Part Three
1970–1979

CHAPTER 19

1970
Bermuda Poised

An exciting time

The new decade ushered in turbulent days for the history of international insurance in Bermuda. The world was in a state of flux. There was conflict in the petroleum industry, in the nuclear industry and in the airline industry. Bermuda saw for the first time the beginning of industry association captives and criticism of the commission system for brokers began to grow as a result of this new type of business. Clients started to rebel against the conventional insurance market. Energy clients, and especially those in the electric power industry, were faced with severe account restrictions on coverages, as well as with huge price increases, including the cost of excluding pollution.[143]

In 1970 there came the formation of the Environmental Protection Agency (EPA), the completion of the World Trade Center, the formation of Amtrak (the vast United States passenger railroad carrier) and the first confirmed discovery of oil under the North Sea. These developments foreshadowed a permanent rearrangement in the landscape of insurance. All the advances in technology that heralded the new decade also brought with them new shifts in the perception and magnitude of risk. The more sophisticated the techniques of design and construction became, the more it would cost to insure them.

At the same time Bermuda became embroiled in social strife. The US Black Power Movement had effectively infiltrated the island. There was much civil unrest, as blacks grew increasingly frustrated with the slow pace of change towards equal rights and so began to take matters into their own hands. Frustration seethed into anger and boiled over in acts of sporadic but alarming violence. On the other hand, earnest attempts on both sides to bring balance and harmony through peaceful change were themselves in turn frustrated by a lack of concerted direction. The body politic seemed unprepared, almost bewildered as to how to meet with this new turbulence of demands.

In their book, *Hamilton, Bermuda— City and Capital, 1897-1997*, Colin Benbow and Marian S. Robb reported on the growing unrest as follows—

> 'As Bermudians were seeing in the New Year (1970), a riot occurred outside City Hall. Some 200 youths were hurling bottles at motorists, breaking shop windows and stealing goods.
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> 'The Police were called in, but a full-scale clash was avoided when a medical student, Mr Ewart Brown, arrived and spoke with the youths. Tempers cooled and the mob eventually dispersed, leaving eight people injured and Church Street littered with broken glass.
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> 'Two cases of arson occurred in March. Firemen put out a blaze in the House of Assembly and found a petrol can near the Speaker's chair. A week later, historic Old Devonshire Church was ripped apart in an explosion and fire, the alleged perpetrator found lying, injured, nearby.'[144]

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[143] Report to J&H Directors meeting 1-4 February 1971 on captives and underwriting pools prepared by Baxter Gentry 22 January 22 1971

[144] Colin Benbow and Marian S. Robb: *Hamilton, Bermuda: City and Capital 1897-1997*, Chapter 30, 1970 – 'Year of the Hooligans', p. 105

However, the worst show of black frustration manifested itself on 17 April 1970 when, as Benbow and Robb further reported, 'The doors of St Theresa's Roman Catholic Cathedral on Cedar Avenue were damaged in an arson attempt, while placard-carrying youths, demanding a lower voting age and the introduction of black studies in the schools, assembled outside City Hall.'[145]

As a result of the escalating unrest, Government Leader Sir Henry Tucker made a rare television appearance, in an effort to quell the violence, which he feared could destroy the financial progress the island was making. In an impassioned appeal, Sir Henry asked Bermudians, 'Where are we headed and why?'

Then in June 1970 E.T. Richards became the first black man in Bermuda to be knighted by the Queen and many hoped that his ennoblement would demonstrate that Bermuda was changing. However such tokens were not enough and those hopes were dashed later in the year, when violence erupted once again.

While Bermuda's social environment experienced great unrest, its financial environment seemed not to be affected. Quite unexpectedly, Bermuda received another boost to its financial sector because of the actions of the Bahamian government. Despite the mass exodus of insurance companies in 1969, the Bahamian government continued to put pressures on the 27 insurance companies that remained domiciled there. *Business Insurance* reported on how Carlton Francis, Finance Minister of the Bahamas, warned the remaining insurance companies, in the following terms—

> 'Unless they can be persuaded to sink some of their funds into local investment, the government might take stronger measures to urge them to do so. Mr Francis' Progressive Labour Party had embarked on a massive capital development program since it assumed power 35 months ago. Addressing insurance men at their annual banquet, Mr Francis said that about 400 to 500 million US dollars would have to be found by the government over the next ten years for capital works.
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> 'The minister made it clear that he expected Bahamian-based insurance companies to contribute their share on the premise that "they should seek to help those who contribute to their savings."'[146]

Owing to the perceived instability of the Bahamian government, Bermuda developed as the most important domicile for captive insurers. Almost 1000 captives were incorporated in Bermuda by the end of the 1970s.[147]

A changing Bermuda

Bermuda was fast becoming a significant domicile for large United States corporations to set up captives and therefore the Government realised it needed to take the steps necessary to secure Bermuda as a credible place from which to conduct business. One of the most significant steps in that direction occurred on the Bermuda Currency Day, 6 February 1970, when Bermuda decimalised its currency, abandoning the British system of pounds, shillings and pence in favour of a Bermuda dollar comprising one hundred cents, thereby taking a major step towards financial independence from Britain. The Bermuda government decided to reform the currency, rather than leave the economy vulnerable to the effects of sudden and unilateral British government action, as had been the case when the pound was devalued overnight in 1967. Clearly and rightly the Bermuda government had decided that the international business now making its way to the island was of such vital importance that it could in no way be left at risk for the sake of a currency and a government over which Bermuda had no control.

[145] Colin Benbow and Marian S. Robb, op. cit.

[146] *Business Insurance*, 19 January 1970, 'Bahama finance head pushes insurer investments', p. 11

[147] Review of the Bermuda Regulatory System by the Filings & Acts Sub-Committee of the Insurance Advisory Committee, December 1993, revised 5 April 1994

Airline industry seeks to set up captive

While Bermuda was trying to deal with its social issues and the influx of international business, the news dominating the global insurance industry headlines was the crisis surrounding the airline industry. Many insurance companies were hesitant to insure the risk of the new 747 airliners because the industry had never been faced with so great an exposure before. Consequently the industry had no past experience upon which to base this entirely new exposure and was at a loss to come up with a fair price.

To combat the vastly greater exposures the new 'jumbo jets' presented, the industry developed for the first time a concept called 'vertical pricing', in an effort to limit its exposure to 'maximum probable loss'. The three key players in the aviation market were the US Aviation Insurance Group, the Associated Aviation Underwriters, and the London market. Each took a quota share of the risk from the first dollar of coverage up. In other words, in the event of a loss each party would assume the burden in proportion to the percentage of the risk that it had elected to underwrite.

Despite the efforts of the insurance industry to develop what it believed to be fair pricing, the airline industry was frustrated by the way it was treated by the underwriters and decided to create its own captive to insure its future risks. In turn, the insurance industry became irate that the airline industry wanted to establish such a captive because the insurers thought there was already an adequate capacity to cover the needs of the airline industry.

Reiss on a roll

International Risk Management (IRM) dominated the Bermuda captive insurance scene between 1970 and 1976. It had blue chip *Fortune 500* companies as clients and was considered to be the 'Rolls Royce' of captive management companies. As an independent non-broker-owned entity, International Risk Management was well ahead of its time.[148]

Fred Reiss was a very shrewd and clever businessman. He succeeded in acquiring as his first major offshore client the largest private company in the United States, Cargill Inc. and once Reiss had acquired companies like Cargill as clients he became confident that he could draw many more. As for Cargill, they remain dedicated to International Risk Management.

Meanwhile, using his charisma, charm and dynamic personality, Reiss set out to build up his client base. He didn't hesitate to go to the top men at the large Fortune 500 companies. In those days it was a little easier to get to the top man because there was no such individual as a 'risk manager' in the way and so Fred could gain access to the top without fear of breaking protocols.

He set himself a goal to get to know the CEOs of all these major corporations on a personal basis. His business came by word of mouth. Because of his unique position he never had to advertise.

Only in the last five years of its operations did IRM resort to advertising, when competition had become rife and IRM had lost its privileged position with the Fortune 500 companies to major brokers like J&H and Marsh & McLennan.

Anna Summers worked with Reiss from 1964 onwards as his first assistant and still works closely with the runoff of the remnants of the company. She remembers how just by his presence Reiss would dominate a room. Everyone there felt the strength of his personality. His employees always said they worked for him, not that they worked for IRM. He kept himself open to them and they in turn were fiercely loyal to him. He was thought of as being very down to earth. He had a nickname, the 'Great White Father', that seems to have come out of Lloyd's of London.[149] Some thought that this was because he had a full head of snow-white hair at a very young age but perhaps there was more to the name than that.

[148] Interview with David Ezekiel, 18 April 2002

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

When Reiss had enough captives under management, he decided that all his clients should get to know each other. So every year he threw a huge party in Bermuda to allow his clients to network and share developments in the industry. It was as a result of these informal gatherings that Reiss was able to tailor his management company to suit so well the needs of his clients. Anna Summers recalls that sometimes there were as many as 600 clients and guests at the Princess Hotel for these annual parties. International Risk Management was the only company that entertained its clients on such a scale in those days. Others in the industry questioned the need for what they saw as an extravagance and expense.

Reiss created around IRM the atmosphere of a club and everyone wanted to be a part of it. Every client was somehow involved with one committee or another and was given a role to play in operations. However, because of his engineering background, Reiss was very selective in the beginning as to the types of clients he welcomed into his club. At first he promoted only 'Highly Protected Risks' (HPRs). These are properties that have reduced loss potential because of sophisticated use of property loss control measures. Reiss thought that only they had all the safety controls in place against the event of a loss.

There were no such things as fast photocopiers and computerised form letters that we know now. For the administrative staff it was a nightmare, trying to get all the programmes and information packages ready for these vast numbers of clients. Each letter for the September meetings had to be typed individually.[150]

In an interview with *Best's Review* magazine, Fred Reiss said of his organization—

> 'We are professional managers of insurance companies; we don't sell insurance. Our responsibility is to see that the fiduciary aspect of the insurance business is complied with—that the insurance company is capable of paying losses when they occur. Our expertise is in protecting the net assets of the captive.
>
> 'Besides providing its clients with guidance in loss prevention and underwriting, the Reiss Organization views reinsurance—the ability to reinsure risks in a stable fashion—as the key to effective captive management.'[151]

Intercontinental Insurance Company

Bermuda had established itself as a viable offshore market and many came to find out what it had to offer. The biggest news of the year was the announcement that a major new reinsurer, namely Intercontinental Reinsurance Co. Ltd., was to be established on Bermuda's shores. *Business Insurance* reported the arrival of Intercontinental Reinsurance to Bermuda as follows—

> '...It has been subscribed to by a mixed bag of "quality" insurance and reinsurance firms. Among them is "Atalfa Inc., a consortium of American insurers, Aetna Casualty & Surety, a subsidiary of Aetna Life & Casualty, Travelers Corp., Fireman's Fund Insurance Co., the Aetna Insurance Co., a subsidiary of Connecticut General Life Insurance Co., and American Overseas Reinsurance Co., an affiliate of Guy Carpenter & Co., which in turn is an affiliate of Marsh & McLennan." Atalfa, the largest single subscriber to the new company, has kicked in a total of $13.8 million to capitalize the venture. Others subscribing to Intercontinental are C.T. Bowring & Co., Ltd., Lloyd's brokers of London (a $3.3 million share) and Schroder Investment Co., Ltd., a subsidiary of L. Henry Schroder Wagg & Co. Ltd., both of London (a $1million share). Intercontinental Reinsurance Co., Ltd. was set up to receive submissions from Lloyd's brokers and to underwrite all of its business in Bermuda. Therefore, enabling it to function as a non-admitted carrier in all US states and to be permitted to write its business with the same flexibility as Lloyd's.

