Part Two
1960–1969

CHAPTER 12

1960
Going International

Image, integration and the long-term view

Although, at the beginning of the 1960s, Bermuda was struggling with the process of racial integration, it was well off in financial terms by comparison with the rest of the world. Henry Tucker had done well. Unlike the economies of most other countries, that of Bermuda 'was free of long-term debt. It had old established businesses with a long record of overseas clients, it was conservative and relatively stable, it had a reputation for respectability and, bearing in mind, this was the colonial era, it had Anglo-Saxon people up front.'[57]

Yet it was this very same image that was causing so much racial conflict at home. Tucker was facing a dilemma in his political and financial career. He had to maintain the Anglo-Saxon image, which the rest of the world saw as a mark of financial stability, without aggravating the unrest that his Government had already provoked by misrepresenting Bermuda's demography.

Despite the signs of social instability on the horizon, the Bermuda establishment continued to promote the island as a stable jurisdiction, on the one hand, while on the other juggling with ways to court international business, without being discredited as a shady offshore haven. In the early 1960s the handling of taxes was very unsophisticated. According to Gordon Phillips, 'most of the business transacted around the world before it was either phased out or changed as a strict matter of policy, lay in the grey area between tax avoidance and tax evasion. Avoidance was for the better advised and evasion for the not so well advised, and there were lawyers aplenty able quite legitimately to circumvent some rather nebulous international tax legislation.'[58]

From the beginning, Bermuda banks saw there was no long-term gain to be derived from being nothing more than an offshore tax haven or from engaging in unlawful transactions, all just for the sake of monetary profit. Therefore they took the appropriate steps to screen out suspect clients. Gordon Phillips continues, 'Bermuda is not for everybody and the Bank (of Bermuda) dealt increasingly only in individual accounts, known to Americans as the carriage trade, and any "funny" and "dirty" money was weeded out. Insurance broking, trust fund management and trade between two or more foreign companies were activities which spilled over from the previous decade, and the next major stage in Bermuda's development came with captive insurance companies.'[59]

Thanks to this good faith and foresight on the part of the banks and the business establishment, Bermuda has always been beyond reproach in matters of taxation and above suspicion in regard to money laundering, even though such restraint has held Bermuda back from ever becoming such a major banking centre as are other less circumspect jurisdictions.

[57] Gordon Phillips: First, *One Thousand Miles, Bermudian Enterprise and the Bank of Bermuda*, Chapter 5 'Building the Sixties', pp. 146–148

[58] ibid.

[59] ibid.

Diversification at American International

As the years went by, C.V. Starr decided he wanted to diversify his company even more. He therefore decided to branch out into the personal accident business. Realizing that he did not have the necessary in-house expertise for that, he went looking for the right candidate and found him in the person of a bright young man named Maurice Greenberg, the youngest Vice President at the large and well-respected US house of Continental Assurance Company of North America (CNA). The hiring of Greenberg was to signal a change in direction for the AIRCO group and particularly for those based in Bermuda.[60]

Integration continues

Although Bermuda was beginning to attract international business, it was still very rare at the start of the '60s to see a black person in a 'leadership role' in the burgeoning financial sector. There was increasing disquiet. A community, in which blacks and whites had always lived politely side-by-side, though never truly together, was becoming restless. Educated blacks were no longer willing to sit on the sidelines while the whites took all the prominent jobs. Yet for those blacks who wanted wider opportunities, the very fact that Bermuda had always been a peaceful community made it the more difficult to start upon integration without arousing an unacceptable level of upheaval.

Not only was it extremely rare to see a black person out front in the financial sector, it was rare to see a black man out front anywhere. The establishment hoped to mollify growing discontent simply by professing itself to be all for integrating hotels, restaurants, theatres and public places. Too many blacks had been frustrated by too many broken promises and empty rhetoric, none of which had led to any action. There were still many establishments that outright excluded persons by discrimination of race, 'colour', creed, or whatever.

Henry Tucker knew that integration was essential. He could foresee the devastation that would befall the economic hopes of Bermuda if the process were delayed. Therefore he declared it time for all in the community to embrace the change if they wanted the island to prosper. Many may say to this day that Tucker's push for racial harmony was motivated as much by his wish for a 'Switzerland of the Atlantic' as by a love for justice but, be that as it may, the cause was just and history was on his side.

One of the catalysts for racial change came in September 1960, when a series of meetings, led by political activist Roosevelt Brown and others such, took place across the island and discussed the changes needed to integrate Bermuda. Randolf Williams records how the group—

> '...originally consisting of ex-scholars from Howard University, formed itself into a body politic, the Committee for Universal Adult Suffrage (CUAS). This group awakened politically dormant minds and educated the "coloured" (euphemism for "blacks"; at the time) public about political matters as never before. Panelists at its meetings were often politicians or those associated with that field. When asked if Bermuda was ready for universal franchise, so called radicals, such as John Swan, Stanley Ratteray, and Mansfield Brock, agreed wholeheartedly that it was. While they all argued speedy reform, the establishment still encouraged gradualism.'[61]

Sir Henry and the CUAS

As commercial and financial companies began setting up in Bermuda, so the establishment became more and more aware of the growing popularity of CUAS among the working class and began to realise that this body was not to be pushed aside and would have to be taken seriously. In that he

[60] Interview with Ernie Stempel, 28 March 2002

[61] J Randolf Williams: *Man of Stature, Sir Henry James Tucker*, Chapter 9, 'Welcome Home Jack', pp. 136–137

was trying to learn as much as he could about CUAS and its influence, Henry Tucker, though white, was yet respected as a leader and, even in the midst of racial strife on the island, he was knighted by the Queen on 12 June 1961 and would be known as 'Sir Henry' thereafter.

Frustrated with the pace of racial integration, small groups of blacks began to meet to discuss the political situation in Bermuda. They decided that there was need for a workers' political party, because they no longer thought the Bermuda Industrial Union, formed in the 1950s, was influential enough to change the fate of the working class. It took several years before such a party was formed, but meanwhile much of Bermuda breathed a changing air.

CHAPTER 13

1961
'*Captive*' Gets a Special Meaning

Fred Reiss

Henry Tucker, Bill Kempe and others continued to search the globe for another pillar upon which Bermuda could build its economy. The island continued to wrestle with integration and significant political changes at home. Then, while all this was happening, along came a man named Fredrick Mylett Reiss, who would change forever the landscape of international insurance in Bermuda. Reiss was not born to wealth or privilege but he never let that keep him from success. Early in the 1940s he won a scholarship to Harvard to study philosophy. It seemed that a lifelong dream had come true and that he would become a philosophy teacher. Instead, as fate would have it, the United States entered World War II and the US military went around the universities recruiting able-bodied young men to serve their country. Reiss was recruited and joined up with the Reserve Officer Training Corps (ROTC) of the US Army.

The military had very strong opinions at that time about what their soldiers were to study and they did not consider philosophy to be a useful discipline for a soldier. So they advised Reiss to change his major to Chemical Engineering. Reluctantly, Reiss agreed. He realised that he was abandoning his dream, but he needed the financial support if he was to continue his studies to graduate level. So he went along with the program. It was only later and in retrospect that he saw himself as having set his life on such a path as he would never have imagined to be possible, given his simple beginnings in Ohio.[62]

His father had served in the cavalry during World War I and Reiss had thought he would follow in his father's footsteps, until he was taken out for a glimpse, and a sniff, of life in a regiment of horse. He opted instead on the freedom and freshness of life on the ocean wave and Fred Reiss joined the Navy. When at long last the war came to an end his university class, the one that would have been the Class of '43, was able to graduate, although a little behind on its original date.

After he finished Harvard, his engineering background brought Reiss into insurance. He was hired as a fire protection engineer at the Ohio Inspection Bureau and it was while working for the Bureau that he happened upon the idea of 'captives'. He was travelling the United States, assessing and developing rates from the state level. The more he travelled, and the more he heard clients lament how difficult it was to obtain coverages from the insurance industry, the more clearly he saw that an opportunity was waiting to be met. He came to the realisation that what corporations sought, but could not find, was how to finance the coverage of their exposures in a way that would ultimately bring down the net cost of insurance to the corporations.

Howard Rose records that—

[62] Interview with Anna Summers and Debbie Reiss, 7 March 2002

> 'Reiss realized that many large corporations faced paying enormous premiums in the traditional insurance markets because of losses on failed research and marketing, the confiscation or nationalization of assets, and new health and safety requirements, from for instance oil plants and new buildings. He reasoned that the new US legislation and similar rules in Britain meant companies could enjoy tax advantages on their premiums at home if they insured their risks through specially-created subsidiaries based abroad.'[63]

Reiss even coined a term to describe the concept. He would call such a subsidiary a *'captive'* and there is a history to this now familiar but originally esoteric usage of a common and familiar word. Rob Rosser, retired executive of Skandia Insurance Company, who began his career with International Risk Management in the 1970s, says that Reiss adopted the term 'captive' as a result of working with his very first client, the Youngstown Sheet & Tube Company of Youngstown, Ohio. Rosser says that company had a series of mining operations, which produced its raw materials. The management of Youngstown Sheet & Tube called these 'captive mines' because their output was put solely to the corporation's exclusive use. When, under the guidance of Reiss, they began to have their own insurance subsidiaries, the management designated them 'captive' insurance companies, because they were writing insurance exclusively for the 'captive' mines. Reiss took a fancy to the term and from then on used it himself, but in a much wider context.

Reiss came to realise that by staying in the public sector he would never gain sufficient access to the people and the information he needed if he was to understand the dynamics of the insurance industry. So he left the Ohio Inspection Bureau and began work as a broker at an insurance brokerage firm called Bruce & Company. He was eager to learn as much as he could and quickly established himself as an enthusiastic hard worker. His efforts were soon rewarded. He was made a partner in the firm. Bruce, the senior partner, needed the youth and enthusiasm that Reiss brought to the business if the firm was stay at the cutting edge of the insurance industry.

Reiss began to travel overseas and so was able to establish contacts at Lloyd's. The more he talked to people, the more excited he became about his 'captive' concept. Believing that he was on to something significant, he branched out on his own in 1958, when he incorporated American Risk Management (ARM). In the beginning, he based his concept on the simple principle of setting up captive insurance companies to insure the risks of the parents. Such a captive company would insure only the parent's risk, and needed only a low level of capital set aside against future losses. However US regulators did not at the time acknowledge the controlled risks of a captive and therefore required captives to have the same amount of capital as a traditional insurance company would need for incorporation. This requirement made it prohibitively expensive for captives to form in the US. Also, because the regulators made no distinction between controlled captives and traditional insurance companies, the captives were required to file annual returns nicknamed the 'yellow peril' (because the cover was yellow and it was an onerous document) to the National Association of Insurance Commissioners (NAIC).

With the concept in hand, Reiss set up 'captives' in Louisville, Kentucky and in Youngstown, Ohio, these being advantageous locations because the states in question were able to offer some tax and regulatory relief that was not on offer from any other states in the US at that time.[64] Reiss was still not satisfied. He knew he could do more with his concept if only he could find the right jurisdictions in which to operate. Therefore, he went in search of a jurisdiction that could understand the nature of captives with a fair regulatory environment and minimal capitalisation requirements.

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[63] *Bottom Line*, May 1993, 'Capturing the Market', by Howard Rose, pp. 31–37

[64] Interview with Debbie Reiss and Anna Summers, 7 March 2002

CHAPTER 14

1962–1964
The Captive Movement Begins

United States Tax Reform Act 1962

Unbeknownst to Fred Reiss, the Tax Reform Act of 1962 would create conditions in which his captive concept would flourish. According to Andrew Barile and Francis J. Mulderig—

> 'In 1962, the Kennedy Administration led an assault upon the escape of foreign profits from current taxation. This net was created by the Tax Reform Act of 1962 which defined certain kinds of income which would become subject to current income tax imputed by the US parent.'[65] With this tax reform act, 'the US government began to tax US shareholders of captives on the investment income they earned by the captive as well as the underwriting profit on US business in the same year that it is earned.'[66]

Business Insurance was of the opinion that the US Revenue Act of 1962 made it possible—

> '...for the first time to set official ground rules in place for the tax treatment of offshore captives. The Revenue Act in effect wiped out the tax advantage of captives writing domestic risks, while retaining it for captives with 95% of premiums coming from foreign risks.'[67]

Although the Tax Reform Act of 1962 was passed to restrict income from going offshore, captives were still being formed, because parent companies had discovered a loophole in the law. Barile and Mulderig account for this as follows—

> 'The premium was deductible by the parent when paid to the captive but since the captive could, as an insurance company, set up reserves for unearned premium, outstanding losses and incurred but not reported losses, the underwriting profit which was includible in the parent's gross income was deferred. This deferral could be anywhere from one year to seven years depending on the type of insurance being written. This was the tax situation for captive insurance companies from 1962 until August 29, 1977. It was a compromise between those interested in ending the tax avoidance uses of insurance and those concerned about the possible interference with non-tax motivated foreign insurance transactions. In any case, this was the solution of Congress to what it saw as an abuse of the tax treatment of insurance.'[68]

Janet Owner, former Senior Officer of the Continental Insurance Company, Bermuda, recalls from company records that the 1962 Tax Reform Act at first seemed to have an adverse effect on the way the Niagara Insurance Company could do business in Bermuda...

