Part Four
1980–1989

CHAPTER 29

1980
Cracks in the Seams

Reputation and misconception

While Bermuda began the year 1980 on a quiet note, it fought hard internationally against the allegation being made by many American businessmen that it was successful because it was a tax haven and not because it was a true international business centre, in the sense of how New York and London were perceived to be at the time. Mindful of this contention, the Bermuda International Business Association (BIBA) expressed a cautionary concern as to the number of conferences that were being allowed to use the island as their venue for discussions of tax avoidance.

Howard J. Ruff, a top United States economic forecaster, visiting Bermuda to discuss how to combat inflation, unintentionally heightened American misconceptions when he said that Bermuda should accept its role as a tax haven and should not become overly preoccupied with labels. *The Royal Gazette* recorded Mr Ruff as saying—

> 'I can understand the concern and although I think it is probably best not to make too much noise about tax advantages here, they should be recognised and accepted. After all, there is nothing wrong with tax avoidance. Millions of honest Americans minimise their tax liability using countries like Bermuda and the Island should not get hung up over it. Tax evasion, and not tax avoidance, is dishonest but whether this is in line with the way Bermuda wants to be regarded does not alter the existing situation.'[291]

BIBA and other organisations took issue with the widespread misrepresentation of Bermuda and began to caution business people as to how they should promote Bermuda overseas. Many feared that if Bermuda pushed to the forefront of its international business marketing campaign the fact that it had a favourable tax environment, the United States government would have no choice but to step in and pass legislation that could hurt the economy of Bermuda by making it very unpalatable for American companies to incorporate on the island.

However a heightened awareness of Bermuda as the place for outsiders to do business did bring a number of new exempted companies to the island. As reported by *The Royal Gazette*, because of this influx local businessmen began to voice concern about what they regarded as—

> '...a form of unfair and unexempted competition from exempt concerns. According to reliable sources, some concerns pursue competitive policies once incorporated, gaining business that would have otherwise gone to local concerns.
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> 'One example, *Business Week* has been told, involves exempt companies which bring clients with them when setting up here and then accept additional clients when their Bermudian operation is underway.'[292]

Because they wanted to see these perceived advantages stopped, the local businessmen concerned called for closer scrutiny of proposed new incorporations.

[291] *The Royal Gazette*, 6 August 1980, 'Face it, Bermuda's a tax haven, says US economist', p. 15

[292] ibid., 4 June 1981, 'Local firms call for exempt company guidelines', p. 13

There were others who objected to this attitude by pointing out that when new companies set up on the Island and gained new business that was not previously there, they could not in fairness be said to deprive the local companies of any business because they would not have necessarily seen it anyway, not even in the absence of the exempted companies in the first place.

A mellowing of the marketplace

By the middle of 1980, as the Bermuda insurance industry tried to come to terms with the Insurance Act of 1978, especially with the new requirement of having company books audited by qualified auditors, Bermuda was attracting the very best kind of new business and had become a market in its own right. However many in the industry debated whether it was in fact straining credibility to rank Bermuda so highly as third only to London and New York among the markets of the world. Kathryn McIntyre of *Business Insurance* reported as follows—

> 'The insurance industry here (Bermuda) is mellowing like a fine wine; it appears even a cold season of claims won't turn it sour. Continued growth and diversification of insurers here and sheer experience are creating a more substantial market. And its third party underwriters are being tapped by the like of Dupont, AT&T, Monsanto and Dow for high excess casualty insurance, says one broker.
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> 'The island bubbles with the diverse mixture of business being conducted: captives underwriting only parent company risks; captives diving into third party underwriting; captives sampling small pieces of third party risks; established reinsurers creating Bermuda companies, and new reinsurance ventures trying to carve a place in the business.
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> 'It's mostly the same business that was growing last year, but a small taste of the Bermuda market this year and last left different impressions. Last year, Bermuda was like a young red wine—bold, brash and sassy. Nearly everyone claimed a part of the great creation of a third insurance market for the world. This year, the market is mellower, still somewhat bold and brash, but not quite so sassy. Fewer people brag about third world market status and more are quick to offer that Bermuda has a long aging process ahead if it is to emerge into that market that can rival Lloyd's and US insurers.
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> '"Third world market status is a long way off in volume and underwriting expertise," says David Vaughn, managing director of Marsh & McLennan (Bermuda) Ltd., one of the largest captive managers on the island. "It takes a long time to move an insurance centre. There's been big growth, but it's not sufficient for world market status."
>
> 'That kind of talk sounds like the market is already aging. Understatement is easier to swallow and more believable than sassy claims of greatness, especially when no one can be sure how big the Bermuda insurance market is. Estimates of Bermuda's market size range form US $2 billion to US $5 billion in gross premiums—with no more than 25 per cent retained on that island. That's a big spread even for estimates. The only hope of accurately gauging the size of the Bermuda market is getting reports from the registrar of companies, who can aggregate business reports and release the reports to the public. But Shelton Burgess and the Bermuda government aren't saying if figures that can be accumulated under the new insurance regulations will ever be uncorked.
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> 'Some Bermuda insurance company executives sneer when market size is questioned. "What's it matter?" asked one with disdain. It certainly matters to risk managers whose brokers suggest they tap the Bermuda market for capacity. Size, to some extent, lends credibility to the third party market, suggesting it will have the money to pay claims. Spared huge disasters in recent years, the Bermuda insurance industry has yet to be tested for its ability to pay off in big losses that hit all insurers at once.
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> 'Bermuda's status in the world insurance market also matters to students of market capacity. The size of the Bermuda insurance industry indicates how much business is siphoning from the United States and London insurers whose capacity for new risks will certainly be diminished if as many risks are being placed in Bermuda as is said.

'But the sceptical insurance company executive who refused to engage in market estimates was unmoved by these arguments. The bulk of the Bermuda insurance industry is still pure captives underwriting only lower-layer risks for their parent companies, he contends. Premiums paid for these layers wouldn't be available to United States or London insurers because, lacking a captive, the parent companies would self-insure the risk, he says.

'While the pure captives stick with mostly lower-layer risks, the third-party underwriters here deal mostly in high-layer catastrophe risks. "World capacity runs out and they come here," says one underwriter. No one admits to writing bad business, a charge often levelled at Bermuda underwriters. Let's hope not. The idea of a third world market developing is always appealing to the consumer who wants more options.

'And nobody likes the smell of anything turned sour.'[293]

The effects of Financial Accounting Standards Board (FASB) #5

By mid-year, at 30 June, there were 4500 exempted companies in Bermuda and at the year-end over 5000, of which approximately 22 per cent were involved in the insurance industry.[294] However Bermuda had a slight shock early in the year, said David Lines, when FASB ruling #5 began to take effect on the insurance industry. Although FASB #5 was passed in 1975 it was not felt until 1980 when, in Lines' opinion, it changed the nature of insurance purchasing. Essentially, the intention was to restrict the use of catastrophe reserves by insurance companies, to disallow a company from reserving for contingencies that had not yet occurred. FASB #5 went further, to clarify that a company could not reserve for such contingencies through internal accounting, or through a captive company, or through a banking arrangement with a totally disassociated insurance company. FASB #5 was in effect trying to do away with self-insurance altogether.

When Lines first interpreted FASB #5, he was nervous that it spelt the end for the Bermuda insurance industry but after mulling it over he quickly realised that it could work in Bermuda's favour, because it increased the need for auditors to review the balance sheets of insurers. In addition, it allowed the Bermuda insurers to show that their balance sheets were up to specifications and that they were not hiding anything from their clients. Lines felt that this was beneficial because FASB #5 stated that reserves had to be open not hidden and he believed that hidden reserves are not good for insurance companies anyway. In the past, companies had been used to building up their reserves over a period of time. If major reinsurance companies had business with clients whereby they got premiums in over a three to four year period, these premiums could go up or down based on loss experience. Prior to FASB #5 such long-term relationships with clients allowed insurance companies to smooth out income over years, because they allowed the insurers to make up income in good years if they had suffered bad years beforehand. FASB #5 forced insurance companies to show on their balance sheets income reserves and equities reserves even if they were in other countries around the world. In so doing FASB #5 negated the whole long-term relationship concept by disallowing reserves to be built up over time. Long term underwriting relationships began to unravel and break up because of FASB #5.[295] This had an effect that has ultimately led to instability for underwriters who are trying to put deals together. However many in the accounting fraternity speculate that FASB #5 was passed to protect shareholders, because in 1980 the value of shares was way down, as a result of accrued liabilities. Consequently this ruling was passed to prevent shareholders from being penalised as a result of aggressive reserving practices.