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

[151] *Best's Review*, March 1984, 'Beyond Bermuda' by Doris Fenske, pp. 22, 24, 114, 115

'The news of Intercontinental opening in Bermuda was received with mixed reactions … Some saw the company as the answer to the capacity crunch around the world. Others believed it would signal the death note for the airline captive, Air Transport Insurance, S.A., which was rumoured to be launched in 1971. Whilst others thought it was not going to have any significant impact on the international insurance industry at all considering it had less than $20 million in capital.'[152]

Lawyer Bill Kempe, of Appleby Spurling & Kempe, was happy to hear the news of Intercontinental forming in Bermuda because he helped to incorporate the company and later became a director of it. According to Kempe, when Intercontinental came to Bermuda it signalled a new era because it was the first real company other than captives to establish in Bermuda in quite some time and the fact that it was backed by the big names in the insurance industry proved that Bermuda was viewed as a credible jurisdiction by some of the movers and shakers of the global insurance industry.[153]

Several decades later, John Dwyer, chairman of the new Intercontinental in Bermuda, the name having been changed to Terra Nova, said that Terra Nova Insurance and Intercontinental Re were originally founded in the late 1960s for the same reasons that the large property catastrophe reinsurers were formed in Bermuda in the early 1990s—

'They formed the two companies to participate in the restructuring of the industry, in what they thought was going to be a very significant opportunity. They wanted to participate in what would be a firming of prices following these natural catastrophes. They wanted a window into a world they hadn't had before.'[154]

The airline industry announced that its pooled captive, which had originally been supposed to incorporate in Switzerland, had decided to switch domiciles and incorporate in Bermuda instead. The founders behind the captive, Air Transport Insurance SA, were concerned that the incorporation process in Switzerland might not be completed by 1 January 1971 and therefore decided that Bermuda would be a more favourable regulatory environment in which to establish the captive. It was ironic that this captive was to be incorporated in Bermuda, the very domicile that many had thought might obviate the need for such a captive with the arrival of Intercontinental Reinsurance Company.

Having decided on the domicile, Air Transport then awaited regulatory approval from the Bermuda government and for all the financing to come from its sponsors.[155]

At first the airlines had planned to establish two captives, one to insure the primary (first dollar) losses of the airline and a second to insure the excess. However, after the insurance industry stepped up to show that it had enough capacity and had a good understanding of how to price the new jumbo jet exposures, the airline industry put on hold the captive to insure their excess exposures.

Thus although the advent of the new pooled excess captive to Bermuda was not about to happen, Bermuda was already taking a position by showing that its user-friendly regulatory system could rapidly respond to global insurance problems.

Johnson & Higgins (J&H), Bermuda

J&H Bermuda was incorporated in 1970 to provide ancillary services to J&H USA. This was in order to take advantage of the flourishing captive market in Bermuda. The appointment some two years previously of Clayton Chambers, to head the J&H New York captive consulting department, was a major boost to Bermuda, because Chambers was very familiar with the way the Bermuda

[152] *Business Insurance*, 16 February 1970, 'Significance of new reinsurance company is weighed by industry', p. 11
[153] Interview with Bill Kempe, 13 February 2002
[154] *Bermudian Business*, Spring 1999, 'Terra Nova hits stride quickly', by Kevin Stevenson, pp. 28–34
[155] *Business Insurance*, 13 April 1970, 'Airline captive headed for Bermuda', pp. 1 & 46

insurance market worked. This made possible a very smooth transition when it came time to expand the relationship between J&H USA and J&H Bermuda, which had appointed Brian Hall and Inter-Ocean Limited to represent their interests on the island.

In a speech to the World Insurance Congress, July 1991, entitled 'Captive Insurers—their role in the Marketplace', David Olsen, a partner with J&H, said—

> '...You may say we (brokers) opened the Pandora's Box when we first tried to restructure insurance programs to benefit the buyer. The movement started innocently enough in the 1970s, just as the cost of casualty insurance began to take off. On behalf of our clients, we brokers began to restructure the way companies bought insurance, skimming cream ever so gently from major underwriters. Our job was to get some of the investment income held by underwriters. Then we began to ask them to insure only the tougher layers of risk, allowing buyers to retain the lower–more predictable–layers of coverage.
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> 'The idea that professional underwriters didn't need to trade dollars with clients on predicable risks seemed to make sense to everyone—especially since, given the right premium, underwriters could continue to make a healthy profit on excess insurance. Presumably they'd buy reinsurance and pass on the truly scary risks to Lloyd's, home of the underwriters' underwriter.
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> 'The chief advantage of retaining risk was that premium dollars were removed from insurance regulation— which required capital to equal one third of premiums, and premiums to be invested in safe but low-yielding investments. Retained premiums were freed to be invested in the open market, as aggressively as corporate financial departments wanted them to be.
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> 'The disadvantage, of course, was that certainly liabilities— such as products liability and occupational disease claims— fell almost exclusively to the insured. But in a heady investment environment, who cared?'[156]

Water Quality Improvement Act of 1970

While the Bermuda insurance industry flourished, the oil companies still experienced difficulties obtaining insurance coverage. According to *Business Insurance*, when President Nixon signed into effect the Water Quality Improvement Act of 1970, the penalties for oil spills were increased and the liability for the cost of cleaning them up were extended.

Prior to this legislation, anyone found guilty of discharging oil from a vessel into navigable water was subject to a fine of US $2,500 for each offence, while the owners of the vessel were likewise subject for each offence to a fine of US $10,000. *Business Insurance* outlined the new regulations put into place by President Nixon as follows—

> 'If the US cleaned up the spill, the owners were liable for clean up costs up to a limit set by the Brussels Convention of 1954. That limit was $5 million, or $67 per gross ton of the vessel, whichever was less. However, to collect, the government had to prove negligence.
>
> 'The new act introduced the principle of absolute liability. Those responsible are liable "without regard to whether any such act or omission was or was not negligent."
>
> 'Except where a spill from a vessel is the result of an act of God, an act of war, negligence by the United States or an act of a third party, the owner of the vessel is now liable for costs of clean up incurred by the government up to $14 million, or $100 a gross ton, whichever is less. Subject to the same exceptions, owners of onshore and offshore oil drilling facilities are liable for clean up costs up to $8 million. Moreover, if the government can prove wilful negligence or misconduct, the owners of a vessel or onshore or offshore facility must pay the government the total cost for cleanup.'[157]

[156] Speech by David A. Olsen, a partner of J&H, July 1991, World Insurance Congress: Restructuring for Opportunity, 'Captive Insurers: Their Role in the Marketplace'

[157] *Business Insurance*, 13 April 1970, 'Nixon approves oil spill penalties liability', p. 46

Global Insurance industry makes moves to exclude pollution

Shortly after the passage of the Water Quality Act, insurers around the world came to the conclusion that intentional pollution was an uninsurable peril and as such began to carve this risk out of their policies. Lloyd's was the first to take a formal position but it was rumoured that the Insurance Rating Bureau had also drafted language to address this exclusion, with the Mutuals, such as Tovalop and OIL following closely behind.

Lloyd's announced four new clauses to cover the ever-increasing world pollution risks. The new exclusions addressed seepage, pollution and contamination, with two clauses specifically created for the oil and gas industry and two for other industries. One in each category was an absolute exclusion while the other allowed the industry to obtain coverage subject to market conditions and to price for third party perils and clean up costs in the event of accidents. This time, Lloyd's specified that in order for the client to obtain pollution coverage the incident had to be a result of fortuitous circumstances or outside the realm of the insured's control. The option to purchase third party pollution coverage was very expensive.[158]

Oil insurance crisis leads to the formation of OIL in Bermuda

As a result of the Cities Services and Union Oil losses (see the 1960s for descriptions of these events), followed by the Water Quality Improvement Act, pollution liability insurance became a classic hard market, resulting in severe contraction of availability and dramatically increased costs for those who could find coverage. For example, annual premium rates for offshore platforms were in the range of two to five percent of declared value. Thus oil companies were penalised yet again because of the nature of their operations.

However the straw that broke the camel's back for the oil industry was when Lloyd's of London announced in October 1970 that they were going to exclude terrorism coverage for oil companies, although, if clients wanted it, they could buy it back. Most oil companies were faced with the economic need to maintain huge retentions that virtually constituted self-insurance. Some companies did elect to become totally self-insured and established catastrophe reserves on their balance sheets, to protect their income statements against the impacts of large uninsured losses. For many oil companies, however, self-insurance was not an option.

The American Petroleum Institute circulated a letter to the Chairs of the major US oil companies, suggesting an industry solution. A study team was assembled, representing several oil companies. Noting that the capital and surplus of the petroleum industry were far greater than the net worth of the commercial insurance industry, the team concluded that the petroleum industry should form its own vehicle to provide insurance coverage. The team also explored the concept of a mutually supported 'spread loss' insurance programme.

A spread loss programme gives a company the ability to stabilise its results over a multi-year period. In a spread loss programme, a customer pays a fixed premium for a number of years and if the customer experiences total losses in a given year that are greater than a certain limit, the insurer or reinsurer reimburses the excess losses to the customer in a lump sum. The customer then pays back the reimbursed amount to the insurer or reinsurer over a period of years, usually by means of increased premiums. This way, the customer's losses for a certain year are 'spread' over a period of years.

Under this concept the oil companies would be responsible for paying their own losses over the long run. In December 1970, the spread loss concept led to the formation in Bermuda of Oil Insurance Limited (OIL), which became Bermuda's first group captive.[159] The 15 original founders

[158] *Business Insurance*, 11 May 1970, 'Liability insurers move to exclude coverage for environment polluters', p. 1 & 46

[159] *Business Insurance*, 13 November 2000, 'Bermuda Market, Exploring the Island's Expertise from tip to tip, Charting Bermuda's History', p. 32, by Shirley Henry, Sources BII and BI reporters

of OIL were Ashland Oil & Refining, Atlantic Richfield, Champlin Petroleum, Cities Service, Diamond Shamrock Oil & Gas, Gulf Oil, Kewanee Oil, Marathon Oil, Murphy Oil, Phillips Petroleum, Signal Oil & Gas, Standard Oil of California, Standard Oil (Ohio), Tenneco, and Union Oil of California.[160]

Edward A. Flieger, a long-time resident of Bermuda, with extensive experience in the management of insurance operations, was appointed as general manager of OIL. He hired Iris Young as his secretary and leased space in Bermuda for a year, that being the length of time for which the shareholders originally committed themselves to OIL.[161] According to Jon King, President and Chief Executive Officer of OIL, Bermuda was the most hospitable domicile of choice in which to incorporate OIL. King cited a combination of two factors. He said that—

> 'Insurance is regulated in the United States on a state-by-state basis, and there is a very heavy overhead cost associated with that. It was felt that a mutual writing insurance just for the owners didn't need that sort of regulation. There was no need to set up all the overhead in order to comply with state–by-state regulations. It was also more efficient to operate in a low-tax environment.
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> 'There was also a concern that if we did offer any kind of coverage for pollution liability, we really wanted to be as far away as possible from United States courts. We wanted to set up a strong arbitration provision so any disputes with members could be settled outside the United States system.'[162]

Companies (Incorporation by Registration) Act 1970

Given the growing interest shown in Bermuda by people looking to establish exempted companies, in August 1970 the Bermuda government passed the Companies (Incorporation by Registration) Act. This allowed Bermudian companies to be formed by Registration rather than by a special Act of Parliament.[163] Some years later Brian Hall, head of the Insurance Advisory Committee and of J&H Bermuda, described the significance of the Companies (Incorporation by Registration) Act in a speech—

> 'Since every company until 1970 was incorporated by private legislation, and due to the fact that the Legislature went into recess during the summer months, lawyers, until the end of the 1960's, would establish a batch of "shelf companies" to facilitate new incorporations during the summer months. At that time law firms retained company charter with names of trees (Elm, Walnut, Oak, etc), railway stations (Paddington, Teddington, etc) and London districts (Covent, etc). In 1970, to expedite and modernise the procedure for incorporations, Government passed the "Companies (Incorporation by Registration) Act"'. This act provides for incorporations under an automatic process of filing with the Registrar and allows for companies to be incorporated within a period of three to four weeks at any time during the year. Very few companies are now incorporated by legislation, and, therefore, nowadays "shelf companies" have become a thing of the past and appropriate names are selected by the owners.'[164]

Bermuda International Business Association (BIBA) is established

As a result of the growing importance of the Bermuda international business, local businessmen saw

[160] *OIL Insurance Limited 25th Anniversary 1971-1995, A Special Report* compiled by Douglas Kline, Senior Vice President OIL

[161] ibid.