> It '...prohibited the Niagara from conducting more than 5% of its business with its parent (or with US risks in general) if it wished to retain the US federal income tax deferment on its earnings.' But after management thought the problem through, they decided that, instead of closing up shop, 'they would continue in business, but as a reinsurer operating in the international area.'[69]

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[65] Andrew Barile and Francis J. Mulderig *The Captive Insurance Company*, Appendix III, www.abarileconsult.com
[66] Andrew Barile and John Kessock, ibid., Appendix II. www.abarileconsult.com
[67] *Business Insurance*, 18 August 1969, 'Bahama Islands get first insurance code; captives seek new home'
[68] Andrew Barile and Francis J. Mulderig, op.cit., Appendix III, www.abarileconsult.com
[69] Interview with Janet Owner, 12 June 2002

The 1962 tax act also had a positive effect on the way Bermuda was perceived by shrewd American business people. Written into the act were the first provisions for taxing offshore US foreign-controlled companies. This in turn led many companies to search out overseas locations that offered secure and suitable domiciles. Quite unexpectedly, Bermuda became a place of choice for large companies. It was also as a result of this change in law that Fred Reiss' multinational clients began to press for the establishment of offshore subsidiaries. His search for locale to accommodate his captive concept took Reiss to such places as Bahamas, Panama, Monaco and Switzerland.

Reiss finds a home for his captives in Bermuda

Despite exhaustive efforts Reiss could not find a jurisdiction that would enable his 'captive' concept to flourish and that would satisfy all his needs until, happening to be at dinner in the country home of a Lloyd's syndicate manager, he met Bermudians H.C (Chet) Butterfield of the Bank of Butterfield & Sons and William Kempe, a partner of Appleby Spurling & Kempe. Immediately after he had spoken with these two men from Bermuda, the one a banker and the other a lawyer, Reiss knew that he had found the home for his 'captive' concept. He would set up 'where the remote Bermudas ride' and from there he would reach to the far horizon.

He was so enthused by this meeting that he did not even wait for Butterfield and Kempe to return to Bermuda. Instead he landed there himself, determined to meet the movers and shakers on the island. Using the charm and charisma for which he later became renowned, Reiss started pounding the pavements, looking for a foothold in the country and, for whatever reason, got in touch with David Graham at Conyers Dill & Pearman. Roger Crombie records that—

> 'Graham had established a useful relationship with Samuel Montagu, a London merchant bank he had engaged in the mid-1950s to help with the shipping proposition which started Bermuda's international business sector, using Grahams' extraordinary global network as kindling to spread the fire. Montagu owned two large insurance broking firms in London. In 1962, at Graham's suggestion, Reiss expounded to the bank the notion of establishing a captive insurance market in Bermuda.'[70]

It was at Graham's suggestion that Reiss managed to meet Henry Tucker of the Bank of Bermuda. Reiss could not have chosen a more opportune time to meet with Tucker, considering that Tucker was on a mission to establish Bermuda as the new 'Switzerland of the Atlantic'. As a result, Reiss was able to have Tucker's undivided attention when he discussed his plan to establish captives in Bermuda. By the time their conversation ended, Tucker was sold on the idea. Reiss was enthused because he found Bermuda to be more congenial for his concept than anywhere else. Its regulations allowed him to simplify the process of incorporating captives while the issue of taxation was of secondary importance.

Unfortunately no one else but Tucker and Graham understood what Reiss was trying to do. Many others doubted its legality and the movers and shakers were concerned to preserve the reputation of Bermuda by keeping any 'funny money' out of the island. Reiss would not be rebuffed. He persisted in his persuasions until in the end, with the assistance of Tucker, Sir John Cox, Sir Harry Butterfield, James Pearman, Roland Lines, John 'Jep' Stewart and David Graham, he was able at last to win enough local support for his 'captive concept.[71]

International Risk Management was incorporated in 1962 by a special Act of Parliament. Reiss' original partners were Henry Tucker, David Graham, and Sir James Pearman. Unfortunately, the concept did not take off right away and met tremendous opposition from overseas, as a major bro-

[70] Roger Crombie: *Conyers Dill & Pearman, A History*, Chapter 19, 'Captive Insurance'

[71] *Bottom Line*, Bermuda Insurance Symposium, May 1993, 'Capturing the Market', by Howard Rose

ker in the United States threatened to lobby Washington if Bermuda pushed this captive concept any further. In addition, a major insurance company in New York also tried to thwart the enterprise even before it was begun.[72]

Some say that the broker and the insurer concerned saw the handwriting on the wall, as to what this 'captive' concept could do to their future earnings. There is speculation that the powerful brokerage house and the equally powerful insurance company believed that, once clients were cognisant of their own abilities to insure themselves, the insurance industry would lose control over those clients and as a result the dynamics of the industry would be changed forever. Intent on keeping control, the broker and the insurer strongly resisted the 'captive' concept in its entirety, so much so that they even led a coalition to Washington in an effort to make the whole captive movement illegal.

These two opponents only relented after recognising that they were jeopardising their own reputations in the industry by adopting such a narrow and extreme position. They were seen as arrogant and greedy and as denying the rights of clients to make decisions for themselves. In retrospect, they can be said to have defeated their own ends. By trying to suppress the captive concept before it had even been tested they provoked the opposite of their intent.

Nowadays, with each hard market, clients are growing ever more sophisticated and are leaning more and more towards finding their own ways of protecting their assets. Some observers go so far as to believe that without the concept of captives the insurance industry would by now be charging clients outrageous premiums for little or no coverage. Hopefully, the captive concept will be seen to have brought about a balance within the insurance industry, by compelling both clients and insurers to find a middle ground for pricing and coverage.

Although Reiss met with lawyers from Conyers Dill & Pearman when he first arrived on the island, he then turned to Appleby Spurling & Kempe (AS&K) to help him break into the US market. And it was through his association with AS&K that Reiss was able to make inroads into the United States. It was Kempe and Chet Butterfield who introduced Reiss to the American Management Association (AMA) in Chicago. Kempe said that once Reiss had his foot in the door at this Association, he never looked back.[73]

The captive idea concentrated more on the management services provided to the industry and that was the side for which Reiss pioneered. He was selling his concept on the basis that companies did not have to undergo the expense of setting up offices in Bermuda. His company would take care of everything for them.

Because his own background was confined to engineering, Reiss was chiefly interested in uncomplicated lines of coverage for US corporations, notably their domestic property but by virtue of the same specialisation he also introduced the principle of providing engineering services to his clients. Reiss would send out his engineers to inspect properties and make recommendations directly to the chief executives in person, because corporations then had no such facilities as their own risk management departments.

Reiss' concept was so simple that the policy wording was the wording of the expiring or renewing policy. A corporation would buy a policy from the traditional market for a higher deductible at around US $200,000. Youngstown Sheet & Tube's captive would issue the primary policy and the premium would be the difference between the expiring policy at lower limits and the renewing policy with a significantly higher deductible. Therefore, there was not much in the management fees to manage this simple concept. Recognising this shortfall, Reiss made his money on the engineering side.

[72] Roger Crombie, op. cit.

[73] Interview with William Kempe, 13 February 2002 and 3 June 2002

His first major offshore client was Cargill, a private company, but soon Reiss had become highly respected by major corporations globally[74], although it is said that Reiss guarded his concept closely, away from the media. He very rarely gave interviews about his company or his clients. Outside Bermuda he maintained a low profile and as a result this 'big' Fred Reiss, who was in fact such an open personality, came to be thought of as a recluse, 'the Howard Hughes of the insurance world'. Reiss was simply being sensible. He knew he was on to a good thing and that if he was too vocal about his concept outside Bermuda, the regulators would lock onto it with such invasive curiosity as to suffocating it at birth.

Despite these efforts to remain quiet about his concept, the success of his company was becoming known worldwide and as a result the insurance captives were becoming major items of news themselves. The closely guarded secret was a secret no more and it soon attracted the attention of the US regulators. Perhaps it was because the concept had been so closely guarded that they questioned its legality. Whatever the reason they attacked it with a vengeance, beginning in earnest in 1962.

Cooper & Lines in search of insurance company revenue

While the US regulators were beginning to wage their war on captives, David Lines, the young Bermudian entrepreneur, realised that no accounting firms had as yet specialised in the insurance business that Reiss was bringing to the island. Consequently Lines decided that this was the chance that he had been seeking to bring in more business.

Not wanting to ruin the opportunity in any way, because he knew it would be a windfall, Lines went in search of resources he needed to help him corner this niche market. First he sought expertise in the UK, hoping to find companies that would be interested in establishing a base in Bermuda, thus enabling him to set up a proper infrastructure for insurance accounting.

He recalls visiting a large insurance company in the UK, after having been properly introduced to the senior manager. Lines expatiated on the benefits of doing business in Bermuda. With a steely glance down his nose and a cutting edge to his voice, the senior manager calmly dismissed this proposition to spread insurance as being 'absolutely and positively not British.' Some twenty more years were to pass before Lines did put together a branch office of that company in Bermuda. By then, we may assume, the senior manager had retired.

Feeling a bit rebuffed by the UK reception, Lines began to search other avenues for insurance opportunities. Following his original plan to provide accounting services along the straight insurance lines such as fire, he did eventually get started with a couple of Canadian companies. He had less luck with the Americans than he had originally anticipated. His only success there was in getting a few American life insurance companies to set up in Bermuda.

Of the several accounting firms with which Lines had discussed the prospect of partnership with his firm in Bermuda, only Cooper Brothers in the UK was willing to accept his proposal. Lines was happy enough, because he knew that only through partnership would he be able to build an insurance franchise and be given credit for the effort he would put into the relationship. Other accounting firms wanted a percentage of his earned income in return for the use of their name. Cooper and Lines had already achieved prominence in the insurance world before merging with Coopers & Lybrand and did so simply because a yet more recognised name would help with the branding of their product. As a result of his early foray into the insurance industry Lines was able to play a great part in helping with the worldwide growth of Coopers & Lybrand themselves.

No one knew what an accounting firm was in those days. The Bermuda insurance community was still very unsophisticated. Everywhere was virgin ground, waiting to be sown. David Lines

[74] Interview with Anna Summers and Debbie Reiss 7 March 2002

remembers the early 1960s as a time of beginnings. There were very few management companies in Bermuda. The concept of conflict of interest was as yet undefined. However the accountants had to abide by a 'code of practice', which stated in essence that an accounting firm could not provide both management and auditing services to the same client. Consequently, many people looked for ways to circumvent the code.[75]

Party Politics

In 1963, at the same time that Lines was laying the groundwork for true insurance accounting to begin in Bermuda, Brian Hall joined Fred Reiss' organisation, International Risk Management, as an account manager. There he was to gain invaluable experience of the captive insurance industry.

While Hall was about to make a career choice that would change his life, his island home of Bermuda was about to undergo a monumental change in its political infrastructure. After trying for several years to form a political party that would address the concerns of the working class, a group of blacks founded the Progressive Labour Party (PLP). This was in direct response to a change in the electoral laws that would enfranchise British subjects over the age of 25 who had been resident for three years in Bermuda. The PLP was girding itself to oppose the 'old Bermuda' and to gain more rights for the black population. With the creation of the PLP, many Bermudians both black and white were filled with uncertainty. No one was familiar with party politics. Many wondered what it would portend.

