfavorable lapse rate is the second major factor contributing to the high cost of industrial insurance. An insurance policy lapses when premium payments cease before non-forfeiture benefits have accrued. For industrial policies, the non-forfeiture benefits typically accrue after three years. But already has machinery for withholding part of earnings to pay income taxes, clerical expense of one more deduction would be minimal. Part of the deducted wage could compensate the employer for any expense. But it would be substantially less than collection and handling costs now paid by industrial policyholders.

If the insured cannot afford a thousand dollar ordinary policy, he may purchase through payroll deductions a smaller face value industrial policy with premiums payable on a monthly basis. With the employer making premium payments, however, insurers could easily offer low-face value industrial policies on a yearly premium plan.

48. In the thirties, many policyholders held more than a thousand dollars aggregate face value in numerous small weekly premium policies. See example in Gesell & Howe, Study of Legal Reserve Life Insurance Companies 276 (TNEC Monograph 28, 1940). The present extent of such holdings is difficult to ascertain since there are no recent studies. Some insurers, however, have taken direct steps to discourage multiple holdings and offer conversion options in policies. Davis at 41. But since the agent's compensation from industrial policies exceeds that from an ordinary policy, see note 36 supra, the agent is unlikely to advertise the privilege of conversion. The insurer, therefore, should directly notify any policyholder of the potential saving as soon as the size of his holdings makes him eligible for conversion.


50. Non-forfeiture benefits are paid after the policy is in force for a specified period of years. Three major types of benefits are: (1) Cash surrender values. (2) Reduced paid-up insurance. The face amount of the policy is reduced to that amount of fully paid-up insurance which the cash surrender would purchase on a single premium plan. (3) Extended term insurance. The cash surrender value is used as a net single premium to buy term insurance in an amount equal to the face value of the policy for as long a period of time as the cash value allows. See Maclean, Life Insurance 160-67 (1935); Davis at 41-44.

51. Cash surrender values are available after three or five years; reduced paid-up insurance is typically granted after three or five years; and extended term insurance is offered after 6 months by larger insurers and after one or three years by smaller insurers. Chart, Davis at 267. See id. at 41-44. Savings Bank policies offer all of the non-forfeiture benefits and they are available at earlier dates. See chart in Bulletin No. 688 at 42-3. Ordinary life insurance policies likewise provide them earlier. Ibid.
most lapses actually occur within two or three months of issuance. In the period 1934-38, total lapsation of industrial policies was approximately eight times the terminations by death or maturity. Lapse rates today are substantially lower, due partly to the improved economic conditions and partly to an earlier non-forfeiture benefit date. But the present lapse rate for industrial is almost four times that for ordinary life insurance.

Although the lapse of a policy may cost its holder only a few months' premiums, it results in higher costs to the insurer and other policyholders. The expense of servicing and recording the many transactions incident to the issue and termination of an industrial policy are not paid for until several years of premiums have been collected. The company recoups some of that loss by charging the amount of the sales commission against the agent's account. All other expenses, however, increase the actual cost of operation, and either increase premiums or lower dividends.

Primary causes of lapse are maldistribution of policies among members of the family, and overloading—selling more insurance to a family than it can afford. Such policies are the first to be dropped in adverse times. Since even

52. Gesell & Howe, Study of Legal Reserve Life Insurance Companies 28-32 (TNEC Monograph 28, 1940). In 1940, a study of industrial insurance in Maryland revealed the following data on terminations of industrial life insurance policies: 524,213 new industrial policies were issued; 487,036 policies were terminated. Almost 80 per cent of the terminations were by lapse and a "major portion of the lapses were in the very early years of the policies' life." Research Division, Legislative Council of Maryland, Research Report No. 11, Industrial Life Insurance in Maryland 10-11 (1942). [Hereafter cited as Maryland Report (1942)]. See also Taylor, The Social Cost of Industrial Insurance 142-44 (1933).

53. See tables in Gesell & Howe, Study of Legal Reserve Life Insurance Companies 279 (TNEC Monograph 28, 1940).

54. In two of the three larger insurers, the ratio of lapsed policies to policies maintained in force after non-forfeiture benefits have accrued was 6 and 27 per cent respectively. The insurer with the lower rate, however, paid its earliest non-forfeiture benefit after 26 weeks. Smaller industrial insurers indicated a ratio ranging up to 50 per cent. Questionnaire. See also Maryland Report at 11 (1942), indicating that in the boom year of 1940, 78.2 per cent of the terminations of industrial insurance in Maryland were by lapse.


56. Questionnaire. Mehr & Osler, Modern Life Insurance 204 (1949). One large industrial company, however, denied that lapses "significantly affect the cost of insurance to a continuing policyholder." Other insurers agreed that lapse costs had to be "met by the Company's operations as a whole."


See Maryland Report at 59 (1942). The report estimated that for 1000 whole life policies issued at age 10 for $250 face value, with an 8% premium, the net loss to the company at the end of the first year is $1800, and $617 at the end of the second year.

58. Questionnaire.

59. Gesell & Howe, Study of Legal Reserve Life Insurance Companies 278 (TNEC Monograph 28, 1940); Mason, The Brandeis Way 286 (1933).
in times of prosperity the typical industrial policyholder spends a major part of his earnings on necessities, premiums on an overloaded or maldistributed policy which seemed small the first week may become an unbearable burden when paid every week. And when the breadwinner dies or loses his job, maldistributed policies insuring women and children lapse for lack of income to pay premiums.

Maldistribution and overloading result from a system of compensation which puts constant pressure on the agent to sell new insurance. Although since 1938 the three major industrial insurers pay the agent a conservation commission for maintaining policies, it usually amounts to less than ten per cent of his income. All other compensation is based directly or indirectly on sales of new insurance.

Apart from the compensation system, other factors contribute to overloading and maldistribution. To the agent, collection of premiums on many small industrial policies in one home is not only convenient, but more profitable. Moreover, the agent has as easy time converting the desire for security and money to pay the expenses of last illness and decent burial into the sale of a low installment industrial policy. Housewives are particularly susceptible

60. CASADY, A BUYER'S GUIDE TO LIFE INSURANCE 14 (1951); GESELL & HOWE, A STUDY OF LEGAL RESERVE LIFE INSURANCE COMPANIES 271 (TNEC Monograph 28, 1940); cf. PUBLIC AFFAIRS PAMPHLET No. 134, STEWART, BUYING YOUR OWN LIFE INSURANCE 2 (1947).