[162] *Bermudian Business*, Spring 1999, 'OIL', by Kevin Stevenson, pp. 66–74

[163] Speech by Sir John Plowman, 29 January 1981, to the Annual General Meeting of the International Companies Division of the Bermuda Chamber of Commerce

[164] Brian Hall speech in 1981 to the Lions Club

the need for an organisation to measure the importance of the international business sector and this gave rise to the Bermuda International Business Association (BIBA).[165]

Bill Kempe, of Appleby Spurling & Kempe (AS&K), and Dick Butterfield, of Cooper & Lines, were instrumental in starting BIBA in Bermuda while at AS&K John Campbell, a young lawyer new to Bermuda's shores, was made responsible for drafting the constitution. The purpose of BIBA was simple. By defining what sort of business Bermuda wanted to attract, BIBA would define what sort of international business centre Bermuda was going to be and what to prepare in terms of infrastructure. The founders wanted to make certain that Bermuda created an environment responsive to the new business. The Association needed to interact with Government, so as to keep the relevant ministries informed as to the nature of international business and how best to respond to its most important needs. At the same time an observant control must be maintained over the quality of companies allowed to establish themselves on the island. Then and to this day, Bermuda has prided itself on quality rather than quantity.

The group was also concerned to balance the legitimate need of international business to function freely with Bermuda's essential need to preserve inviolate the high reputation it had worked so hard to maintain. Bermuda must be able to legislate without being either overburdened or overly burdensome. Clearly the founders had a thorough knowledge and understanding of how the local environment worked because BIBA was made up of all those who provided services to the international business sector, such as lawyers, accountants, bankers, auditors, and the like. However there was no representation of international business companies and this caused problems later on, as some of the international businesses came to believe that in fact their needs were not being represented and therefore formed their own organisation, the International Companies Division of the Bermuda Chamber of Commerce (ICD).

BIBA in its heyday was so powerful that if any member wanted to make a speech on international business outside Bermuda he had to get clearance from the BIBA counsel. This requirement was put into place to protect the image of Bermuda. Other jurisdictions, organisations and companies might not be held in such high regard as Bermuda and BIBA was determined to maintain a distance. It did not want its members going anywhere and everywhere giving speeches that might leave unfavourable impressions and come back later to jeopardise Bermuda's cherished reputation.[166]

Followed closely by The International Companies' Division of the Chamber of Commerce (ICD)

Ernie Stempel of American International Company was the driving force in the development of the ICD and eventually served as its first Chairman many years later. The only previous resource for the business community had been the BIBA and Stempel had reservations as to whether this organisation adequately represented international insurance companies because he believed it had its own agenda.

Stempel enlisted the support of not just insurance companies but of all the international companies, including Merck Sharpe and Dome, the oil companies and shipping companies. The purpose of the ICD was to make the voice of the international companies heard. The formation of such an alliance did nothing to ingratiate Stempel with the 'old guard' in Bermuda because the ICD chose not to follow the rules that BIBA had in place but instead went their own way.[167]

[165] *Bottom Line*, May 1992, 'An Economic View, International Business: Raised Expectations, The Offshore Financial Sector Challenges Tourism for Primacy', by Robin McPhee, pp. 21–26

[166] Interview with John Campbell, Sr. Partner, Appleby Spurling & Kempe, 24 October 2002

[167] *Bottom Line*, Bermuda Insurance Symposium May 1993, 'Insured for Life', by Robin Zuill

Bermuda Insurance Diploma

Up to the end of the 1960s, the workforce in Bermuda lacked the sophistication we see today and the largest employers of Bermudians returning from university were the Banks, Government, local insurers Bermuda Fire and Marine, Argus, Kitson, and the large international insurance company American International Company. Therefore, when the captives began to show signs of growth and longevity, many in Bermuda felt it was time to introduce an educational programme designed to help Bermudians interested in pursuing a career in the international insurance sector. As a result a new scheme was introduced to allow young Bermudians to gain a professional insurance qualification under the guidance of the Chartered Insurance Institute of London. The scheme allowed Bermudians to obtain the Bermuda Insurance Diploma and was taught by Mr W.D. Grieg, a Fellow of the Institute, who worked for L.P. Gutteridge, on secondment from the Commercial Union Group of Assurance companies, and Mr Simon Everett, an Associate of the CII, employed by Harnett and Richardson. The course was designed to give sound theoretical training in law relating to insurance, commercial practice, and the scope and make up of the Bermuda insurance market.[168]

A change in direction for the global insurance marketplace

As recorded on the front page of *Business Insurance* for 4 January 1971, in an article entitled, '1970—the good, the bad and the ugly—challenged risk men', 1970 was a year many risk managers chose to forget—

> '...1970 was a year 'fraught with problems. More problems than solutions, really. Yet for some there is something strangely wonderful about all this. For the guy sitting in a corporate office working up insurance programs it all has to do with challenge. Society has created some problems for itself and now he must attempt to solve them.
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> 'On the property and liability side, for example, society has demanded the huge catastrophic risks corporate insurance buyers were faced with last year. The huge 747s got off the ground. A travelling society demanded that, but in its demands it didn't realize the jumbo insurance problems that were created. An urbanized society demanded more and more petroleum products, and oil refineries continued to flourish in and around cities. One, a Humble Oil & Refining Co. installation, blew up in Linden, N.J., last month—to the tune of more than 50 million US dollars. A pill-oriented society demanded more and more of pharmaceutical houses and drug firms got more than they bargained for in terms of products liability....
>
> 'On the employee benefits side, events in 1970 were perhaps less dramatic but no less challenging. Unions demanded—and in most cases got—more in the way of benefits and pensions and an increasingly vocal majority continued to put pressure on the health system and health insurance.'[169]

It was also in 1970 that asbestos pollution began to rear its ugly head. Prior to 1970, no one really thought about asbestos. It was not until New York City, in the latter part of 1970, proposed a new air pollution code banning, among other things, asbestos fire proofing sprays used on steel girders of buildings, that the alarm was raised about the inherent dangers of using asbestos. According to *Business Insurance*—

> '...The movement to ban such sprays began last April when New York's department of air resources forced contractors to stop work on several large buildings, including the World Trade Center, where such sprays were being used. Work was resumed only when builders complied with new application regulations...

[168] *The Royal Gazette*, 26 August 1970, 'Now a plan to train in insurance'

[169] *Business Insurance*, 4 January 1971, '1970—the good, the bad and the ugly—challenged risk men', by Stephen Gilkenson, pp. 1, 6 & 47

'Only within the past three years have politicians, health experts and environmentalists started hammering home the fact that the "snowy fallout" from asbestos fireproofing sprays could be harmful to the environment. Since cries to ban such sprays have arisen, the public is starting to focus attention on the safety hazards within the industry. Asbestos workers have always suffered from asbestosis, a disease contracted when tiny asbestos fibres become lodged in the tissue surrounding the lung.

'Asbestos, a fibrous stone, has more than 3000 uses. It looks very fragile, but it has the tensile strength of piano wire. Because its fibres are soft and pliable, it can be woven and spun into textiles used for theatre curtains, potholders, fireproof felts and filters for gas masks. Nearly 95% of the asbestos produced in the US is used by the cement industry, which combines it with other materials such as Portland cement, asphalt, vinyl and plastics. Asbestos cement pipes, insulation board, shingles and clapboard are heat and weather resistant....'[170]

These incidents set the tone for a changing global insurance marketplace, in direct response to the changing needs of society. Bermuda was on the receiving end of many of the new challenges that society was placing on itself because of its rapid quest for capitalisation and modernisation. 1970 also ended with a feeling of great uncertainty for the island because no one could answer Sir Henry's questions, 'Where are we heading and why?' As a result, on 1 November 1970, the year effectively ended with a demonstration by 'the Black Berets, carrying placards denouncing just about everything—the lack of social welfare, the jury system, high rents and a dearth of mortgages, "Gestapo" tactics by the Police, and the lack of press freedom.'[171]

[170] *Business Insurance*, 7 December 1970, 'Asbestos pollution: The fallout affects the industry', p. 57

[171] Colin Benbow and Marian S. Robb: *Hamilton, Bermuda: City and Capital 1897-1997*, Chapter 30, '1970-Year of the Hooligans', p. 106

CHAPTER 20

1971
Hot New Centre

Change and more change

The Government of Bermuda had no wish to see more of the violence that unsettled the island in 1970. Further steps were needed to promote racial equality. The question was where to begin. On the basis that young children did not yet share the racial prejudices of older people the Government decided to integrate the primary schools in 1971. This was intended as the first step towards integrating the school system as a whole.

Apart from this integration of the primary schools, 1971 proved to be an uneventful year for Bermuda's social environment, as compared to 1970. However Bermuda was making immense progress in the financial sector because the global insurance industry had begun to go through a fundamental change. As industrialisation, globalisation and the demand for capital all grew at exponential rates, so it became evident that the insurance industry had come to a critical point. It must meet the challenge of new and sterner conditions or fail. Risk Managers found themselves left without insurance coverages that had been readily available to them in the past. Pollution coverage was virtually nonexistent. The rates for malpractice insurance skyrocketed. Architects and engineers were finding it impossible to obtain coverage for Errors and Omissions at anything like an acceptable cost.

Texas comes to Hamilton

In March of 1971 Mr Joseph H. (Joe) Blades, President of J.H. Blades & Co., Houston, and of St Johns Insurance Co., Hamilton, Bermuda, told the annual international finance conference of the American Management Association that—

> 'For those who do not believe or recognise today's insurance revolution, it will really be "the winter of despair", for in my opinion the insurance industry will never return to the so-called "good old days" of plenty and the desire to provide a market of all risks, attempting to live on an investment profit with little regard to underwriting.'[172]

At this conference, Blades also promoted the concept of using captives to help companies take control of their insurance programmes by giving subsidiary insurance companies direct access to reinsurance companies and giving them the ability to coordinate their insurance programmes on a worldwide basis. What country was better placed than Bermuda to traverse the changing landscape of the global insurance marketplace?