Then on Thursday, 16 May 1963 everyone realised that the politics of Bermuda were about to undergo lasting change. Randolf Williams records the events of that historic day in his biography of Dame Lois Browne Evans. 'Some sixty-six candidates contested some thirty-six seats… Approximately 12,000 of some 14,896 registered voters across Bermuda voted on that day. The result was that the composition of the House underwent some of its most dramatic alterations in Bermuda's history. Ten new members were elected, six of them members of the Progressive Labour Party. Two PLP members—Messrs (Arnold) Francis and (Walter) Robinson—were returned to the House. The number of coloured MCPs (Members of Colonial Parliament) increased from seven to eleven. Once again, the male-dominated House had two women but unlike in 1948 these two women were united in representing a party, one that deemed itself socialist. Lois (Browne Evans) once again made history (she had already become Bermuda's first female barrister in 1953), she was the first coloured woman elected to the Bermuda House of Assembly.'[76]

1963 proved to be a very busy year for Bermuda both economically and socially. By the end of 1963 matters up for discussion among the new members of the House included such important issues as the integration of the schools and the writing of a formal and clearly defined Bermuda Constitution, reforms demanded by the newly formed PLP. Some people looked to 1964 with high hopes while others approached the New Year with dread. The island was on the cusp of major change but there was much uncertainty as to whether the change would be for the better or the worse.

[75] Interview with David Lines, 3 June 2002

[76] J. Randolf Williams: *Lois—Bermuda's Grand Dame of Politics*, Chapter 4, 'Girls, What are you doing now?'

CHAPTER 15

1965
A Catalyst for Global Crisis

Party political challenge and response

By 1965 the people of Bermuda were beginning to make some slow progress toward resolving the racial struggle that beset the island. Both the House and the public were caught up in the matter of integration because it had been pushed to the forefront and there was no possibility of its ever being relegated to the background again.

Many believe that the white Bermudian establishment dared not ignore the issue, for fear of the financial repercussions that would result if unresolved racial problems stood in the way of Bermuda becoming a financial centre. This fear was exacerbated by the riots, civil rights marches and killings in the US, especially because Bermuda's closest neighbour was steadily becoming such a major influence on its people.

The issue of integrating the school system and allowing free education for children between the ages of five and fifteen was put forward and debated. Then, in the summer of 1964, as a direct response to the formation of the PLP, another party was born in Bermuda, the United Bermuda Party (UBP). The two people who were considered to be the founders of this party were Sir Henry Tucker and the Governor, Lord Martonmere, who was much disliked by the PLP. Because the fathers of this new party were already in Government, it became the ruling party by default and as a corollary the PLP became the official Opposition. Party politics had come to Bermuda.

Alexander and Alexander

On 12 May 1965, while Bermuda was fast making a name for itself in the international insurance world and undergoing social and political transformation, Alexander and Alexander (A&A) became the first major brokerage operation to incorporate a subsidiary on the island. A&A's initial local sponsors were Bermuda Fire and Marine. Its board members included Sir Henry Tucker and Sidney Pine, a New York lawyer responsible for helping to legitimise the captive concept around the world.

According to Alan Cossar, managing director of Alexander Insurance Managers, the original reason for incorporating A&A in Bermuda was to start writing international pensions and employee benefits. However, as far as his records indicate, there seems to have been little success at the time, so little that when it came to the board meeting of 30 June 1966, the board members appeared ready to close down the operation. From 1966 to 1969 no real business was transacted by A&A.[77]

Hurricane Betsy

Just at the time when the leaders of finance and commerce in Bermuda were beginning to appreciate the significance of international insurance, a natural disaster struck the US that would have a

[77] Telephone interview with Alan Cossar, Managing Director of AIM, 11 March 2002

profound effect on the global insurance industry. The American National Oceanic and Atmospheric Association records the details—

'Hurricane Betsy developed from a tropical depression on August 26, 1965 east of the Windward Islands and intensified as it moved west. On September 2nd, the central pressure fell to 27.82 inches (942 mb)—the lowest recorded during the life of the storm. Warnings to the Bahamas were posted on September 5th and southern Florida was warned on the 10th. Betsy moved south through the Bahamas, then west over the Florida Keys. Damage from winds, high tides and wave action was confined to an area from Fort Lauderdale, Florida, southward. Flooding over the upper Keys was extensive.

'Betsy turned to the northwest upon entering the Gulf of Mexico and its forward speed increased to 22 mph. The eye arrived at Grand Isle, Louisiana, the evening of September 9th. The eye was 40 miles in diameter on the Louisiana coast

'Great devastation was caused by high water on the central Gulf Coast from the point where the centre made landfall at Mobile, Alabama. Evacuation advice prompted 300,000 people in Louisiana to seek safe shelter. However, 58 people lost their lives because of winds and floods in that state. There were four deaths in Florida; other lives were lost in the adjacent waters of the Gulf and the Atlantic. The total of 75 deaths in Betsy was the greatest loss of life along the Gulf coast since Audrey in 1957. Highest sustained winds of 136 mph were recorded at Port Sulphur, Louisiana, with gusts to 160 mph reported along the Gulf Coast.Betsy's damages in 1990 dollars amount to $6.5 billion, the third costliest US hurricane of the 20th Century. Only the Atlantic coast's Hugo (1989) and Andrew (1992), with more than $7 billion and $25 billion respectively, exceed Betsy's devastation.'[78]

The effects of this catastrophic hurricane were to send ripples through the global insurance industry, as it was to bring to light the inherent weaknesses of the industry and force it to find ways to correct them. Some changes were to benefit the industry while others were to cripple it later on.

According to Brian O'Hara, head of XL Capital Corporation—

'The Bermuda market is a product of our industry starting in 1965 with Hurricane Betsy (Florida) and the shrinking property capacity that started the trend of captives which picked up momentum again in 1975 with the shrinking casualty capacity.'[79]

Lloyd's feels the pinch

The effects of Hurricane Betsy had a significant and altering effect on the mighty Lloyd's of London. This hurricane was to mark the beginning of decades of underwriting decline at Lloyd's. Not only did Hurricane Betsy kill people in the Carolina Coast. It then backtracked through Florida into the Gulf of Mexico where it took out a dozen expensive offshore oil platforms. These platforms were insured by Lloyd's. Because of the costs of the platforms, the underwriting results were devastating for Lloyd's and caused a loss year for the first time in Lloyd's history. For the first time, the 'Names' were presented with a bill to help cover the cost of the loss created by Hurricane Betsy rather than with their normal profit cheques at the end of the year. The substantial costs incurred by individual Names may have had something to do with a decline in their numbers, for the first time in a century.

As a result of the devastating effects of Hurricane Betsy, Lloyd's appointed Lord Cromer in November 1968 to chair a Working Party that would recommend ways to encourage and maintain an efficient and profitable Lloyd's underwriters' market, including the attraction of additional 'Names' and their capital, which market would be of a size to command world attention. On 23 December 1969, Lord Cromer submitted the report of the Working Party to Lloyd's, but only to

[78] National Oceanic and Atmospheric Administration website www.aoml.noaa.gov *Memorable Gulf Coast Hurricanes of the 20th Century*

[79] Brian O'Hara speech to Bermuda Insurance Institute 6 March 1998

Lloyd's management and not to the 'Names' themselves.

> 'The Cromer Report' made certain determinations and conclusions, including but not limited to the following—
>
> 'a) In the decade between 1957 and 1966, Lloyd's had lost ground in the world insurance market...
>
> 'b) Lloyd's had an urgent need to build up its reserves. More capital was needed to create reserves, which were necessary to meet what the Cromer Report called "violent fluctuations in profitability"...
>
> 'c) In 1965 and 1966, Lloyd's for the first time in its 300-year history, experienced overall deficits... these two years were GB£38 million and GB£18 million...
>
> 'd) Technological advances throughout the world created new hazards which may be difficult to assess... (T)hese problems were further aggravated by devaluation of the pound and inflation...standards of underwriting at Lloyd's may have fallen in recent years...
>
> '...The Cromer report was not made available to Names until the mid-1980's…when it was only available upon specific request by a Name, should such Name be aware of the existence of the Cromer Report.'[80]

Hurricane Betsy also had another damaging effect on the Lloyd's marketplace because marine underwriters for the first time realised the dangers of concentrating their risks all in one basket. Therefore, they sought reinsurance across a spread of reinsurers, something that had never been done before because of the powerful name of Lloyd's in the industry. Reinsurers saw the opportunity left in the marketplace by Lloyd's and stepped in to fill the void. For the first time a world wide reinsurance marketplace developed, as marine underwriters sought markets easily accessible to them. Hurricane Betsy can be called the catalyst for the acceleration of Excess of Loss reinsurance in the market, as marine underwriters sought to lay off their risks to reinsurers and reinsurers accepted the new risks to take advantage of shortages in the reinsurance marketplace. As a consequence, Lloyd's share of the reinsurance marketplace steadily began to decline.

However, realising that its market share was being diluted by the newly created world wide reinsurance marketplace, Lloyd's went aggressively after treaty reinsurance business (entire account transfers) to try, by drastically reducing its premiums and relaxing its underwriting guidelines, to replace the capital it had lost as a result of Hurricane Betsy. Unfortunately the world could not turn its back on Lloyd's, because of the reinsurance capacity it could provide, and soon began again to reinsure its exposures through Lloyd's. This proved devastating to Lloyd's later on, when the true extent of its over expansion and conflict of interests became widely known, but it was also as a result of the problems at Lloyd's of London that Bermuda began to see relationships being forged between the two markets.

Trouble on Bermuda's tranquil shore

At the same time that Bermuda was undergoing significant social changes on the one hand, while earning notable respect by making a name for itself in global insurance on the other, it received worldwide attention and frivolous notoriety of a different kind, when the American magazine *Argosy* published an article on the supposed 'Bermuda Triangle', coining for the purpose a term that has persisted as an unwarranted irritant ever since. Meanwhile, however, real trouble of a serious nature was brewing on the island itself.

On 18 January 1965, workers at the Bermuda Electric Light Company (BELCO) went on strike because they wanted to become a part of the trades union. The strike turned violent after

[80] www.truthaboutloyds.com, 'American Names Association ANA', 'The fraudulent Lloyd's scheme', 'The Cromer Report'

picketers attacked the police when they came onto the Serpentine Road property. In total 18 people were injured and one police officer was beaten to death. As a direct result of this violence, the Bermuda Rifles (primarily a white contingent) and the Bermuda Militia Artillery (primarily a black contingent) were mobilised to assist the police and restore order. Within a year, these units were amalgamated to become the Bermuda Regiment.

Such untoward upheavals in the social climate would be unsettling at any time. The violence at BELCO, coming as it did just when international insurance was beginning to take root, unnerved some in the international insurance industry. For whatever reason the leaders of that industry kept their nerve and remained undeterred in the long run, yet one source revealed that during this time of unrest Fred Reiss himself began to look for other jurisdictions in which to realise his ideas. He settled on the Caymans and began to set up a duplicate infrastructure there on which he could replicate his 'captive' concept. That way, should the unrest in Bermuda get so bad as to force him to move, he would still have a place in which to carry on without a major interruption of business.

Some commentators speculate that the rioting at BELCO gave the impetus that prompted many of the international insurance companies to begin diversifying geographically, so that they would always have the flexibility of choice between one country and another. In this way they would always have at least one stable location from which to continue their global operations in the event that a prior location became destabilised.

Likewise some believe it was this breakdown of relations between employers, along with the escalation of racial violence, that prompted Sir Henry Tucker to lead his United Bermuda Party (UBP) in making an end to the 'plus vote', an additional vote that gave property owners an electoral advantage. This abolition of dual voting was news that the PLP had awaited. It made possible at last a true and universal equality of the franchise.

CHAPTER 16

1966 and 1967 Losses and Benefits

Constitutional and Parliamentary changes

In November 1966, while both social and economic changes were taking place on the island, the Bermuda Constitutional Conference began work in London, to shape a constitution for Bermuda, and in 1967 the British House of Commons approved the new Constitution. Bermuda was also getting ready for party politics, as the voting age was reduced from 25 to 21 years and the House of Assembly increased the number of seats in the House to 40 by dividing Pembroke Parish into four constituencies.

