# CHAPTER 33

# 1984
# An ACE in the Hole

### *Parry and counterthrust*

1984 opened with a spirited defence of Bermuda's reputation by Malcolm McLachlan of Ancon, who called for a sense of global perspective and went on public record as saying that only the failures and not the successes made the headlines—

> 'Since the beginning of last year (1983), three companies (two being captives) and one underwriting agency have stopped writing new business; three (one a captive) have become insolvent and one (not a captive) has decided to move away from Bermuda.
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> 'Of the three, which have ceased writing new parent business, the largest, with gross written premiums in 1982 in excess of US $20 million, was Walton Insurance Ltd. Last year its parent, Phillips Petroleum, bolstered its capacity by US $65 million and it has since received a further US $55 million capital injection. The other two, quite small, were Trent Insurance Co., Ltd., an Alexander Howden Group company, and Ramus Insurance Co. Ltd., jointly owned by Dutch shipping and insurance interests. Neither decision has apparently anything to do with their Bermuda domicile.
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> 'The three insolvencies were Ajax, Thames, and Dover Insurance Companies, Ltd., all small and none run from Bermuda. Continental Reinsurance Corporation (Bermuda) Ltd. was the one moving away for reasons of operating efficiency and cost savings.
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> 'None happened specifically because of a Bermuda domicile or, put it another way, could have happened in the other traditional jurisdictions. It is illogical to draw general conclusions from these events and apply them to all Bermuda domiciled insurers.'[343]

According to Julian Griffiths, insurance and reinsurance consultant—

> 'Still, between 1980 and 1984, the insurance industry was facing the worst market it had ever seen. There was a huge escalation in the legal systems in both the United States and Europe. No one had ever seen a period as bad as that. In fairness, the Bermuda underwriters were only taking small lines on major programmes. They were the followers, not the leaders. When one looks back at the results of this period in Bermuda, one can say yes they were bad, but the question that remains is, were they any better anywhere else in the world? The difference between Bermuda and the rest of the world is that many of the Bermuda insurers were not in it for the long haul. They were driven by tax changes. But comparatively so did a lot of companies in the United States as they jumped from one state to the next, trying to find the state which would provide them with the best tax benefits. What's interesting is that not one company that was writing business in 1979-1984 in Bermuda was still functioning as a risk-taking insurer in 1996.'[344]

By 1984, the world reinsurance markets and not just the 'naïve' captive reinsurers of Bermuda had reached a crisis point because of the sustained soft market. As a consequence, they discovered their polices were so grossly underpriced that they were unable to meet their claim demands and

[343] *The Royal Gazette*, Business, 17 January 1984, 'It's the failures that hit the headlines', by Malcolm McLachlan
[344] Interview with Julian Griffiths, 28 March 2002

remain profitable. Hence the worldwide reinsurance industry faced massive losses. The majority of Bermuda captive insurers had their solvency threatened by losses from unrelated reinsurance that forced them to withdraw from writing open market business. From this negative trend the Filings and Acts Sub-Committee of the Insurance Advisory Committee recognised the need to separate companies that were pure captives from those writing varying degrees and classes of third party business and to regulate them accordingly. Bermuda also realised that it needed to set more rigorous standards for direct insurers writing unrelated third party business.[345]

Against this background of uncertainty the Bermuda government dealt the insurance industry an unforeseen blow. For the first time, the industry saw its partnership with the government as threatened when, without prior consultation, the Bermuda Monetary Authority set out to require that insurance companies either register as underwriters or brokers or form separate companies to carry out each separate business function. This requirement was to be implemented on the first of February.[346]

## *US Internal Revenue (IRS) takes up the cudgels again*

By way of driving more nails into the coffins of captives struggling to survive in a difficult environment, the United States government tried to introduce a new tax bill, which would have raised the excise tax to four per cent on foreign directed premiums. Fortunately the bill failed. However, the IRS mounted a heavy attack on the offshore captive market. *Reactions* reported the attempt—

> 'At the moment, the United States Internal Revenue Service (IRS) is attacking with rather more than its usual vigour the tax privileges of offshore United States owned captives. The IRS onslaught of captives is across a wide tax front.'[347]

Charles Taylor of *Insurance Weekly* further expounded on the US attempts to thwart the offshore captive industry—

> 'Early in 1984 two measures were enacted in the United States, which were directed against captives offshore. The first recharacterised (as) United States-source income that income related to the insurance of United States-based risks written by United States-owned foreign corporations. Previously, it was considered foreign-source Subpart F income, and United States taxes due on the income could be offset with foreign tax credits. 'Another measure recharacterised for Controlled Foreign Corporations was the income generated by insuring foreign-related risks. Such income is now considered Subpart F income, and as such is taxable in the current year. Previously, it was not taxable until repatriated to the United States. The two measures taken together significantly increase the taxes due on income of captive insurance companies, though whether the "income" on foreign risks is intended to mean underwriting or both underwriting and investment income is not yet clear…
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> 'For United Kingdom owners of captives, things have not been so bad. The much discussed proposals of the United Kingdom Revenue to restrain the use of controlled foreign companies in low tax countries were finally embodied in the 1984 Finance Bill and took effect from April 6, 1984. These reduced the taxation advantages to a United Kingdom company having its own (captive) insurance company offshore but are not so penal as the measures with which the United States Internal Revenue Services is threatening the future of American owned offshore captives in Bermuda, Cayman Islands and elsewhere. It is still possible for a United Kingdom parent legitimately to defer United Kingdom Tax on 50 per cent of a captive's declared profits and to continue to enjoy tax deductibility on premiums paid to a captive. And there is no tax charge for a United Kingdom company, which has less than a 10 per cent share in controlled foreign company.

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

[346] *The Royal Gazette*, 19 January 1984, 'Drop new company rule proposal say insurers', p.17

[347] *Reactions*, August 1984, 'The taxman closes in on captives'

'So, captive owners now know more or less what the worst is that they have to contend with. Will there be a gradual or rapid escalation of companies following Ancon and Insco out of Bermuda? Firstly, it is worth pointing out that it is not captive insurance companies only who are pulling out or limiting their involvement—though attention had been focussed on them. Even the well established large, so-called professional reinsurers have given notice of their intention to stop writing business in some countries or for particular classes if rates do not improve….