Many believe that in this speech Blades gave voice to his decision that it was time for him to open an office in Bermuda if he wanted to be at the forefront of the rapidly changing insurance industry. For it was in 1971 that this oft described, larger-than-life and very colourful man, Joe

[172] *Business Insurance*, 15 March 1971, 'Blades says "tell the truth" about market shortage', pp. 22 & 28

Blades, formed his Blades Group of Companies in Bermuda. He ran an advertisement in the local newspaper, looking for staff. A young Bermudian, Stuart Grayston, who was working at American International Company at the time, answered the ad and was hired for the job.

According to Robin Spencer-Arscott, insurance and reinsurance consultant, American International Company had become much smaller by the time that Blades set up in Bermuda, because the American Life Insurance Company had relocated to the US. When the new companies came to Bermuda they began to offer higher salaries and more opportunities to employees than the established companies and it was for these reasons that Grayston left American International to set up the office for Blades.

Meanwhile Blades was not shy about making his presence known. He flew the flag of the Lone Star State outside his first office on Pitts Bay Road in Hamilton and had a plaque mounted on the building, which read, 'Texas Embassy'. Visitors would often come by and in all credulity sign the ambassadorial guest register. He was finally censured for not flying the British Union Jack higher than the Texas flag. The Texas Embassy was suddenly no more as he had to take down the sign!

Bermuda's new captives

For all the reasons given above, Bermuda soon began to benefit by the tough market in the United States as more and more companies sought ways to restore some stability in their insurance programmes. Offshore insurance was no longer looked down upon as merely the place of last resort where only those risks were lodged that had found no takers anywhere else.

Large brokers made their way into Bermuda by way of partnerships with already established local companies. They formed separate captive divisions, because they could see the writing on the wall, that captives were here to stay. Risk Managers blamed the traditional insurance marketplace for this exodus.

Of all the possible domiciles in the world, Bermuda proved to be the most successful in attracting captives, because of its economic, social and political stability, because of its convenient location, because it was English speaking, because it had readily available banking facilities, management and reinsurance skills, and because a company could be formed in Bermuda with relative ease and at a reasonable cost.

On 30 August 1971 *Business Insurance* reported the success of Bermuda in attracting business as follows—

> 'According to Felix Kloman of the Connecticut based Risk Planning Group, 100 is a reasonable estimate of the number of United States corporations currently looking into setting up captives in Bermuda. Mr Kloman also estimated that 30 or 40 new captives have been put into operation since January and that 40 more should be formed by year's end.'[173]

As the influx of new companies came to Bermuda, so American International began to lose core people. It had been the largest international insurance company operating on the island and accordingly the personnel were much sought after by those corporations looking to establish themselves in Bermuda. Companies like American International and Bermuda Fire and Marine provided the training for many future insurance executives elsewhere.

CRISTAL

Despite clarification by Lloyd's as to how it would treat pollution claims and also as a result of the Water Quality Act of 1970, the oil industry still had great difficulty obtaining for its tankers afford-

[173] *Business Insurance*, 30 August 1971, 'The offshore captive: Bermuda is booming', by Annette Duffy, pp. 54 & 56

able pollution coverage in the traditional marketplace. After two of Standard Oil Co. of California's 17,000-ton tankers collided, on 18 January 1971, in zero visibility fog outside the Golden Gate Bridge, San Francisco, it became clear that the industry needed more help in respect of insurance.

Business Insurance reported as follows—

> 'The early morning collision, in fog that closed all airports and slowed traffic to the traditional snail's pace, not only tore a huge hole in the mid-section of the *Oregon Standard* by her sister the *Arizona Standard*, but it also spilled 840,000 gallons of black, heavy bunker oil onto the waters of San Francisco Bay. The company said 336,000 gallons were recovered but that figure "may be subject to revision. We not only will have the cost of repairing both of the big tankers," a company spokesman explained, "but also the considerable cost of attempting to clean up the gummy, gooey mess in the Bay." Wildlife was threatened along the shores of Sausalito and Angel Island and conservation groups immediately began setting up bird-rescue teams.'[174]

This major accident brought home to the oil industry the fact that it lacked coverage for third party losses, despite having set up TOVALOP (Tanker Owners Voluntary Agreement Concerning Liability for Oil Pollution), the Bermuda based company established in 1969 to cover first party damage. The accident made the oil industry realise that, despite having TOVALOP, which covered vessels to the tune of 100 US dollars per gross ton of shipping, there was limited third party coverage in place and no cover available at a reasonable price for the cost of cleanup and damage to wildlife. TOVALOP had not been designed to cover third party and other such losses. Standard Oil was left to meet this massive bill by itself.

Five days after the Standard Oil incident, a Humble Oil and Refining vessel scraped bottom in the harbour of New Haven, Connecticut and lost 386,000 gallons of her cargo in Long Island Sound. Once again TOVALOP responded to the physical damage of the vessel but not to any third party exposures. At their Brussels Convention of IMCO (Inter-governmental Maritime Consultative Organization) the oil industry decided to do something about the lack of reasonable insurance to cover third party exposures, including clean up costs in the event of a major oil spill.

As a consequence of the Convention, more than 40 oil companies from around the world, together accounting for some 70 per cent of the crude and fuel oils transported on the oceans, signed a new, self-insurance agreement, expanding liability coverage for oil spills to as much as 30 million US dollars per incident. This pact was designed to supplement TOVALOP and was to be known as CRISTAL (the Contract Regarding an Interim Supplement to Tanker Liability for Oil Pollution).

Once agreement was reached to establish CRISTAL, Bermuda was chosen as the logical venue because TOVALOP itself had been established there. Because of the lack of affordable third party pollution coverage it was essential to get the company up and running immediately. The Bermudian law firm appointed to do so was Conyers Dill & Pearman (CD&P) and Nicholas Dill of CD&P was the lawyer responsible for setting up CRISTAL. Dill said that he had to do so in a hurry and as an ordinary company because they could not wait for incorporation by a Private Act of Parliament. CRISTAL was set up as a mutual but because of the time constraints it was incorporated as a company with share capital. Each oil company had only one share, with the balance of the shares being issued by nominees as other oil companies joined. The operation of the company was based on the agreement between members. There was a call mechanism, assessed annually on the number of barrels of oil moved during the previous year.

CRISTAL was another example of insurance buyers finding their own solution to the lack of available insurance from the traditional insurance marketplace.

[174] *Business Insurance*, 1 February 1971, 'Self-insurance and TOVALOP cover oil spills on two coasts', p. 1

It was designed to compensate private individuals and companies as well as governments. It thus provided the essential liability coverage that oil companies so desperately needed after the withdrawal of coverage by major insurers. CRISTAL was not designed to be a permanent facility but as one that would provide temporary cover of shortfalls left by the insurance industry, until such time as a conventional solution was found in the traditional marketplace. It was run on a day-to-day basis by way of cash contributions from the 40 major sponsors, contributions that varied according to the size of shipments transported across the oceans.

Lincoln Loan Association

No sooner had Bermuda become the premier offshore domicile for captives than in July 1971 the United States Supreme Court, in its adjudication of the Lincoln Loan Association case, issued a ruling that caused OIL to be shut down. According to Doug Kline, Senior Vice President of OIL, the decision was interpreted to mean 'that if and to the extent "premiums" paid into an insurance facility are set aside in a reserve which is maintained as discretely identifiable to, and inuring directly to the benefit of, the company paying the premium, then such payments may not be considered deductible as a business expense for tax purposes.'[175]

In other words, the United States Supreme Court stated that there was no transfer of risk because the company was basically self-insuring its own risks through its captive. Therefore the Courts saw no valid claim that such payments into the captives should be tax deductible. Accordingly, although the specifics of the Lincoln Loan tax case did not correlate in their entirety with OIL's method of operations, 'the Company's tax advisors felt that the facts were so close that it would preclude OIL from receiving a favourable tax ruling unless the Company's rating plan was significantly revised.'[176]

Kevin Stevenson editor of *Bermudian Business* reviewed the original design of OIL in terms that clarify why OIL had to be shut down—

> 'The original OIL was essentially a "spread loss" insurance programme. It was designed to be a risk financing-facility, which collected premiums in advance and maintained segregated reserves, which were specifically identifiable to the individual participants. The intent was that a member, having received payment for a loss from OIL, would then "pay back" the difference between the loss and the cumulated reserve.
>
> 'This "pay back" was intended to be treated as a "retrospective premium" and spread over the five years following the loss. In reality, the original OIL provided for no transfer of risk. By moving from a "spread loss" insurance facility to a mutual, the shareholders were forced to deal with the critical issues surrounding how to equitably allocate premium among the membership.'[177]

Early in September 1971 and as a result of the Lincoln case, the directors and shareholders of OIL met at the Inverurie Hotel in Bermuda to discuss how to modify OIL, because it was now evident that their original concept for forming OIL had been flawed. The directors agreed to liquidate OIL and start again. Accordingly the first OIL was wound up, with effect from 31 December 1971, on the day before its first birthday. The company's total assets were distributed to its 15 founding shareholders.[178]

[175] *OIL Insurance Limited 25th Anniversary 1971-1995, A Special Report* compiled by Douglas Kline, Senior Vice President OIL

[176] ibid.

[177] *Bermudian Business*, Spring 1999, 'OIL', by Kevin Stevenson, pp. 66–74

[178] ibid., Summer 2001, 'A Well Oiled Machine, OIL Insurance at 30: how a quiet Bermuda company has covered the risks of big oil', pp. 82–98

Captive insurers under investigation by the United States Justice Department

As Bermuda became the popular destination for captives, it soon emerged that the United States Justice Department was taking an interest in companies with captives in Bermuda. According to *Business Insurance*, several United States companies, including Tenneco, Celanese, Boise Cascade and El Paso Natural Gas, had their records subpoenaed in a Justice Department inquiry. A source involved with captives on the island was quoted as saying that the Justice Department was 'primarily concerned with the possible violation of Department of Commerce regulations and, in particular, with the possible illegal movement of funds from the captives to Southern Rhodesia.'

According to the source, the Justice Department official 'indicated that he was an economist, not a lawyer, and they were in the very early stages of the inquiry. However,' he added, 'the Justice official did note that there are facets to the investigation being considered by other Justice department officials and that he was not at liberty to discuss these.'[179]

Some speculated that there was a permanent federal grand jury sitting in New York, to investigate Swiss bank accounts and other similar transactions, and it was curious as to premiums going offshore to Bermuda. Others speculated that the Justice Department was looking for loopholes in foreign regulations.

Business Insurance reported that—

> 'Insurance premiums paid to an offshore captive, for instance, do not necessarily qualify as "transfers of capital" under foreign investment regulations. Another interest of Justice may be the use of the British method of accounting in setting up insurance reserves. This allows companies to keep more tax-free profits in the foreign subsidiary than those required by regulators in the US. Moreover, the tax less situation in Bermuda allows a company to reinvest untaxed dollars rather than return profits to the United States where they would be taxable income.'[180]

Bermuda government's first informal count of captives

As a result of this new flurry of activity within Bermuda, and the spotlight turned upon it by the outside world, the government of Bermuda decided to form a Registrar of Companies Department, which could make and provide a formal accounting for the activity of the international business sector.

Peter J. Hardy, a teacher at the Berkeley Institute high school in Bermuda, was reading through the newspapers when he spotted an advertisement for a Registrar of Companies. Reckoning that he had nothing to lose, Hardy applied and much to his surprise was given the job. Unfortunately the school term was about to begin. He was bound by contract and the school could not find a replacement in time. A compromise was reached whereby for two years Hardy taught in the morning at the Berkeley Institute and turned to his duties as Bermuda's Registrar of Companies in the afternoons. It was not until 1970 that he took up the post of Registrar on a full time basis.