Exempted Companies Undertaking Protection Act 1966 and Non-resident Insurance Undertaking Act 1967

With a view to protecting the growing international insurance industry, the government began to take an interest in legislation that would enable the industry to operate more smoothly. According to Howard Rose, the captive movement began in earnest once International Risk Management was incorporated, with government and business leaders giving priority of policy to the nurture of international business. Rose maintains that the 1966 Exempted Undertakings Tax Protection Act provides that exempted companies will not be taxed before 2016.[81]

The Non-Resident Insurance Undertaking Act 1967 was legislated to provide permissions at a regulatory environment for foreign insurance companies to conduct business in Bermuda.

Global insurance industry in a capacity crisis

From the middle to the late 1960s inflation was a worldwide problem. By 1967 the global insurance market was in a crisis. In a speech to the Chartered Property and Casualty Underwriters (CPCU) conference in San Francisco, William S. Mortimer of Hunt Foods said, 'corporate risk managers are showing an increased interest in self insurance for worker's compensation and liability coverage because costs of claims control are "too high".'[82]

Around the same time John Phelan, the President of American States Insurance Company, made a speech to those attending a joint seminar sponsored by the Marine & Fire Association of Japan and the Society of Chartered Property and Casualty Underwriters. He warned that the property and catastrophe insurance market was heading for a 'capacity crisis' in which the risks of catastrophe loss are expanding 'far more rapidly' than the capacity of the private insurers.

In that speech Mr Phelan predicted that tomorrow's catastrophes would be bigger than those of yesterday or today. If Hurricane Betsy had cost US $650 million in 1965 then certainly the industry could expect a billion dollar storm in the 1980s or '90s. Swiss Re estimated that the crash of one jumbo jet of the '70s would have a total catastrophe potential of US $184 million. 'This is

[81] *Bottom Line*, May 1993. 'Capturing the Market', by Howard Rose, pp. 31-37

[82] *Business Insurance*, 30 October 1967, William S. Mortimer, 'Claims handling makes liability coverage too high', p. 14

a generous, but not impossible, estimate.' The same reinsurer predicted that the liability in such a crash would be $150,000 per person—'up from $100,000 per person in conventional jets.' Mr Phelan contended that 'the long term survival of private insurance may very well depend upon our ability to provide very responsive insurance against great catastrophes—and function exceptionally well in the handling of very large catastrophe losses.'

World reinsurance markets were currently 'limited and distinctly cautious'. After a series of batterings, which included 'Betsy', London was 'a shrunken market' for excess loss coverage. 'London has been the traditional refuge of the primary insurer of catastrophe risks; the other world markets, for various reasons, being of less consequence in this field. There's good reason to believe that London will never again be quite what it once was as a catastrophe reinsurer.' The main reason for the shrinkage was that the rates for primary carriers had been 'very thin' and 'thin primary rates mean that catastrophe reinsurance premiums are under pressure.'

'Another cause of the limited catastrophe market lies in the fundamental nature and the necessary objectives' of the corporate primary insurer. 'The primary insurers seek, through reinsurance, to achieve stability of underwriting results over quite short periods of time. Because its operating results are on view to stockholders and policyholders, the US primary company's underwriting view is rather short range. It seeks stability of results on a year to year basis at worst, and would prefer this stability on a quarter-to-quarter basis.'[83]

Cities Service Company fire and explosion

On top of the crisis that was brewing in the global insurance marketplace as a result of Hurricane Betsy, on 8 August 1967 a major fire and explosion occurred at a 300,000-barrel-per-day refinery in Lake Charles, Louisiana, owned and operated by Cities Service Company. This caused major damage, not only to the refinery but also to the insurance industry. It was to go down in history as the first of two manmade catastrophes that changed the way in which oil companies were to purchase insurance, the second catastrophe being the Union Oil Spill in 1969 (previously discussed in Chapter 18).[84]

Simmonds goes under

By the end of 1967 John G. Simmonds Inc., one of two US oil insurance pools, announced that it was going out of business. This led the oil industry to debate whether it should fund its own pool or start a subsidiary carrier. Said *Business Insurance*, 'An estimated $36,000,000 Cities Service Co. chemical explosion, absorbed by the Simmonds pool and Lloyd's of London, is the straw that broke the camel's back. The Cities Service loss destroyed several units of the oil company's refinery in Lake Charles, Louisiana last August after a gasoline cracking unit exploded—the largest chemical explosion for 1967.'[85]

According to Douglas Kline in the 25th Anniversary Report of OIL Insurance Limited—

> 'An energy insurance pool known as the Simmonds Group, which was supported by major US insurance companies, covered the loss. Total property damage to the Lake Charles facility was small: $17 million (perhaps $150 million in today's devalued coin) but the loss caused the Simmonds group to stop underwriting energy risks and disband. That left the Oil Insurance Association (OIA) as the only available source of insurance to cover the major property risks of American Oil companies. What OIA coverage was available carried high premiums and low overall capacity.'[86]

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[83] *Business Insurance*, 30 October 1967, 'Industry facing "capacity crisis", warns Phelan', p. 15

[84] *OIL Insurance Limited 25th anniversary 1971-1995, a Special Report*, compiled by Douglas Kline, Senior Vice President OIL

[85] *Business Insurance*, 27 November 1967, 'Simmonds pool folds; oil companies move to create subsidiary', p. 1

[86] *OIL Insurance Limited 25th anniversary 1971-1995, a Special Report*, compiled by Douglas Kline, Senior Vice President OIL

George Young of *Business Insurance* wrote—

'Many of the oil companies in the John G. Simmonds Inc. pool which have been served cancellation notices effective 1 January were reportedly having a difficult time getting insurance. A debate within the oil industry about starting its own insurance pool or subsidiary carrier is still going on. But it seems the oil companies might prefer to stay in the open market if the insurance industry can provide the coverage. Limits in the billions of dollars would be needed by the oil industry, according to one source.

'C.V. Starr Co., which offered to buy Simmonds earlier this year, is soliciting insurance companies to participate in an oil industry pool. None of the companies approached was reported to have been in the Simmonds Pool, and it was doubted that Starr could generate enough capacity to meet the needs of the oil industry.

'According to oil industry sources, the Oil Insurance Association, (OIA) is already having trouble getting reinsurance for its oil companies—possibly caused by a retreat in London from high capacity US risks. Small oil companies and those with bad loss experience are expected to be rejected by the OIA if they apply for insurance. An oil company executive contended that the OIA preferred to write coverage for large oil companies. Many of the oil companies, in the cold because of Simmonds' folding, were reported to have been refused by OIA previously. A source estimated that at least 300 small companies were in the Simmonds pool before it folded.'[87]

Ford Motor loses court case

As well as an increase in damages due to natural disasters, the 1960s saw an increase in damages awarded on account of manmade disasters. In 1967 the Florida Supreme Court handed down a ruling that left manufacturers liable at law under implied warranty that their products would work effectively, just as they could be sued under implied warranty against personal injury. The owner of a 1964 Lincoln Continental sued the Ford Motor Company on the grounds that, by reason of continual breakdowns and failures, it 'gave no useful service as a motor vehicle.'[88] Ford denied the existence of a warranty, written or implied, as to the efficacy of the vehicle, but the court ruled for the plaintiff and Ford was found liable.

The fact that product liability was becoming stricter made the insurance world very nervous. Underwriters began to ask how they would be able to quantify and price this new risk. On 30 October 1967 J. P. Olsen, the insurance manager for Ingersoll-Rand, wrote in a perspective for *Business Insurance* that 'manufacturing companies and their liability insurers have been viewing with increasing concern recent court decisions which appear to be stripping them of many of their legal defences to personal injury actions arising from the use of manufactured products. The wringing of hands is not without justification—although the nervousness of some underwriters and their defence counsel tends to exaggerate what is admittedly a serious problem.'[89]

British pound devalued overnight

As if all this were not enough and to compound the misfortunes of London insurers, the pound sterling was suddenly subject to massive devaluation. Over the weekend of 25 November 1967 it fell by 14.3 per cent, from US $2.80 to US $2.40. 'The move', said *Business Insurance*, 'is an attempt to lower the cost of British goods in foreign markets, and at the same time discourage the flow of imports into Britain.'[90] This devaluation severely depressed the value of reserves at Lloyd's. Martin E. McConnell, President of Stewart Smith & Co. (Aviation) Inc., said, 'this is bound to affect

[87] *Business Insurance*, 11 December 1967, 'Demise of US pool strains oil facilities', by George Young, p. 2

[88] op.cit., 30 October 1967, 'Court extends implied warranty from injuries to faulty products', p. 18

[89] op.cit., 'Perspective, Product liability gets stricter and stricter', by J.P. Olsen, p. 35

[90] op. cit., 27 November 1967, 'Insurance men study devaluation of pound', p. 1

Lloyd's sterling reserves. Underwriters will want to take in more "hard currency" to try to increase the flow of dollars into the British economy.'

James Hughes, insurance manager of Martin Marietta Corp., was quoted as anticipating 'murderous competition' with emphasis on selling from all aspects of the British economy. 'After all, if you woke up and found your money was worth 14 per cent less, you might take bigger chances.'[91] The London market went looking for ways to redress its fortunes. Bermuda was to gain business from London from two sources. The first was the Weavers syndicate and the other was to be found in the Protection and Indemnity Clubs.

Meanwhile the devaluation of the pound was not without affect on Bermuda itself. The island economy was intimately linked to that of Britain. The banks in Bermuda closed for two days while they tried to forecast the repercussions. The Bermuda government, the Bank of Bermuda and the Bank of Butterfield were all caught in a critical dilemma as to how they should respond. Bermuda was unprepared. There was no contingency plan against such an eventuality, no strategy in place to limit the damage.

Because of its implications the downgrading of a currency can provoke an emotional uproar even disproportionate to its actual financial cost. In his history of the Bank of Bermuda, Gordon Phillips brings to the situation a more balanced reassessment, presenting the facts, in place of the parliamentary rhetoric indulged in at the time—

> 'It has been argued that, with a payments surplus between 1965 and 1977 of some $83,000,000, Bermuda had little need to devalue the pound. President Lyndon Johnson's cutbacks on overseas travel for US residents had little effect upon the Island, and hotel beds had an occupancy rate of 75 per cent through the year, worth $14,500,000 to the economy. For all that, the Board agreed that Bermuda had no alternative but to devalue. Both banks and the Government talked discreetly about a flight of sterling had the Island not done so. Despite this discretion, there were quibbles and an impression was left that "the Bermuda Government was a wholly owned subsidiary of the two banks" (*The Financial Times*, 30 January 1968). In December, Sir Henry Tucker had pointed out that if the Bank kept accepting sterling deposits for conversion into local pounds, it could mean that in any subsequent devaluations, the overall situation in Bermuda would deteriorate. This drastic action on the part of a beleaguered British Government posed very real problems for the Bank and, in common with Butterfields, it was forced to close for two days while briefings were held and routine work was suspended.'[92]

Protection & Indemnity (P&I) Clubs

Whatever the anxieties and omens that attended the sterling devaluation, it promptly gifted Bermuda with a windfall at the hands of Bill Kempe, whose marketing efforts now bore fruit. No sooner did havoc reign in the currency market than the Protection & Indemnity Clubs were on their way to Bermuda. The origins of these 'P&I' Clubs can be traced back to the England of the 1860s. They were formed because no insurance company was willing to cover the liabilities of passengers and crew on ocean going vessels. Therefore ship owners banded together and organised their own 'captives' to cover each other's liabilities. In technical terms these were the first mutual association captives ever be formed.

In contrast to the generality of the insurance industry, most Protection and Indemnity Clubs have what might seem to be an idiosyncratic choice for their financial year-ends. Whereas the vast majority of corporations choose unremarkable days, such as quarter days, 30 April or the like, most P&I Clubs observe the hour of noon GMT on 20 February, this being the day when the ice is said to go out on the Baltic.

Such an apparent oddity suggests an echo of something far more remote than anything of the

[91] *Business Insurance*, 27 November 1967

[92] Gordon Phillips: *First, One Thousand Miles, Bermudian Enterprise and the Bank of Bermuda*, Chapter 5 'Building the Sixties', pp. 157-160

1800s, namely the Hanseatic League, that association of over 100 free, independent, merchant cities which came to dominate commerce in Northern and Central Europe for some 5000 years, from the 12th until the late 17th century. There are parallels with the practices of modern times that are worth mentioning here, some of them even as though mirrored in this book.