61. DAVIS at 67.

62. The conservation commission of one large industrial insurer's agents was 9.5 per cent of their total income. Another large insurer stated the commission to be "4 to 5 per cent." Smaller insurers on the average paid about 5 per cent. Some did not pay any conservation commission. Questionnaire.

63. PUBLIC AFFAIRS PAMPHLET No. 134, STEWART, BUYING YOUR OWN LIFE INSURANCE 2 (1947). See notes 31 and 32 supra. In addition to sales commissions, collection and conservation commissions are ultimately derived from sales of new policies.

Although an agent loses his sales commission when a policy lapses, text to note 58 supra, and risks a decrease in his conservation compensation if lapses on policies sold by him exceed the lapse rate of the company as a whole, DAVIS at 67, these penalties are patently inadequate deterrents to overselling. The loss in conservation commission is inevitably small since the total conservation commission is rarely more than five per cent of the agent's total income. Note 62 supra. If the policy lapses, the agent has neither gained nor lost a sales commission. It is a small risk, therefore, to sell a policy which has a questionable future. But if the policy lasts for several years, the agent has gained both sales and collection commissions.

64. See page 54 supra.

65. One agent described his sales approach as follows:

"AGENT: I will metaphorically draw a hearse up in front of his door and park it there until he signs.  
MR. GESELL: What do you mean by that?  
AGENT: I mean I will have to paint pictures of the Grim Reaper and everything else to frighten the person into believing that unless the person is actually covered with insurance, death might take place almost momentarily."

Quoted from TNEC Hearings in GESELL & HOWE, A STUDY OF LEGAL RESERVE LIFE INSURANCE COMPANIES 271 (TNEC Monograph 28, 1940).
to the agent's importunings. In 1949, for example, women held 46 per cent of all industrial insurance in force. Finally, there is an element of gambling in the purchase of industrial insurance. The money spent seems a small outlay for the possible returns.

The cure for the high lapse rate of industrial insurance can come only by removing the pressures which lead to overselling and maldistribution. Careful selection, training, and supervision of agents and their selling practices would help. If more drastic measures were needed, the insurer could be penalized for excessive lapse rates. If, for example, the insurer's lapse rate consistently exceeds a maximum fair to insurers and policyholders alike, sanctions such as charter revocation or fines could be imposed. To keep within the maximum, all insurers, as some have already done, would take effective steps to prevent overloading and maldistribution. Accordingly, an insurer might proscribe sales to non-employed women and children unless the breadwinner already holds two or three times as much insurance. The insurance agent need not suffer from greatly diminished sales; approximately the same amount of persisting insurance could be sold. But it would be differently—and properly—distributed among the family.

**The Sound Health Clause**

Industrial life insurance risks are generally selected without a medical examination. The insurer's only information about the medical history and health

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67. Large industrial insurers have, in recent years, devoted much attention to training and regulation of agents in an effort to reduce lapse. *Davis at 61-5, 223-8*. Lapse ratios in these companies were considerably lower than the ratios in smaller insurers who have made little effort to reduce lapse. *Questionnaire*.

68. Companies chartered or doing business in New York face civil sanctions if their expenses in the transaction of industrial insurance exceed a statutory maximum. *N.Y. Ins. Law § 213-a*. The proposed lapse maximum goes one step beyond that statute and directly attacks an element in the high cost.

69. The larger insurers have self-imposed limitations on sales to women and children. See note 70 infra. Smaller insurers have some ineffective limitations. Thus, one company prohibits sales of more than $2000 of insurance to children. *Questionnaire*. This amount is not only high in absolute terms, but meaningless as a device to prevent lapse because unrelated to the insurance holdings of the breadwinner or the financial status of the family.

70. Some larger insurers have a self-imposed limitation approaching this. "No insurance will be issued on a housewife or other adult dependent which would result in more than $500 being in force on such a person, unless the wage earner is insured for at least twice the proposed amount. No weekly-premium insurance will be issued on . . . children under ten which will result in a total outlay of more than 25 cents a week . . . . Even this amount will not be issued if the father is not insured. [No] monthly premium industrial policies . . . will . . . be issued on juvenile lives unless the father is insured for at least $1000." *Davis at 17*.

71. See page 47 *supra*. 
of the applicant comes from the soliciting agent's investigation and the insured's own representations in the application. Typically the applicant is asked whether he is in sound health, has received medical treatment or attention within the past few years, or had any one of several specified diseases or symptoms. Additional questions concern height, weight, occupation, and family medical history. In every policy, corresponding provisions permit the insurer to void the policy if the insured was not in sound health, or if, at the time the policy was delivered, he had any of the several specified diseases.

This "sound health" clause is the most frequent basis on which industrial insurers contest claims. If the insured dies within a year or two after the policy is issued, the company conducts an investigation into his medical history. If there is reasonable ground for belief that the insured had misrepresented the state of his health, or if he breached any of the conditions in the sound health clause, the claim is likely to be resisted.

Some companies, particularly the larger industrial insurers, have more liberal practices in paying claims than the clause requires. If, for example, the insured had a latent disease when the policy was delivered, these insurers pay the claim despite the wording of the clause. But there is no guarantee that the practice will continue or that the liberality is applied in every case.

72. See note 10 supra.
73. See, e.g., Metropolitan's application form, Davis at 104-5.
74. The sound health clause in the industrial policy takes many forms. It may require either "delivery in good health," e.g., Western & Southern Life Ins. Co. v. Spencer, 95 Ind. App. 281, 179 N.E. 794 (1932), full disclosure of all medical treatment or attention, e.g., Hill v. Metropolitan Life Ins. Co., 259 App. Div. 278, 18 N.Y.S. 2d 753, 756 (2d Dep't 1940), or both, e.g., Chorney v. Metropolitan Life Ins. Co. 54 R.I. 261, 172 A. 392 (1934). See also clause quoted in note 79 infra.

In 1943, an analysis of 31 industrial insurers revealed that: 20.8 per cent of the industrial insurance issued had only the delivery in sound health form of the clause; 23.3 per cent had only the medical treatment clause; and about 20 per cent incorporated both. Davis at 262. One large insurer had no sound health clause in the policy and bases contest solely on misrepresentations in the application attached to the policy. Id. at 261.

76. If the insured dies after one or two years, the policy is, by its terms, incontestable. Incontestable clauses appear in virtually every life insurance policy, ordinary or industrial. Many states have statutes requiring them. Vance, Insurance § 97 (3d ed. 1951). Typically the clause states that after one or two years the policy shall be incontestable except for any circumstance expressly excepted. A majority of the clauses except only non-payment of premiums and allow the insurer to adjust the size of the recovery for misstatement of age. Id. at 579.
77. Insurers were asked if they would, in practice, contest a claim if the insured had a latent disease when the policy issued. Of seven who answered, all but one said they would not contest. Questionnaire. That they may have no legal obligation to pay, see page 61 infra.
Where public relations is not a problem or larger claims are in dispute, the company is likely to contest.