[293] *Business Insurance*, 7 April 1980, 'Bermuda market grows and mellows with age', by Kathryn J. McIntyre

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

[295] Interview with David Lines, 3 June 2002

FASB #5 had an impact upon Bermuda. Insurance companies were only allowed to put up definitive reserves and this put a limit to reserves in total. Contingency reserves were no longer allowed and so the manipulation of reserves was a thing of the past. It also affected the way auditors reviewed the statements of insurance companies because the auditors began to scrutinise reserving practices more intently. *Business Insurance* reported on the change in the attitudes of auditors—

> 'Nearly everywhere on the island insurance managers and owners are complaining, or at least acknowledging, that auditors won't accept their reserves as established. "Auditors are qualifying more audits than they used to because of the intangible beast called the IBNR," says David Vaughan, managing director of Marsh & McLennan (Bermuda) Ltd. Incurred but not reported losses (IBNRs) are those the insurer believes have occurred but have not been reported.
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> '..."Most captives are getting qualified audits because they don't have sufficient experience to substantiate their reserves," says Edward F. Bader, a partner with Arthur Anderson & Co., in Hartford...Mr Bader contends the increased number of qualified audits this year reflects the growing sophistication of auditors in Bermuda. They are more consistently applying the same audit standard in Bermuda as is applied to US insurers, including the tests of the Financial Accounting Standard Board standard No. 5. That accounting standard requires that to reserve a loss it must be probable that the loss has occurred and that the amount of the loss can be easily estimated. "We can't operate on someone else's best guess," says Mr Bader, who works closely with Arthur Andersen's office in Bermuda on captive audits. "We say, show us where the losses add up to that or show us past experience to prove that."'[296]

International companies blamed for socio-economic problems

With the number of insurance companies seeking to establish in Bermuda came a whole new wave of insurance executives who needed housing and their children needed to be educated. Some local opportunists saw a way to make some easy money and began raising their rents to take advantage of this new source of income. Average Bermudians found themselves displaced by the few 'advantaged' expatriate workers. Similarly, with the number of expatriate children needing to be educated, many thought the private education system was overburdened.

The international business community was blamed for Bermuda's socio-economic problems, including the lack of housing, rising rents and the strains on the private school system. Taking these criticisms to heart, Executive Committee Chairman of the International Companies' Division of the Bermuda Chamber of Commerce, Mr Walter Johnson, came out in defence of the international business sector's impact on Bermuda's socio-economic climate. *The Royal Gazette* reported him as stating that—

> 'There are some 5,000 exempted companies whose names appear in the list of the Registrar of Companies but only some 200 are represented by staff in Bermuda. Therefore, the remaining 4,800 companies do not exert any strain on housing, schools, or any segment of the economy. On the contrary, they only contribute to the benefit of the country in the way of corporate fees, payments of Bermuda concerns such as lawyers, accountants, bankers, and computer services. There is nothing negative about their presence in Bermuda.
>
> 'Mr Johnson said that the staff of international companies in 1979 represented five per cent of the country's total work force of 28,832 of which non-Bermudians totalled 577, comprising two per cent. And he added: "Non-Bermudians in other areas of Bermuda's business, principally in the hotel sector, totalled 16 per cent of the overall work force."'[297]

[296] *Business Insurance*, 24 March 1980, 'Qualified audits irk Bermuda captives', by Kathryn McIntyre, pp. 1 & 74

[297] *The Royal Gazette*, 30 July 1980, 'Don't blame us for housing problems, says I.C.D. chief', p. 16

DES ruling and implications

1980 also saw more significant changes to the United States liability system, which began to cost the insurance industry. The first came in the form of a ruling with respect to Diethylstilbestrol, commonly known as DES, a synthetic oestrogen in pharmaceutical form that had been given to millions of pregnant women between 1938 and 1971, in order to prevent miscarriages and ensure healthy pregnancies. DES had proven itself to be counter-effective. It was found to put the health of both the expectant mother and her unborn child at risk in a number of ways. The new ruling exposed manufacturers of DES to industry-wide liability, because it allowed them to be held liable based on their marketshare. The problem was so large that lawyers for the plaintiffs sought the broadest base from which to seek compensation for their clients. They went after every manufacturer who had ever touched DES.

The passing of the Superfund Act

The second significant change was the passage of the Superfund Act. The United States Congress passed the legislation in the wake of the Love Canal pollution scandal. This new law made a lasting change in pollution liability coverage. It created a system that gave the Environmental Protection Agency (EPA) the right to clean up waste sites and then to recover the cost of so doing from the parties responsible for the pollution. Violators of the law were held liable for all government response costs, as well as for damage, destruction or losses of natural resources. No liabilities could be transferred. The insurance industry shuddered, because no one could forecast to what level the assessment of cost from an environmental accident might escalate in the end.

Nuclear Electric Insurance Limited (NEIL) formed

Prior to the partial meltdown at Three Mile Island in 1979, nuclear insurance pools had never been faced with a major disaster. They were unprepared for the catastrophic scale of a nuclear incident and lacked the resources with which to respond. As a result, many cut back on the insurance they were willing to provide. This caused much anxiety for the management of nuclear power plants. Several of them joined forces to seek the insurance they desperately needed if they were to remain in operation. One way that was found, in response to the unavailability of replacement insurance for nuclear power plants, was the formation in Bermuda in September 1980, of Nuclear Electric Insurance Limited (NEIL), managed by Mr Hubert Nexon. NEIL was formed as a direct consequence of the Three Mile Island disaster.

NEIL's initial policies were issued for extra expense coverage, resulting from accidents at insured sites. (Extra expense coverage is designed to reimburse the insured client for expenses, above and beyond his normal monthly expenses, incurred to avoid or minimise the suspension of business, and would include such things as renting temporary accommodation in the event that the client's was rendered hazardous.) In 1981 NEIL began issuing excess property policies to complement the policies being issued by Nuclear Mutual Limited (see Chapter 22 above). The response to NEIL was remarkable. By October of 1981 no less than 73 per cent of operating power plants in the United States had purchased this cover and by 1984 the total property limits of Nuclear Mutual Limited and NEIL exceeded one billion dollars.

Bermuda Independent Underwriters Association (BIUA)

By 1980 the number of underwriters on the island was such that they decided it was time to speak with one voice. Consequently, on 16 December 1980, they formed the Bermuda Independent Underwriters Association, at an inaugural meeting attended by eighteen underwriters, whose intention was the creation of an entity 'to promote awareness and solidarity concerning the island's underwriting environment'.[298] The first elected chairman of the BIUA was Brian O'Hara, who ran the Trenwick operation in Bermuda.

Brian O'Hara recalled that the group thought it necessary to set up a separate underwriting organisation because of the majority of captives that were going into third party commercial business. He said that part of the motive for forming the BIUA was to foster a degree of professionalism. To many observers it seemed that captives were entering third party business for the wrong reasons and that they lacked the professional expertise needed to underwrite this new exposure.

Bermuda at the end of 1980

In the 1980s Bermuda played a pivotal role in helping American International Group to extend its activities into communist and socialist countries. These had until then been left untapped by any other major insurance corporation. A series of Joint Ventures within such jurisdictions as Poland, Hungary, China, Romania, and others where the concept of private insurance was unknown, were never the less incorporated in and administered from Bermuda.[299]

It was also in 1980 that the Bermuda insurance industry saw the resignation of the dynamic Bermudian Registrar of Companies, Shelton Burgess. Many in the insurance industry worried about how they would be able to replace him because he had been such a trailblazer. He had set the stage for the regulation of the industry to be a partnership between government and the private sector. After much debate, Burgess was succeeded by Austin Ward.

Bermuda also ended the year with a political cliff-hanger when on 9 December 1980 the island voted for a new Government and the incumbent United Bermuda Party (UBP) lost several seats in the House of Assembly, holding on to only 22, whereas the opposition Progressive Labour Party (PLP) gained several seats, taking them up to 18. While the PLP was disappointed with the results, because they were sure they were going to win the election, in the eyes of many the number of seats they gained was a major victory for the party. The UBP no longer had such a strong hold on the House and the outcome of this election was the closest the two parties had ever come. Both were left to try damage control, as they pondered the cold realities. On the one hand the UBP was alleged to be in disarray and its leader, Premier David Gibbons, was seen by many as lacking the appeal of Lois Browne Evans, the dynamic leader of the Opposition. On the other hand the PLP had to ask itself why it could not win a majority of votes when the odds had been in its favour for victory.

Regardless of upsets in the political scene, the end of 1980 saw Bermuda in great financial health as compared to the rest of the world. A report released by the Bermuda Monetary Authority declared the island's balance of payments to be very favourable. The introduction to the report stated that—

> 'Bermuda in 1980 provided a striking economic contrast to most other countries. Elsewhere inflation continued and… growing unemployment prevailed. In Bermuda, inflation was also too high but unemployment was minimal—real growth was achieved.[300]

[298] Speech by Kathryn McIntyre, 1995

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

[300] *The Royal Gazette*, 4 June 1981, 'Balance of payments is up 143 per cent', p. 13

CHAPTER 30

1981
Market of Last Resort

Approval, abuse and response

According to Kathryn McIntyre of *Business Insurance*, by 1981 Bermuda ranked as—

'The main port of the estimated US $6 billion captive insurance company industry and a port of call for international reinsurers trading risks. More than 1000 of the 1400 captives worldwide (are) based in Bermuda. They include pure captives underwriting the risks of only related companies, reinsurance pools in which captives mix and share their choice business, senior captives underwriting risks of unrelated companies to put to work their accumulated capital, and new reinsurance ventures. Sailing in behind the captives, the traditional market fraternity of insurers, reinsurers, and brokers is taking up berth in Bermuda. "The Bermuda market is in on every major placement that the major brokers make," said a leading US broker.