By its provision of common security and its subvention of international commerce, by the organisation of convoys and the funding of mutual defense, by the construction of safeguards against navigational hazards, and by building its own fortified towns, cities of exceptional sophistication, with markets of great variety and counting houses or *bourses* that were the forerunners of the modern stock exchanges, in all these ways and in many others, the operations of the League went far beyond casual commerce, to embrace the attainment of special privileges, the establishment of foreign branches, and even the negotiation of regional trading monopolies.

The Hanseatic League may be said to have foreshadowed the great commercial empires of the 18th and 19th centuries, the European Economic Community at the mid 20th century, the multinational entities of the present day, and the services of modern insurance, even to the formation of 'captives', such as those that give this book its title. Thus, although the League originated in the German cities on the shores of the Baltic, its reach came to extended far and wide, from England on one side to Russia on the other and in England, for example, the German 'Merchants of the Steelyard' were a powerful Hansa colony at London, holding free trade privileges within their country of domicile and having houses at many other English ports.

Truly 'there is nothing new under the sun' and we may ask ourselves whether the year-end of the P&I Clubs, that day when the ice goes out from the Baltic straits, a day that was fundamental to the fortunes of the Hansa, is in fact an historical vestige of that association and so much older than the origin of the P&I Clubs themselves, or whether it was simply someone's whimsical evocation of a distant past.

Protection & Indemnity Companies are not designed to make profits and therefore a call mechanism was developed so that when members had a bad year, a call could be made to cover the losses, thus enabling the Clubs to break even. The call impels association members to pay out their agreed shares of the loss suffered by a member company. Many of the Clubs have even developed reserves in an attempt to level out good and bad years.

Between 1960 and 1964, during his visits to London in search of business for Bermuda, Bill Kempe had discovered the P&I Clubs. After observing various handicaps that the concept was encountering in England, he knew it could work well in Bermuda. The most contentious issue for the Clubs at that time was the currency exchange restriction placed upon them.[93]

Clubs resident in the UK were subject to exchange controls, much to the discomfiture of foreign ship owners with assets on deposit at the Clubs to cover calls. Kempe urged the Clubs to set up in Bermuda, assuring them that they would thereby free themselves from restraints on their international growth. He explained that once they set up as exempted companies in Bermuda they would be free to hold any currency except the Bermuda dollar. He also explained that because their members owned fleets from many different countries, flying flags of many different nations and not necessarily their own, Bermuda could offer them its neutrality as a base for their operations. In Bermuda they could work across borders, free of currency restrictions and able to make their own investment decisions without interference.

Much to Kempe's disappointment, nothing came of these visits to the P&I clubs until November 1967, when Harold Wilson's Labour government devalued the British pound in hopes of reducing the large external deficit. Wilson attributed the post-war revival of British exports to the massive devaluation of 1949. In this he was mistaken, just as he was mistaken to believe that the devaluation of November 1967 would yield similar results. Given the turbulent condition of the

[93] Interview with Bill Kempe, 13 February 2002

world economy at that time, devaluation of sterling could only worsen the British external deficit.

On top of that, the British government brought in monetary measures so restrictive as to prove a nightmare for the P&I Clubs, especially because a significant number of them were based outside the UK. As a direct consequence of all this, some six to eight of the largest P&I Clubs lost millions overnight. Within forty-eight hours these same Clubs were knocking at Bill Kempe's door. They came to ask his help in protecting their members from ever again suffering catastrophic losses due to restrictive exchange controls.[94]

Kempe can be heralded as the father of P&I Clubs incorporated in Bermuda. His untiring effort to establish working relationships with the Clubs was rewarded at last. In 1969 two Protection & Indemnity Clubs were established by private charter in Bermuda. These were the United Kingdom Protection and Indemnity Association (Bermuda) Limited, also known as the UK Club, and the Standard Steamship Owners Protection and Indemnity (Bermuda) Limited, or Standard Club. They were followed at a later date by the Steamship Mutual Underwriting Association (Bermuda) Limited, or Steamship Mutual.[95]

The members of these Clubs were able to take advantage of Bermuda's neutral standing in the world. The island was to benefit from the fact of the Clubs holding their annual meetings in Bermuda. These meetings brought a lot of revenue because directors from around the globe would travel to Bermuda with their families. Much as the increase in hotel occupancy may have been attributed to tourism there is no doubt that international business also was bolstering the economy with the establishment of the P&I Clubs in Bermuda.

Ford establishes a Captive

While the oil industry was experiencing its first catastrophic loss and the P&I Clubs were coming to Bermuda, the Island experienced a second windfall when Ford Motor announced that it had chosen Bermuda as the location for its own captive, which was to be known as 'Trans-Global'.

Business Insurance reported as follows:

> 'Ford Motor will establish a captive insurance company in Bermuda to provide property and business interruption coverages for its foreign plants and facilities. John Sagan, Ford treasurer, confirmed that the auto company will switch coverage on some of its overseas plants from foreign insurers to the wholly-owned company.
>
> 'While the Ford official declined to comment on reasons for the move, it was learned that Ford has been concerned about the cost of its overseas property insurance and business interruption program. Premium costs have exceeded losses by four times, it is understood.
>
> 'Formation of a captive company probably would give Ford advantages other than stricter cost control. With a Bermuda base, Ford would be free of US taxes. Moreover, the activities of the company would be unaffected by balance of payments considerations that might restrict a US based company.'[96]

Subsequent reportage confirmed that 'Ford's operating subsidiaries in 35 countries were paying insurance premiums that seemed high, and particular kinds of insurance were often unavailable in many of the 124 countries in which its subsidiaries did business. It (the captive) was organised to provide comprehensive insurance coverage at reasonable cost and reasonable profit. It was a bona fide insurance company, conducting insurance operations, setting premium rates, adopting forms of insurance policies, appointing general agents, and obtaining reinsurance.'[97]

[94] Interview with Bill Kempe, 13 February 2002

[95] Nicholas Dill: *Global Reinsurance, Marine Insurance and Bermuda*, Conyers Dill & Pearman, 1997

[96] *Business Insurance*, 11 December 1967, 'Plan captive in Bermuda to cover Ford's foreign risks', p. 1

[97] *Journal of Commerce*, 12 May 1978, 'Offshore tax case won by Ford Motor paves way for captives', by Christopher Elias, pp. 1-2

Chapter 17

1968
Capacity Shortage at Lloyd's

Political background

Both politically and economically, 1968 was to start with a bang for Bermuda. In January the island was preparing for its first general election based on universal suffrage. Under the terms of the newly created and accepted Constitution the 'plus vote' was no more and everyone over the age of 21 was to have the right to vote. With the adoption of the new Constitution, Bermuda became a self-governing dependency and began its first steps towards independence from the Mother Country of England. 1968 heralded in a new era for the people of Bermuda because they began to take responsibility for the governing of their own country. Meanwhile, the Black Power movement that had arisen in the US had also found its way to Bermuda. Workers were demanding more rights, so much so that for ten days both the bus drivers and the dockworkers were out on strike for higher wages.

Equally well it may have been the decision on 1 January 1968 by no less a mammoth *Fortune 500* company of the US than Ford Motor to establish a new property insurance captive in Bermuda that prompted the island government to stabilise the local infrastructure of finance. In the January 1968 issue of *Business Insurance* Ford's Insurance Manager Roy Jacobis said, 'The Bermuda company was formed to provide a closer check on insurance operations for its foreign operations.' The President and Managing Director of the new Trans-Global was to be R. A. Cover, former supervisor of foreign insurance activities at Ford's headquarters in Dearborn, Michigan.[98]

Later in that year Ford's captive, Trans-Global, was disappointed when it was unable to secure all of the reinsurance it deemed necessary for its operations. 'Ford Motor Co. has been unable to place more than half the reinsurance it wanted for its offshore captive, Trans-Global Insurance Limited. In negotiations with reinsurance markets, including some of the carriers that had primary coverage before it set up Trans-Global, Ford has been able to get only 50 per cent of the middle layer insured.'[99]

Earlier in the year, an air of civil unrest hung over the island as bus drivers and dockworkers went on strike. The US and Bermuda were shaken and saddened by the assassination of one of the world's great civil rights activists, Martin Luther King, Jr.

In the April of 1968 several black youths were refused entry to a floral fair. As a result, riots broke out. Police used tear gas to disperse the crowds. A curfew was imposed. British troops were called upon and when they arrived the riots stopped but clearly the tiny island was no more immune to the political tensions of the age than it was to financial shocks from overseas.

'No man is an island, entire of itself; every man is a piece of the continent, a part of the main…' John Donne wrote those words just 15 years after Sir George Somers and his crew were shipwrecked on the island of Bermuda in 1609. If they were true then, they have become all the more

[98] *Business Insurance*, 29 January 1968 p. 27

[99] op. cit., 26 August 1968, 'Ford's captive finds gaps in reinsurance', p. 3

so with every passing century since and never more so than today. One theme of this book is how Bermuda came from what seemed total isolation to its present position of global significance and responsibility.

In May 1968 Bermuda held its first general election under the new constitution. The United Bermuda Party won 30 seats while the PLP won 10. Sir Henry Tucker, the leader of the United Bermuda Party, became the first Government Leader.

Lloyd's reports operating loss

While the insurance industry in Bermuda was beginning to show signs of growth in 1968, Lloyd's of London was reporting the first operating loss in its 280-year history, following the closure of the 1965 account, which included losses from Hurricane Betsy.[100] The disastrous results had also to bear the impact of currency devaluation, which had the negative effect of drastically reducing Lloyd's reserves.

According to Ralph Hiscox, the Chairman of Lloyd's, as reported by *Business Insurance*, 'buyers have been paying bargain rates for insurance during the past 20 years and must be prepared for rate increases from Lloyd's Underwriters. To put its own "house in order", Lloyd's underwriters are becoming more critical of the risks they assume.' Another factor in the restricted reinsurance market, Mr Hiscox contended, was mergers between insurance carriers. He said whereas before the mergers two insurers might have each underwritten $500,000, the newly merged firm ends up underwriting a combined $750,000.'[101]

'For the first time in its history, Lloyd's of London is asking for financial backing from sources outside the United Kingdom. The move is seen to alleviate the severe capacity situation here by pumping new capital into Lloyd's.'[102] This decision by Lloyd's to seek outside financial backing confirmed Phelan's prediction in 1967 that Lloyd's would never be the same again after Hurricane Betsy. It was later confirmed in the edition of *Business Insurance* for 26 February 1968 that Lloyd's was in fact going to accept non-British investors for the first time in its history.

Weavers makes contact with Bermuda Fire and Marine

So, as a result of this capacity shortage, senior members of Lloyd's were for the first time prompted to seek investors outside the UK. More than 30 years later, foreign capital makes up a significant portion of Lloyd's underwriting capacity.[103] It was at about this time that a syndicate of Lloyd's made contact with a local company, Bermuda Fire and Marine, a contact that was to be the catalyst for the company's demise some decades later on. If only the company could have foreseen the spiral that was about to unwind…

At the time, Lloyd's was still a very prestigious institution. Accordingly in 1968, when the Weavers syndicate approached the Bermuda Fire and Marine, with an investment proposal, and stressed that there was money to be made, simply by participating in the operations of the syndicate, it was with the utmost confidence and good faith that Bermuda Fire and Marine pledged its support.[104] So began a relationship that was to continue until 1993, when the Bermuda Fire and Marine severed its ties with the syndicate after experiencing disappointing results from its initial investment.