Before the contest reaches a court, two problems face the claimant. A policy—now read for the first time—may be worded to give the company an apparently ironclad case. Once the claimant hurdle this psychological barrier, he must decide whether the size of recovery is worth the expense of litigation. And when the case gets to court, the liberal practices of the companies will have little effect on the court's decision.

**Contest Based on the General Sound Health**

General sound health clauses in ordinary and industrial life insurance policies evoke different legal results. An ordinary life insurer in order to prevail must prove both the insured's unsound health and its materiality to the risk. But the policies of industrial insurers may be interpreted to establish sound health as a "condition precedent." Accepted legal doctrine requires

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78. An insurer's reputation in the neighborhood is particularly important in industrial insurance. The agency system is based on territories and the agent is expected to blanket an area. Davis at 54. A strict claims policy may lose sales among hundreds of prospective customers who hear of it.

79. For example, the policy issued by one large insurer reads:

> "If on the date of issue of this policy the Insured was not in sound health, or if prior to said date, the Insured was rejected for insurance by this or any other insurer, or had any pulmonary disease, cancer, sarcoma, or any disease of the heart or the kidneys, or if within two years prior to said date, the Insured was attended or treated by any physician or other practitioner, or attended any hospital or institution of any kind... for any serious disease, complaint or surgical operation, this policy shall be voidable by the company... unless reference to each such rejection, attendance, treatment or prior disease is endorsed herein by the Company.""

80. Policies average $300, see note 7 supra, while court costs and attorney's fees may be as high as in ordinary life insurance litigation. Most cases make no provision for the award of reasonable attorney's fees to the policyholder. See, e.g., cases cited in notes 82 and 89 infra. But see Weddle v. Prudential Ins. Co. of America, 130 Neb. 744, 266 N.W. 624 (1936) (§200 attorney's fee awarded because "the case was ably and vigorously argued" and "presented new and important issues of law.").

Some states have statutes imposing penalties on unsuccessfully contesting insurers. The penalty is a reasonable attorney's fee plus a percentage of the recovery. E.g., Ga. Code Ann. 56-706 (1933). But under these statutes the penalty is payable only when the contest is in bad faith, ibid., or vexatious and without reasonable cause. Ill. Stat. Ann. c. 73 §767 (1940).

81. Logan v. New York Life Ins. Co., 107 Wash. 253, 181 Pac. 906, 908 (1919); 21 Appleman, Insurance Law and Practice §12426 (1945). But see Vance, Insurance 643 (3d ed. 1951). Vance states that there is a conflict of authority on the burden of proof. Although the cases he cites do go both ways, Vance's authorities for the proposition that the insured or beneficiary has the burden of proving sound health are three industrial insurance cases and one ordinary life insurance precedent. Vance, op. cit. supra, at 643 n.21.

a claimant to affirmatively prove performance of every condition precedent to recovery. If the claimant cannot prove sound health, insurers may successfully contest without offering any evidence of his unsound health.

Actual not apparent good health is required by the clause. Testimony of relatives, friends, neighbors, or employer is not decisive proof of the insured's good health. A qualified doctor familiar with the insured's health at the time of policy delivery could prove actual good health, but rarely is a doctor with this knowledge available. Consequently, a claimant would have to resort to a difficult and costly post-mortem examination to establish the sound health requisite to recovery.

The time reference of the industrial sound health clause raises further difficulties in the claimant's case. While the clause in ordinary policies generally refers only to changes in health between acceptance and delivery, the industrial policies are more stringent.

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83. Fonzi v. Boston Mutual Life Ins. Co., 224 Mass. 6, 7, 112 N.E. 612 (1916); Vance, Insurance 423 (3d ed. 1951); Patterson, Essentials of Insurance Law 205 (1933). But cf. Weddle v. Prudential Ins. Co. of America, 130 Neb. 744, 266 N.W. 624, 627 (1936) (sound health a condition precedent, but insurer has the burden of proving that the insured was not in sound health). See also Mass. Gen. Laws c. 175 § 186-a (1949). Under the statute delivery of a life insurance policy creates a presumption that any condition precedent to the formation of the contract has been performed. What effect this will have on the burden of proving conditions precedent to liability is uncertain.


The condition precedent rationale is not universal by any means. Many courts have decided that the insurer has the burden of proof whatever label is attached to the sound health clause. E.g., Krajewski v. Prudential Ins. Co. of America, 305 Ill. App. 64, 26 N.E. 2d 892 (1940).


87. Needless to say, no claimant would resort to a post-mortem examination. Apart from the expense, it would in most cases require disinterring the insured. Recovery on industrial policies will rarely, if ever, justify such a step. Yet, in the absence of a qualified doctor familiar with the actual state of the insured's health, a post-mortem examination seems the only way to demonstrate the actual good health of the insured.

88. Vance, Insurance 423-3 (3d ed. 1951). Vance notes a conflict among rulings on the time reference of the sound health clause. But the authorities supporting the proposition that "a majority" of courts interpret the clause to refer to health at the
trial clause more frequently demands sound health on the delivery date.\(^5^9\) A pre-existing latent disease which might not impair the ordinary claimant's right to recover \(^6^0\) thus bars recovery to the industrial claimant.\(^6^1\) Where the burden of proof is on the claimant, sound health on one particular date is more difficult to prove than the fact that the insured did not acquire an ailment within a certain period of time.\(^6^2\) Where the burden of proof is on the insurer, it need not undertake the difficult proof that a disease developed in the interval. And since the insured's health typically declines, the insured's proof of unsound health at a later date is manifestly simpler. Whichever party has the burden of proof, the time reference of the industrial sound health clause can only aid the insurer.