'Next, the old "tax dodge" label that attached itself to captives. If the label is unfairly attached to captives, as their owners invariably argue, then the tax measures, which have been introduced in the United States and United Kingdom will not severely damage the offshore industry. That is to say, captives formed for sound insurance reasons will not be undermined by any of the proposed tax changes. It has been argued that even if United States captives' premiums are not allowed as tax deductible, at least the claims payments and reinsurance premiums paid by the captive will be, and these benefits allied to that of direct access to the reinsurance market will continue to make captives attractive.'[348]

Some in Bermuda, including Brian Hall, head of Johnson & Higgins (Bermuda) Ltd., remained optimistic about the future of the captive market, despite the persistence of the IRS and others in characterising any captive established in Bermuda as a 'tax dodge'. As Hall was reported in *Insurance Weekly*—

'His company's business has not been adversely affected by the new United States Tax Act, because its captives are "not driven by tax motives". He expects the present trend of rate hardening in reinsurance markets to result in a lot of new business flowing in Bermuda's direction.'[349]

## *More companies wind down*

News of more companies winding down in Bermuda hit the headlines. US steel group, Armco Inc., wound down its insurance operations in Bermuda and agreed to sell its Armco Insurance Management subsidiary to Bermuda-based Altamid Management Company. The move was the result of an overall change in the business policy of the steel group, which had recently reported a US $672.5 million loss for 1983 and announced a plan to sell its insurance operations in the United States and Europe as well as in Bermuda. One result of the sale of Armco was that Becher & Carlson, a Los Angeles based insurance brokerage and management company, would open its own office in Bermuda, after being managed there by Armco Management for the previous three years.[350]

## *Scandal at Cambridge Re*

In the midst of all these closures and the bad press they received, rumours circulated that one of them was not without scandal. Cambridge Reinsurance, a captive owned by National Sea Products of Nova Scotia, stopped underwriting in April 1984 and went into liquidation. The Bermuda office of Ivanhoe International was appointed to handle the runoff. Some months later, customers and creditors expressed alarm at the way in which Ivanhoe was doing this.

Of the Cambridge Re affair, *The Royal Gazette* reported that—

'Local customers say Ivanhoe are interpreting insurance contracts strictly to the letter rather than complying with the spirit of agreements. At least one company is considering legal action for non-payment of claims by Cambridge.

'…In a thinly veiled reference to Cambridge, Mr Bert Hunt last week told a Bermuda Insurance Institute lunch meeting about industry fears over "the particular stance being adopted by one runoff manager." Mr

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

[349] ibid.

[350] *The Royal Gazette*, 28 March 1984, 'Armco ARM goes to Altamid'

Jim Meldrum, executive vice president of Ivanhoe's Toronto based parent company said, "We are acting as a proper agent and are following Cambridge documents. I do not know what is meant by the spirit of contracts." Ivanhoe has already made clear its objectives as runoff manager. In a June 15 letter to about 300 Cambridge customers, Mr Larsen explained the steps his company is taking and says Ivanhoe has accepted responsibility "in the interest of the insurance industry in Bermuda."'[351]

The storm over the Cambridge runoff and the resulting shadow it cast over Bermuda's image grew even larger when the minutes of a private meeting held by fourteen firms with an interest in the runoff were leaked. The minutes recorded 'heavy criticism of the runoff and discussion of a series of options, including joint legal action by a number of insurance firms owed money by Cambridge Re and the suggestion that Government should be asked to withdraw work permits for Ivanhoe staff.'[352]

Rumours were rife, that Ivanhoe was holding tight to the purse strings because they were getting massive payoffs from the Cambridge runoff and were offering to compensate brokers overseas. The Bermuda industry was very worried as to how this runoff would affect its reputation in the reinsurance world, a reputation that had already suffered damage.

*The Royal Gazette* quoted Ivanhoe's Mr Warren Larson as saying—

'...rumours about Ivanhoe getting massive payoffs from the runoff were rubbish. We don't get anything unless there is a certain number of dollars left at the end. We don't get to keep the residue. The *Gazette* further said that Larsen was surprised by the degree to which professional people gave credence to rumours they heard in the street. 'We're trying to do the best job we can. I'm happy to explain the problems to people. We're a management company doing this as a contract.'[353]

Despite the bad press that Cambridge Re had occasioned Bermuda, the liquidation process in 1985 had the effect later on of showing just how innovative Bermuda could be, in dealing with the insolvency of an international reinsurance company. According to John Milligan-Whyte, of Milligan-Whyte & Smith—

'In a court-appointed supervised compulsory liquidation of an insolvent reinsurer, a statutory provision under Bermuda law permitting the estimation of contingent liabilities was employed, with the help of modern actuarial expertise, in order to expedite the process of liquidation. This Bermuda initiative had sparked similar initiatives in Ireland, England, and the United States. Cambridge's liquidators recognised the need to find a more expeditious way of valuing insolvent reinsurance companies' debts to its creditors and thereby quantifying and facilitating the collection of debts owed to the insolvent reinsurer by its retrocessionaires.

'...Pursuant to the discretion by statute, Cambridge's liquidators developed an actuarial methodology for estimating Cambridge's contingent liabilities, which was tailored to Cambridge's circumstances. On 7 and 8 December 1988, Cambridge's liquidators obtained orders from the Supreme Court of Bermuda to implement the actuarial estimation initiative. Cambridge's liquidators declared the first dividend in 1989 and the sixth and final dividend to creditors in 1994.'[354]

## *Bermuda Risk Exchange*

Despite the fact that some companies were winding down or no longer underwriting, the captive business in Bermuda was still going strong and in consequence the Captive Insurance Companies Association set up the Bermuda Risk Exchange, as a mechanism for pooling risk.[355] The Risk

[351] *The Royal Gazette*, Business Week 3, 'Cambridge runoff alarms creditors', July 1984

[352] op. cit. 11 October 1984, 'Storm over Cambridge Re runoff and our image', p. 15

[353] ibid.