The reasoning behind Bermuda Fire and Marine's decision to enter the international reinsurance arena was later set forth in part in their 1964 Annual Report as follows—

[100] *Business Insurance*,Millenium Special Issue, 'A Timeline of Key Events in Risk Management'
[101] op. cit., 17 June 1968, 'Lloyd's to suffer first loss in history', p. 11
[102] op. cit., 1 January 1968, 'Lloyd's sends letter to non-British sources seeking new investors' p. 1
[103] op. cit., Millenium Special Issue, 'A Timeline of Key Events in Risk Management'
[104] Interview with Cyril Rance, 4 March 2002

> 'In order to broaden the base of our general insurance business, your directors decided in 1964 to enter the international reinsurance market. Prior to that date, we had participated to a limited degree in this business through a reciprocal treaty with many of our overseas associates; but in the year above mentioned we entered the reinsurance market through well-established representatives in New York City. Subsequently, we arranged to transfer the account to brokerage firms located in London. We could not have chosen a less propitious time to enter the international reinsurance market. Underwriters around the world during the past five years have experienced losses unprecedented in this country except for those arising from the extraordinary perils of war.'[105]

Hard market in 1968

As a result of the reduced capacity offered by Lloyd's because they virtually controlled the reinsurance market in the United States, risk managers were all reporting higher rates, increased retentions, and tighter policy language for the 1968 renewal year.[106] Risk managers were reeling from the punitive measures they thought the insurance industry was taking. They began to look for non-traditional ways to manage their risks. 'Ed Hansen, insurance manager for Union Tank Car Company, said, "Realistic deductibles will be more important for buyers in 1968." He defined realistic deductibles as using higher retentions to lower premium costs, winning greater risk consciousness in the field and getting better coverage from carriers…He said risk managers are looking beyond brokers and carriers for advice on managing their company's risks.'[107]

The oil industry was still hurting from these blows when an estimated $2,000,000 fire loss at a Standard Oil refinery in California sent shivers down the spines of underwriters as they remembered the cost of the huge Cities Services fire and explosion in 1967.

Business Insurance reported—

> 'An insurance industry source indicated the world insurance market will view the fire as an example of the catastrophic potential that exists if it had spread to the main section of the refinery.
>
> 'With the folding of Simmonds, many oil buyers threatened with January 1 cancellations have been forced to buy insurance through the Oil Insurance Association, a group of 54 insurance companies. Buyers were reportedly unhappy about the price but said the OIA was the only source in the industry with capacity to write large risks.
>
> 'Starr Technical Risks Agency, a newly formed oil pool for onshore property, was able to solicit several insurance companies from Simmonds but could only generate enough capacity to write smaller risks.
>
> 'OIA's insurance program was reported affected by the oil industry's capacity dilemma caused mainly by a reluctant attitude in London toward participating in catastrophic coverages here. *Business Insurance* learned that OIA isn't taking any risks more than $9,000,000 without first clearing reinsurance with London.
>
> 'One source indicated that London is charging a high price for reinsurance which OIA passes to its buyers. Buyers were vexed not only with the price of insurance but also with the limited market to buy coverage. One source indicated that alternatives are still being sought…'[108]

OIA was experiencing its own growth pains as a result of its increased importance to the energy industry because it was by then the biggest energy insurer left in the marketplace. 'Petrochemical companies that came over to OIA from Simmonds were still waiting for their premium quotations, which are expected to be high, months after Simmonds shut down. An oil industry source maintained

[105] *The Royal Gazette*, 2 July 1969, 'Mixed year for Fire & Marine', p. 13 & 14

[106] *Business Insurance*, 1 January 1968, 'Risk managers see higher rates in '68', p. 1

[107] ibid.

[108] ibid., 'Big oil fire raises qualms'

that most of the 500 Simmonds accounts were accepted by OIA on binders, which are preliminary agreements to provide insurance, until rates and deductibles are set by underwriters.'[109] Energy risk managers were being left in the vulnerable position of not knowing what their rates or deductibles were going to be. They all just prayed that they did not have losses so that they would not have to explain to their bosses why their firm's coverages were not in place at the time of loss. For these reasons the oil companies began to feel the need to control their own destinies.

Business Insurance reported—

> 'While some buyers are still debating setting up a captive company or self insurance operations, the reinsurance markets and domestic capacity continue to shrink, according to industry spokesmen. Insurance executives polled by *Business Insurance* generally conceded that a serious capacity problem does exist for buyers hoping to find "low priced" coverage.
>
> 'Fireman's Fund Insurance Co., however, maintained there is plenty of capacity and that the problem is one of buyers not wanting to pay the price. "There is a tendency on the part of all purchasers to equate availability of the product at their price, and this may be the key to the shrinking capacity in the purview of the insurance buyer, "said Myron DuBain, VP of Fireman's Fund. "Capacity is there when insurance is written at an adequate premium. Lacking this incentive, the insurer cannot be interested and his capacity to accept the liability is withdrawn from the domestic market."'[110]

Despite the belief of insurers that there was plenty of capacity around if the insureds were willing to pay for it, risk managers were growing frustrated by the state of the market and were prompted to look more seriously at establishing captives. According to *Business Insurance* at the time—

> 'One consultant estimates that as many as 200 companies are currently in various stages of studying captive operations. A partial list of such companies includes Allis-Chalmers Mfg. Co., Carnation Co., Consolidated Foods Corp., Flor Corp., Hunt Foods & Industries, soon to be part of Norton Simon Inc., Holiday Inns of America Inc., International Harvester Co., Kaiser Industries, Nestle Co., Ralston Purina Co., and Scott Paper Co. Estimates of the number of house insurance companies run as high as 350, but the number of true captives, those that write only the parent companies' risks, is probably closer to 100 worldwide. One broker said, in addition, there is a cash flow advantage with a house insurance company. For example a captive allows monthly payments whereas a regular carrier usually requires prepaid premiums. He said that the increase in the number of captives has forced some carriers to modify this requirement. Captives have also forced carriers to make more attractive offerings to the insured. Some brokerage houses, along with carriers, have adopted negative positions with regard to captives and, according to one risk manager, go out of their way to discourage them. However, Johnson & Higgins, E.H. Crump & Co., Memphis, and Alexander & Alexander have set up a special team to advise clients on captive companies.'[111]

US brokers come offshore to Bermuda

It didn't take the onshore US brokers long to realise that this 'captive' phenomenon in Bermuda was no longer something to be brushed aside. They realised that they needed to act quickly before their franchise was destroyed. More and more of their clients were looking to self-insurance and other alternative markets for ways to escape punitive pricing and lack of coverage. As the captive concept began to flourish there was no way that Fred Reiss could handle all the business that was coming to the island. Instead major US brokers began to form management companies to handle some of the captive business. The first broker to make a move on the captive management side was Alexander and Alexander.[112]

[109] *Business Insurance*, 22 April 1968, 'Capacity again plagues petrochemical field', p. 12

[110] ibid.

[111] op. cit., 1 July 1968, 'More US business concerns study captive insurer approach', pp. 2 & 8

[112] Interview with Cyril Rance, 4 March 2002

Brian Hall presents another viewpoint as to why the brokerage houses came to Bermuda. 'During the 1960s the brokerage houses strongly resisted captives, and it was only when Fred Reiss started to "eat their lunch" that they responded in the late 1960s with the creation of their own captive management companies in Bermuda. At that time these companies were managed by resident service companies, since there was still a strong belief and expectation that captives would die on the vine, as commercial capacity was re-established, following the "normal" market cycle. At that time, brokers did not want to have a permanent presence here!'[113]

Seeing the growth of the captive industry in Bermuda, Marsh & McLennan Co. formed the captive manager Marsh & McLennan Management Service (Bermuda) Ltd in 1968, to ensure that they did not lose out on what many considered a very lucrative market.[114]

Johnson & Higgins (J&H) expands into captive consulting

Richard Meyer, Executive Vice President of Johnson & Higgins, one of the larger US brokers, said Johnson & Higgins made the wise decision that they would not only follow their clients but also would keep ahead of their clients. In the early days J&H dealt exclusively with the *Fortune 1000* companies and it was these companies that were leading the charge in forming captives.

Senior management within J&H realised from talking to their clients that captives were of growing interest to them. As a result J&H made a prompt decision to set up a separate business unit in New York to deal with the new trend because they wanted to be sure they had the best and most extensive resources available to provide the utmost service. They wanted to understand how this whole new captive concept worked.

In an effort to find a resource that would extend their knowledge and understanding of captives they hired Clay Chambers, because he had previously run the Hoechst Celanese captive in Bermuda, Elwood Insurance Ltd, which was managed by International Risk Management with Brian Hall as its account manager. J&H thought that with his background and because of his first-hand experience in Bermuda he could be instrumental in establishing a sound captive division for them. It was thanks to Chambers' foresight in seeing the importance of captives to the future global insurance industry that J&H established the adequate infrastructure that later enabled J&H to become the largest captive manager in the world.

C.V. Starr appoints Greenberg

By 1968 C.V. Starr's health had begun to deteriorate. Because Maurice 'Hank' Greenberg had done such a great job in building up the personal accident business at AIU, Starr appointed Greenberg as his successor. Starr had never been seriously interested in doing business in the US. His interests were more in the overseas markets. However, Greenberg was very interested in the US and once he was handed the torch to carry on the AIU name after Starr had died, Greenberg began to buy companies to manage in the US.[115]

He gripped the helm at AIG with a passion. He led the group through a succession of acquisitions. He took the company public in 1969 when its shares were first publicly listed. With Greenberg's succession began a new era for AIG and for those domiciled in Bermuda.[116]

[113] Brian Hall Speech, 1990, 'A History of Captives in Bermuda'

[114] *Business Insurance*, 13 November 2000, 'Bermuda market, Exploring the Island's expertise form tip to tip, charting Bermuda's history', p. 32, by Shirley Henry, sources Bermuda Insurance Institute and *Business Insurance* reporters

[115] Interview with Ernie Stempel

[116] *The American International Group, 50 years in Bermuda, a brief history*, 1997

International Tanker Indemnity Association Ltd

Bermuda was to receive another boost as a result of the growing insurance capacity problems for the oil companies. *Business Insurance* reported that—

> 'Seven big international oil companies including British Petroleum Corp., Gulf Oil Corp., Mobil Oil Corp., Shell International Marine Ltd., Standard Oil (N.J.) and Texaco Inc., have proposed setting up an industry operated captive insurance company to compensate the government for the cost of cleaning up oil spills which had occurred to their coastlines.'

The captive was to be called International Tanker Indemnity Association. Ltd., and was to be located in Bermuda. It would be open to any tanker operator, either private or government owned. The International Tanker Owners Pollution Federation Ltd. in London would administer the plan. According to an industry source the insurance operation would 'not be a money making venture by a long shot. What we want is enough money in the cash register to take care of any spills which may occur.'

The captive would be operated on the lines of a Protection and Indemnity group, in which members agree to chip in more than their annual premium if experience warrants it. The reason for the captive, the source explained, was that indemnifying governments for the cost of cleaning up oil spills was 'beyond the scope of existing insurance operations' since neither governments nor the tankers have a legal liability to clean up the oil. 'Underwriters come in when there's legal liability,' the executive explained.

'Legislation is pending in Congress which would hold the tanker operator trading to and from US ports liable for removing oil spilled off the US coastline—or else the US government would arrange to do so with the owner fully liable. Liability would hold regardless of whether the owner was at fault (the only exception being when the spill was an "act of God").'[117]

Increasing costs of malpractice insurance

According to *Business Insurance*, towards the end of 1968 medical malpractice rates also began to increase dramatically. Doctors and hospitals were finding it increasingly difficult to obtain insurance at reasonable costs. The rising cost of medical malpractice insurance was attributable to—

> '...an increasing number of substantial awards handed down by the courts—awards reaching $500,000 and even $1,000,000. Two suits have been won against doctors exceeding the $1,000,000 mark. During this year alone, one insurer pointed out, costs, fees, court-awarded settlements may approach $75,000,000. Hospitals have become vulnerable to awards reaching $500,000 per person.
>
> 'Insurance executives and medical personnel agreed that the public has become more claims conscious, but they point out that it will be the public that bears the rising costs of insurance coverage through higher medical costs—both doctor's fees and daily hospital room rates. Doctors in 29 states have experienced premium increases—in some cases as much as 100%.
>
> 'Looking at the present trends in patient suits with awards continuing to get higher, one insurance executive acknowledged that hospital and doctors alike "have to guarantee a cure or else face a possible patient claim."'[118]

1968 marked a significant turning point in the history of Bermuda in terms of its politics and socio-economic infrastructure, as more and more large US *Fortune 500* companies considered setting up captives on the island.

[117] *Business Insurance*, 18 November 1968, 'Seven big oil firms back captive carrier for oil pollution costs', p. 50

[118] ibid., 'Higher malpractice rates hike medical costs', p. 24

CHAPTER 18

1969
A Different Bermuda

Oil companies study captive idea

1969 was to prove itself a much quieter year politically and socially than 1968, which had proved to be the year of monumental changes to the way the island operated. Moreover 1969 proved to be a financially strong year as the oil companies began to find their place of refuge in the favourable regulatory environment of Bermuda. 1969 would set the stage for significant changes to the financial infrastructure of the island, although few save those involved would be aware of this at the time.