**Contest Based on the Non-Medical Treatment Clause**

Some industrial companies, notably the larger industrial insurers, have eliminated the general sound health clause. In its place, a clause permits the company to void the policy only if within two years before issuance, the insured had medical treatment or attention not reported in his application.\(^6^3\) This variant of the sound health clause, although more favorable than the broader

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\(^5^9\) Contest Based on the Non-Medical Treatment Clause

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form, still imposes a heavy burden on the claimant. Though an applicant can be expected to remember and report treatment for a serious disorder, he may have had medical attention for a seemingly trivial disease or for a disease not serious at the time. Moreover, a doctor may not have informed him of the gravity of the disorder. Under these circumstances an applicant may easily fail to recollect or report the treatment. In court, however, the insurer need not prove the existence of a disease or its materiality to the risk; it must prove only unreported treatment. To recover, the claimant must then proceed to prove that the disorder was not serious or material. The difficulty and expense of proving non-seriousness or non-materiality is manifest. Often the claimant will be unable to bring into court any evidence of the disorder actually treated. Even if he can produce this evidence, a medical expert may be needed to testify that it was not a "serious disorder" or that it was not material to the risk. For claimants under low-valued policies, that proof and even the litigation itself may not be worth the expense.

**Sound Health Clauses Limiting the Companies' Liability**

In the policies of some industrial insurers, another variant of the sound health clause reduces or eliminates insurers' liability if the insured dies of any one of a number of specified diseases within one or two years after the policy is issued. The list of diseases is long and typically includes all of the major killers. Under such clauses, recovery is denied although the insured was free from any of the diseases when the policy issued. While these

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Courts construe medical treatment strictly. Treatment for trivial or temporary disorders may be held "treatment" within the meaning of the non-medical attendance or treatment clause. Cases collected in Note, 63 A.L.R. 846, 848 et seq. (1929).


96. *E.g.*, Tolar v. Metropolitan Life Insurance Co., 297 N.Y. 441, 80 N.E.2d 53, 55 (1948) (court upholds rule that the insurer need not prove the existence of insured's ailment or its materiality to the risk).

97. Typical of the clauses is: "The company shall pay no more than one eighth of the death benefit named herein should death occur in the first six months of this policy's existence, one quarter of same should death occur in the second six months, and one half should death occur in the third six months, should such death result from or be contributed to by heart disease, tuberculosis, chronic bronchitis, cancer, Bright's disease, pneumonia, liver trouble, pellagra, cerebral hemorrhage, paralysis, high blood pressure, influenza, or any chronic disease." Gray v. Louisiana Industrial Life Ins. Co., 193 So. 278, 279 (La. 1940). See variation of limited liability clauses in Universal Life Ins. Co. v. Lillard, 14 Life Cases 232 (Tenn. 1950) (death due directly or indirectly to specified diseases); Walker v. Superior Life Ins. Co., 62 A.2d 192 (Mun. Ct., D.C. 1948).

98. See note 97 supra.

clauses are regularly enforced by courts, they are reasonable only if the premiums are lowered to correspond to the vastly smaller risk which the insurer covers. If premiums are not lowered or dividends raised, the company gets a windfall every time a policyholder dies of one of the diseases.

The Multiple Sound Health Clause

Most industrial life insurance applications require representation of sound health, non-medical treatment and freedom from specified diseases. These requirements reappear as conditions of liability in the policy. If a contesting insurer is confronted with the defense that the agent falsified answers in the application, the insurer can prevail on the theory that contest is not based on any misrepresentation but on breach of the conditions in the policy. Likewise, these multiple conditions can circumvent some statutory restrictions. For example, a statute prevents insurers from resisting claims on the basis of health if medical examination has been waived and the applicant's answers are recorded by the agent. Insurers may avoid such statutes by arguing that the contest is not based on health but on the non-medical treatment condition. The multiple sound health clause, therefore, can be a multiple trap for the insured.

Although one company has eliminated the sound health clause in all its forms, it serves some function. The clause gives insurers a method,


101. In upholding these clauses, courts do not examine the premium or dividend rates of the insurers issuing the policies. See cases cited in notes 97 and 100 supra.

102. See, e.g., Metropolitan's application form printed in Davis at 104-5.

103. See note 74 supra.

104. See page 67 infra for the effect of such a defense.


108. An inspection of sample industrial insurance policies received by the YALE LAW JOURNAL revealed that one large insurer had no sound health or non-medical treatment
however crude, for segregating clearly uninsurable risks. Where the policyholder fraudulently misstates the condition of his health, the clause offers the company a clear basis for contesting the claim. On the other hand, sound health is not a fact, but an opinion. If the applicant honestly believes he is free from specific diseases and reports that belief to the agent, the insurer who waives a medical examination and relies on the opinion should not be permitted to defeat claims by later holding the insured to a statement of fact. Courts in ordinary life insurance cases increasingly treat statements of general health as mere opinion. Under these precedents, the insurer, to escape liability, must prove that the opinion was not honestly held. Industrial insurers, however, need not make this showing.

Davis notes that this insurer bases contest solely on statements in the application, a copy of which is attached to the policy. Davis at 261.

Some courts have so held. See, e.g., Service Life Ins. Co. of Omaha v. McCullough, 234 Iowa 817, 13 N.W.2d 440, 444-5 (1944); Northwestern Mut. Life Ins. Co. v. Wiggins, 15 F.2d 646 (9th Cir. 1926); Lampke v. Metropolitan Life Ins. Co., 279 N.Y. 157, 18 N.E.2d 14, 17 (1938).

VANCE, INSURANCE 394, 403 (3d ed. 1951). See also National Life & Accident Ins. Co. v. Green, 191 Miss. 581, 3 So.2d 812, 814 (1941) (dissenting opinion): "If the insurance company, in order to avoid the expense incident to a medical examination, should choose to accept the risk on the recommendation of their soliciting agents, they should be bound by such acceptance in the absence of proof that the applicant has knowingly made those representations in order to obtain the insurance." See Note, 14 Mo.L.Rev. 204, 205 (1949): "The applicant who with good reason actually believes himself in sound health is subject to a manifest injustice when the insurer is allowed to avoid its obligation subsequently by a showing that there was in fact an existing illness which ultimately contributed to the death. By the insertion of the sound health clause the applicant makes his actual state of health—not what he believes his health to be—an operative condition having the same harsh consequences as formerly arose from the currently supposed abrogated doctrine of common law warranty."

Many insurers now ask the applicant questions on which he can have certain knowledge. John Hancock, for example, asks the insured: Have you ever had, or consulted or been treated by a physician or other practitioner for any of the following: Disease of the heart; pain in the chest; shortness of breath; any surgical operations? John Hancock Mut. Life Ins. Co. v. Conway, 14 Life Cases 1050 (Ky. 1951). Yet, the court in the same case notes that an innocent misrepresentation will void the policy. Id. at 1051.


112. Service Life Ins. Co. of Omaha v. McCullough, 234 Iowa 817, 13 N.W.2d 440 (1944); Patterson, Essentials of Insurance Law 339 (1935); 1 Appleman, Insurance Law and Practice §216 (1941).