[354] John Milligan-Whyte: *International Insurance Law and Regulation Bermuda*, November 1999

[355] *Business Insurance*, 'Bermuda Market, exploring the Island's expertise from tip to tip, charting Bermuda's history' by Shirley Henry, p.32, sources, Bermuda Insurance Institute and *Business Insurance* reporters

Exchange was formed by a Special Act of Parliament because of its unique structure, which was designed to operate as a facility for insurance interchange among insurance companies sponsored by industrial and commercial companies. It also provided a way for its members to reinsure each other's risks of diverse classifications on a controlled and efficient basis, thereby expanding the profits of the members and the services they could offer their sponsors. In January 1984 the Risk Exchange began operations, with 17 member companies. Members of the Exchange were captive insurance companies owned by industrial and commercial companies located in the United States, Canada and Europe.[356]

The Exchange was designed to expand the insurance operations of its members in efficient and profitable ways. The principal objectives were—

- to expand the underwriting activity of insuring members by increasing controlled business retentions and thereby increasing income,
- to eliminate unproductive reinsurance commissions and the costs involved in individual exchanging of risks,
- to introduce profitable non-related insurance business in order to increase income and reduce tax problems,
- to allow for individualised underwriting acceptance, reviewed by an experienced participating underwriting organisation, which could be designed to fit management objectives and policy,
- to adjust the member's existing risk profile by expanding risk spread.[357]

The Exchange entered into contracts with Altamid Management Company, for management and operating services, and Hudson Underwriting Limited, of the Skandia America Group, for underwriting services.[358]

The first company to withdraw from the Bermuda Exchange was Westbury Reinsurance, the captive of the Mead Corporation, a diversified Ohio-based forest products company. Mead pulled out of the Exchange because it thought the company had over-expanded its insurance activities. Mead's participation was small, so its withdrawal was not thought to affect the Exchange.[359] However the exchange died in 1997, amid a prolonged soft market.[360]

### *Bermuda, the 'Sick Joke'*

Following the winding down of companies, London continued to chastise Bermuda. One leading underwriter, Robin Jackson of the Merrett Syndicate, dismissed Bermuda as 'a sick joke', despite the fact that there were 850 captives registered on the island, collectively generating US$ 4.5 billion in annual premium income. Jackson pointed to what he considered the high turnover and limited experience of underwriters on the Island. In addition he contended that Bermuda's distance from major insurance centres was such that even highly skilled underwriters could not match the amount of information available to their counterparts in New York and London.[361]

Another London underwriter was quoted as saying, 'If someone gets drunk at lunch and takes a casual attitude to risks in the afternoon, you can see a line of brokers in front of him with the rotten business they're trying to unload. Then there's what we call "Friday afternoon slips", or insur-

[356] *Reinsurance*, March 1984, 'Captives, Bermuda Opens Risk Exchange', by Paul Bawcutt

[357] ibid.

[358] ibid.

[359] *The Royal Gazette*, 5 April 1984,Business Week, 'Underwriting temporarily suspended'

[360] *Business Insurance*, Shirley Henry, op.cit. above

[361] *Fortune*, 23 January 1984, 'Danger Signals for Bermuda's happy captives' by John W. Dizard, pp. 153–160, ©1984 Time Inc. All rights reserved.

ance business that the brokers haven't been able to place during the rest of the week. At one time it seems as though a lot of that went to some Bermuda captives.'[362]

## *The Hong Kong Connection*

Despite these disparaging remarks from London, Bermuda would soon again attract more companies, old and new. Meanwhile, in a small but immensely important jurisdiction on the other side of the world, stark fears of economic, social and political upheaval, consequent on a fundamental change of the paramount power, would bring fresh opportunities for Bermuda to restore its international business reputation.

Under the Kowloon Extension Agreement of 1898, Great Britain had acquired Hong Kong and the 'New Territories' as part of its Empire on a 99-year lease until 1997. After its liberation from Japan, at the end of the Second World War, Hong Kong began to swell, in population and in wealth. In 1949 the Chinese Communists seized power on the mainland, after winning the civil war. Hong Kong became a refuge for hundreds of thousands of people. In the 1950s and '60s an ongoing flow of manpower and money from the mainland, together with foreign investment attracted by liberal tax policies and placed in the hands of a free, energetic and highly motivated populace, developed Hong Kong into one of the most dynamic and fast growing free market economies in the world. Then, in 1984, Britain and China signed the Joint Declaration on Hong Kong, setting out the terms under which sovereignty would revert from Britain to China on 1 July 1997, as had been provided in the 1898 agreement. An open and democratic society, with all its attributes, would be subject to Communist rule.

For countless Hong Kong citizens, and not only for the business elite, this caused a wide range of anxieties. Could the Communists be trusted to keep their promises of 'one country, two systems'? What would happen to freedom of information, education, and religion, to human rights, to the press and the legislature? What would happen to the currency, to the banking system, to the tax system, to international relations, as with Europe and North America?

There were many who thought it wiser not to wait and see. Vast numbers of Hong Kong Chinese emmigrated to more congenial places of domicile, such as Canada, the United States, Great Britain, and other such countries. Bermuda likewise became a highly favoured choice for the placement of Hong Kong investment capital. Whatever tectonic shift of international politics may have lifted this tide, so far as Bermuda was concerned it could not have risen at a better time.

A major boost to Bermuda's business image came when Jardine Matheson announced that it was moving its corporate headquarters to the island. Bermuda won out over other jurisdictions because of its 'established political stability' and its reputation as a financial centre. *The Royal Gazette* wrote of a success achieved in Hong Kong by Bermudian lawyer Mr Ian Hilton, a senior partner with Appleby Spurling & Kempe—

> '... And as luck would have it, Mr Hilton just happened to be in Hong Kong in January on one of his periodic business trips to that colony. A visit he described as "coincidental but also very fortunate" and one which put him in the right place at the right time.
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> 'But there is nothing new about Jardine's Bermuda connections. It has maintained an exempted company here for the past five or six years—a finance raising company handled by Appleby Spurling & Kempe. And Ray Moore, a lawyer and a director of Jardine Matheson, has visited the Island on vacation on a number of occasions.
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> 'But the visit in early March was a first for former chairman, Mr Henry Keswick. He led the team of executives from Jardine Matheson who met with Government, legal and banking interests in Bermuda.

[362] ibid.