'Other jurisdictions—like the Cayman Islands, Bahamas and Guernsey offshore and Colorado and Tennessee in the US—vie for captive business, claiming unique advantages and growing inexpensive service capabilities to rival Bermuda's. But no other captive domicile bustles with so many captive managers or pulses with a concentrated reinsurance market. And no commercial insurance rate-cutting or cash-flow programs can stop the growth of captives in Bermuda.

'Risk managers are turning a risk-funding alternative forced upon them by expensive and unresponsive insurance markets into a major force in the international insurance and reinsurance business...Captives and commercial reinsurers, the American insurance system and the British insurance style, purists, eclectics, create and coexist in the Bermuda insurance market.

'The market is 1017 registered insurers writing US $4 billion to US $5 billion in premium, about 90 per cent of the 1017 registered insurers were captives managed by one of more than 50 active managers on the island. Among the captives were association-owned companies, some so large, such as Oil Insurance Ltd. and Nuclear Mutual Ltd., that they had their own management staffs. About 40 of the insurance companies, whether under their own management or through an underwriting agent, actively underwrite insurance for over 30 reinsurance brokers on the island and slews of US and London brokers who fly in for a couple of days, according to one broker's market roster.

'The amount of volume flowing in this market is estimated to be at US $4 billion to US $5 billion, with US $1.5 billion of it written as commercial insurance, not captive business. From afar it appears to many that the market is stagnating in a saturated state of development compared with its potential growth during the 1970s. Horror stories of too little office space, too few qualified Bermudians and not enough housing for expatriates are told by promoters of other jurisdictions competing for captive business. Many observers are also waiting for the quick growth of captive underwriting outside risks to show heavy losses. Most recently, the insurance market has buzzed with speculation that Phillips' Walton Insurance Co. will be among the first to show bad underwriting results from growing too quickly.'[301]

[301] *Business Insurance*, 6 April 1981, 'Bermuda dominates captive market', by Kathryn McIntyre, pp. 13–16

No sooner had *Business Insurance* written the above report about the Bermuda market than it released an article stating that pure captives that had become commercial reinsurance companies discovered that they weren't 'immune to the sour underwriting results turning the stomachs of insurance company executives around the world.'[302] Results of the three largest reinsurers, Walton, Insco and Mentor, all deteriorated quite rapidly. However, Harold E. Tornquist, Chairman of Walton at the time, defended the results of the Bermuda marketplace and his company when he said, 'If the industry is running at a 105 per cent to 106 per cent loss ratio, we can't do sensationally better than anyone else.'[303]

The worldwide insurance market took a turn for the worst and the Bermuda international insurance marketplace felt the results of poor underwriting decisions as well. The London market took delight in slinging mud at the reputation of the Bermuda international insurers. *Business Insurance* quoted underwriters and brokers in London as saying—

> 'They avoid doing business on the sunny island of Bermuda to avoid getting burned. Few Bermuda based captive insurers exhibit the professionalism, security and continuity London wants in reinsurers. Only the "untouchable" risks go to Bermuda. They're reinsuring substandard people on substandard business. It's where a lot of cheap and bad business is being dumped. It's the market of last resort.'[304]

Julian Griffiths, a former London broker who moved to Bermuda, said a lot of Bermuda's poor underwriting results came from London brokers. He said it was common practice for London brokers to intentionally send business that no one else wanted, knowing that it was not likely to be profitable. As Griffiths said in those days, the motto of many brokers was, 'It's not our job to ask underwriters the questions. It's their job to ask us the questions. If they don't ask the questions, we don't volunteer.'[305]

In the article quoted above, 'Bermuda tactics just can't impress London brokers', Stacy Shapiro of *Business Insurance* wrote as follows—

> 'The widespread impression of the Bermuda insurance company employee is of a clerk who just types and files and knows nothing about insurance, reinsurance and how to pay claims…Lloyd's sources criticize Bermuda companies as investment—not underwriting—oriented business people, and say they are erratic in granting renewals.'[306]

Lloyd's badmouthing of the Bermuda market resulted in brokers and underwriters in Bermuda strongly defending their reputations. *Business Insurance* wrote the following rebuttal to the detractors of Bermuda—

> 'Insurers here (in Bermuda) aren't housed in tents upon shifting sands. One could imagine such a scene from descriptions coming out of London, where the competition charges Bermuda with lacking professionalism, security and continuity. The scene is quite different. Visits to insurers' stylish offices turn up British- and US-trained underwriters, some with decades of experience from leading insurers. The expanded staffs include claim specialists to handle the losses beginning to emerge as the insurers' business matures. Computer systems are being installed to streamline operations. "There is probably more underwriting talent here per million of premium volume than anywhere else in the world," contends Norris Hayes, VP of Mentor Insurance Ltd. "The business done here is done at least as professionally as in the US market and in many cases more professionally," says Angus Robinson, Senior VP of Trenwick. "The level of experience among the underwriters is significantly higher than in other world markets. We don't have junior people looking at risks down here."'[307]

[302] ibid. 'Spotlight Report', p. 22
[303] ibid.
[304] ibid. 'Bermuda tactics just can't impress London brokers', by Stacy Shapiro
[305] Interview with Julian Griffiths, 28 March 2002
[306] *Business Insurance*, 6 April 1981, 'Bermuda tactics just can't impress London brokers', by Stacy Shapiro
[307] ibid. 'Spotlight report—Top underwriters, insurance offices root in Bermuda', p. 24

Business Insurance listed the most professional and active operations as being, by consensus, Insco, Hudson Re, Mentor, Walton, Belvedere, Trenwick, Beneficial International, and Ancon.

> 'It annoys me when people say the market lacks expertise. I feel we are criticized by people who haven't come to Bermuda to meet the underwriters,' says broker Paul Branscombe, VP of Willcox Baringer (Bermuda) Ltd.[308]

US Risk Retention Act 1981

While the Bermuda market defended its reputation against vicious attacks by rival market Lloyd's, the United States Congress passed the 1981 Risk Retention Act, allowing special captives—known as risk retention groups—to write products liability and completed operations coverage for members across the country, after meeting the insurance licensing requirements of only one state.[309] The Act was passed in direct response to the lack of products and completed operations coverage in the United States insurance marketplace and allowed companies of similar background to form an entity known as a 'risk retention group' to cover these losses within their group.

Under the provisions of the Act, once the risk retention group met the capital and licensing requirements of one state, it could write coverage for member policyholders in all 50 states of the US without having to comply with many of the regulatory requirements in other states. This allowed Risk Retention Groups to significantly lower their costs over traditional captives to allow the premiums for products liability and completed operations coverage to become more reasonable and hence more available.

Triple Trigger coverage

Not far behind the passage of the Risk Retention Act, a United States federal court reached a landmark decision that created 'Triple Trigger' awards. In *Keene Corp.* v. *Insurance Co. of North America*, a federal appeals court ruled that there was a triple trigger of coverage for asbestos-related diseases. This decision greatly expanded a policy-holder's ability to tap multiple policies for long-tail claims.[310] 'Triple trigger theory', also known as 'Continuous or multiple trigger theory', encompasses the entire period a person is exposed to a hazardous substance and the period after exposure during which the exposed person's condition deteriorates until it is fully manifested. Therefore, under this controversial theory, all insurers of occurrence policies in effect from the time of exposure to the time of manifestation are responsible for paying any claims brought forward. Consequently, under the triple trigger theory, it is virtually impossible for an insurer to close out its policy year, as there is always the possibility of a hazard lurking in the background, which as yet has not even been identified.

The introduction of the triple trigger theory was responsible for the insurance industry becoming fully aware of just how broadly occurrence policies could be interpreted in the future by the United States legal system. Peter Wilson, Managing Director of H.S. Weavers, once a major underwriting syndicate in Lloyd's, described the effect of the triple trigger theory on occurrence policy wording as follows—

> 'The occurrence policy language when drafted and originally sold, clearly contemplated manifestation of injury or discovery of damages during the period of the policy. Today we have to live with the interpretation of the occurrence policy language by the US Courts and to make the position worse each court decision is different. This is not good for the insurer or insured.'[311]

[308] *Business Insurance*, 6 April 1981, 'Spotlight report—Top underwriters, insurance offices root in Bermuda', p. 24

[309] ibid. Millenium Special Issue, 'A Timeline of Key Events in Risk Management'

[310] ibid.

[311] Peter Wilson, Managing Director of HS Weavers Agencies: *The Review - Worldwide Reinsurance*, March 1988, 'The Ultimate Solution?', pp. 50–52

The Companies Act 1981

As the rest of the world made landmark decisions that affected the Bermuda international insurance industry and the insurance industry globally, the Bermuda government passed the Companies Act 1981. It was put into place to streamline the registration process for companies incorporating in Bermuda. It is also considered to be the principal statute governing the formation and operation of Bermuda companies.