113. See, e.g., DeFord v. National Life and Accident Ins. Co., 182 Tenn. 255, 185 S.W.2d 617 (1945); National Life & Accident Ins. Co. v. Green, 191 Miss. 581, 3 So.2d 812, 813 (1941). See VANCE, INSURANCE 34 (3d ed. 1951): [T]he courts appear to hold an applicant for a non-medical life insurance policy to a higher degree of good faith because of the fact that with this type of policy the insurer has not had the benefit of a
To guarantee recovery by all legitimate claimants, the insurer should carry the burden of proving unsound health, the materiality of any misrepresentation, and the fraudulent character of any statement of opinion. The insurer, contesting on the basis of the general sound health clause, should prevail only where the opinion as to health is not honestly held. In addition, the industrial sound health clause, just as the clause in ordinary life insurance policies, should refer only to a change in health between the dates of application acceptance and policy issuance.

The non-medical treatment clause is less subject to objection. If the company is given notice of medical treatment, it cannot contest. But insofar as the burden of proving non-materiality and non-seriousness is shifted to the claimant, the clause may unduly prejudice legitimate recovery. Since the insurer contests on the basis of unreported treatment it discovers, it can be expected to have information on the nature of the disorder. To require the claimant to carry the burden of a costly and often impossible proof seems not only uneconomical but unjust.

While reform of existing doctrine would permit virtually every non-fraudulent claimant to recover, recoveries on fraudulent claims could spread.

medical examination ... but relies entirely on answers of applicant as to his health and medical history.” See also National Life & Accident Ins. Co. v. Atha, 199 Ga. App. 835, 675, 677 (1943). But see, Gulf Life Ins. Co. v. Shelton, 155 Fla. 539, 21 So.2d 39, 40 (1943) (industrial policy, insured died from ulcers, recovery allowed because insured “did not know” of the existence of the disorder). 114 See page 61 supra.

115. “The insurance company is . . . in a position where it is, or should be, better able to produce the requisite testimony as to health than the beneficiary, and no hardship can be said to result from placing the burden to produce evidence upon the party best able to do so.” Rosenblum v. Sun Life Assur. Co., 51 Wyo. 195, 65 P.2d 399, 405 (1937).

116. Fear of fraudulent recoveries in large part motivated courts to construct harsh industrial insurance doctrines. See Clark v. Prudential Ins. Co. of America, 219 Wis. 422, 263 N.W. 264, 265-6 (1935). (non-medical selection of risks influenced court to hold that sound health is a condition precedent). Fraud and bad faith are often difficult items of proof. Fuller, The Special Nature of the Wage-Earner's Life Insurance Problem, 2 LAW & CONTEMP. PROB. 10, 43 (1935). Every fraudulent recovery raises costs to honest policyholders. But every rule attempting to eliminate fraudulent recoveries may frustrate legitimate claims. Some courts have perceived this as more costly than allowing some fraudulent claimants to recover. In these jurisdictions recovery is, therefore, governed by rules which are similar to those applicable in ordinary life cases. See, e.g., Metropolitan Life Ins. Co. v. Taylor's Adm'r., 219 Ky. 549, 293 S.W. 1051, 1062 (1927) (sound health clause refers only to time between application and delivery); Pierce v. Life Ins. Co. of Virginia, 178 S.E. 189, 191 (Ga. App. 1935) (accord); Schmidt v. Prudential Ins. Co. of America, 190 Minn. 239, 251 N.W. 633 (1933) (court upholds legislative action binding insurer in non-medical policies to an applicant's honest opinion as to health).

See also MACLEAN, LIFE INSURANCE 219 (1935): “Where the amount of insurance is small, there is little inducement for fraud . . . ” TAYLOR, THE SOCIAL COST OF INDUSTRIAL INSURANCE 85 (1933): “For the most part . . . statements regarding health are undoubtedly made in good faith . . . ”
Faced, however, with potentially greater liability, the insurer would exert greater effort to detect fraud at the time of the selection of risks. Wasteful litigation and pre-litigation investigation would be replaced by more thorough-going investigation at the selection stage. Rejection of applications would eliminate the costs of paying commissions, administering policies, and contesting them. Since an illness of which the insured is aware is difficult to conceal, an agent's diligent investigation would often suffice. Even if fraudulent claims filtered through to recovery, the cost would be spread among thousands of policyholders. No longer would catch-all rules frustrate some legitimate claimants' recoveries in the attempt to weed out fraud.

**Judicial Disposition of Fraudulent Applications**

Although non-medical selection of risks invites fraudulent applications, the agent himself is often the cause. Typically, he asks the questions and records the answers on the application. Because no doctor or other company employee checks the certification of the risk, the agent can insert any answer which

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117. Much information can be gathered by a diligent agent. Height, weight, and age, correlated with occupation and environment, can give the insurer useful information. Maclean, Life Insurance 201-2 (1935); Mehr & Osler, Modern Life Insurance 246-50 (1949). Davis at 107-8. Habits and reputation in the neighborhood, as well as the general knowledge of friends, neighbors, and employers will, in many cases, segregate risks which are uninsurable. The time and expense of such an inspection is minimal. The industrial agent operates in a given neighborhood, id. at 54, and becomes familiar with its residents. Nothing more than a phone call or a visit to a neighbor may spot a fraudulent application.

Insurers have found by experience that "nothing is to be gained by subjecting the applicant to a medical examination." Wood, Influence of the Medical Examination on Life Underwriting, in address delivered before the Association of Life Insurance Presidents, New York, December 4, 1925, quoted in Taylor, The Social Cost of Industrial Insurance 115 (1933). Taylor says: "Indeed, it is estimated that the selection produced by medical examination disappears in the case of Industrial policy-holders in the second year. That is, leaving out the mortality experience of the first year, . . . Industrial policy-holders who have not submitted to a medical examination . . . will show about as good a record as a group who have been examined." Id.

118. A person with a disorder serious enough to materially increase the insurable risk rarely conceals its existence from friends, neighbors, or his employer. Either he informs them directly or by inference. Thus, the information may come to an employer by the applicant's absence from work or by his inability to do heavy work. Moreover, neighbors usually know if the insured has recently visited a doctor, or who the family doctor is. Local clinics have much information on families in the neighborhood. Brief but careful questioning of such persons will usually reveal the existence of a disorder or enough suspicious facts to induce the agent to require a medical examination.

permits the policy to issue. Where the fraudulent application results from collusion between agent and applicant, the law is clear that the policy is voidable. But if the agent falsifies or omits the applicant's honestly and fully reported medical history, the law offers uncertain protection to the innocent industrial policyholder.