'Jardine could have picked any one of a number of other sites. There are plenty of eager claimants—the Caymans, the Channel Islands, the Netherlands Antilles, to name a few. But Mr Hilton said Bermuda was chosen because of its "established political stability" and its "reputation as a financial centre". Also he said, "It was felt that a Bermudian company applying for listing on the Hong Kong Stock Exchange carried a lot of credibility..." He pointed out that there are other Bermudian companies trading on stock exchanges in London and North America and—"this carries a lot of weight in their decision." Jardine, he says, were also "wanting a place where the laws were like Hong Kong's —particularly the company laws." This, he said, was "to ensure the continuity of operation and the legal framework to which the shareholders were accustomed."... Mr Hilton said the biggest thing that Bermuda will get out of the move is the "endorsement" of being chosen by "a company of such international prestige."'[363]

One hundred other Hong Kong companies followed suit.[364] Jardine Matheson's decision to come to Bermuda not only helped to bolster Bermuda's reputation to the outside world; it also caused Bermuda to make some fundamental changes to the way outside companies were viewed. Jardine Matheson came with a wish list of things it wanted done in order to feel comfortable about becoming a Bermuda company. According to John Campbell, senior partner at Appleby Spurling & Kempe, when Jardine Matheson came to Bermuda, it was 'an eye opener to the way companies who were listed on the stock exchange were run.'

Because Jardine Matheson had never had outside directors, they wished to remain that way. At the time, Bermuda required every exempted company to have a significant number of persons ordinarily resident in Bermuda to form a quorum. Therefore private legislation was passed to allow the absolution of the requirement that outside directors were needed. Jardine Matheson's arrival and demands were met with cooperation from the Bermuda regulatory body and were an example of Bermuda's ability to respond to the needs of its international businesses.

After Jardine Matheson's announcement that it would move to Bermuda, *Business Insurance* ran an editorial on 2 April 1984 entitled 'In defence of Bermuda', which went a long way towards refuting the calumnies about Bermuda that were being mouthed in London and elsewhere. The editorial said—

'Granted it's warm and sunny and has lots of beaches, nice golf courses and palm trees. But just because Bermuda has been a tourist centre since the 1883 visit by Princess Louise, the daughter of Queen Victoria and wife of the governor general of Canada, (that) doesn't preclude the country from hosting a responsible community of international reinsurers.

'Yes, yes, we've heard it all... The place is a tax dodge; the regulation is too lax; the underwriters lack experience and, even if they arrive experienced, the island is too far removed from the mainstream of insurance commerce to tap good insurance business and to keep in touch with the latest developments; and, worst of all, the insurers there won't be around to pay their bills.

'And yes, we know Robin Jackson of Merritt Syndicates PLC at Lloyd's of London regards Bermuda as a "sick joke". Nonetheless, we contend that neither potential clients of Bermuda-based reinsurers nor companies considering Bermuda as a domicile for a reinsurer should be swayed by such arrogance and narrow-mindedness. Let's be fair.

'The fact that Bermuda does not have any income tax on individuals or corporations does not make it sleazy. It makes it enviable. Certain reinsurers in Bermuda enjoy a competitive edge over US reinsurers, thanks to the tax-free nature of their domicile (New Hampshire, by the way, doesn't have income tax).

'And the fact that Bermuda's insurance law is not as rigid as US state insurance laws does not necessarily invite the insolvent demise of reinsurers.

'We are not convinced that Bermuda's insurance law is inherently any less effective at regulating the sol-

[363] *The Royal Gazette*, 5 April 1984, 'World search led Jardine Matheson to Bermuda', p. 17

[364] *Financial Times*, 9 September 1985, 'Underwriters now take a more selective approach to business', by Roger Scotton

vency of insurers than state insurance laws in the United States. The Bermuda government has been too lenient in granting extensions for insurers to file annual reports attesting to their solvency and so we applaud the announced crackdown to enforce filing deadlines and to engage the services of an experienced insurance professional as a consultant. But we'd like to see how that works before endorsing the suggestion that Bermuda needs to strengthen its regulations.

'By the way, if anyone has a foolproof method of regulating the solvency of insurers, step forward, because we haven't seen any yet.

'We are convinced that the flexibility granted reinsurers in conducting their business by Bermuda's insurance law offers advantages. Reinsurers in Bermuda are able to design and offer innovative programs and respond to the complex insurance and financial needs of US corporations whose risk-funding options have been limited by restrictive regulation on US reinsurers. As state regulators begin to clamp down on all reinsurers in the United States because of a few scandalous insolvencies, you will see additional respectable US reinsurers establishing subsidiaries in Bermuda.

'The often-levelled criticism that anyone who underwrites in Bermuda must be less talented than underwriters in London or New York is absurd. Of course, there are varying degrees of talent and experience in Bermuda, as on Lime Street and John Street. Every market has its share of incompetent underwriters, evidenced by the lousy underwriting results we see pouring out of established companies.

'The charge that good underwriters will go stale in Bermuda is also absurd in this day of advanced telecommunications and air travel. Any underwriter in any city can go stale if he or she sits in the office, not talking with colleagues, not exploring new areas. But the leading Bermuda underwriters, to their credit and sometimes exhaustion, travel more than they ever did in previous positions in more established marketplaces. They also appear to make more of an effort to keep contacts in New York and London than many who live in those insurance centres.

'And when they are home in their offices, we think Bermuda underwriters enjoy a unique position of being shown programs led by both U.S and London underwriters, broadening their perspective.

'We also must object to the accusation that only underrated and poorly written business is ever shown to underwriters in Bermuda. Underwriters in Bermuda are the first to admit that if all they did were sit and wait for business to be shown to them, they would get the dregs. But, they are calling on contacts worldwide—in person to develop the best business they can. And brokers are showing Bermuda-based underwriters a broader spectrum of business, astutely aware that if they use Bermuda as a dumping ground, it is they who will be eventually dumped by disgruntled underwriters.

'There are those, however who persist in showing underrated and poorly underwritten insurances to underwriters in Bermuda, but it's not all being written. Brokers admit they are having a tougher time placing risks with Bermuda-based reinsurers. One may fairly point out, by the way, that the underrating and poor underwriting were performed elsewhere.

'It's worth remembering that the victim of bad business dumped on Bermuda in earlier days, Walton Insurance Ltd, is to this day paying claims—with additional funds pumped in by parent Phillips Petroleum.

'Finally we asked Mr Jackson to elaborate on his characterization of Bermuda to enlighten us and you, but he declined. "I think I've said all that I need to say about Bermuda because I seem to have gotten myself into enough trouble already," he said.

'You have, Mr Jackson, but you will be forgiven. Your comment, and others like it, is a springboard for this kind of commentary—and we hope ensuing debate— that will lead to better understanding of the Bermuda market.