The first task that confronted him was implementation of the controversial 1969 Companies Act, which was effectively the inception of the 60/40 requirement for Bermudian over non-Bermudian ownership of a business. Hardy and his staff of two were faced with the daunting task of separating companies in need of a license from those already within the terms of the 60/40 rules. At the same time, he was responsible for setting up the Registry. He therefore had first to obtain all the files from the Registrar General and Accountant General and then had to match the companies between the two Government offices, so as to create for the very first time an accurate Registry

[179] *Business Insurance*, 11 October 1971, 'US grand jury probes captive insurers' financial operations', p. 1

[180] ibid.

of Companies in Bermuda. To help in equipping him for this task he was sent to London and then to Edinburgh to study the way those Registries were set up.

When Hardy undertook Bermuda's first informal count of captives, he found there were as many as 150 of them incorporated there. The business community, on both the international and the local insurance sides, became concerned. Made aware of the number of captives on the island, and putting that together with the rumblings abroad about the legitimacy of Bermuda, they considered that the Exempted Companies Act and other current government regulations no longer provided sufficient formal structure with which to meet the rapidly changing realities of the Bermuda insurance scene.

The industry formed a group consisting of accountants, bankers, lawyers and insurance professionals from both the domestic and international sides. At their initial meetings, these men attempted to draw up an Insurance Act that would police the industry, a measure to be known as the Insurance Act of 1971. In the outcome it was not until 1978, after much debate about how best to regulate the various sections of the industry that the Insurance Act was at last brought into law.[181]

The captive companies reacted in a very mild way to the proposed new legislation. One source told *Business Insurance*—

> 'The move was not at all unexpected. Furthermore, I think everyone in this business agrees that it is a desirable move for the government to make. The Island has become such a popular base for insurance operations, captives and others, and so rapidly that there was a danger of the undesirable element creeping in. The government wants to avoid this and the act will provide it with a new tool with which irregularities and possible alley cat operations can be caught before they damage all of us.'[182]

First Bermuda captive conference

It was an exciting occasion when the Bermuda insurance industry hosted its first big captive conference, organised by the American Management Association (AMA). Prospective clients were keen to understand the lure of Bermuda. Risk managers were anxious to find alternatives to the dire insurance market conditions in which they found themselves. As a result, some 300 delegates attended the conference.

Jack Lancaster, VP and Director of American International Reinsurance Co. Ltd., an offshore unit of the American Home Group, spoke at the conference about the pros and cons of establishing a captive in Bermuda. He voiced concerns about the infrastructure problems inherent to the establishment of captives on the island, among them the need to bring in experienced management staff and the need to train locals so that they could in due course take over the responsibilities of management, work force, housing and schools. Lancaster spoke also of the notable reputation Bermuda had earned by carefully going for quality rather than quantity.

Business Insurance reported Mr Lancaster as saying—

> 'Local government authorities and others have been vigilant and diligent in establishing and maintaining an atmosphere that emphasizes quality rather than quantity. Clearly those of us operating from these islands benefit from the establishment and maintenance of such high standards. The absence of insurance regulations makes it important that each company operating here function as its own policeman…'

Business Insurance further gave Mr Lancaster's views that insurance legislation shortly to be introduced would be 'sensible' and, according to his understanding, would 'deal separately and specifically with exempted companies' business.'

[181] Interview with Cyril Rance, 4 March 2002

[182] *Business Insurance*, 11 October 1971, 'Bermuda insurance act will be drafted shortly'

In summary Mr Lancaster was quoted as saying—

> 'This is important because the activities and problems of exempted companies underwriting risks located outside of Bermuda are quite different from those of local companies transacting purely local business. My colleagues and I support this legislation and consider it necessary at this stage in Bermuda's development…It is important that we create a reputation as a responsible market… Just the fact that we are in Bermuda is a hurdle to overcome subject to automatic scepticism…'.[183]

New ways of purchase

To some the end of 1971 signalled the end of the capacity crisis, except for liability (third party) risks, particularly as a result of the New Occupational Safety and Health Act (OSHA) in the United States. For some the turn of the year ushered in a significant change in the way insurance was to be bought in the future. Many in turn believed that a time of innocence had passed, as soon as Hurricane Betsy did its worst to Florida, Lloyd's and the rest of the insurance industry.

No longer did the industry have absolute control over its clients. Many of these had begun to seek their own solutions to their insurance needs. In order to retain their client base, insurers had to open up capacity and coverages in areas where they may not have felt comfortable in the past.

The end of the year saw further changes in Bermuda, as American International Company opened its new building on Richmond Road, Niagara Insurance changed its name to Security Reinsurance Corporation Limited in order to boost its image on the international market, and INSCO (the captive of Gulf Oil) set up in Bermuda. Beyond all these specifics changes were the many clients who entered the New Year investigating whether to come to Bermuda to explore the possibility of establishing captives there to ease their insurance concerns.

On 29 December 1971 *The Royal Gazette* carried the headline, 'Government Leader Resigns'. This posed a huge question mark over the immediate political future. Sir Henry Tucker had led the country through so much. Where would the island be without him? What was to be the future leadership? Many saw his resignation as a sign that Bermuda was about to be cast upon uncharted waters.It is only human to look askance at change.

[183] *Business Insurance*, 25 October 1971, 'Captive seminar: All the pitches were not curves', by Stephen Gilkenson, pps. 45 & 46

Chapter 21

1972
Hub of the World

An interesting time, an unsettling time, for Bermuda and its economy

In 1972 Bermuda was on the threshold of several new beginnings, social and economic, for it was then that the reins of government passed from Sir Henry Tucker to Bermuda's first black Government Leader, Sir Edward T. Richards. Though many may have thought in private that Richards was the only choice for the leadership, in public the opposition claimed that he was being used to present some semblance of resolution to the racial problems of the island.

1972 was also the year when government began to realise just how much importance was accorded to Bermuda as an alternative market. Likewise Bermuda's competitors began to realise just how much of a threat Bermuda posed to their own commercial livelihood—so much so that the state of Colorado became the first of the United States to enact legislation encouraging the formation of captive insurance companies that could underwrite corporate risks for domestic exposures. This decision to allow such captives to be formed in Colorado was obviously one way for the United States to prevent an offshore exodus of companies. There was widespread fear that if these companies left the United States, their tax dollars would forever be lost to the Internal Revenue system

However the Colorado Act was limited, in that it only allowed captives to insure domestic risks and not those of foreign operations. To this extent the Act was flawed, because it still did not allow companies to consolidate their worldwide insurance operations into one facility and therefore did not offset the advantages that the Bermuda captives were offering.

Moreover the Colorado legislation did not offer the same investment freedom that captive owners could enjoy once they had established a captive in Bermuda. Thus, although Colorado naturally caused some angst for the young Bermuda captive insurance industry, it proved in the outcome to be by no means so grave a threat as was originally anticipated.

Meanwhile the overseas influences on Bermuda's economy were growing rapidly. One move that caught the Bermuda Government and the financial sector of Bermuda completely off guard was the British Government's decision on 23 June to contract the sterling area and set the pound free to float against other currencies. According to Gordon Phillips, author of *First, One Thousand Miles*—

> 'Without any notice, Bermuda, along with thirty other countries, was divorced overnight from the armchair comfort of the British pound. Faced with a potentially unbearable set up—a complete mix of reliance on dollar tourism and part-sterling offshore company business—a still-traumatised Government responded swiftly to ensure stability of the Bermuda dollar.'[184]

Trying desperately to protect the international business sector, which he had worked so hard to bring to Bermuda, Sir Henry Tucker visited London to ensure that no British capital would have to go back to Britain at Bermuda's expense. It was in direct response to these unprecedented and

[184] Gordon Phillips: *First, One Thousand Miles…*, Chapter Six, 'Swings and Roundabouts', p. 183

unforeseen actions of the British government that the Bank of Bermuda and the Bank of Butterfield, in concert with the Government of Bermuda and the Bermuda Monetary Authority, decided it was time to tie the Bermuda dollar with the US dollar. On 31 June 1972 Bermuda became the world's smallest independent monetary authority.[185]

It took some time for Bermuda's government and financial sector to get over the severe blow dealt by the British government. Many felt rebuffed, not to say betrayed, in view of the loyal and unstinting support Bermuda had given during the most perilous crisis in Britain's history. However, when the emotional sense of rejection had passed, the financial sector realised that by forcing Bermuda out from under its protective arm, the British government had actually done the island a favour. Bermuda's ability to respond to outside financial needs would no longer be defined and perhaps circumscribed by trading at par with the British pound. Nor would Bermuda any more be constrained by the exchange controls to which it had previously been subjected by its link to the British pound sterling.

Instead, Bermuda was saved from being dragged down by the rapid decline of the pound and could now trade freely with the United States, a partner that was becoming more and more important to Bermuda's gross domestic product, along with the number of US companies that were establishing links to the island through the use of captives and trusts.

OIL begins operations

Historians of economics will record that the consumption of petroleum and its derivatives was a fundamental feature of the past half-century and perhaps of the one to come. The fact that worldwide demand had tripled since 1949 was not without an impact on Bermuda in 1972. To provide the massive infrastructure needed to meet this ever-increasing demand, the oil companies had embarked on major capital expenditure projects in every sector of their industry. Uppermost in the minds of their executives was the interlinking of all operations, from exploration and production to refining and marketing.

One result of this development was that the oil companies deemed it to be of the utmost importance that they reform their industry captive, OIL, despite the negative implications of the Lincoln Loan Association ruling. As a result, and after considering different strategies, the original board members and shareholders of OIL came up with the ingenious concept of allocating premium payments among their members. Kevin Stevenson of *Bermudian Business* reported on this in the words of Jon King, President & CEO of OIL—

> 'They came up with a unique concept which still stands today, and which we now call "post-loss" funding," says King. "OIL has never underwritten in any normal sense. This is a risk-sharing pool on a very large scale. What we do is determine the premium based on the actual losses over the previous five years.
>
> 'There are contractual commitments from the owners of OIL to pay premiums to make up for those losses. So, whatever losses OIL has determines the premium over the next five years, and as a result OIL is constantly refunding itself
>
> 'The actual premium that OIL collects is determined by a formula and it is mathematically determined by the losses OIL has sustained over the past five years. The rating plan simply divides it up in an equitable way among the various members.'[186]

It was with this formula that the new OIL began operations on 1 January 1972, with 16 shareholders, 15 of them in the United States and one in Europe, selling its insurance product at cost.

[185] op.cit.
[186] *Bermudian Business*, Spring 1999, 'OIL', by Kevin Stevenson, p. 70

Amerada Hess, Forest Oil and Petrofina replaced Diamond Shamrock and Kewanee Oil.[187] The first policy based on this concept was written almost immediately after the company was reformulated. Jon King of OIL describes the initial days of OIL to *Bermudian Business*—

> 'OIL collected about $25 million in advance premiums in its first year. The company also put together a $50-million bank line—guaranteed by OIL members—and started writing a limit of $75 million. It was a gutsy call. It was a new concept and no one was sure it was going to work… In fact, in the early days some of the risk managers kept duplicate insurance because they weren't sure OIL was going to survive.'[188]

OIL is criticised

Dismayed by their loss of business to self-insurance and to the neophyte Bermuda insurance market, London underwriters became very vocal in their criticisms of OIL. These led many risk managers to question whether OIL was in fact a viable alternative to the traditional marketplace. On the other hand they did not want the facility to fail. They decided to hedge their bets and buy policies with the new OIL while still continuing to purchase insurance from the London market. In essence, they doubled their policy limits, just in case.