A claimant may admit to the insured's unsound health, but blame the agent for its misrepresentation in the application. The doctrines of waiver or estoppel are the legal tools with which the claimant seeks recovery. A waiver occurs where the company has knowledge—actual or constructive—of the applicant's unsound health, but then issues a policy and collects premiums on it. Estoppel, on the other hand, prevents the insurer from contesting where the applicant has been injuriously misled to believe himself a covered risk. The agent's falsifications or omissions in filling out the application typically estop the insurer from contesting on the basis of the facts misrepresented.

These doctrines, however, do not guarantee recovery in industrial insurance cases; courts may apply three contrary rationales. In the first place, when the applicant signs his application, he has usually placed his signature below a statement which denies the agent's authority to waive answers, modify the application, or bind the company by making promises or receiving information.

120. An agent inserting false answers runs several risks. He may lose his license, e.g., N.Y. Ins. Law § 117(1)(c), or he may be discharged by the insurer if there are complaints by claimants. His risk appears great in relation to the returns—a few dollars in commissions—but the chance of detection is small. If the policyholder lives after the contestable period of one or two years, the company rarely investigates. Cf. National Life & Accident Ins. Co. v. Hearn, 14 Life Cases 819, 820 (Okl. 1951) (agent testified that supervisor encouraged him to write policy if agent thought insured would outlive the contestable period). The spot checks on agents' practices are not extensive, and formal complaints to state insurance departments on license revocation proceedings are rare. See statement by Massachusetts Insurance Department Actuary quoted in Taylor, The Social Cost of Industrial Insurance 98 (1933).


127. Ibid. See cases cited in 17 Appleman, Insurance Law and Practice §9401 (1945).

128. This is substantially the wording of the limitation in the application of one of the three large industrial insurers. Most other insurers have similar limitations in either or both the application and policy.
The policy usually contains a like provision. In the face of this blanket limitation on the agent's authority, courts deny recovery even where the misrepresentation admittedly was the agent's work. Secondly, by signing the application, the policyholder can be held to have ratified the fraudulent misstatements of the agent. Recovery is denied because the insured cannot be innocent; it takes two to make a fraudulent application. Finally, most industrial insurance applications and policies carefully state that any ill-health or past disease must be endorsed in the policy by an official of the company. Recovery is denied to an insured whose disorder or medical attention is not included in the endorsement.

When the fraudulent application results from the agent's misstatement, legal doctrines generally offer the court a choice of protecting the innocent insurer or the innocent policyholder. Since the agent's falsification of answers raises an estoppel, courts could avoid the express limitation on the agent's authority.

132. See, e.g., Metropolitan Life Ins. Co. v. Samis, 172 Md. 517, 192 A. 335, 338 (1937) (as a matter of law, applicant guilty of fraud. "The aid of the . . . insured . . . was essential."); Metropolitan Life Ins. Co. v. Alvarez, 133 N.J. Eq. 65, 30 A.2d 297, 299 (1943) (applicant in accepting the policy and application attached has "adopted and ratified the [agent's] misstatements.").
133. See, e.g., Adkins v. Kentucky Cent. Life & Accident Ins. Co., 131 W. Va. 436, 48 S.E.2d 436 (1948); Kentucky Central Life and Accident Ins. Co. v. Lynn, 304 Ky. 416, 200 S.W.2d 946, 948 (1947). "We perceive that an insurer's agent might waive every precautionary feature of a written application for an insurance policy and might act in such a misleading manner that only the jail should be his proper home, yet if the contract itself . . . subsequently came along and said on its face 'this is our binding agreement and only the insurer's president or secretary may waive any part of it' we see no basis for excusing the insured from the operative force of such a contract, as written and delivered. . . . [T]he court was incumbent upon him to have read it over and then, if dissatisfied with his contract as written, to have raised a righteous row in protest.
134. See page 67 supra.
and the required endorsement of unsound health by invoking the doctrine that such policy provisions are inoperative in estoppel cases. Under this rule the company is bound so long as the fraud of the agent occurs in the course of the agent's employment—even though expressly forbidden. Because actual knowledge of the false answers is necessary for a binding ratification, courts could avoid the policyholder ratification theory since, by definition, the innocent policyholder has no actual knowledge. Where his knowledge is proven, the policy is voidable for collusion.

Aside from available legal principles, sound reasons for protecting the applicant exist. Insurance applicants, especially industrial insurance applicants, rarely read the completed application or the limitation of the agent's authority, nor might they understand it if they did. Moreover, the applicant fully relies on the agent; what he says and does is to the policyholder synonymous with what the company says and does.

In industrial cases, however, courts have often chosen to protect the insurer. Because no medical examination screens risks, these courts fear a flood of fraudulent applications. Moreover, in every estoppel case the insured is


Where the application is attached to the policy, complications may arise. The theory is that the insured has an opportunity to examine the agent's misstatements and, upon learning that there is misrepresentation, has a duty to notify the insurer. *E.g.*, Forwood v. Prudential Ins. Co. of America, 117 Md. 254, 83 A. 169 (1912). But some courts have held this fact immaterial. *E.g.*, John Hancock Mut. Life Ins. Co. v. Yates, 59 Ga. App. 713, 179 S.E. 239, 243 (1935), aff'd., 182 Ga. 213, 185 S.E. 268 (1936). *See also Vance, Insurance* 263 (3d ed. 1951), stating that a majority of courts considering the question have held that the insured may show he has not read the application and had no knowledge of misstatements contained therein.

Another rationale available to courts as a device for allowing recovery is that clauses limiting the agent's authority do not affect a waiver resulting from delivery of the policy itself by an agent with knowledge of unsound health. *E.g.*, Hill v. Metropolitan Life Ins. Co., 259 App. Div. 278, 18 N.Y.S.2d 753, 755 (2d Dep't 1940).


137. Continental Ins. Co. of New York v. Pierce, 39 Kan. 396, 18 Pac. 291, 293 (1883); Clubb v. American Accident Co. of Louisville, 27 Ga. 502, 25 S.E. 333 (1895) (insurer unable to contest so long as applicant was ignorant of false answers in application); 17 Appelman, Insurance Law and Practice 9 (1945): "The fact that the insured may have signed the application would not render him responsible for false statements inserted by the agent therein without his knowledge where he had given truthful answers and had no reason to believe that they would be falsified by the company's representative.