Having suffered premium increases of 25 per cent to 100 per cent at their renewal dates on 1 January 1969, many oil companies began to ponder the establishment of facilities that would cater to their own needs. According to B*usiness Insurance*, 'It was the $35,000,000 Cities Service loss at Lake Charles, La., in 1967, causing the folding of the Simmonds pool, which led to the study of the oil captive. A fire and explosion doing damage of over $50,000,000 to Royal Dutch Shell's biggest European installation about a year ago spurred the study.'[119]

A further study, conducted by L.S. Miller, President of Risk Management Inc. of Los Angeles, and a former general manager for OIA, revealed that the domestic market could not handle another catastrophe on the scale of the Cities Service loss. His report suggested that the oil companies form a captive to insure 'fire and extended coverages for onshore risks in excess of $10,000,000, or the figure may drop down to $5,000,000 or go up to $20,000,000 depending on individual cases.'[120]

Union Oil spill

A second manmade catastrophic event occurred in 1969, the Union Oil spill, which changed the insurance buying practices of the oil industry. Due to its impact on people and the environment, this event attracted much greater publicity. A special report compiled for the 25th anniversary of OIL Insurance Limited tabled the consideration that a major oil spill, off the coast of Santa Barbara, California, was consequent upon the course of Union Oil Company's development of an offshore oil field. The resulting damage to the wildlife and the surrounding shoreline brought widespread public attention and focused the commercial insurance market on the financial consequences of incidents involving pollution and the environment.[121]

Shortly after the spill, a $1.8 billion class action suit filed in the County Superior Court named Union Oil Co. and its partners, Texaco, Gulf, and Mobil, as defendants 'after their runaway undersea well covered 800 square miles of ocean surface with crude oil. A spokesman for Schramm,

[119] *Business Insurance*, 6 January 1969, 'Oil industry, like airlines, study captive'

[120] ibid.

[121] *OIL Insurance Limited 25th anniversary 1971-1995, a Special Report* compiled by Douglas Kline, Senior Vice President OIL

Raddue, and Seed, attorneys for the plaintiffs, told *Business Insurance* that the "class action was for all persons who suffered damage because of the twelve day long leak." The suit charges that the companies carelessly, recklessly, and negligently carried on drilling activities', so causing the oil spill.[122]

Each partner reportedly purchased separate insurance coverage for his interest in Union Oil's undersea well, with the only common insurance policy written being that for workers' compensation. Consequently the Union Oil loss also exposed for the first time a lack of understanding in the insurance marketplace as to how joint venture partnerships should be organised.

Atlantic Richfield and Sinclair Oil merge

When Atlantic Richfield and Sinclair Oil announced that they were merging, this signalled the biggest oil merger in history and set the stage for many more to follow. Thereby reducing the chances for smaller oil companies of making an impact on the oil industry. The new company, Atlantic Richfield, was to become the seventh largest oil company in the United States.[123]

The 1969 insurance buyer – forceful and articulate

1969 also saw the entry of a new and sophisticated type of insurance buyer, one who was growing increasingly frustrated with the way the traditional marketplace conducted its business. As a direct consequence of this change, *Business Insurance* published the following opinion—

> 'We have the distinct feeling that the insurance industry—and Washington legislators—will be listening this year when corporate insurance buyers register their views. Until recently, it must be admitted the industry didn't exactly wait with baited breath for pronouncements from buyers. This was so for a number of reasons: the corporate insurance men lacked unity, they didn't recognize their own strength, and nobody listened to them.
>
> 'If this state of affairs was once the case, it certainly isn't anymore. There's no doubt that insurance buyers are now registering their viewpoints in more forceful terms, especially in the legislative area. At their seventh annual conference in New York last month, members of the American Society of Insurance Management (ASIM) let it be known in no uncertain terms that they were going all out to gain a 'free market' for corporate buyers. In fact, ASIM members served notice on the big industry groups that insurers could not afford to ignore the ASIM position. "We ought to know who our friends are," was the way one insurance manager put it.
>
> 'We are delighted that the buyers are laying it on the line. We are also happy that ASIM spokesmen are as articulate as they are in defining the goals of the society and of corporate insurance executives. In an interview with Managing Editor Richard C. Bjorklund, ASIM's new President, William S. Mortimer, had straight-from-the shoulder advice to insurers and brokers. Some of the things he had to say in the last issue of *Business Insurance* may even have caused some ASIM members to gulp. But we think Mr Mortimer is dead right in his assessment of the changing conditions of the insurance market.
>
> 'In supporting an "industrial insured" exclusion in state legislative measures designed to restrict nonadmitted carriers, Mr Mortimer acknowledged that ASIM is "on a collision course with agents and some segments of the US insurance industry who wrongly believe that they can keep business for themselves by shutting out nonadmitted carriers." Mr Mortimer said that "what this short-sighted position fails to recognise, however, is that risk managers are fully prepared to turn to noninsurance or self insurance programs… Admitted insurers have not provided needed capacity in the past and present when given an opportunity to do so."

[122] *Business Insurance*, 17 February 1969, 'Oil leak brings huge suit, liability confused', p. 1

[123] op. cit., 17 March 1969, 'Insurance buyers work out risk merger details for Richfield –Sinclair' p. 1

'One of the big changes in the thinking of the buyers, in our eyes, is that they no longer automatically accept the standard industry line. For instance, a survey conducted for ASIM and shown to members for the first time at the conference revealed that 24% of the US members favoured Federal regulation of the industry and 32% thought the present state workers' compensation system was inadequate.

'Mr Mortimer himself, while preferring state regulation, said that if ASIM can't get "reasonable uniformity" in state laws, then "we would be forced to reluctantly favour or at least not oppose Federal regulation." The new president of ASIM also had some words for brokers. He predicted a change in the relationship between brokers and risk managers because of the "growing ability and competence of corporate risk managers and their use of risk management concepts. Producers in the future will have only a limited role in many risk management functions if they continue to concentrate their efforts to sell insurance. The producer is presently oriented to insurance; we're moving in another direction," said Mr Mortimer.

'The insurance industry had better take a new look at the 1969 insurance buyer. He thinks he's not getting as good a deal from the traditional insurance market as he might, and he's perfectly willing to explore new approaches—which just might leave the industry sitting on their renewals.'[124]

1969 definitely signalled the year of the corporate insurance managers gaining their voice and place in the insurance industry. No longer were they to be placated. They wanted to know and understand the facts so they would not look like fools to their management.

TOVALOP

By 1969, because they were not getting the answers they needed to satisfy their managements, buyers were looking for solutions beyond the traditional marketplace. Under widespread discussion was a novel idea known as 'Tanker Owners Voluntary Agreement Concerning Liability for Oil Pollution' (TOVALOP). In its issue for 23 June 1969 *Business Insurance* introduced the concept in the following words—

'A new tanker owners' voluntary pollution indemnification plan, originally proposed to compensate national governments for oil spills off their coasts, has been expanded to include other pollution liability coverages. The original coverage was for expenses "reasonably incurred" by tanker owners to prevent or clean up pollution off coastlines as a result of the negligent discharge of oil from a tanker. Under the new arrangement, the sponsors backing the TOVALOP plan have lined up the participation of the British protection and indemnity clubs to write new clean-up coverage.'

This new facility gave owners protection against oil spill removal costs and conventional P&I oil pollution coverage, including third party liability, from an industry-sponsored insurance company known as the 'International Tankers Indemnity Association' in Bermuda, from the various P&I clubs, or from their own commercial insurers, who would reinsure their coverage through the Bermuda-based indemnity company.

'The TOVALOP move,' said *Business Insurance*, 'interestingly enough, comes at a time when other insurance interests—particularly Insurance Co. of North America and Lloyd's of London—are preparing to withdraw from the pollution liability market. In a speech to the American Petroleum Institute in San Francisco this month, Peter Green, Chairman of Janson Green & Son, specialists in P&I and third party coverages, predicted that "before long pollution of every kind however arising will be excluded from all third-party policies and will only be obtainable as a separate insurance—including cleanup—rather as a "cost of control" is written for the drilling business. One oil insurance manager told *Business Insurance* that the latest exclusion is "still unacceptable, as any oil company such as ours has extensive exploration and production activities which must have insurance coverage."'[125]

[124] *Business Insurance*, 17 March 1969, 'Opinions, The 1969 insurance buyer: forceful and articulate', p. 20

[125] op. cit., 23 June 1969, 'Tanker owners' group adds broad pollution liability cover', p. 1 & 46

With every policy restriction, increased deductible, and perceived draconian measure taken by the insurance industry, the oil men moved closer and closer to devising their own remedies for the lack of insurance coverage available to them.

Brian Hall opens Inter-Ocean Management

Seeing all the activity that was breaking out in the offshore insurance world, Brian Hall decided to take fate into his own hands and to enter the insurance arena on his own. He was in due course to be hailed as 'the original child of the Bermuda offshore company sector.'[126] Hall felt he had outgrown his tenure at International Risk Management (IRM), and therefore went actively seeking a job with other insurance interests. He even went to Bermuda Fire and Marine and spoke with Colin Young and Cyril Rance about the possibility of setting up a captive management company for them. The captive concept was as yet too novel for Bermuda, with Fred Reiss still the only captive manager in town, and Young and Rance were intrigued but not buying.

Yet Hall had gained invaluable experience working under Reiss at International Risk Management and had also learned something essential from this very fact of being turned down by other insurance companies. He decided to branch out on his own and to form his own captive management company, to be known as 'Inter-Ocean Management Limited'.

As Dr David Saul, former Premier and Finance Minister of Bermuda said in an interview for this book, it was brave of Hall, in 1969, to go off on his own, to the point of daring. Especially in a small, tightly knit, and conservative environment such as Bermuda, it still required in those days exceptional guts for a young man to leave the security of employment and embrace the uncertainties of entrepreneurial risk. Especially was this true of Hall's chosen field. Not many people understood insurance and it was thought that anyone involved in it must by its very nature be somewhat weird. As a matter of fact, when Hall decided to venture off on his own, many of his contemporaries laughed at him. They expected him to fail.[127] Hall himself admits to being unsure whether he was self-employed or unemployed.

A senior businessman had told Hall that if he wanted to set up in business he had better do it while he was in his twenties, because if his venture failed people would credit him with trying. If on the other hand he waited until he was in his thirties and failed, well, then they would say that he should have known better. Hall decided to brave it out on his own before he hit the dreaded thirties.

He asked his father for a loan to get him started. His father agreed to put up half of the £4000 Hall needed but told him that he would have to put up the rest. Hall got a bank loan for the balance secured against his home and started Inter-Ocean Management.

He never went back to Reiss' clients for business. He did, however, market to companies considering a Bermuda captive. If there were captive conferences, he would obtain the list of those attending and he would write to every one of them, letting them know of his operation. Because of their affiliation with Reiss, Hall got little encouragement from CD&P or the Bank of Bermuda to help him to expand his business. They thought that one captive manager, International Risk Management, was all that was needed. Accordingly, Hall turned for advice and help to AS&K and the Bank of Butterfield. He also offered a small ownership interest in his company to Bill Kempe and to Sir Dudley Spurling, a founder of the law firm, Appleby Spurling & Kempe.

Hall got his operations up and running. Six months passed and Bermuda Fire and Marine was finally beginning to understand the captive concept. They asked him to come and run their new

[126] *The Royal Gazette*, 22 January 1985
[127] Interview with David Saul, 14 May 2002

management company. He declined. Then, due in part to Brian Hall's prior relationship with Clay Chambers, and exactly one year after Inter-Ocean Management had been brought into being, it was invited by Johnson and Higgins to manage their Bermuda affairs. This was the opportunity that Hall had been seeking. He has never looked back.[128]

Bahamas – 'Bend or Break!'

Almost as though the Fates were taking a hand at the wheel of fortune, at the same time as the infrastructure was beginning to fall into place for captives in Bermuda, so events in the Bahamas were to set in train a migration of captive companies to Bermuda in search of peace and stability. A circus of folly, bluster and crossed purposes, set against a backdrop of malignant chauvinism, cast the Bahamas into a time of political uncertainty.