According to the *AS&K Guide to Companies in Bermuda*, prepared by Appleby Spurling & Kempe (AS&K), one of the leading law firms in Bermuda, the principle reason behind the Act was to modernise Bermudian corporate law. The Companies Act 1981 continued the tradition of earlier Bermudian legislation in distinguishing 'exempted' companies from 'local' companies. The *Guide* explains—

> 'Bermuda companies fall into two principal categories: local companies and exempted companies, both of which are regulated by the government legislation, the Companies Act 1981. Local companies are companies incorporated by Bermudians to trade primarily in Bermuda. Broadly speaking, local companies are required to have at least 60 per cent of their issued share capital beneficially owned by Bermudians.
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> 'Exempted companies are formed primarily for the benefit of non-residents of Bermuda; to enable such persons to carry on business outside Bermuda or with other exempted undertakings in Bermuda. Exempted companies are exempted from the provisions of the Bermuda law which require that at least 60 per cent of the issued share capital be beneficially owned by Bermudians.
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> 'In general terms, the Companies Act 1981 restricts an exempted company from carrying on business in Bermuda unless it has been granted a license to do so by the Minister of Finance.'[312]

Bermuda in turmoil

Not only did the Bermuda international insurance industry face challenges in 1981, so likewise did the people of Bermuda. In April of 1981, the non-medical staff at Bermuda's only hospital, the King Edward VIII Memorial Hospital, went out on strike, after failing to reach an agreement over salaries. Shortly thereafter hotel and government employees went out in sympathy with the Hospital employees. Yet worse was to come, when large crowds blocked the Causeway, the only access to the airport, literally shutting down the island. The Bermuda Regiment was called out and the police riot team was also put on alert, for fear of riots like those of 1978. Instead the strike ended peacefully on 7 May1981, when a compromise was reached.

Premier David Gibbons later said that one of his worst mistakes, as Premier, was the handling of the 1981 strikes. Many in the community blamed him for not intervening in the dispute to begin with, believing that had he done so, the strikes might never have happened.

Pinnacle Reinsurance

As the Bermuda Companies Act of 1981 was being passed, Pinnacle Reinsurance began operating in Bermuda. Pinnacle is believed to be the first specialist reinsurer set up solely to write financial reinsurance business including Time and Distance Policies (T&D). This type of policy was first used by the Lloyd's market as early as the 1960s but did not become popular until the late 1970s. It was based upon the principle of the time value of money and took into account the 'long-tail' nature of liabilities and latent claims that develop over time. When properly used such policies had several advantages. From the standpoint of the reinsured they could lower the cost of closing out a

[312] *AS&K Guide to Companies in Bermuda*

policy or an underwriting year by matching long term investments with similarly maturing liabilities. From a reinsurer's perspective, they incurred minimal risk and could therefore be offered at minimum cost. And from a taxation point of view, T&D policies tended to accelerate taxable income, resulting in higher tax payments.

Despite their advantages, however, T&D polices were subject to abuse, as when they were used to disguise incomplete or inadequate reserving of syndicate accounts. In due course regulators and accountants in the United States and Europe took exception to the fact that these policies transferred little or no risk. It was then that the regulatory bodies changed the statutory and GAAP accounting rules, to require that in order for these contracts to be considered insurance there must be a meaningful transfer of risk.

Allen Kilby, John Merritt, and Steve Lawrence started Pinnacle Reinsurance when they saw an opportunity to provide T&D polices to the clients of C.E. Heath, a Lloyd's broker. These clients were looking for a facility that would serve their needs and provide them with a return at the same time. The success of Pinnacle far exceeded original expectations.

Verbena Daniels, Registrar of Companies

In 1981 Austin Ward resigned as Registrar of Companies and was succeeded by Verbena Daniels, who had served as Assistant Registrar ever since 1971 and who knew the system inside out. She now made history as the first woman to be appointed Registrar. Aware that in some respects her appointment was unprecedented, and that accordingly much would be expected of her as a standard bearer and forerunner for her own successors in the future, she set out from the start to manage the Registrar's Office in the most equitable, professional and orderly manner possible.

Verbena Daniels proved herself more than equal to her new responsibilities, and tackled each task with hard work, enthusiasm and determination, showing herself to be a remarkable Registrar, with an attention to detail and an encyclopaedic memory matched by no other. Indeed she became renowned for her ability to recall word for word entire passages of legal precedents regarding the incorporation of companies in Bermuda.

Moreover she was possessed by a desire to understand the total picture of the international insurance industry and to perceive how best her department could respond to its needs, so as to ensure that Bermuda kept its stellar reputation. Verbena Daniels became known as 'Bermuda's First Lady of Business', and served the Island as Registrar until she retired from the position in 1990 and moved into the private sector.

Aneco Re is embattled

During Ms Daniels' first year as Registrar of Companies, Aneco Reinsurance (see Chapter 27) found itself in the unenviable position of resisting a hostile takeover. Francis Mulderig, chief of Aneco Reinsurance, described 1981 as a tough year for his company. Unbeknownst to him, when Federated Reinsurance, a New York company, bought three large blocks of Aneco's shares, it was the first move in a battle for ownership and control.

Wanting to make sure that everything was above board, Mulderig decided to do some checking into Federated's bid, because Federated bought reinsurance from Aneco Re and therefore had access to inside information that was not available to other shareholders. When Mulderig started digging he found that Federated's majority shareholder was none other than Charles E. Hurwitz, the young Texan who was known for bringing the London Bridge from the Thames to his development company in Arizona but who was also, according to *Barron's Weekly*, reputed to be involved in 'liquidations, defaults, lawsuits, corporate gymnastics and charges of fraud.' Mulderig further discovered that Hurwitz had been required by the SEC to sign 'a consent to a permanent injunction barring him from violations of the securities laws.'

The Royal Gazette reported that once Mulderig discovered this information, it needed only one more revelation to be the last straw—

'Hurwitz's share-buying spree in McCulloch Oil, using Federated Re as the front man, did it. And by the middle of March 1981, Aneco had severed business links with Federated and was in deep talks with the Monetary Authority. There was nothing the Bermuda exempt company could do about the stock then under Hurwitz's control. But it could and did, cover its corporate tail against further purchases.

'Bermuda exchange control regulations forbid the sale of exempt company shares without the prior approval of the Authority. But the rules were waived for Aneco when it was incorporated here in November 1978. Since the insurer's shares were to be publicly traded in the United States, the regulation would have been difficult to enforce and Aneco had been given blanket approval for all stock which was not privately held to change hands freely.

'Aneco promptly asked for its blanket approval to be modified. The Authority agreed and a new requirement was instituted which demanded that anyone buying 10 per cent or more shares in the company must seek official clearance.

'But what seemed like the end of a slight spot of bother, was only the beginning, as Aneco quickly discovered towards the end of April last year, when it attempted to shift around some of its privately held shares. It was then that the knives came out. Within a few weeks the first of many writs thudded onto Mr Mulderig's desk, in a Federated attempt to block the stock transfer. At around the same time, a Cayman Islands company called Cayman Islands Reinsurance Corporation, bought a 7.2 per cent stake in Aneco and in June announced it intended to begin a proxy fight to assume control of the Bermuda firm and appoint its own directors. Aneco smelled a rat.

'Recall(ed) Mr Mulderig, "It seemed odd at the time that a company with only 7.2 per cent of the shares should expect to win a proxy fight and that was when we suspected they were not acting alone, but in concert with others."

'The others, Aneco believed, included Federated and a New York stock broking firm called John Muir and Company—a name that was to crop up several times during the takeover fight. It was John Muir, which brought Aneco public in 1978 and John Muir again, which underwrote the Cayman Islands Re issue in December 1980.

'On Monday, June 15, 1981, Aneco filed a suit in New York charging that Federated Development—a Houston-based major holding of Charles Hurwitz's and the parent company of the Federated Reinsurance—and John Muir were illegally and unethically conspiring to take over Aneco. It claimed both companies had access to confidential information—Federated through a reinsurance treaty and John Muir via its position as Aneco's market maker.

'The scrap was well and truly underway, albeit a few hundred miles away. But less than a month later it came home to roost on Aneco's doorstep, when Cayman Islands Re filed two writs in Bermuda's Supreme Court. The beleaguered Aneco replied with a Bermuda Supreme Court action naming the entire cast—Federated Development, Federated Reinsurance, Charles Hurwitz, Cayman Islands Re, John Muir and numerous directors and associates.

'By this time the Bermuda reinsurer was well and truly worried, not so much by the mounting legal costs, though these were beginning to look formidable enough in themselves, but by the adverse publicity the affair had generated. "Reinsurance business," said the Aneco chief, "relies heavily on the integrity of a company and if there is the slightest hint of a lack of integrity then an insurer loses his credibility and his business."

'The erosion of Aneco's corporate credibility began to work its way through to the company's earnings and by late summer last year it knew for sure that it was losing business. "We were actually told business was not coming our way because of the questions over the ownership of the company," said Mr Mulderig.

'Aneco's first break—it later proved to be the turning point for the whole affair—came during pre-trial proceedings in New York. Said its chief executive: "Cayman Islands Re's prospectus said that its investments would go into highly liquid instruments, as with all reinsurance companies." But a pre-trial hearing showed that $3 million of its $5 million capital was tied up in a Toronto property deal and that the balance was being (used) to purchase new John Muir issues. The events of the next few months were a litany of disasters for the alleged predators. In the wake of the hearing a Cayman Islands Reinsurance stockholder began a class action suit against his company. By late August, John Muir had been forced into liquidation through its failure to meet U.S. Government capital requirements under the Securities Investor Protection act. And to cap it all, it became known in September that Cayman Island Re's chief executive officer, who was destined for Mr Mulderig's job had the takeover been successful, was reported to have been convicted of insurance fraud. The scrap was finally nearing an end.