These concerns of the London underwriters aroused enough interest for *The Times* to report as follows from London—

> 'Insurance broking sources estimate that OIL alone has cost the London market between US $10 million and US $20 (£4m and £8m) million in lost premium income. But equally London has not had to bear whatever losses have been sustained by the subscribing companies in that period. The London market view is that OIL will not be able to cope indefinitely with its insurance load…'[189]

In addition, OIL came under intense scrutiny from the US Internal Revenue Services (IRS), to determine if there was a legitimate transfer of risk in the new OIL corporate structure and not just a funding mechanism, as the previous structure had seemed to indicate.

Hopewell International Insurance

Meanwhile the captive insurance industry in Bermuda flourished. At last respected authorities such as Sidney Pine, a New York lawyer with strong connections to Bermuda, were conveying the message that captives were not only necessary in order to save on taxes but that they could also make companies more efficient, especially large companies with diverse operations throughout the world.

Corporations began to understand that forming captives would allow them to manage those risks that the traditional market either did not want to insure at all or else would insure only at the price of extraordinary premiums. As reported by *Business Insurance*, it became clear that the primary reason for forming a captive was to insure—

> 'the deductibles and the uninsured risks of the group and thereby build up a separate and segregated fund of assets in a separate corporation which will manage the funds, gain insurance expertise and set up prudent tax deductible reserves against otherwise uninsurable risks. Subsequently, the captive may be used to insure risks, which can profitably be transferred from the regular carriers. Finally, once the insurance expertise has been built up, a captive may be used to go into the insurance business as a profit center.'[190]

[187] ibid. Summer 2001, 'A Well Oiled Machine, OIL Insurance at 30: how a quiet Bermuda company has covered the risk of big oil', pp. 82–98

[188] ibid.

[189] *The Times*, 23 February 1972, 'Concern as oil firms bypass London insurance market',© NI Syndication, London 1972

[190] *Business Insurance*, 10 April 1972, 'Captives: Bermuda. Colorado, taxes and beyond', by Marianne Burge, Price Waterhouse & Co. New York, pp. 10, 47, 53 & 54

At the same time, Fred Reiss looked for ways to maximise his hold on the large Fortune 500 companies that came his way. Transworld Insurance, the brainchild he set up to reinsure the risks of his captives, did not last very long and was sold to Pinehurst Financial. Realising that he needed another vehicle to replace Transworld, Reiss went to everyone he knew and asked them to help him set up a new reinsurance company. He finally gathered enough support to open Hopewell International Ltd, a property risk pooling facility, formed to allow captives to access reinsurance markets.[191]

Hopewell was originally designed to provide a buffer for its clients against hard markets or markets that were not responding to the needs of clients. When these situations arose, Hopewell would be in a position to respond. It was also a way for clients to write unrelated business by pooling their risks with others into the same captive.[192]

Hopewell International was the vehicle for the property insurance pool, known as the Hopewell Treaty. It was owned by 34 captive insurers, clients of the Reiss Organisation, and was managed by International Risk Management. The business written by Hopewell was shared with approximately 250 professional reinsurance companies and with Hopewell's shareholder retrocessionaires (insurers of reinsurance companies). Hopewell and its subsidiaries retained about 30 per cent of the risks accepted, with the remaining 70 per cent being reinsured by major professional reinsurers such as Swiss Re and Mercantile and General.

The treaty featured unlimited liability. The pool was protected by mandatory excess of loss reinsurance in excess of US $25 million for individual risks having exposures up to US $100 million. Doris Fenske of *Best's Review* described the Hopewell facility as follows—

> 'Initially, casualty reinsurance also was reinsured through Hopewell. The primary casualty insurance vehicle for Reiss clients is United Insurance Co., formed in the Caymans and Shannon, Ireland. Like Hopewell, United was managed by the Reiss Organization and is owned by a group of its captive clients. However, the Reiss group, through Transnational Ltd., is also one of 32 stockholders in the firm, which is not the case with Hopewell.'[193]

Casualty business written by Bermuda captives

A. Peter Law was first introduced to the Bermuda marketplace in 1971 when he was risk manager of US Industries (USI), the US $1 billion conglomerate, as he had to incorporate its captive, Diversity, there. Diversity was formed as a way to self-insure workers compensation for the company's numerous and widespread operations.

The Occupational Safety and Health Act (OSHA) 1970 found that the vast majority of American workers, and their families, were dependent on worker's compensation for their basic economic security in the event such workers suffered disabling injury or death in the course of their employment. Therefore, the full protection of American workers from job-related injury or death required an adequate, prompt, and equitable system of workmen's compensation as well as an effective programme of occupational safety and health regulation.

In addition to establishing OSHA in 1970 Congress went on to serious questions that had been raised concerning the fairness and adequacy of the worker's compensation laws in light of the growth of the economy, the changing nature of the labour force, increased medical knowledge, changed hazards associated with various types of employment, new technology creating new risks to safety and health, and general increases in the level of wages and the cost of living.

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

[192] Interview with Bob Whiting, 17 October 2002

[193] *Best's Review*, March 1984, 'Beyond Bermuda', by Doris Fenske, pp. 22, 24, 114, 115

Congress then established the National Commission on State Workmen's Compensation Laws to undertake a comprehensive study and evaluation of such laws in order to determine if they provided an adequate, prompt, and equitable system of compensation.

After conducting the study, the Commission made several recommendations to improve the worker's compensation laws in the United States. In direct response to these recommendations, several states expanded worker's compensation benefits and made coverage available to workers who had been deemed ineligible for worker's compensation in the past. However, the requirements of each state were different and thus presented a challenge for companies seeking to comply with workers' compensation laws. Many sought other means to insure this now highly publicised coverage in the United States and one way was through the use of captives. Bermuda, because it was fast becoming the captive domicile of the world, was the natural choice for many looking to self-insure their workers' compensation exposures through the use of captives.

Law had always felt that there were economic advantages to self-insuring workers' compensation, but he was hampered by the fact that individual states required companies to file with it to determine if the company qualified to become a self insurer. He decided not to let this bureaucratic nightmare stand in the way of making his operation more cost effective and profitable. Consequently he consolidated all his casualty programmes, namely workers' compensation, automobile and general liability, into one cover, with one US licensed insurer capable of providing safety and claims services nationwide. Under Law's plan, the insurance company also had to be willing to reinsure the first US $100,000 per loss with Diversity. In this way, he believed he would gain the benefits of being self-insured without suffering the bureaucratic nightmare of trying to comply with the requirements of individual states.

Excited about his idea, Law then went to some ten international insurance companies in the United States to market the concept, thinking he would find a home with either Insurance Company of North America (INA) or Kemper, because of their established reputations as providers of services to self insurers. Only INA was interested in the concept and wrote his comprehensive programme in 1972.

Law's concept set a new precedent for the use of captives because, prior to Diversity, there had been no other captives writing primary casualty coverages. As a matter of fact, according to Law, there were no auditors on the island at the time who understood the term, 'incurred but not reported losses' (IBNR). Diversity was first managed by Fred Reiss' IRM but because IRM's focus was on property they had great difficulty in grasping casualty business. As a result, Law switched his operation to Joe Blades management, which was being run by Stuart Grayston in Bermuda. Diversity was subsequently managed by A&A, now Aon.

Not too long after Diversity began writing USI's primary casualty risks, other companies followed suit. Some years later, Law found that the reason why several of the insurance companies turned down his plan initially was because they thought it was too easy to accomplish. They feared, justifiably as it turned out, that too many of their insurers would skirt the onerous regulations in this way and vast amounts of premium would end up in the coffers of captives rather than in theirs. The reinsurance market had no role in this. It was a transaction between a corporation and a primary company with the primary company being persuaded to reinsure the major portion of the premium (the level of risk that had the expected losses) with the corporations' captive.

The global centre for captive companies

By the end of 1972 the name 'Bermuda' had become synonymous with captives. If companies looked to establish captives, they looked to Bermuda. Therefore the mood of Bermuda changed from one of a slow pace to one of frenetic decision-making. 1972 also saw the start of a trend for more oil captives to establish captives on the island. One of the biggest did so in 1972, when Phillips

Petroleum set up its captive, Walton Insurance Limited, in Bermuda, its purpose being primarily to write the offshore risks of Phillips. Walton was managed by J&H Limited and as a result, Brian Hall was named President of Walton.[194]

In September 1972, in response to the rapid growth of its international captive sector, Bermuda began the process of revolutionising its internal and overseas telephone services by installing a two million US dollar electronic exchange using two computers. This new exchange, the first of its kind in the western hemisphere, was to give Bermuda subscribers trunk dialling facilities throughout the United States, Canada and the Caribbean. The facility would likewise make it possible in the not too distant future to dial direct to almost anywhere in the United Kingdom, Europe, and eventually the world.

This facility also provided Bermuda with 6,000 more exchange lines. At the same time Bermuda moved from the five-digit dialling system to the seven-digit dialling system, so as to allow it to modernise its telephone system and be able to communicate with countries around the globe.

Not all was progress and enlightenment. On 11 September 1972, just at a time when many believed that social violence had faded out, Bermudians were shocked by the premeditated and cold blooded assassination of Police Commissioner George Duckett and the attempted murder of his wife and daughter. A state of emergency was declared and Scotland Yard was called in to investigate.

As the old year gave way to the new, although Bermuda kept on advancing technologically, the island still seemed as yet unable to keep up with social changes that threatened upheaval unless they were peacefully met and absorbed.

[194] Notes from Brian Hall, 29 May 2002

CHAPTER 22

1973
Turning Points

Risk managers more prevalent

1973 saw several new developments. The year began with the largest personal injury liability ever awarded. A young boy in San Francisco was involved in a fight at school and was hit on the head. His father took him to hospital a few hours later because the boy was complaining of headaches. The doctor who treated him saw nothing wrong with the boy and he was released from hospital. His condition worsened and so he was taken back to the hospital where it was found that in fact he had a brain haemorrhage. Despite surgery the damage was irreversible. The court ruled that the doctor had acted on behalf of the hospital and that the hospital therefore was liable to the boy and his family for damages in the amount of four million US dollars. Medical malpractice rates began to skyrocket as a result.

Also in 1973 life insurance companies, with their huge pension benefits reserves, began to take over the aviation market because of the tremendous profits that insurers anticipated from the underwriting of this new risk.

Furthermore, the United States dollar was devalued, thereby causing much anxiety as to how this would affect insurance premiums for United States companies that bought coverage from overseas markets.

As a result of the 1972 National Commission on State Workmen's Compensation Laws, a Worker's Compensation Bill was introduced in the United States, requiring that by 1975 all states should comply with minimum federal worker's compensation standards. Senators Jacob Javits (Republican-New York) and Harrison Williams (Democrat-New York) sponsored the Bill and Representatives Carl Perkins (Democrat-Kentucky) and Dominick Daniels (Republican-New Jersey) backed its companion bill.

Against this backdrop, the insurance buyer became more sophisticated and demanded more of his insurance broker. Where the broker could not help him, the buyer sought alternative ways of solving his problems. As a result, more companies hired Risk Managers, for a position that in the past many companies had declined to take seriously. These managers were to put together insurance programmes, which were becoming increasingly complex, due to changing technology, new regulations and the sophistication of insurance buyers.