138. Note 121 supra.

139. See *Vance, Insurance* 258 (3d ed. 1951).


141. *E.g.*, Kentucky Central Life and Accident Ins. Co. v. Lynn, 304 Ky. 416, 209 S.W.2d 946, 949 (1947) (unless court protected insurer, it would not have "a reasonable opportunity to remain in business.").
usually an uninsurable risk. Implicit in the decisions is the view that allowing recovery simply because an agent falsified answers would be unjust to the insurer.

Although preventing fraud and denying recovery on uninsurable risks are desirable enough objectives, protecting the insurer in court need not achieve them. Under present case law, the insurer is as often protected from its own agent's fraud as it is from the policyholder's. But if the insurer were bound by every fraudulent act and statement of its agent in the course of employment, innocent policyholders would always recover. Ultimately, insurers would act to reduce recoveries by uninsurable risks. But as long as an insurer can find protection in finely printed stipulations enforced by courts, effective action in weeding out fraudulent applicants may be long in coming.

PRESENT CHECKS ON INDUSTRIAL LIFE INSURANCE

Legislative Regulation

Present statutory control of industrial life insurance is inadequate to the task. Industrial life insurance is frequently exempt from mandatory benefits and policy provisions required of ordinary life insurers. Few states have statutes designed to solve the problem of non-medical selection of risks. Some, however, permit successful contest of claims only if the insurer can prove willful misrepresentation on the applicant's part. Problems of waiver and estoppel are generally left to courts. And while several states have directed legis-

142. See, for example, cases cited in note 130 supra.
144. See page 66 supra.
relative attention to cost reduction, the statutory schemes fail to attack the underlying causes of industrial insurance's high cost to policyholders.

**Regulation by Competition**

Competition from alternative types of life insurance has likewise failed to cure defects in industrial insurance. None of four potentially vigorous competitors has directly challenged the appeal of industrial—universal availability, "easy" payment in low installments, and immediate cash benefits upon death.

In recent years, group insurance has been the most significant alternative. Available where a specified percentage of employees of an enterprise form a group with the employer's consent, group insurance in force exceeds the face value of industrial insurance in force. The policies are generally issued without medical examination. Its cost, per dollar of coverage, is considerably lower than the cost of industrial insurance, and the employer pays

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149. See Vance, Insurance 44 (3d ed. 1951). New York has the most comprehensive statutory regulations of the cost of industrial insurance. Under N. Y. Ins. Law § 213-a, the expenses incurred in the transaction of industrial insurance cannot exceed a maximum determined by totaling percentages of all premiums paid by industrial policyholders. If an insurer exceeds the statutory limit for more than two years, N. Y. Ins. Law § 213-a(9), it may lose its license, or be liquidated. N. Y. Ins. Law §§ 40(5), 513, 511(f). The law requires the insurer to fix the agent's compensation in advance. N. Y. Ins. Law, § 213-a(5). It fixes maximum commissions for new business which in effect equalize the percentages of first year premiums payable as commissions on all forms of industrial with monthly ordinary, N. Y. Ins. Law §213-a(7). Compensation based on the volume of new business or the aggregate number of policies sold is prohibited. N. Y. Ins. Law § 213-2(6).

150. The New York legislature, supra note 149, missed an opportunity to correct some basic problems. The statute has no provision designed to reduce or discourage home collections. The statute does not positively encourage sales of monthly ordinary by allowing payment of a higher sales commission than payable for weekly premium industrial insurance. No steps were taken to reduce lapse by enforcing proper distribution among members of the family. Fixing compensation in advance does not deter the agent from encouraging home collections since the compensation will likely be based on the size of premiums collected in previous years. Moreover, "compensation" may be interpreted as meaning merely the fixing of a percentage of premiums collected or a percentage of first year premiums rather than a salary; if only the percentage need be fixed in advance, the statute removes no pressure to sell new policies or encourage home collections.


152. Usually 75 per cent of the employees must be insured if premiums are paid by employer and employees jointly. Standard Definition of Group Insurance of the National Convention of Insurance Commissioners, 1917, quoted in Mehr & Osler, Modern Life Insurance 209 (1949). This definition has continued to serve as the basis of group insurance. Davis at 234.

153. In 1949, group insurance in force amounted to approximately 42 billion dollars in face value. Life Insurance Fact Book, 20 (1950). In the same year there was almost 32 billion dollars of industrial life insurance in force. Id. at 23.


the premium in whole or in part. The amount of insurance held by any individual participant is greater than the average industrial policyholder's coverage. But group insurance is not widely distributed among low-income earners in the United States. Many small plants have no groups. And non-employed women and children, a large market for industrial, are not covered. Finally, policies are on a yearly term basis; the insurance lasts only so long as the insured continues to work in the group.

The Social Security Act offers an equivalent of industrial life insurance in lump sum death payments to survivors of eligible workers. Under the 1950 amendment to the Act, an individual payment benefit may run as high as 312 dollars. While this sum would appear to satisfy the demand for burial expenses, the estimated average payment under the Act is only 160 dollars. Inevitable administrative delay may hold up actual payment for months. And here again, non-employed women and children are not covered. Perhaps after many years of operation, social security benefits will cut significantly into the industrial insurance market. At present the effect is negligible.

156. Id. at 214.
157. The average group policy has a face value of approximately $1400, calculation based on table in Life Insurance Fact Book 20 (1950), while the average industrial policy is approximately $300 in face value. Id. at 23.
158. Many statutes require the group policy to cover "not less than twenty-five employees." E.g., Ill. Ann. Stat. c. 73, § 842 (Supp. 1950). Since many of the lower income wage-earners work in shops and plants of less than twenty-five employees, they may not be covered by group insurance. Moreover, many states require groups to be not less than fifty employees. Mehr & Osler, Modern Life Insurance 209 (1949). It has been estimated that a reduction of the minimum group limit in all states to twenty-five employees would make group insurance available to approximately 75% more employers. Id. at 210.
159. Massachusetts Savings Bank Life Insurance Council, Casaby, A Buyer's Guide to Life Insurance 10 (1951). When the employee leaves the group, however, he may purchase ordinary life insurance from the same insurer in an amount not to exceed his group coverage. Davis at 238.
162. Social Security Board, A Handbook on Federal Old Age and Survivors Insurance 81 (1941). The 1950 amendment to the Act does not significantly change the size of the lump sum death benefit. Under the old Act, the benefit was six times the primary benefit; under the new Act it is three times the primary benefit, but the primary benefit has increased enough to make the size of the benefit the same. Sen. Rep. No. 1669, 81st Cong., 2d Sess. 28, 66 (1950).
163. Id. at 28.
Savings Bank life insurance\textsuperscript{164} is the most attractive alternative to industrial, and potentially its most potent competitor. Sold to any buyer over the counter at Savings Banks, in any amount and under a variety of plans,\textsuperscript{165} and protected by the soundness of the banking system, Savings Bank life insurance is the cheapest protection offered the wage earner.\textsuperscript{166} Despite low costs, policies are fair and benefits high.\textsuperscript{167} But because the advantages of Savings Bank life insurance are not widely publicized,\textsuperscript{168} it is little used by low-income groups.\textsuperscript{169} And most important, at present it is available in only three states.\textsuperscript{170}