'By the end of September, the Cayman Islands' firm had abandoned its proxy fight and Aneco's business started to pick up.'[313]

Bermuda's only asset is itself

As 1981 came to an end the world was facing a severe recession, as a result of rising unemployment in Europe, and great uncertainty caused by the assassination of Egyptian President Anwar Sadat. Donald Lines, the chief general manager of the Bank of Bermuda, warned its shareholders about the degree of Bermuda's economic vulnerability and reminded them that the island has nothing to sell but itself. As a result of pending instabilities in the rest of the world, Lines said it was difficult to predict how well Bermuda would fare in the future.

Tourism figures were again on the decline, while small business owners also lamented that their sales were down by some 15 to 20 per cent over the previous year. It was time for Bermudians to take stock of what they wanted and what was most important to continued financial and social stability.

[313] *The Royal Gazette*, 15 July 1982, '1981—A tough year for Aneco', p. 18

CHAPTER 31

1982
A Time of Reckoning

Insurance a global mess

1981 can be seen in retrospect as a high point for international insurance in Bermuda, before it was plunged into uncertainty and gloom. Until 1982 Bermuda had been riding high in the reinsurance markets and with the captives. Then a very different and very difficult period began. Many feared that Bermuda's reputation as an insurance centre had been ruined. Many said, 'I told you so.' On the other hand, many worked to rebuild the island's reputation.

However it must be said that Bermuda was not the only country where insurance was going through a rough time. The whole insurance industry around the world was in a state of flux. In fact 1982 was a bad year in general, with the global economy in severe recession. *The Economist* reported on the condition of the international insurance industry as follows—

> 'This year, many of the world's insurers face their worst underwriting results since Hitler's war. In 1982, and for the first time this century, insurance underwriting capacity exceeded demand. Premium rates have been pared to the bone as insurers and reinsurers scramble to expand (or just retain) their market share. Few countries or types of insurance have been spared. Marine and aviation rates have been falling since 1973. Lloyd's of London's latest figures (for the 1979 account) show that its marine business made an underwriting loss for the first time in ten years and the loss on the non-marine account was worse for 1978. In North America, which accounts for almost half the world's annual premium income of US $260 billion, the recession has hit the industry hard.
>
> 'Insurance company expenses have skyrocketed. In the United States the combined operating ratio (that is, claims and expenses expressed as a percentage of premium income) of property and casualty or non-life, insurers rose from 103.1 per cent in 1980 to around 106 per cent last year—and could rise to 112 per cent this year. After counting in investment income, that would give the industry as a whole a return on equity funds of just over 10 per cent, compared with a current yield on long-term American treasury bonds of 12 per cent.'[314]

In short, the global insurance industry was in serious trouble. There was overcapacity, so that prices were at an all time low, while incoming losses further exacerbated poor underwriting results at the same time as Bermuda began to feel the effects of a weak economy. The combined result was that 25 insurance companies had to close down by the end of the year. It seemed to many observers that the Bermuda insurance industry was seeing its last days as a major player on the international scene as a whole.

Although at the beginning of the year there were 757 companies registered in Bermuda, reporting total assets of US $13,586 million, capital and surplus US $7.5 billion, gross premiums of US $6.1 billion, and net premiums written of US $4.2 billion, by the end of the year the closure of 25 insurance companies signalled trouble ahead for the Bermuda insurance industry.[315]

[314] *The Economist*, 25 September 1982, 'At Risk, A survey of international insurance, Slow: danger ahead', by Vince McCullough

[315] Andrew Carr to Richard Meyer: 'Captive update', J&H office memo, 27 September 1983

And as is true of the Bermuda insurance industry, many of its service providers viewed the tumult of the global insurance industry as the opportune time to begin running off companies and hence began to develop departments specifically to manage company runoffs.

One thing after another

The Bermuda insurance industry received two more severe blows in 1982, first when the Internal Revenue Service (IRS) ruled against Mobil Oil's captive Bluefield and then when the Tax Equity and Fiscal Responsibility Bill was passed in the United States. In a shocking decision, the United States Claims Court ruled that—

> 'Mobil Oil (was) not entitled to a refund for disallowed tax deductions against millions of dollars in insurance premiums it paid its captive subsidiaries including Bermuda-based Bluefield Insurance. The long awaited judgment will have a significant impact on Bermuda's captive insurance community of about 950 companies.
>
> 'The ruling, which has been awaited for more than a year, will hit the American owners of captives set up here and in other offshore domiciles with the primary aim of minimising or reducing their US tax liabilities.
>
> 'At stake in the Mobil case were tax deductions against at least US $35 million in premiums paid to four offshore captives by 35 Mobil subsidiaries during the tax years of 1961 to 1969. Mobil paid the disputed taxes about seven years ago but filed suit against the United States government seeking a refund of the taxes paid.
>
> 'The United States government's post trial filings argued that insurance transactions between related companies do not constitute insurance for tax purposes. It claimed the captives were "profit-maximization centres" and described as "an incredible tax-avoidance mechanism."
>
> 'Mobil's counter-argument was that the government was disregarding what it called the doctrine of separate corporate entities and that insuring through an affiliated corporation was no different from other legally accepted transactions between related companies. The court, however, thought otherwise.
>
> 'The court argued that insurance through a wholly owned captive is essentially the same as setting up reserves and that the risk of losses remains with the parent and is reflected in the balance sheet and income statements of the parent.'[316]

Shortly thereafter President Reagan delivered another blow to the industry when he signed into effect the Tax Equity and Fiscal Responsibility Bill (TEFRA). *Business Insurance* reported that—

> 'The tax law signed by President Reagan earlier this year could substantially increase the tax liabilities of oil and gas producing companies that own offshore insurance companies. Captive managers in Bermuda, where most of the major United States oil companies have domiciled one or more insurance subsidiaries, are buzzing with speculation about how parent corporation tax departments will interpret the new law and how it will impact on offshore insurance operations.'[317]

TEFRA severely hurt the oil companies' revenues outside the United States because the definition of Sub-part F income was expanded to include for the first time certain income from foreign marine and export refinery operations.

The passing of the Tax Equity and Fiscal Responsibility Bill, as well as the ruling against Mobil/Bluefield, combined with the poor underwriting results, are together believed to have brought about the demise of oil company captives in Bermuda. Shortly after these two rulings, Insco announced that it was shutting down its operations in Bermuda, which in some respects set in train the effect that oil companies no longer wanted to be in the insurance business.

[316] *The Royal Gazette*, 1982, 'Court Shock for Mobil'

[317] *Business Insurance*, 8 November 1982, 'Oil company captives see new tax liabilities', by Rhonda L. Rundle, pp. 1 & 56

The Rance Report

Concerned that the whole international insurance industry was starting to unravel, the Bermuda government turned to the private sector for help, as was a common practice at the time. The government approached Cyril Rance, head of Bermuda Fire and Marine, to help set the record straight by preparing a report on the strengths and weaknesses of Bermuda as an international centre, with suggestions as to how business could be improved in the future. Rance then enlisted the support of his peers, from a cross-section of the industry, to produce a comprehensive report for the government about the state of the insurance industry.[318]

The Committee consisted of Cyril Rance as Chairman, with David Anfossi, Robert Baker, Shelton Burgess, Senator Charles Collis, Brian Hall, Bert Hunt, Walter Johnson, George Lee and Brian O'Hara. It was agreed that the Minister of Government and Commercial Services, Sir John Plowman, would sit in on the Committee's meetings, which he did until he resigned on 15 January 1982.[319]

The report made several recommendations, among them—

- that growth be controlled, because the Committee feared that Bermuda's resources were in danger of being overstretched;
- that with respect to growth and exposure companies already formed and transacting business should have priority over new companies being formed and that wherever possible new companies entering the Bermuda market should not be labour intensive;
- that in the future, because of Bermuda's lack of housing, condominiums and cluster housing be reserved for International Company personnel and/or Bermuda residents and not be for sale to non-residents;
- that there be no form of income tax;
- that work permits be limited to two years duration except for key employees, who could stay on, save that the cost of their work permits be increased substantially each year they remained beyond the two year period;
- that Government give formal consideration to the establishment of Bermuda as an Arbitration Centre;
- that the screening process for new companies wishing to enter the island should be improved by having more members of the insurance industry on the vetting committee;
- that as of 1 January 1983 the minimum share capital for an ordinary exempt company be increased to US $25,000 from US $12,000, for general insurance companies from US $120,000 to US $250,000, for Life Assurance Companies to US $500,000 and for Composite Insurance Companies to US $750,000; also that the proposed minima be paid before the commencement of business, although up to 50 per cent of the required amount could be in irrevocable letters of credit; and that all companies operating in Bermuda prior to the proposed change should be allowed up to five years in which to bring their capital structure into conformity with the new requirements;
- that the Government should support the introduction of insurance studies at the Bermuda College.

A&A and Alexander Howden

As if the unfavourable US tax rulings were not enough, the Bermuda international insurance industry found itself dragged into a brawl that had broken out in London, where the firm of Alexander & Alexander Services Inc. (A&A) had in January acquired a long established British brokerage firm, the Alexander Howden Group. The first overt sign of trouble came in late July, when A&A

[318] Interview with Cyril Rance, 4 March 2002

[319] *Report by the Special Committee appointed to investigate the Future Direction of International Company Business in Bermuda,together with a response by the Ministry of Finance*, November 1982

announced that it was conducting a fair value audit of its Howden acquisition. Rumours and speculations began circulating in the London market, despite press releases by A&A that originally played down the significance of the audit, calling it routine after a merger.