'Yes, the Bermuda market. With all due respect to another outspoken Brit, Jonathan Crawley of Aneco Underwriting Ltd. in Bermuda, we think there is a Bermuda market. It encompasses all those reinsurers underwriting unrelated risks in their Bermuda offices who have chosen to set up shop in a country blessed with no taxes, flexible regulation and an ear to the marketplaces on both sides of the Atlantic.

'Why all this attention to Bermuda? We tend to agree with Leslie Dew, president of Insco Ltd, that the criticism levelled at Bermuda springs more from competitive bias than concern for the policyholder.

'For our part, we focus our reporting resources on Bermuda once a year, and keep up with developments during the year, because the country is host to the largest number of captives formed by our primary readership—US corporate insurance buyers. And now it's host to reinsurers that provide reinsurance to these captives and excess insurance to self-funded medical and worker compensation insurance plans. And, Bermuda-based reinsurers are writing portions of reinsurance behind major US and London underwriters.

'Some of them are doing business well; others are doing their business poorly. Time and financial reports will tell us which companies are which.

'But just because a company is located in Bermuda doesn't mean it should be shunned, or embraced, any more than a company based in New York or London. Every company should be judged on its merits: its balance sheet and its professionalism.

'In that regard, we intend to expand our coverage of Bermuda-based companies that release annual statements by compiling their results for our readers.

'We are not, we hasten to add, any more "pro-Bermuda", as we have been characterized, than we are pro-New York or pro-London. We are simply trying to give Bermuda-based companies a fair shake by reporting fairly and accurately on their activities.'

In the same issue of *Business Insurance*, and to refute the contentions by other jurisdictions that Bermuda was losing control, Finance Minister David Gibbons announced that to the contrary the government was already demanding compliance with the reporting requirements.

'Registrar of Companies, Verbena Daniels, at the request of the minister of finance, has notified seven companies that have failed to file required reports for both 1982 and 1981 that the minister intends to invoke his powers under Section 32 of the Act unless they have sufficient reasons to convince him otherwise.

'Under Section 32, the minister of finance can order a company to cease underwriting and can control the company's assets. This is the first time Section 32 will have been invoked for only failure to file required reports. It has been invoked twice before, but for several reasons in addition to failure to file reports.

'In addition, Minister of Finance David Gibbons has put insurers licensed in Bermuda on notice that the deadlines for filing statutory reports will be more strictly enforced in the future.

'...Later in a wide-ranging interview with *Business Insurance*, Mr Gibbons said he made this policy statement for two reasons— " We have been under the shadow of a lot of these problems at Lloyd's. Some of their members have acted in the past in contravention of their rules. However, in no case in which we were involved was there an activity here in Bermuda in contravention of Bermuda law. The policy statement was to identify that as a problem and clarify our position and to encourage the authorities at Lloyd's to press on with their policing of their own members. On the other hand, certain companies in Bermuda have not filed the appropriate financial statements and I served notice simultaneously on them that we are going to resolve that problem up to the point of revoking their licenses. You can't exhort others to come to grips with the skeletons in their closet without equally assuming the responsibility in your house," he said.

'... Mr Gibbons noted that Bermuda regulators do not operate in a vacuum. He is in regular contact with committees at Lloyd's of London and Ms Daniels has many contacts in the United States whom she can consult formally, he said. The Bermuda government also will cooperate with authorities in other jurisdictions when the subject of inquiry involves activity that violates Bermuda's laws, Mr Gibbons said.'[365]

[365] *Business Insurance*, 2 April 1984, 'Bermuda will enforce insurer reporting law', by Kathryn McIntyre, pp. 30–31

## *Bermuda Fire and Marine and Fidentia*

As if the winding down of business in Bermuda was not bad enough, Bermuda's largest local insurer, Bermuda Fire and Marine and its oldest law firm, Conyers Dill & Pearman (CD&P), were pulled into the Fidentia scandal.

*Business Insurance* reported on the Fidentia problems as follows—

> 'Fidentia Marine Insurance Co., which a Lloyd's of London committee of inquiry says two Lloyd's underwriters used to reap profits from syndicates, is still accepting business, a Fidentia board member says. Lawyers James A. Pearman, who helped Lloyd's underwriters Raymond Brooks and Terence Dooley form Fidentia in 1970, said Mr Brooks currently is broking business to Fidentia from Italy. "Mr Brooks is no longer living in England but now is based in Milan," Mr Pearman said. "He is broking business into Fidentia through (Bermuda Fire and Marine Insurance Co)."
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> 'Mr Brooks and Mr Dooley, who ran Lloyd's managing agency Brooks & Dooley (Underwriting) Ltd., were suspended from Lloyd's in October 1983 after the Committee of Lloyd's completed the first part of a report into the underwriters' relationship with Fidentia. The six -month suspensions were extended for a further six months in March of this year pending the outcome of disciplinary proceedings.
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> 'In addition, Mr Pearman and his brother Richard—who are Lloyd's members, Fidentia directors and partners in the Bermuda law firm of Conyers Dill & Pearman—have been reprimanded by Lloyd's and ordered to pay legal costs of 1,500 pounds (US $1,965) for refusing to appear before the committee of inquiry probing the Fidentia affair.
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> 'Both brothers stated in a June 18, 1984 article in *Business Insurance* that they would refuse to appear before the Committee again. Richard Pearman said he was surprised that they were fined. "We bent over backwards to be as helpful as we could," Mr Pearman said, adding that they gave Lloyd's as much information in writing as they could without prejudicing their client, Fidentia. Both brothers thought the fines were unfair since they were following the instructions of Fidentia's board members, none of whom are Lloyd's members who could be fined by the market.
>
> 'After nine months of research, a 231-page report was released about the dealings of the underwriters of Fidentia. The report concluded that the underwriters were guilty of "substantial misconduct" under Lloyd's regulations, charging that they abused their fiduciary positions by channelling business to Fidentia on terms calculated to benefit Fidentia at the expense of the syndicates.
>
> 'Fidentia was incorporated in Bermuda November 5, 1970, as an offshore subsidiary of Brooks & Dooley's British holding company, Brookgate Investments, which had been set up in July of that year. Mr Brooks submitted a written statement to Bermudian authorities in September 1970 saying that Fidentia would write "Mainly reinsurance treaties of Lloyd's syndicates and international insurance companies on a quota-share basis." The statement added that Fidentia would write "only a small participation" on these treaties and would be "following the lead of the international reinsurance market" and maintained that the only connection between Brooks & Dooley (Underwriting) Ltd., and Fidentia would be that "both will be subsidiaries of Brookgate Investments." However, the Lloyd's report on the Fidentia affair says Fidentia did not live up to these promises. On the same day that Mr Brooks signed the statement to Bermuda's authorities, "There was concluded by cable a 5 per cent quote share reinsurance of the 1970 whole account of Syndicates 89 and 880 reinsured by Midland Reinsurance," the Lloyd's report states.
>
> 'Midland Reinsurance Co., a Bermuda company owned by Lloyd's brokers Bellew Parry & Raven Ltd., was to retrocede 95 per cent of the risk to Fidentia, the report says, adding that the transaction "was not written as a minor per centage of a 100 per cent treaty and was in no real sense a case of Fidentia following the lead of the international reinsurance market." The report claims that Mr Brooks intended from the outset that all major underwriting decisions on Fidentia business "would be taken…by him alone."