With dedicated Risk Managers, brokers found that they had to prove their worth to the clients. Risk managers demanded much more sophisticated coverages and detailed programmes, such that only skilled and imaginative brokers could put in place. As a result insurance programmes became broader while broker commissions were reduced across the board, as brokers tried to make their services more cost effective to their clients. The industry was definitely changing.

OPEC (The Organization of Petroleum Exporting Countries)

Just when Lloyd's at last took the step of admitting women to work in the underwriting room, so in a more current time frame the Organization of Petroleum Exporting Countries (OPEC) exerted its newly concerted influence over the dynamics of petroleum supply. OPEC today describes itself and its background as follows—

> 'The Organization of the Petroleum Exporting Countries (OPEC) is a permanent, intergovernmental Organization, created at the Baghdad Conference on September 10–14, 1960, by Iran, Iraq, Kuwait, Saudi Arabia and Venezuela. The five Founding Members were later joined by eight other Members: Qatar (1961), Indonesia (1962), Socialist Peoples Libyan Arab Jamahiriya (1962), United Arab Emirates (1967), Algeria (1969), Nigeria (1971), Ecuador (1973-1992), and Gabon (1975-1996).
>
> 'OPEC's objective is to co-ordinate and unify petroleum policies among Member Countries, in order to secure fair and stable prices for petroleum producers; an efficient, economic and regular supply of petroleum to consuming nations; and a fair return on capital to those investing in the industry.
>
> 'The OPEC Conference of Ministers meets in ordinary session twice a year, and is responsible for the formulation of the general policy of the Organization.
>
> 'OPEC rose to international prominence during the 1970s as its Member Countries took control of their domestic petroleum industries and acquired a major say in the pricing of crude oil on world markets. There were two oil pricing crises, triggered by the Arab oil embargo in 1973 and the outbreak of the Iranian Revolution in 1979, but fed by fundamental imbalances in the market; both resulted in oil prices rising steeply.'[195]

Ellen Parson, Senior Managing Editor of *Electrical Construction & Maintenance* magazine, described the energy crisis of the 1970s as follows—

> 'Although the drama of the 1960s was a hard act to follow, the 1970s made its own unique mark on the electrical industry. Plagued by gasoline shortages, rising energy prices, and inflation, this decade is most remembered for its energy crisis, which revealed the nation's dependence on foreign oil and inspired numerous energy conservation efforts. Aggravated by these energy problems, unemployment reached 8.5% (the highest since the Great Depression) in 1975, and inflation was increasing at an annual rate of 9.5%.
>
> 'The Arab oil embargo in 1973 brought an end to the era of secure, cheap oil. As a result of the Arab-Israeli War, the Arab oil-producing countries cut back oil production and imposed trade embargoes on oil shipments to the United States and the Netherlands. Although these cutbacks represented only a 7% loss in world supply… by the end of this decade, the price of crude oil was close to 19 times higher than it had been just 10 years before.
>
> 'According to *EC&M* archives, the energy crisis hit the electrical industry especially hard. In the early 1970s, editors write that Americans are painfully coming to terms with a new truth: There will not be enough fuel to support their way of life in the future. "It is conceivable that the energy crisis in the United States will do more to disrupt and change the American way of life than any other ongoing domestic problem confronting the nation today," writes David F. Hanley, chairman of National Engineers Week (an event sponsored by the National Society of Professional Engineers). In a 1974 article, Hanley goes on to emphasize the importance of energy conservation and calls for nothing less than a full-scale national energy policy involving all segments of the energy industry.'[196]

Many blamed the gas crisis of the 1970s in the United States on the decision by OPEC to double the price of oil in retaliation for the US support of Israel. However it is the belief of many that most of the shortages in the United States were caused by the gasoline companies themselves, who used OPEC as an excuse to raise prices. The energy crisis put a stranglehold on the US economy. US consumers were being warned on a daily basis to conserve energy. Gas stations closed down for lack of gasoline. Businesses were badly affected by shortages of power for air-conditioning, heating, lighting, transportation and industrial processes necessary to operations.

[195] Official website of OPEC, www.opec.org

[196] *Electrical Construction & Maintenance*, 1 June 2001, 'The 1970s (1970-1979)', by Ellen Parson, Senior Managing Editor

While the oil companies and the general public felt the might of OPEC, there was on the hand a triumph of sorts in the United States when the Sears Tower in Chicago was completed. At 1454 feet it was the tallest building in the world at that time. Its completion launched an era of ever taller skyscrapers that soon dotted major cities across the globe and incidentally drove up the need for property insurance.

Nuclear Mutual Limited (NML)

The growing energy crisis in the United States caused many to look for alternative sources. One possible alternative was nuclear power. The growing interest in atomic energy as an alternative to oil raised safety concerns about generators, transportation and exposure to radiation. For fear of such hazards of nuclear energy, traditional insurers shied away from anything to do with nuclear power, so forcing its exponents to find their own insurance solutions.

In 1973 Bermuda again benefited from the restrictions of the traditional insurance marketplace when Nuclear Mutual Limited (NML) was formed. Several electric utilities already operating in the United States came together because they wanted to control the coverages, terms and conditions of the new nuclear facility. Each member of this consortium could be assessed for an amount up to fourteen times its annual premium in the event of a loss. When it first opened, NML provided a maximum limit of US $450 million per facility.

Strict Liability

As ambitions grew for ever taller buildings and as the consumption of oil resources was being tested, so at the same time a change in the way strict liability was interpreted by the United States judicial system had an impact on the landscape of the insurance world. Strict liability is defined as being the attribution of a liability even when there is no proof of negligence. It is often applied in product liability cases against manufacturers, who are legally responsible for injuries caused by defects in their products, even if they themselves were not negligent.

The strict liability doctrine was first applied in *Greeman* v. *Yuba Power Products, Inc.* (1963). The plaintiff was a worker injured by a power lathe, which had been purchased from the manufacturer by his employer. The plaintiff sued the manufacturer. When the matter came to court it was argued that an element of the case was the concept of 'privity', i.e. shared knowledge or a legally recognised relationship as between employer and employee. The plaintiff discovered that warranties without privity had never been extended beyond food products cases, and that he had failed to give timely notice of the manufacturer's 'breach of warranty', as required by the applicable statute, the Uniform Sales Act. However, instead of ruling against the plaintiff, the California Supreme Court held that the case did not really involve warranty but could be resolved by imposing strict liability.[197]

Strict liability had never been applied to non-product-related injuries until the Fifth United States Court of Appeal ruled in *Borel* v. *Fireboard* (1973) that an asbestos manufacturer had a duty to warn insulation workers of the hazards of asbestos, thereby making this the first case to extend strict liability for a failure to warn users of a product's possible hazards.[198] Clarence Borel was a dying asbestos insulation worker. It took him four years to prove that eleven asbestos insulation manufacturers knew the dangers inherent in exposure to asbestos but chose not to warn him and others of this exposure. This case set in escalation a trend whereby the United States tort system became a scourge of the insurance world.

[197] *Commercial Liability Risk Management and Insurance* Volume 1, Donald S. Malecki, Ronald C. Horn, Eric A Wiening, James H. Donaldson, Chapter 2, 'Premises, Operations, Products, and Contractual Exposures, Strict Liability in Tort', p. 97

[198] *Business Insurance, Millenium Special Issue*, 'A Timeline of Key events in Risk Management'

The imposition of strict liability by the United States court system dramatically changed the law of liability in many ways. Product liability lawsuits also increased by 400 per cent from 1968 to 1973. Consumers saw the opportunity to make money by suing corporations for not properly labelling or designing their products. Strict liability allows any user or any consumer of a defective product to sue the manufacturer or retailer of the product without regard to whether any warranty was proferred to the user of the product or not. It has also removed any need for the consumer or user to prove negligence on behalf of the manufacturer or retailer. More importantly, as reported by John Giles, an attorney at law, in *Business Insurance*, it has removed 'the citadel of privity'.[199] A defendant can be held liable for any injuries sustained, despite whatever efforts he may have taken to minimise or eliminate risk. In the case of strict liability, negligence is not a prerequisite to liability. This erodes the general principle of law, which states that a plaintiff must prove negligence on the part of the defendant in order to be compensated by insurance.

Bob Baker heads Security Reinsurance Corporation Limited

While the insurance world was at a turning point in terms of the emerging role of the risk manager, of OPEC, of nuclear power, and of liability exposure, Bermuda had emerged as a credible insurance jurisdiction. As a result, it began to attract some very influential insurance people to help it keep pace with the changing insurance industry.

In May 1973 Robert Baker, a well-seasoned and respected American insurance man, took the helm of Security Re (the first large reinsurer to come to the island in 1959 as Niagara since American International Company in 1947). He had been trained in the traditional way of underwriting through his old company, Swiss Re in New York, and was surprised by the cavalier attitude of some of the London underwriters and brokers that he found in Bermuda. He was used to long-term relationships between retrocessionaires and reinsurers and was shocked by the London mentality of going wherever one might get the best deal of the moment, regardless of loyalties or the long term.

Baker says the whole philosophy of reinsurance is based on the acceptance that reinsurers cannot exist without the expectation of getting repaid over the long haul. However he soon discovered that this was not the philosophy of the London underwriters to be found in Bermuda. They seemed to delight in their benefits from the disadvantages of the reinsurers. Most regrettably they cared nothing for long term relationships, because every year they closed their books and thus felt no need to worry about what losses might come back to haunt them. To their minds, when they closed out the year so likewise were the losses closed. Baker thought the London underwriters in Bermuda were far too focused on short-term results.

He felt Bermuda was an easy target for shrewd operators who had smoothly mastered the arts of networking and talk. They came to Bermuda seeking a fresh market in which to peddle their risks, especially should their home market be starting to feel the effects of sloppy reinsurance practices. They found a lot of innocent capacity in Bermuda. Sadly the Bermuda market did not see the writing on the wall. In another decade some major players in the Bermuda captive market were to implode under the weight of sloppy third party reinsurance business with which they had blindly let themselves become involved.[200]

[199] *Business Insurance*, 23 April 1973, 'Product liability lawsuits increase almost 400% in past five years', by John W. Giles, p. 56

[200] Interview with Bob Baker, 26 April 2002

A year of tumult

While the financial sector grew rapidly in Bermuda, an air of unrest still hung over the social scene. The cost of living had risen so much that the average Bermudian felt himself robbed in his own country, to such an extent that the Government introduced for the first time, 'an innovative and perhaps long overdue policy to ensure that Bermudians received first preference for jobs in the hospitality and construction industries. On the monetary scene, the new Bermuda dollar had been devalued to 10 per cent of its United States counterpart.'[201]

Many demanded that the government concern itself about the expectations of Bermudians and therefore called upon the retired Sir Henry Tucker to help forestall the problems that would arise if expectations got out of hand. As a result, on 22 February 1973, Sir Henry sent out a warning in *The Royal Gazette*— 'Bermuda needs cooling off. We have grown too far, too fast.'[202] He feared that Bermuda had become an island of overspenders.

It came as no surprise when the Budget revealed that Bermuda suffered from economic stress and strain. Government introduced several measures intended to resolve the crisis, the most significant being the introduction of a payroll tax on employers. Peter Hardy, Bermuda's first Registrar, was appointed Commissioner of Employment Tax and therefore had to leave the Registrar's Office. Shelton Burgess, a young, ambitious and clever Bermudian, was appointed to be the new Registrar. He was later to be hailed as a true visionary of the international insurance industry in Bermuda.