Then in August A&A announced that it had uncovered unexpected liabilities, but added that there were assets recoverable to offset them. At issue was alleged misuse of US $56 million in Howden funds and property by five former directors of that company. Initial attempts to settle the matter quietly were unsuccessful. On 20 September A&A filed two suits in London, the first claiming 'damages for fraud and/or misrepresentation and/or negligent misstatement' during the Howden acquisition and the second, with four other plaintiffs, seeking damages resulting from an allegedly 'dishonest scheme' to use Howden insurance and reinsurance premiums for personal gain. A&A also filed a report with the US Securities and Exchange commission.[320]

The assets in dispute were as glamorous as they were substantial—works of art, among them a Pissarro and an Odilon Redon, a villa in the south of France, a small Geneva bank, a trust fund in Lichtenstein, millions in stocks and shares, an oil company in Texas...They lacked only the charm of a Cary Grant to polish the script for a movie.

Our concern here is neither with specific individual allegations, nor with the findings of the courts, nor with the outcome of disputes in London or Washington, but with why fingers were once again pointed at Bermuda? This may have been due to the involvement, however unwitting, of certain Howden subsidiaries. Extensive investigations did reveal that poor business had been run through Bermuda operations, so that Bermuda became to that extent one locale of the Howden affair. However Bermuda emerged well enough at the end of the day, because it could be shown that there had been no intent to deceive. Such business as was written in Bermuda had simply been accepted in good faith. Any shenanigans that there may have been were not in Bermuda but in London and Europe.

The process of investigation raised questions at Lloyd's. Some observers even believed it to have been a catalyst for the review of business practices there. As a result of all this a new Deputy Chairman and Chief Executive Officer, Ian Hay Davison, former managing partner of the UK accounting firm Arthur Anderson, was brought into Lloyd's to curb the inside deals. The Bank of England and other financial institutions recommended that Lloyd's set up an independent watchdog to oversee its operations. Meanwhile Bermuda played a key role in helping Davison get to the heart of the matter. According to Allison Moir, author of *Partners in Peace and Prosperity*—

> '...Davison set up a lunch at Lloyd's with (David) Gibbons to find out what the Premier knew about the unacceptable practice in Bermuda's insurance industry. Gibbons attended the meeting wearing not his Premier's hat as much his finance hat. "We met because everyone was saying, 'It's Bermuda's fault. They're allowing this to happen.' I said, 'How...do we know who the villains are?...Lloyd's won't give us any information," recounted Sir David. Once Davison understood that, in fact, Bermuda was not directly involved or at fault, an immediate rapport was established between them...Davison's first step on addressing this problem in Bermuda was to open the lines of communication and information between Lloyd's of London and Bermuda. "I make one man a contact," said Davison to Gibbons, "and when an applicant comes to Bermuda and says, 'I want to set up an insurance company,' you call this contact. If he says, 'Thirty-foot barge pole,' that's a code for 'don't touch him under any circumstance'..." Davison's strategy seemed to work. Word spread quickly through Lloyd's, which was essentially a private club, and the creating of captives with unbalanced portfolios ceased. Davison did, however, have a recommendation for Gibbons, namely to pass legislation in the House of Assembly that incorporates stringent rules and guidelines for the above-board operation of the insurance industry in Bermuda...' [321]

[320] further details see *Business Insurance*, 27 September 1982, 'A&A sues ex-directors to recover Howden funds', by Stacy Shapiro, pp. 1, 58 & 59

[321] Allison Moir with Sir Peter Ramsbotham and Sir David Gibbons: *Partners in Peace and Prosperity*, Chapter 6, 'Reshaping Bermuda's Economy—The Insurance Act 1978', pp. 134–135

What came out of the Howden affair was the exposure of 'Baby Syndicates'. These were created to siphon off the best business to the profit of a certain few Names, while all the poor business was put into the mainstream syndicates in such a way that less informed Names had no idea what they were getting into.

Gibbons takes a stand on company regulations

Months after resigning his position as Premier while still retaining his position as Finance Minister, David Gibbons took a tough stance on the Bermuda international insurance industry, both because of the number of insurers that were shutting down their operations in Bermuda and because he had been obliged to watch Bermuda get pulled into the scandals at Lloyd's. *The Royal Gazette* reported on the Finance Minister's tactics.

> 'The insurance industry's protracted honeymoon with Government is over. It ended yesterday when Gibbons announced an unprecedented crackdown on companies which fail to adhere to Bermuda's insurance law. Gibbons warned that several courses of action for dealing with "delinquent companies" were open to him and that he "would not hesitate to use the sanctions available to him including the cancellation of an insurer's registration and winding up." The tough new policy follows several complaints from the industry, which has long argued that the credibility of the Bermuda insurance market, particularly in the eyes of insurers overseas, has been eroded by Government's soft approach to regulatory enforcement. Referring to the recent spate of insurance scandals at Lloyd's of London and what he called "abuses by members of your profession," the Minister said that a number of scandals carried "a Bermuda connection" which had "tainted" the whole market.
>
> 'He told the meeting of brokers, "I, therefore, welcome the steps that the Lloyd's authorities are now taking to put their own house in order, even if it means that, in the short run at any rate, the growth of the Bermuda insurance industry will suffer. Our responsibility does not extend beyond ensuring that insurance companies registered in Bermuda comply with all the requirements of the 1978 Act. It must be obvious to all that our very status as an offshore centre prevents us from exercising control over the flow of funds into and out of Bermuda. If Lloyd's members have been illegally transferring funds here, then that is a matter for the UK authorities. For my part, I shall endeavour to ensure that the regulatory control I possess is exercised to the fullest possible extent."
>
> 'While publicly washing his hands of responsibility for what he termed the industry's "external" problems, Mr Gibbons said he regretted "that each additional disclosure casts another cloud over Bermuda and encourages those in the United States and the UK who would wish to curtail our development as an offshore centre. If that means enforcing rigidly our own regulatory procedures, then so be it. In the long run, we all share a common interest in seeing the traditional integrity of the insurance business re-established."'[322]

Although at first Bermuda did not look very professional when it became embroiled rather naively in the Lloyd's fiasco, Bermuda did come out unsullied in the end. As we have seen above, the Bermuda connection through Alexander Howden was actually a breakpoint that helped to identify fraudulent practices and thereby to shape the future business practices at Lloyd's.[323]

A time of regrouping for Bermuda

By the end of 1982, the ruling Bermuda government party had undergone significant changes of its own, with the resignation of Premier David Gibbons on 15 January 1982 and the appointment of John Swan as Premier, the youngest incumbent and only the second black to hold that office. Many

[322] *The Royal Gazette*, 1982, 'Finance Chief to get tough with insurers'
[323] Interview with Bill Storie, 12 March 2002

had considered it time for Gibbons to go because he had become known as the 'Premier who did not want to lead.'[324] Many also believed that the United Bermuda Party needed a black leader and that 'the lack of one had probably contributed to the loss of votes in the 1980 election. Also to be considered were the 1981 labour strikes, which had worsened the relationship between the union and the Government; the latter was still characterized in the minds of many voters as consisting of white, monied business men.'[325]

It was also at the end of 1982 that Bermuda's allure as an offshore insurance centre began to wane. Once an island booming with captive activity, Bermuda now entered a 'period of respectable middle-aged maturity'.[326] The formation of new captives slowed considerably, as clients chose to buy coverage in the traditional market, because it was more cost effective for them to do so, rather than to form new captives. As a result the number of captive formations on the island began to decline. By contrast the number of companies going into liquidation was on the rise. Bermuda had come at last to feel the effects of the soft market.

Alongside the changes the Government had undergone within its own party, its own members and also those in the Opposition began to have doubts as to the likelihood of the captive industry ever becoming the pillar surpassing tourism that they had originally hoped it would be. Consequently Financial Secretary Dr David Saul brought in the Archer Group, to assess the financial well being of the island. When the Archer report was completed, the following two important facts were revealed—first, that the contribution of cruise ship passengers to the island's economy was minimal in comparison with that of the tourists who came to stay in hotels and, second, that about 30 per cent of Bermuda's GDP came from those international companies that had a real presence on the island.

Lawyers fighting for the importance of international business in Bermuda were finally able to prove that companies with a real presence on the island were major contributors to its GDP. With this in mind the people directly involved in the Bermuda insurance industry were able to go into 1983 empowered by the belief that this period of quiet was actually a positive time of regrouping for those who were serious about remaining in the Bermuda marketplace.

Lastly, Bermuda ended 1982 with a social landmark, the signing of the Human Rights Declaration on 9 December 1982. This declaration urged Bermudian residents that they 'solemnly affirm the necessity of eliminating discrimination in all its forms and manifestations, and the promotion of friendly relations and cooperation among all people of our community.'[327] Premier John Swan officially declared 10 December 1982 to be 'Human Rights Day'.