'Fidentia has been managed from the time of its incorporation by BF&M Management, which also managed Midland Reinsurance. Fidentia's management contract said the managers' duty was "on the authorization of Fidentia to underwrite and accept on behalf of Fidentia or decline such insurance and reinsurance business as may be offered to Fidentia from time to time." But the Lloyd's report says the degree of autonomy allowed the managers was theoretical and that, in practice, BF&M Management "exercised and were expected to exercise virtually no underwriting selectivity." Moreover, it pointed out that BF&M Management staff were expected to function "as clerks or administrators in Bermuda to do as they were instructed as regards underwriting."

'In testimony to the Lloyd's committees of inquiry, BF&M Management officials reasoned that business passed to Fidentia was "necessarily desirable" because it originated from Mr Brooks' syndicates, which would not have offered poor business to a company owned by Brooks & Dooley. The Lloyd's committees disagreed, saying much of the Fidentia business would not have been accepted by any "arm's length" reinsurers "either at all, or at least on the terms offered by Fidentia."

'Fidentia acted as a direct reinsurer or accepted Lloyd's syndicate risks passed on by other reinsurers, in some cases, the ceding reinsurer was Midland, in other cases, it was BF&M or North Atlantic Insurance Ltd., a BF&M subsidiary. Syndicate business, the report said, also reached the company through Capital Marine Insurance Co., Ltd., and Manor Insurance Co., Ltd., both Alexander Howden, Glanvill Enthoven & Co., and Colburn French & Kneen. The committee said that between 1979 and 1981 about 27 million pounds (US $37.8 million) or 75 per cent of Fidentia's premium income was derived from business emanating from the Lloyd's syndicates.

'The Lloyd's inquiry was particularly critical of the terms on which Fidentia's quote share business was written and the quality of the security available to the syndicates.

'The report noted that claims accounting and profit commission provisions along with "substantial" deposit premiums, calculated by Mr Brooks and payable to the syndicates, were intended to "maximize Fidentia's investment income by extending as much as possible the residence time of premium in the hands of the reinsurers."

'These provisions, said the report," had the effect of providing unjustifiable underwriting and cash flow benefits of Fidentia and thereby enabled it to earn estimated additional profits in investment income and on underwriting of about 3.8 million pounds (US $5.3 million) to June 30, 1983."

'The committee also maintained that it was "a continuing objective of Mr Brooks to build up Fidentia's asset base as speedily as possible and…that he saw the quota-share reinsurances of his syndicates as the most effective and therefore the primary means of contributing to this objective."

'Mr Brooks was further criticized for what the committee called "the inadequacy of security" offered by Midland, Bermuda Fire and Marine, Manor, North Atlantic and during its first five years, Fidentia.

'By 1982, said the report, Fidentia's excess of loss and stop loss business had produced underwriting profits of about 90,000 pounds (US $126,000) from a total premium of approximately 3 million pounds (US $4.2 million) under 35 different policies. Fidentia's facultative business had produced premiums of more than 6 million pounds (US $8.4 million) by the end of 1982, the report said.

'Overall the committee found that Fidentia, which had little reinsurance protection, carried "an unacceptable concentration of risk" because a large proportion of its business originated from one source—the Brooks syndicate. The inquiry estimated that Fidentia's transactions with the Brooks syndicate up to June 30, 1983, led to investment income of 8.1 million pounds (US $11.3 million). After allowing for an underwriting loss on closed years of about 1.9 million pounds (US $2.6 million), the committee found Fidentia netted 6.2 million pounds (US $8.7 million).

'In April 1983, before the Lloyd's report was issued, Mr Brooks told syndicate members in a report that Fidentia had suffered a 1.8 million pound underwriting loss on syndicate business from 1970 to 1982, but the Lloyd's committee notes the report was "misleading by its omission to make any reference to the investment profits which Fidentia derived from its business emanating from the Brooks syndicates."

'The Lloyd's report also claims that Mr Brooks and Mr Dooley violated their "fiduciary duties". The report noted that the position of a syndicate underwriter is one that "gives rise to the highest degree of trust between the person with the authority to bind the syndicates and the members of the syndicates themselves...It is thus difficult to conceive of a more obvious conflict of interest than that which arose out of the fact that Mr Brooks and Mr Dooley had a direct interest in maximizing Fidentia's profits and that they were procuring the creation of potentially profitable reinsurances by Fidentia of the very syndicates to which they owed their fiduciary duties," it charged. The committee's report called for a "comprehensive prohibition on all future related party reinsurance transactions," which (it) described as "by no means uncommon in the Lloyd's market." It is argued that the mere disclosure to Lloyd's members that such transactions had been entered into "is not an adequate substitute for an overall prohibition", because Lloyd's members "would not have sufficient information to evaluate or appreciate the possible significance of such transactions."

'Although the report made clear that it had not uncovered any criminal offences, Britain's tax authorities are showing increasing interest in Lloyd's activities. And, the Fidentia investigation, the fourth of its kind in the London market, has spawned a new Lloyd's probe. The latest inquiry, announced in February, is examining the activities of Lloyd's underwriting agency Bellew Parry & Raven. It will probe any personal benefit received by executives of Bellew, Parry & Raven through arranging business for Lloyd's members with companies in which the executives had a direct or indirect interest. Bellew Parry & Raven's interests in Bermuda include a management company, BP&R Management, and Midland Reinsurance Company.'[366]

By August BF&M Management Co., Ltd announced that it did not intend to renew the management contract it had with Fidentia. And by the end of the year, Lloyd's expelled Mr Brooks and suspended Mr Dooley for 21 months for their actions in the Fidentia affair.