In recent years, labor unions have become insurers of their members. The Amalgamated Clothing Workers Union, for example, provides life insurance benefits of $500 to $1000 to its 300,000 members through a chartered life

\textsuperscript{164} Savings Bank Life Insurance was created in 1907 by Louis D. Brandeis in response to criticism of industrial life insurance. See \textsc{Mason, The Brandeis Way} (1938) for an historical analysis of its inception. For an exhaustive analysis of its structure and function, see \textsc{U.S. Dept. of Labor, Bulletin No. 688, Operation of Savings Bank Life Insurance in Massachusetts and New York} (1941).

\textsuperscript{165} Savings banks may issue whole life, limited payment life, renewable term, and endowment policies. They may also issue annuity contracts, a combination of life insurance policies and deferred annuity contracts, group insurance, and such other types as the Insurance Department deems desirable. \textsc{Bulletin} No. 688, \textit{supra} note 164, at 17.

\textsuperscript{166} See \textsc{Bulletin} No. 688, \textit{supra} note 164, \textit{passim}. See table on page 49 \textit{supra} for comparative costs of ordinary, industrial and Savings Bank Life Insurance.

\textsuperscript{167} See chart comparing policy provisions and benefits of the savings banks and ten insurance companies in \textsc{Bulletin} No. 688, \textit{supra} note 164, at 42-43. The policies contain no sound health clause. See sample policy on file in Yale Law Library. See also \textsc{Public Affairs Pamphlet No. 134, Stewart, Buying Your Own Life Insurance} 13-17 (1947).

\textsuperscript{168} For example, \textsc{N. Y. Banking Law, § 269} provides that the banks "shall not employ solicitors of insurance." Massachusetts and Connecticut have similar no-solicitation rules. The rule, in effect, bars active proselytizing although it permits newspaper and radio advertisements and brochures. As a result of pressure on the state legislatures to keep publicity at a minimum, \textsc{Mason, The Brandeis Way} 260 \textit{et seq.} (1938), relatively few persons are sufficiently informed of SBLI to become purchasers. \textsc{Public Affairs Pamphlet No. 134, Stewart, Buying Your Own Life Insurance} 17-18 (1947). An unpublished survey prepared by Facts and Figures for the Massachusetts Savings Bank Life Insurance Council indicated that only half of the lower income groups heard of SBLI. \textsc{Survey, T. 26} (1949) "[A] large group in the lower income levels remains relatively untapped." \textit{Id.} at 5.

\textsuperscript{169} "[W]orking-class families, for whom the insurance is especially beneficial, have, for the most part, failed to take advantage of this cheap over-the-counter insurance." \textsc{Stewart, op. cit. supra} note 167, at 17. But see \textsc{Bulletin} No. 688, \textit{supra} note 164, at 17: "[T]he majority of . . . policies are issued to a similar class of buyers [as industrial insurance buyers]."

\textsuperscript{170} See note 164 \textit{supra}. Bills for enablement of Savings Bank insurance have failed to pass in 13 other states. \textsc{Public Affairs Pamphlet No. 134, Stewart, Buying Your Own Life Insurance} 24 (1947).
insurance company.\textsuperscript{171} Premiums are paid wholly by the employer.\textsuperscript{172} The company insures almost every one of the union members.\textsuperscript{173} Other unions purchase group insurance policies for their membership.\textsuperscript{174} While such programs offer a substitute for industrial insurance, union insurance is still in an experimental stage.\textsuperscript{175} Today many unions have no life insurance department. And often low-income workers are not members of unions.\textsuperscript{176}

CONCLUSION

High cost and uncertain coverage are the outstanding defects of industrial life insurance. The enormous expense is primarily traceable to wasteful selling and premium collection methods and a high lapse rate. Uncertainty of coverage results from many factors. Because the industrial policyholder is not medically examined, he may never know whether he qualifies under the sound health clause in the policy. Moreover, courts may, under a rigid interpretation of the sound health and non-medical treatment clauses, require the claimant to carry an expensive and often impossible burden of proof. Some industrial insurers limit or deny recovery if the insured dies of certain diseases.

\textsuperscript{171} AMALGAMATED CLOTHING WORKERS OF AMERICA, A STITCH IN TIME 12 (1950). The size of the benefit depends on the industry in which the worker is employed. Men's Clothing workers get $500, Store Workers $1000. Id. at 10-11.

Other unions are insurers of their members, \textit{e.g.}, the Distributive, Processing, and Office Workers Union. Unlike the Amalgamated, the DPO insurance branch is not a chartered life insurance company but a trust operating under an exemption from the insurance laws. N.Y. INS. LAW § 466(1). Benefits range from $1000 to $7000 depending on size of weekly earnings and length of service in union shops. TRUSTEES OF THE 65 SECURITY PLAN, THE 65 SECURITY PLAN 32 (1951).

\textsuperscript{172} AMALGAMATED CLOTHING WORKERS OF AMERICA, A STITCH IN TIME 11 (1950).

\textsuperscript{173} Ibid.

\textsuperscript{174} Ibid.


\textsuperscript{176} See, \textit{e.g.}, the resolution on a UAW-operated Insurance Company adopted at the UAW 13th Constitutional Convention, April 51, instructing the International Executive Board "to make a comprehensive study of the various aspects of the insurance problem and the best methods of meeting the needs of our membership..." And see statement of President Reuther: "The UAW-CIO has approximately 1,250,000 members—this is a large enough group to handle its own insurance on a mutual non-profit basis and make sizable savings for the workers." Quoted in communication to the \textit{Yale Law Journal} from Harry Becker, Director of the Union's Social Security Department, dated April 9, 1951 in Yale Law Library. The Seafarers International Union, A.F.L., has recently decided to experiment with an insurance plan administered jointly with the ship operators. N.Y. Herald Tribune, Feb. 23, 1951, p. 28, col. 8.