[324] J. Randolf Williams: *Lois: Bermuda's Grande Dame of Politics*, Chapter 11, 'Not again', p. 273

[325] ibid. p. 274

[326] *Business Insurance*, 25 April 1983, 'Growth of captives slows but they won't be abandoned', by Rhonda L. Rundle, p. 3

[327] *The Royal Gazette*, 9 December 1982

CHAPTER 32

1983
The Reckoning Continues

From change to restless change

1983 saw a continuation of the decline of the international insurance industry in Bermuda. Meanwhile the island had to deal with social changes that were necessary if its citizens were to begin a period of readjustment. The most significant change came on 1 January 1983, when the new British Nationality Law took effect. As a result of this change Bermudians became citizens of a British Dependent Territory. By February a general election was called and the United Bermuda Party, under the leadership of the new Premier John Swan, retained its large majority over the opposition Progressive Labour Party. Then in March the Governor resigned, after allegations of 'irregularities' in the governmental expense account. In April the newly elected government set out to find the cause of the growing social problems on the island. They appointed Dr David Archibald to head a Royal Commission on Drug Abuse. The Commission concluded that drug abuse was indeed prevalent in Bermuda's schools.

Simultaneously, the Bermuda insurance industry suffered, even though 35 insurance and reinsurance companies and 1186 captives were registered there.[328] Leslie Dew, the man who had put Bermuda on the insurance world map and helped to boost its credibility, was mentioned in the *Institutional Investor*—

> '...But today there's trouble brewing in paradise, and (Leslie) Dew now says that his ideal of a new Lloyd's-like market "was something of a pipe dream." Overcapacity and underpricing in the distressed world insurance market have hit the newest market with greatest force, causing some captives to suffer real hardships and others to pull back. What looked like a cash cow to industrial companies is now beginning to look like a cash drain to some, and risk managers and chief financial officers alike are beginning to re-evaluate their presence in Bermuda.'[329]

Walton stops underwriting

1983 began on a sour note for the industry in Bermuda when, in January, Walton Insurance stopped underwriting and laid off 23 people.[330] By the time it did so Walton was holding five per cent of the world's aviation policies.[331] Jill Husbands, then the aviation underwriter at Walton, said she had managed to build up a reputation as a good aviation underwriter and hence controlled a quality book of aviation business. Once Walton ceased underwriting, a significant void was left in the global aviation marketplace. [332]

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[328] *The Royal Gazette*, 'It's the Failures that hit the headlines' by Malcolm McLachlan (Ancon), p. 8

[329] *Institutional Investor*, June 1983, 'Insurance Crisis in Bermuda', by Mary Rowland, pp. 143–149

[330] *Fortune*, 23 January 1984, 'Insurance, Danger signals for Bermuda's happy captives', by John W. Dizard, ©1984 Time Inc. All rights reserved.

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

[332] Interview with Jill Husbands, 12 November 2002

John Dizard later wrote of the Walton demise—

'The biggest captive caught in sticky London business was Walton Insurance, Phillips Petroleum's Bermuda captive. Walton stopped taking on outside business at the beginning if 1983, but business the company had written in the past has led to losses in excess of US $70 million for Phillips. In September, Phillips announced it was injecting another US $55 million into Walton to keep it from failing.

'Unlike most of the captives in Bermuda, Walton's books were dominated by outside business—some 85 per cent of the company's premium business in 1981 and 1982 came from clients other than Phillips. And there's not much doubt that Walton's own underwriters were unusually naïve in trusting certain fast talking London brokers as much as they did.'[333]

Insititutional Investor recorded the buzz on the street—

'...Once the word of Walton's troubles hit the global marketplace, those who prophesied the doom of Bermuda's success jumped on the bandwagon. One New York broker said, "Walton's just the tip of the iceberg." Another added, "There's going to be a daisy chain when one goes down and two or three follow right behind." Albert Lewis, a former New York insurance commissioner, warned, "They're gonna go belly up as quickly as you can say 'Lloyd's".'[334]

Because the market was so bad, underwriters stopped accepting business in Bermuda. Overnight the Bermuda international insurance industry seemed to lose its attraction for the rest of the world. Mary Rowland of the *Institutional Investor* wrote the following about the state of the Bermuda industry—

'...While a ratio of 3 to 1 (net premiums written to capital and surplus)— is considered conservative in the U.S., Bermuda underwriters say that no one in Bermuda writes even as high as 1 to 1.'[335]

Many reasons were given for the death of the Bermuda insurance market dream, including the following hypothesis of Mary Rowland's—

'...Insurers say that many industrial companies got into the insurance business through the back door. Without developing a strategy or hiring professionals they decided to write third party business to protect the tax deductibility of premiums paid to their captives. One former Bermuda underwriter points out, for example, that many companies used accountants or claims staff in the crucial position of underwriter.

'...Most insurers in Bermuda agree that the market started out with only a few professionals. In those days some companies "gave away their pen", passing their underwriting authority to third parties who may or may not have used it in the companies' best interests. (Leslie) Dew says, "Lots of captives on the island have been caught by giving binding authority to people who were incompetent or fraudulent."...One New York broker added some truth to the finger-pointing when he said, "A lot of people had no choice but to write bad business. There was great pressure. Everyone was doing it, and it was the only way to get business."

'...To be sure, the difficulties in Bermuda are not entirely the fault of the captives. The Bermuda insurance market, like the rest of the world's, is in worse shape now than at any time in recent history. "I've been an underwriter for 52 years," Dew says. "The market is the worst it has been in my lifetime." But for Bermuda, which had been relying on the overflow from other markets, good business has simply disappeared. "Bermuda is not considered a traditional market and does not see a cross section of the available business," points out (Walton's President John) Kempe. So when Bermuda captives became wary of certain kinds of business—marine, aviation, long-tail casualty and asbestosis, for example—there was no other kind of business to write. As Transcon's (President Edward) Gomez says, "You have to wait in line to get fire business."

[333] *Fortune*, 23 January 1984, op.cit., "©1984 Time Inc. All rights reserved."

[334] *Institutional Investor*, June 1983, 'Insurance, Crisis in Bermuda', by Mary Rowland, pp. 143–149

[335] op.cit.

'...One Bermudian broker, who agreed there will be a shakeout in Bermuda, thought that might not be a bad idea. "It's true that a number of companies are looking at themselves and asking, 'Should we be here? What are we doing?'" said this broker, but, "that's good for Bermuda. It's grown too fast. In the future the market won't be the free-for-all it's been in the past." His conclusion—"It's timely for Bermuda to have a pause."'[336]

Bermuda and the Caribbean Basin Initiative

On 21 February 1983 Bermuda was notified that, as part of the Caribbean Basin Initiative, the United States Congress was considering proposals for tax concessions to United States companies that wished to hold their conventions in the Caribbean. This set in train a prolonged effort on the part of Premier John Swan to win similar concessions for Bermuda. The prospect was a welcome one, and the benefit to visiting US corporations must make Bermuda attractive as a venue for their conventions, thereby giving a much needed assist to Bermuda's beleaguered tourist economy. Yet at the same time Premier Swan knew that any initiative he might make must be subject to at least one major reservation.

Even though the legislation now before Congress might be so written as to include Bermuda within its purview, and however welcome its benefits, never the less he could not enter into any arrangement with the US government that would require the Bermuda government to disclose and make available confidential information about American companies located in Bermuda. To do so would be a devastating breach of trust, with far reaching and unforeseeable results.

Swan went for help to the newly appointed American Consul-General, Max Friedersdorf, a man who had gained a reputation for his undisputed success on Capitol Hill during the Reagan administration. Together Friedersdorf and Swan worked out a plan, which was indirectly passed on to President Reagan. The President himself was in agreement with Bermuda's desire to have the conditions lifted from the concessions. Proponents of Bermuda's case could point to the fact that, unlike any of the other jurisdictions affected, Bermuda did not receive any financial or other aid from the United States. In that respect, as in many others, Bermuda's situation was very different from that of the Caribbean. The only similarity in fact was that Bermuda and the Caribbean were both competing for the same US convention dollar. All that Bermuda asked was a level playing field that would yet respect its international business obligations. However, when the bill went before the United States Ways and Means Committee, it was recommended that Bermuda remain in all respects within the Initiative.

However, despite being lumped in with the countries of the Caribbean, Bermuda still hoped that it would deservedly obtain the concessions and for a time the prospects looked positive. The Initiative including Bermuda, passed the House Ways and Means Committee, with only the minor restriction that, instead of Bermuda being unconditionally exempted from informational requirements, a Presidential waiver of the same would be required and permitted in civil matters only. Unfortunately not even this much of a special concession was granted. Instead Bermuda would be subject to the same conditions as the islands of the Caribbean, if it was to benefit from the Initiative.

This was a devastating blow for Premier Swan who had worked so hard to achieve an exemption. He began to think of other ways to get around the new requirement because, with the decline of private tourism, he knew Bermuda needed whatever income could be generated by international business on the island. It was not until 1984, under the direction of Finance Minister Clarence James, that Bermuda decided to put forward its own tax convention. United States Consul-General Friedersdorf agreed that Bermuda should do so but stated that he could not lobby on Bermuda's behalf. To do so would create a conflict of interest.

[336] *Institutional Investor*, op.cit.