## *A work of genius—Bob Clements and the founding of ACE*

The industry was beset on every side. Unprecedented awards for victims of asbestos-related illnesses precipitated huge global losses. US courts were giving heavier Directors and Officers awards. There was the creation of the Superfund in the United States. On top of all that came the disaster at Bhopal. Many large insurers ceased to write business on the occurrence policy form, one that provided third party liability coverage for incidents occurring during a policy period, regardless of when the claim might be filed.

This occurrence policy form had been the policy of choice for insuring third party losses. As a direct consequence of the huge losses described above and of their impact on the two biggest insurance markets, Lloyd's and the United States, companies left the liability market, thereby causing rates to escalate. The industry was in a crisis, far worse than that of 1974.

Then, like a breath of fresh air, Bob Clements, Managing Director of Marsh & McLennan, who was to become the father of the next wave of insurance in Bermuda, came breezing through for the island. Clements had seen the signs of a new crisis like that of ten years before and decided that this time he would do something about it. For over a decade the idea of creating an insurance company that would respond to the needs of his clients had lain dormant in his mind. Now it began to take shape. Not only did he want to save the messenger from the proverbial fate of being undeservedly shot, he also wanted to help in filling a void. Therefore he undertook the long task of getting support for a new insurance company to be called American Casualty Excess (ACE).

Speaking about the state of the market in those days and with particular reference to the creation of ACE, Clements said that—

[366] *Business Insurance*, 16 July 1984, 'Fidentia still in business despite Lloyd's inquiry', by Roger Scotton

'ACE and XL were widely viewed at the time of their formation as Band-Aids for a dysfunctional liability insurance marketplace. For years thereafter they were commonly referred to, even in Bermuda, as captives, or at best, industry (association) captives. Market dysfunction created the opportunity, but my own view of the real objective was always different. In the original ACE prospectus we wrote, "It is expected that the Company will take its place in the vanguard of the world insurance industry and that its investors will have a chance to profit thereby."

'To me it was an opportunity to contribute to the liberation of the industry from the locked in inadequacies and inefficiencies of distribution systems and an organisation style dictated by the inhibitions of 19th century technology. That is to say freedom from tied distribution systems and from dependence on a branch-plant organisation, not to mention liberation from the need to forfeit new market opportunities to mutualisation.'[367]

His timing could not have been better. The primary insurance companies were expecting the reinsurers to turn their backs on the occurrence policy form and to retreat from the liability marketplace. It was rumoured that the reinsurers would withdraw their support altogether on 1 January 1985. Accordingly the primary insurers went to the Insurance Services Office (ISO) to work out their own solution to the liability crisis and together with the ISO they came up with the 'claims made policy'. This was designed by the large primary insurers and the ISO to limit the exposure of primary insurers with respect to unknown future losses. The policy would recognise only such claims as would be presented to the insurer during the term of the policy or within a specific period after its expiration. This provision, which the insured would have to purchase, was called 'extended reporting' or 'discovery'.

This new policy met with a severe backlash. When policyholders and brokers learned of its provisions they were furious. It seemed that the policy had been drafted in isolation from them and that the language was far too restrictive. Most policyholders and brokers thought it was unfairly stacked in favour of the insurance companies. As a result there was widespread sales resistance against this form at any price.

Needing to find a balance between the limited claims-made policy and the limitless occurrence policy, Clements conceived a hybrid or cross between the two. This was to be known as the 'occurrence reported' policy and it provided broad coverage while yet precluding the 'stacking' of claims among different years.

Clements was the genius behind the concept of the policy, in that he wrote the original specifications. However, to shape those rough 'specs' into an original policy draft, he selected a team of very senior, highly skilled brokers, within Marsh, including Tom Keating, Myra Tobin, Tom Clarke, Al Holzgruber, Paul Goularte, Bob Redmond, Paul O'Donnell, Phil Brown, Vince Stahl and Bob Newhouse. It was Newhouse who came up with the idea of adding Directors and Officers to the concept, in order to attract more customers quickly.

Once the original draft was written, Clements enlisted as leading counsel to the project as an 'incredibly important silent partner', namely Immanuel (Ike) Kohn, the managing partner of the New York law firm, Cahill, Gordon & Reindel. Together Kohn, Walter Cliff and Thorn Rosenthal, also partners in Cahill Gordon & Reindel, were brought in to make the draft policy a revolutionary new reality. Clements said that in many ways the drafting of the policy wording was vital to the project because the old occurrence policy form had been burdened by defective language, which had curtailed the market response because there was no way the industry could sell the product and still remain profitable.

According to Thorn Rosenthal, 1984 was an auspicious year in which to start an insurance company. Rates were firm. Clements had devised a new approach that would revolutionise general

[367] Copy of a speech by Bob Clements, courtesy of Cyril Rance, 19 February 2002

liability underwriting. The new concept would be better suited to the needs of Marsh & McLennan's clients than was the claims made policy, this latter having been designed by industry without reference to clients, accordingly restrictive, and flawed by an absolute pollution exclusion, by sunset provisions, by illusory coverage and by exorbitant premiums. Rosenthal set about drafting a policy that would bring Clements' idea to fruition, working closely with Clements and the brokers from Marsh to put the form together.

The new form was designed so that only one policy period would apply to any given claim. All related claims were to be broadly integrated into one occurrence, so as to protect ACE from exposure to multiple limits from different periods for a single problem. The trade off for the insured was that ACE would adopt an unprecedented net limit of US $100 million excess of a US $100 million attachment point for response to occurrences in any given policy year.

However, because all claims arising out of one common problem were to be integrated into one policy year, Rosenthal and the team of brokers faced new difficulties. The first was that normal claims activity with respect to a consumer product sold in high volume, year after year, over a long period of time, could eventually result in an accrued loss of more than US $100 million. The second cause for concern was that an insured client might consider himself financially safe in continuing to sell a product, even though he knew it to have problems. In which case the insured would reap the profits of the sales and ACE would pay the inevitable claims.

The purpose of the policy was to provide protection against unforeseeable catastrophes and not to 'trade dollars' or otherwise assume normal commercial risks. Rosenthal and the brokers therefore developed a form of wording designed to protect the policy from abuse. It would cover losses arising out of future sales of products with known claims or loss histories only when the injury or damage for such sales was 'fundamentally different in nature or vastly greater in order of magnitude' than the known claims or losses.