None the less, as the financial side of Bermuda took shape, the social side fell apart. On 10 March 1973 the Governor, Sir Richard Sharples, and his aide, Captain Hugh Sayers, were both assassinated, only six months after the assassination of the Police Commissioner. Government began the process of trying to calm the social tensions that were rising on the island. The Bermuda government took steps to distance itself from the perceived colonial structure of Britain by first changing the title of Government Leader to Premier. Constitutional changes were enacted accordingly and Sir Edward T. Richards, head of the United Bermuda Party, became Bermuda's first Premier. Members of Colonial Parliament became Members of Parliament. The Executive Council was transformed into a Cabinet. Such moves were meant to signal an effort at easing the tensions arising between the two races. Nevertheless many observers feared the worst for Bermuda and they included some of the very same international companies that had sought out the island because of its political stability.

In the rest of the year, Bermuda suffered more civil unrest and two more shootings. It seemed as though the island was besieged by the disenfranchised. Many concerned Bermudians asked themselves where things were headed and many were glad to see the tumultuous year of 1973 come to an end.

[201] J. Randolf Williams: *Peaceful Warrior—Sir Edward Trenton Richards*, Chapter 18, pp. 234–235

[202] J. Randolf Williams: *Man of Stature—Sir Henry James Tucker*, Chapter 15, p. 233

CHAPTER 23

1974
Recession and Third Party Business

No end to instability

1974 was marked by great uncertainty and concern. The world economy was suffering the worst recession since the 1930s. Bermuda was not immune. Premier Sir Edward Richards called for 'an economic policy of reasonable restraints during this difficult period.'[203]

Sir Edward also faced a crisis within his own political party, when it came to light that several members had formed a group to be known as the 'Black Caucus'. It was claimed that many like-minded members had become disenchanted with Sir Edward's leadership, on the grounds that he was not doing enough to further the cause of the black community, neither within the party nor outside it. Although not the official leader of the group, Gloria McPhee came to the fore as the voice of the Caucus. It was of prime concern to them that the UBP should address black needs, in respect of such issues as housing, education, equal opportunity, and upward mobility in the work force. The group believed that only in this way could government avoid a repetition of the racial unrest that had marked the 1960s.

McPhee met with Sir Edward to advise him officially of the formation of the Black Caucus. She told him the group believed that only through the efforts of blacks in the party would the voice of the black population be heard and racial integration come about. Sir Edward shied away from such remonstrations. Mindful of his position, he distanced himself from the group. They had not expected him to join them but they did feel themselves rebuffed when in turn they went to the whites in the party and presented their case. In all, 1974 proved to be a very unsettling time for Bermuda's ruling party, as it sought to set its own house in order, thereby to present the people of Bermuda with a united front, while preserving Bermuda's status as a stable environment in which to conduct business.

The world economy was also in a state of instability and disarray. This had a negative impact on investment returns for the insurance industry. Additionally, some blamed the soft market on life insurance companies, for entering the property and casualty side of the industry as they sought to expand their capital outside normal markets. Whatever the reasons, insurance industry results for 1974 showed a loss.

Lloyd's suffered more than most from the declining results. No longer was Lloyd's the only market for large risks. With the assistance of life insurance companies to strengthen its overall capital, the American market had grown less dependent on Lloyd's.

In view of all the changes that were taking place in the American marketplace, London brokers began to set up operations in the United States, hoping thereby to recover lost income. The first to

[203] J. Randolf Williams: *Peaceful Warrior—Sir Edward Trenton Richards*, Chapter 19, p. 265

do so was Lowndes Lambert International. Early reports of its activities indicate that it was most interested in handling the reinsurance of captive carriers, especially of those involved in underwriting employee coverages, illustrating yet again the growing importance of captives, and by extension of Bermuda, on the global insurance industry stage.

Captive movement continues in Bermuda

Despite the efforts of the US Internal Revenue Services (IRS) to put a damper on the captive movement, and despite the persistent soft market in the insurance industry, American companies continued to seek ways to establish captives in Bermuda. Since 1971, when the captive movement had begun in earnest, the number of captives operating in Bermuda had risen to a reported total of between 350 and 400. It was widely believed that by 1974 the interest in captives must have peaked. Yet although the number of new incorporations was not so high as in the early years, captives were still being formed in Bermuda. In the early 1970s three men were instrumental in selling the Bermuda captive concept, namely Fred Reiss, who liked to remain in the background and so kept a very low profile, Sidney Pine, and Joe Blades.

Fred Reiss' company, American Risk Management (ARM), had gained the reputation of being the key to the whole Bermuda captive movement. At the time, ARM was based in Englewood Cliffs, New Jersey and, according to *Business Insurance*, was the silent player in selling Bermuda to companies as a suitable jurisdiction for setting up offshore captives. It would seem that Reiss and his company were trying to remain below the radar of the IRS, so that they could go about their business undisturbed.

Another name that began to be known in respect of the growing interest in captives was that of Sidney Pine, a US tax lawyer, who happened to be the tax counsel for American Risk Management. Pine was of the opinion that the IRS questioned whether the captive mechanism involved any real risk transfer or whether, as in the case of OIL's first attempt, it was purely a self-funding mechanism. Pine set out to prove that the captive concept was much more than a self-funding mechanism and in so doing became a strong supporter of Bermuda.

The third man was the very colourful Joe Blades, chairman of the Blades Group of Companies in Bermuda, a man well-known and respected in the insurance industry. He used his reputation to sell the merits of Bermuda. He first came to Bermuda in June 1969, when he formed St John's Insurance Company Limited, which later formed Blades Management Company to provide management services and/or underwriting services for various Bermuda insurance companies. Aware of the growing interest in reinsurance, Blades then formed J.H. Blades & Co. (International) Ltd., to act as a reinsurance intermediary for both incoming and outgoing coverages. The company also acted as a correspondent for London underwriters and worked closely with international agents and brokers. In addition to that Blades had a 40 per cent interest in a local company, Grayston, Blades & Associates Ltd., which acted as a managing agent for Continental Insurance although for Bermuda business only.[204]

Having a vested interest in making sure that business flowed to the island, Blades went to every large insurance function that he was able to attend and would gladly accept invitations to speak, so that he could describe the benefits of establishing in Bermuda. By this time, his own operation in Bermuda had grown and on his staff was a young Bermudian by the name of Robin Spencer-Arscott. Spencer-Arscott recalls that when he went to work for Blades he was told that by the time he left the organisation he would be known around the world.

[204] J.H. Blades, Chairman of Blades Group of Companies, 'The Bermuda Insurance Market', a speech to the Insurance Institute of London, 8 February 1977

When Spencer-Arscott left American International to join Blades in 1973, no one could have prepared him for the completely different approach to the insurance industry that he would find when working with Blades. By contrast with his experience at American International, he was thrust into the 'open-market', and had to learn to deal with brokers, whereas before he was only dealing with the internal business of American International. He says he finally found his calling in life only when he began to work with Blades.

Blades was very successful and a well-known insurance figure all over the world. When Spencer-Arscott first attended the American Society of Insurance Managers Conference (ASIM) with Blades he was amazed by how well known his boss was. He vividly recalls how in those days everyone wore wide lapel jackets and how Blades would pretend to be admiring the fabric of a man's suit, while in fact quickly checking the nametag, whereupon Blades would strike up a conversation with this hitherto nameless colleague as if they were long-lost friends.

Blades was not only big physically, his personality was larger than life. He was also very honest. When he shook hands on a deal he would stick to his word. This exceptional man became one of the major promoters of Bermuda in those early days of captive companies.

Bermuda still trying to develop insurance regulations

Bermuda was growing at a much faster rate than anyone one on the island could have expected or even imagined. In response the business community continued to seek the most effective and efficient ways to regulate the insurance industry.

These had been the subjects of debate since the process began at the start of the 1970s. The major challenge for those trying to draft legislation was how to find the balance between what was appropriate and fair to both the local and the international insurance companies that now comprised the Bermuda insurance industry, a diverse array that had arisen very rapidly, without much time in which to consider the implications of their different needs as they worked side by side in the same marketplace.

Captives begin writing third party business

As the Bermuda regulators were trying to come to grips with their changing insurance scene, the captive insurance industry began to write third party business, in direct response to the intense scrutiny to which it had been subjected by the US Internal Revenue Service. *Business Insurance* reported on the new trend in Bermuda—

> 'Mr Blades, whose firm is estimated to be the second largest Bermuda captive management company, noted during his presentation [at the 12th Annual American Society of Insurance Management (ASIM)] that "several of our Bermuda captives are participating with Swiss Re, in addition to London", as evidence of captives going to outside markets. "I think you'll find more and more Bermuda companies acting as brokers on commercial business, too," Mr Blades predicted. "A few are already participating with the large national brokers, some as the sole producing agents for their business," he added.'[205]

Viability of captives threatened by US House Ways and Means Committee

As a result of campaigning by Representative Wilbur Mills (Dem. Ark.), the House of Representatives Ways and Means Committee once again threatened to tighten the sections of subpart F regarding foreign income earned by US controlled overseas subsidiaries.

[205] *Business Insurance*, 13 May 1974, 'Captive operators moving to write outside commercial insurance books', by Susan Alt, pp. 1 & 45

A staff member close to the House Ways and Means Committee told *Business Insurance* he was 'sick and tired of hearing about the foreign profits of multinationals who pay little or no federal tax here. The whole point of the measure is to get at United States firms getting income for insuring their United States risks by operating through foreign subsidiaries.'[206]

Those involved in captives adopted a 'wait and see' approach because they weren't quite sure what the new bill was trying to do.

Director's and Officer's (D&O) and Kidnap and Ransom are the hot coverages

With many clients questioning the prices of D&O coverage, the D&O market found itself having to justify costs until a record \$3.3 million dollar settlement was paid in the R. Hoe & Co bankruptcy suit. The London market agreed to pay out on this settlement. Shareholders sued R. Hoe & Co for negligence and also Coopers & Lybrand for negligence in preparing and certifying the records of R. Hoe & Co.

Another coverage of increasing prevalence in the United States was Kidnap and Ransom, after a run of cases in which American executives were the victims. Some critics argued that it was ill advised to introduce such coverage, because it would only encourage more kidnapping if the perpetrators thought that insurance was in place to foot the bill.

Problems with US pension law

Another stab at the viability of captives came when the United States Congress passed the Employee Retirement Income Security Act (ERISA) of 1974, because one of its clauses stated that no more than five per cent of a captive's premium income could be derived from insuring the parent firm's employee benefits. The regulated benefits included life and health insurance premiums, as well as income from pension annuity contracts.

This law was passed because the US government feared the abuses that could be committed by captives. It was to take effect as of January 1975 but companies had three years in which to phase out practices that exceeded the five per cent.

Not a good year on the whole

The worsening global economy, the rapidly changing and in some ways worsening legal environment in the United States, and the erosion of investment income by a poor performing stock market, all gave the insurance industry reason to be glad when 1974 came to an end. The year had yielded the worst results in the insurance industry since 1932, in terms of combined loss and expenses ratio and in terms of money lost by underwriting.

Despite poor results overall for the global insurance market, the 1974 results by line of business were in fact mixed. Some were firming up, especially on the liability side, while for others the market was still very soft. The London and United States markets duelled over market share as US insurers became more aggressive in the choice and types of risks they would underwrite.

The Bermuda captive industry continued to flourish, despite American attempts to take away every tax benefit that might be derived from a captive. The appeal of captives had so far outgrown tax benefits alone that clients now used them to facilitate the risk management of their global operations.

[206] ibid., 10 June 1974, 'House committee planning to scuttle offshore captives' income tax breaks', by Richard Gordon, pp. 1 & 2