Continental Re goes to New York

Then came another blow. One of Bermuda's oldest reinsurers, Continental Re, announced it was moving its corporate headquarters to New York, on the ground that Bermuda had become too expensive. Fifteen people were to lose their jobs. Nigel Harley, Continental's president, said, 'Ours is a pure reinsurance operation—one of the biggest in Bermuda. It can run more easily out of New York where we will also be able to combine with our sister company Continental Re of New York.'[337]

An irrecoverable loss

Following on the grim reading about the insurance industry came the tragic news that Shelton Burgess, in years past the revolutionary Registrar of Companies, had been found dead, apparently by his own hand.

Many in the industry were profoundly shaken, not only because they had always thought that Burgess had so much going for him but also because those who knew him consider themselves to have been the fortunate recipients of a rare privilege. They remember him as a visionary, a man devoted to an idea, who was utterly determined to see his island home grow until it became the insurance capital that it is today. They remember a man who worked around the clock to ensure that proper regulatory infrastructure was put in place so that Bermuda should become in reality what he had seen in his mind.

Those who were close to him say that he died of wounded pride and a broken heart. Burgess himself believed that he had much to offer Bermuda, only to find when he stepped down out of the limelight, and no longer was Registrar, that suddenly he was looked upon as a man of little or no importance. Some of his friends say he was profoundly disappointed by what he felt to be a lack of respect shown to him once he had left public life.

Bert Hunt speaks up for Bermuda

In the face of continued attacks on the integrity of the Bermuda international insurance industry, Bert Hunt, head of the Bermuda Insurance Institute, in an address to the National Association of Insurance Brokers (NAIB), given in mid-1983, spoke out in defence of Bermuda as a credible insurance centre.

> 'We, in Bermuda, are certainly aware that in recent times, we have been criticized. When companies are bracketed together solely because of their domicile this makes no sense whatsoever. Particularly in an environment where there are companies as diverse as pure captives, captives writing unrelated business, managers, insurance companies, reinsurance companies and last but not least brokers. A glance at some of the names of the Insurance Brokers Association of Bermuda will itself demonstrate diversity. Some are truly local, some with overseas control and others who are really branches of the big names in USA., UK, etc. …
>
> 'Our industry today is quite rightly concerned with security and continuity and just because an insurer happens to be registered in Bermuda, does not, of itself, make that security suspect or make it certain there is not likelihood of the insurer remaining in business. In fact, if you care to look at the financial statements of some of the Bermudian companies, you will find they are far healthier than some companies in other parts of the world. Financial strength certainly has to be considered, but I suggest to you in this day and age this is not the only criterion for judging an insurer. Today, one should look at the type of business the company is writing, who are its main reinsurers, is it well managed, who are the underwriters, do they really know the business they are underwriting, do they have the experience and the expertise and did they learn the hard way in the marketplace. …

[337] *Insurance Weekly*, January 1985, 'Turning Point for Captives', by Charles Taylor

'It would be foolish for me to stand here and say every company registered in Bermuda is impeccable any more than I would be able to say every company registered in London, New York or San Francisco, Paris or Tokyo was impeccable. Nevertheless, one must admit there is or has been a Bermuda stigma, if that is the right word, so why is this so? Firstly I suggest a certain amount of sour grapes. Captives have certainly removed some of the cream from the old market but after all a large volume of captive reinsurance goes back into the old market. Secondly, increased capacity of the market, caused by, in part, captives getting into unrelated business...

'Another criticism one hears about Bermuda is that it is not fully regulated. No, it does not have the bureaucracy that you find in some parts of the world. In my view that is its strength, particularly bearing in mind the liaison between the government departments concerned and the industry. Bureaucracy does not, of itself, prevent insolvencies...

'History shows we are an adaptable industry and will continue to be so. As far as Bermuda is concerned, I am of the opinion it will have a part to play in the future. Companies are still coming here and being registered here...'[338]

Paumanock Insurance Company Ltd.

Although the reinsurance market had its problems with companies such as Walton and Cambridge Re, one success story of the 1980s was Paumanock Insurance Company Ltd. In mid 1980, Frank B. Hall asked Robin Spencer-Arscott to manage their Bermuda captive operations with the plan to add an underwriting management arm. One of their clients was Grumman Corporation, a defense contractor whose captive, Paumanock Insurance Co. Ltd., was managed by Frank B. Hall in Bermuda. Grumman wished to turn Paumanock into a fully fledged reinsurance company writing third party business to brokers, to begin with, in the London and European markets. Spencer-Arscott had put an initial team together and Paumanock began writing an account from 1 January 1981, with a capital of $11 million. Progress was not swift at all to begin with. The company was fighting an uphill battle for credibility, coming in as it was on the heels of companies such as Walton, Mentor and others. However perseverance paid off and, after repeated visits and continued demonstrations of stability to brokers and companies in London, Paumanock became not only accepted but sought after as a reinsurer. The Company, whose account became worldwide in scope, grew to over $100 million in capital and wrote a similar amount in premium by the end of 1992. Unfortunately, at that time, senior management at Grumman decided to close the reinsurer down. The defense contractor was laying off thousands of employees due to a severe reduction in their business and the new CFO of Grumman could not justify maintaining a non-core business entity, albeit a profitable one.[339]

Bermuda Risk Exchange begins

Despite the bad press surrounding the Bermuda international insurance industry, Paul Bawcutt, an independent risk management consultant out of London and one specialising in captives, was commissioned by 23 *Fortune 500* companies to conduct a feasibility study in anticipation of a hard market coming down the road. They also wanted to see if it was practicable to set up a risk- assuming captive in Bermuda. These companies wanted a mechanism that they owned and operated by themselves. However, because the group represented a diversity of risk managers with differing backgrounds and captives run by Marsh, American Risk Management or J&H, it proved very difficult to find a unanimous solution.

[338] Bert Hunt, speech to the National Association of Insurance Brokers (NAIB), mid 1983

[339] Notes from Robin Spencer-Arscott

In addition, because of the diversity of the group, it was decided that the underwriting should not be handled by any of the risk managers. Therefore the group put out a tender for an insurance company to handle the underwriting. They interviewed a number of large insurance companies, including Swiss Re, Continental, and Zurich. Representing Continental, Bob Baker and Rob Rosser went to New York, were interviewed for the assignment, and were successful. They were hired to underwrite for the Bermuda Risk Exchange and to report to the board.[340]

Not such a wasted year after all

In retrospect it can be said that 1983 may not have been so bad a year as it seemed to many at the time. *Business Insurance* ran a story supporting this summation as early as 2 July 1984—

> 'Bermuda based insurers and reinsurers that underwrite unrelated risks report a better aggregate 1983 combined ratio than United States-based reinsurers and have plenty of capacity to write new business, the first annual *Business Insurance* survey of the Bermuda-based companies reveals.
>
> 'The 17 Bermuda-based companies for which complete statistics were available for 1983 produced an aggregate combined ratio of 97.5 per cent. That compares with a 116.4 per cent combined ratio in 1983 for US based reinsurers, according to the Reinsurance Association of America (BI, April 30). Even after eliminating the results of the giant Exxon Holdings Corp. subsidiary Ancon Insurance Co. Ltd. S.A., whose combined ratio of 35.5 per cent was produced primarily by excellent results on Exxon risks, the remaining 16 companies produced a combined ratio in 1983 of 111.7 per cent.
>
> 'It's important to note, however, that the US $794.5 million in net premiums written in 1983 by the surveyed Bermuda-based insurers and reinsurers equals only about 11 per cent of the US $7 billion in net reinsurance premiums written by US based reinsurers. The 19 Bermuda-based companies in the *Business Insurance* survey underwrote gross premiums of about US $1 billion against policyholder surplus of US $1.5 billion, a premium–to-surplus ratio of just 0.67 to one. A two to one ratio of premium to surplus is generally considered appropriate, meaning that in total these 19 companies could more than triple their premiums to US $3 billion…While the Bermuda-based reinsurers generally reported better results than their US based counterparts, only their policyholder surplus improved against their own 1982 performance.'[341]

Although the frenetic pace of writing business during this giddy period in the history of international insurance in Bermuda had come to an end and many of the companies that wrote the most premium without regard to their bottom lines had ceased writing business, there was still a positive outcome. The law firm Appleby Spurling & Kempe looked back later on this period of uncertainty in Bermuda and came to some conclusions that were by no means entirely negative—

> 'While this (the state of the Bermuda international insurance market) may be thought of as terribly destructive, especially in hindsight, many positive elements were added to the insurance world because of this era of creativity and growth. To begin with, it became clear that the use of captives no longer had to be limited to the simple model of one parent linked with one captive. The vehicle of a captive insurance company is now frequently used by industry associations, and ultimately by unrelated commercial enterprises, to help control insurance costs. Another development that can be traced to this period of creativity is the type of transactions that, in the 1990s, are referred to as financial (or finite) insurance or reinsurance. Clearly, the implicit inclusion of investment income was a key ingredient in the captive movement of the late 1970s and the financial reinsurance markets of the 1990s.'[342]

[340] Interview with Rob Rosser, 12 November 2002

[341] *Business Insurance*, 2 July 1984, 'Bermuda companies post underwriting profit', by Kathryn McIntyre

[342] Appleby Spurling & Kempe: *Guide to the Bermuda Insurance Market 2000*, 'Third Party Business', pp. 3-3 & 3-4