In later years Allison Moir, along with Sir David Gibbons, a former Finance Minister and Premier of Bermuda, and Sir Peter Ramsbotham, a former Governor of Bermuda, were to recall those years of political upheaval in their book, *Partners in Peace and Prosperity*—

'Lynden Pindling of the Bahamas was our biggest ally…Pindling gave a speech, known as the "bend or break speech", in which he threatened international companies based in the Bahamas. Pindling required that all foreign workers be replaced by Bahamians.' Deeming this to be impossible, 'offshore business flocked to Bermuda. Indeed in two years 20,000 expats who had been working in the banking and insurance industries in the Bahamas left that country, taking most of those industries with them in their suitcases when they left. Many set up shop in Bermuda. And in 1999 in the Bahamas, only 31 inactive insurance companies remained.'[129]

That histrionic speech by Pindling has gone into folklore as the mythological reason for the flight of international business from the Bahamas. The real cause involved much more. Around the same time that Pindling delivered his speech he also drafted legislation to impose a premium tax of one per cent on insurance premiums. It was not made clear at the time whether this tax was to be applied locally or internationally but either way, what with the 'bend or break' speech, a change in government, and the possible introduction of this premium tax, the insurance companies that had established themselves in the Bahamas had very good reason to be nervous.[130]

Business Insurance also ran an article on 18 August 1969, explaining the flight of the insurance industry from the Bahamas as follows—

> 'American offshore captive insurance operations in the Bahamas are quietly pulling out for Bermuda and other places in the midst of formal enactment of the local government's omnibus insurance act. The Bahamas Insurance Act of 1969 requires that all insurance companies register with the government, maintain minimum capital reserves and annually publish financial statements in an official newspaper. It restricts borrowing power and gives government certain other regulatory powers.
>
> 'Although the measure is designed to protect the public against corrupt insurance operators and in general clean up the insurance industry in the islands, the captive insurance companies have not been exempted. This is being taken on many sides as a sign that the government is tightening up on controls of foreign insurance and other companies in the colony.
>
> 'Twelve to fifteen American captives have left the Bahamas for Bermuda or other places in the year and half since the measure was first introduced in the legislature, while another dozen or so are now in the process of closing their Nassau operations.

[128] Interview with Brian Hall, 24 April 2002

[129] Allison Moir with Sir Peter Ramsbotham and Sir David Gibbons: *Partners in Peace and Prosperity*, Chapter 6, 'Reshaping Bermuda's Economy', The Insurance Act 1978, p. 133

[130] Interview with Mike Murphy, 29 April 2002

'The new legislation—particularly the sections calling for public disclosure of income and general government regulation of investments—"has scared the hell out of the captive insurance companies", according to one New York tax attorney close to the Bahamas captive situation.

'One consultant called the measure "a nationalist piece of legislation", and it is being widely interpreted as a harbinger of increasing regulation of the foreign business community on the part of the local government.

'*The National Tribune*, however, reported that a prime factor in the pull-out was the fear that government might take steps to freeze their assets in a general trend towards forcing greater local investment by insurance companies. Local politicians objected to the bad press and one inferred that the local newspaper was hell bent on destroying confidence in the country. Some politicians said insurance companies should be obligated to contribute to the betterment of the infrastructure.

'John R. Coddrington, the British permanent secretary of the ministry of finance, told *Business Insurance* that the insurance act was essentially a sequel to similar legislation in the banking and finance area passed in 1965 and a move that might have been expected whether or not the government had changed hands.

'Although there is "not quite the same undesirable business going on," Mr Coddrington said the experience with scandals and the absence of effective controls over the industry prompted industry action. The insurance act was carefully developed after consultations with experts in the US and the United Kingdom and insurance interests in the Bahamas, and has been welcomed by the local insurance industry, the official asserted.'[131]

Once the influx of captives began, the legal firms, banks and accounting firms lost no time in teaming up to promote Bermuda in this embryonic stage of its financial growth. Places like New York, Toronto and London were actively visited in an attempt to encourage businesses to set up in Bermuda.

Fortunately the Government of the day, realising that it did not fully understand this new Exempted Company Business and the complexities of insurance, left it up to the private sector to be the trailblazers. It was from this moment that a partnership between the private and public sectors began. The Government of Bermuda learned to listen to the concerns and interests of the international business arena so that it could develop its expertise in regard to this new area of commerce for the greater benefit of the island.

Niagara takes advantage of the hard market

Growth at Niagara was gradual and not what had originally been anticipated. However by 1969 Niagara saw a dramatic increase in business as a result of the hard global market. In order to 'facilitate the writing of large treaties emanating from the London market, the Continental Corporation contributed an additional surplus of $10.2 million. By the end of 1969, premiums written had risen to $17.9 million on a policyholders' surplus of $18.1 million.'[132]

Spreading the wealth

By some estimates the ruling class of Bermuda consisted of only five families, in those days of the 1960s that now seem so far away. Be that as it may, by the end of the decade the privileged few, whoever they were, had no other choice than to accept that if Bermuda was to be seen by the outside world as a credible, responsible, viable and attractive jurisdiction, the ruling élite had to be seen to spread their wealth around the Island. At any rate a beginning was made in that direction even if it was at first of benefit only to a chosen few.[133]

[131] *Business Insurance*, 18 August 1969, 'Bahama Islands get first insurance code; captives seek new home', pp. 25, 42 & 43

[132] Interview with Janet Owner, former Senior Officer of Continental Insurance Company, Bermuda, 12 June 2002

[133] Interview with Lisa Marshall, 9 April 2002

International interest in the Island soon flourished, to the extent that two large law firms, CD&P and AS&K, were finding it difficult to handle all of the business coming to the island and so they had to pass on some of the business to smaller firms.[134] The same years also marked the beginning of the entrepreneurial age for Bermudians who came from outside the ruling class. They were at last allowed to share in the benefits to be derived from the changing financial structure of Bermuda.

Cyril Rance recalled that—

> '...the more the idea of captives was being discussed the more interest was being shown. The senior executives of the major broking houses lost no time in educating their personnel and within months these same executives were on the Island setting up local relationships and management offices.
>
> 'Bermuda at the time needed assistance. Competent expertise was required, new office space was in short supply and there was definitely a shortage of housing to meet the influx of senior personnel arriving to set up business. This in turn increased the requirements within banking, insurance and legal professions to an extent that it was putting a real strain on the island's infrastructure.'[135]

AIG repatriates life insurance business to the US

The influx of new companies to Bermuda was taking a toll on other national and regional economies as other parts of the world began losing valued income to this new competitor. In direct response to this threat, the State of New York decided to tempt the wayward companies home again. Because its income was being significantly reduced, especially in light of a current global recession, the State would establish a free trade centre zone. It went looking for suitable large conglomerates, hoping to entice them to resettle by promising that they would be free of any New York State tax.

One of the six companies approached was American International Company in Bermuda. It was clearly seduced by the whole idea of free trade and decided to pack up its life insurance division and move to New York. Talented young Bermudians like Jack Lancaster and Hal Dale were invited to move with the company. Lancaster elected to go while Dale turned the offer down and chose to remain in Bermuda instead. He later went on to open the accounting firm Anfossi and Dale.[136]

When American International Company decided to move its life insurance company from Bermuda to the new free trade zone in New York, their reasoning was given as follows—

> 'In 1969 the tax law changed in the US, making it no longer cost effective for AIG to run the life insurance operations out of Bermuda, so this business was repatriated to the US. The Bermuda office was significantly reduced and several Bermudians transferred to the US to continue to oversee the operations they had managed in Bermuda.'[137]

However the new free trade centre never really took off. Ernie Stempel was told he had to remain in Bermuda to run the rest of American International's Bermuda operation. He commuted back and forth to New York, so as to remain involved with the management process. Some say that it was Stempel alone "who kept Eastern Airlines in business". No one else travelled in those days as often and extensively as he.[138]

[134] Cyril Rance speech 1985

[135] *The Bermudian*, Focus on Business, April 1991, 'Is Bermuda poised to fulfil its function during the 1990s?' by Cyril Rance

[136] Interview with David Saul, 14 May 2002

[137] *The American International Group, 50 years in Bermuda, a brief history*, 1997

[138] Interview with David Saul, 14 May 2002

Hurricane Camille

Dubbed the most violent storm in US history, Hurricane Camille spared the insurance industry the worst of its wrath because it was a much tighter storm than Hurricane Betsy in 1965. To say that the industry was relieved would be an understatement. It could not have withstood another Betsy during this very precarious stage of its history.

'One insurance company executive sighed, "If I could have aimed Camille, I would have sent her in just the direction the storm took because vast property damage and loss of life were averted when the storm missed centres of heavy population."'[139]

Boycott Bermuda

Quite by surprise, Bermuda was pulled into an American scandal when Washington State Insurance Commissioner Karl V. Hermann warned insurance buyers to boycott insurance companies in Bermuda and the Bahamas. His warning came upon the discovery by his department that World Insurance Co. Ltd. of Bermuda had assumed liability for an 80-boat Seattle fishing fleet.

According to *Business Insurance*—

> 'The operator of World Insurance, Allen J. Lefferdink, has been associated with a number of marginal insurance companies, some of which are now defunct, it is reported. Among the dealings conducted in Hamilton, Bermuda, by World Insurance is a reinsurance agreement with Farmers and Merchants Mutual Fire Insurance Co., a Missouri "minimutual" that has written commercial coverage far beyond its authorized boundaries and charter limitations.
>
> 'The warning was made simply because it is not possible for the department to guarantee the soundness of the companies that operate out of Bermuda and the Bahamas. He said that the statement by the commissioner does not suggest that all companies based in these two locations are unsound; rather it should mean that the department has no way of telling. This attitude towards companies domiciled in the Bahamas and Bermuda was echoed to *Business Insurance* by Federal postal authorities active in the investigation of insurance fraud. "We have been blocked from learning anything about Bermuda companies because these companies operate under legislative charters that protect them from scrutiny by law enforcement officials," an investigator said.'[140]

Acting quickly on this bad press for Bermuda, Sir Henry met with Lefferdink to ask him to cease operations in Bermuda. Lefferdink left the island under a suspicious cloud but Bermuda readily distanced itself from any of his wrongdoings.

> 'Sir Henry Tucker told *Business Insurance* that beyond saying that Mr Lefferdink left the colony by agreement, the government is not eager to comment on this matter. Bermuda takes pride in the probity of companies operating here, and adverse publicity does nothing to enhance our ability to attract international companies of high standards. The majority of Bermuda insurance companies are owned by companies with unquestioned reputations and the government of Bermuda is very concerned about the character of the companies domiciled here.
>
> 'Bermuda, he (Sir Henry) explained, has no insurance laws "because we regard insurance as a highly sophisticated business and the adoption of an insurance code in the American sense would impose an obligation to properly police its provisions".'[141]

[139] *Business Insurance*, 1 September 1969, 'Insurers call Camille narrow but vicious', p. 2

[140] op. cit., 10 November 1969, 'Boycott Bermuda, Bahamas insurers, regulator tells buyers', p. 1

[141] op. cit., 8 December 1969, 'Lefferdink exits after Bermuda "agreement"', p. 1

The end of the 1960s

At the end of the decade there was competition within the global insurance industry to see who could come up with the most attractive rates and comprehensive coverage to insure the new jumbo jets that were about to become airborne. Lloyd's and the US were competing against each other and against the airline industry that was considering setting up a captive in Bermuda.

The end of the 1960s also saw further restrictions in Directors and Officers cover. The market was in a state of flux. New alternatives were being set up in an attempt to combat the industry's woes. And so the stage was set for Bermuda to play a more and more important role in the international insurance industry.

Little could Fred Reiss have foreseen how his original concept for captives, which involved an 'emphasis on tax-driven structures, in the form of the so-called "pure captive companies" would sow the seed for Bermuda to evolve into an alternative risk transfer market by the late 1960s, and eventually led it to become the insurance centre of the world. Reiss' concept had flourished so much that, by the end of the 1960s, Bermuda was home to some 76 insurers.'[142] It is also interesting to note that despite Reiss having put the captive concept on the map, by the end of the 1960s, he only managed 14 captives while every other company that was in Bermuda was self staffed or was housed in a lawyer's office.

Bermuda was also a changed country. Segregation was slowly coming to an end, party politics were being introduced, the socio-economic picture was being diversified to include international business, which would eventually open the door to more opportunities for a cross section of Bermudians, and the economic power of the five families was beginning to decline.

[142] Joe Johnson, speech,—'Alternative domicile; why Bermuda?', January 1987