The next question was how to treat losses that originated prior to the inception of ACE. These would normally have fallen during the watch of the commercial market and on its occurrence policies. The first thought proposed was an absolute exclusion but the pharmaceuticals balked at this because they would be left without coverage for ongoing problems with respect to drugs, already on the market in great quantities, that might have had some initial and inconsequential history of problems but that could incur catastrophic losses in the future. Eventually the absolute exclusion was changed with respect to product exposure. After all, the needs of the insured had been seen as paramount ever since the inception of the policies. It should be noted that these policies are now in their fifth revision and, to accommodate the needs of the clients, endorsements continued to be crafted on a regular basis, whenever the underwriters deem them to be necessary and insurable.

Once they had refined and formulated the concept, Clements and his colleagues went out to sell it to potential investors. They met with interest, but not enough to capitalise the company. Refusing to let the concept die, Clements and the others saw their opportunity in the worsening shortage of D&O coverage. Their new company would offer 'excess follow form D&O coverage', meaning that the D&O policy would follow the terms and conditions of the insurance companies immediately antecedent to where the ACE policy would begin. Their gambit succeeded and within a short time they had the capacity needed to form ACE. The basic premise of joining the ACE 'club' was that if a client put up US $10 million in capital, he could buy a general liability and/or a D&O policy.

All of those at Marsh believed that underwriting was best left to the underwriters and brokerage was best left to the brokers. This made for a very trying set of circumstances in which to raise capital for ACE. There was also a serious concern by the reinsurance division of Marsh, Guy Carpenter, that the special project would be offensive to its clients. So Clements and the others agreed that the concept would be offered at no charge to Lloyd's and the largest carriers in the United States. He then met with the CEOs of Aetna, Hartford, Travelers, CNA, Continental,

Home, and CIGNA. He also went to London and offered the concept to the leading syndicates in Lloyd's. They all declined. Lloyd's went so far as to call the concept a 'self-immolation scheme'. They thought it was bound to fail.

The management of Marsh was by now convinced that no one in the marketplace was interested in ACE. Therefore they decided to go ahead with the project but only if it could be accomplished without any capital investment on their part. Marsh was unable to attract support for the project from any professional investors so it was concluded that the only way of raising this capital was to go to the companies who were likely to be its first customers.

Insurance companies were glad to write primary coverage at that time because they could command very high premiums. They saw no point in wasting capacity on a high excess layer that would not give them premiums to justify the risk. They decided not to take a chance.

That left Clements having to get the money from user-friendly capital. He next approached JP Morgan because it had a strong banking relationship with Marsh and moreover knew the financial managements of most if not all the companies that were potential investors and policyholders.

Fortunately JP Morgan was in the early stages of building up a programme of investment banking. One Monday morning a man with a striking, charismatic presence walked in to see Clements, listened to his plan, and immediately showed an enthusiastic appreciation of the concept. This visitor was Robert Mendoza, the executive in charge of the Morgan programme. Clements later said that it was easy enough for Mendoza to embrace the concept because there was no downside for him, whereas Marsh feared that if ACE failed then its own reputation would be ruined overnight. Morgan by contrast was in a different business, that of raising money. It was not incumbent upon them to find workable solutions to insurance problems.

Clements was still faced with the fact that the ACE concept made more sense to the brokers than it did to the board of Marsh. He did however have major support from his close colleague, Bob Newhouse, who became instrumental in helping to get the ACE concept off the ground. Like Clements, Newhouse was losing revenue for lack of orders and sought an immediate remedy. Together they were well aware of the dire straits in which the insurance market found itself and they sensed that the ACE idea was about to move from being notional to being the practical solution to a very serious problem.

As Clements was getting the infrastructure in place, he realised he needed a well-known insurance man to head up the ACE organisation in Bermuda. The next player stepped onto the stage. John Cox, retired from Insurance Company of North America (INA), had worked in Bermuda long before with the life subsidiary of AIG and had helped Francis Mulderig to start his rent-a-captive facility. Legend has it that Cox was lounging around his pool in June of 1985 when the telephone rang. He answered the call without the slightest premonition that it would bring him out of retirement in a major way. Clements was on the other end of the line and asked him to start up the new company, ACE, in Bermuda. Without a moment's hesitation Cox took the job on the spot.

According to Rosenthal, Cox was brought in because Clements thought he would add the credibility they needed to get the operation taken seriously. Clements said Cox was a well known and important figure in the industry because he had been in the upper management of AIG in the life insurance business and had then moved to INA to run their property and casualty business, where he made a quite a name for himself. By accepting the job at ACE Cox instantly added substance to the company and proved himself to be effective in selling both the concept of ACE and insurance in the early days.

After a year of very hard work, the 34 firms that agreed to sign on were together with Clements and company in an organisational meeting at the Hamilton Princess in Bermuda. Suddenly and without prior notice, a risk manager from a pharmaceutical company stood up and gave a speech.

He first thanked Marsh and JP Morgan for the fine effort they had put into forming the ACE

Corporation and said how much he appreciated what they had done. Next he acknowledged that they should be suitably, indeed handsomely, compensated. The sting in the tail came as he continued. Even so and notwithstanding all that they deserved, he said, the compensation package that Morgan and Marsh had put together for themselves was far too generous. This unexpected charge abruptly changed the tenor of the meeting.

Quickly reacting, Clements took to the podium and for the next fifteen minutes spoke of the initial reasons why he had created the ACE Corporation in the first place, namely the better to serve the clients of Marsh and to enhance its reputation for being able to meet a client's needs. He assured the audience that he would have done the ACE deal for nothing but that once the question had been raised, as to how the organisers would be compensated for the deal, Marsh and Morgan had sat down and combed through promoter compensation arrangements that had been used by other new organisations. Clements said they had looked at no less than six recent transactions. Extemporaneously he described each one from memory, as to what had been the promoter's compensation in each case. He compared them to the compensation for Marsh in the ACE transaction. He concluded that in fact his group had wanted to be conservative, as compared to the other deals he had mentioned, and had accordingly designed a package less generous than any of them.

As Clements came to the end of his discourse, Jim English of JP Morgan was in a state of silent but acute agitation. Robert Mendoza had missed his plane. That left English as Morgan's senior representative present, but English was still a junior at the time and by no means welcomed the prospect of following Clements and having to defend Morgan's compensation in the face of the investors.

Thirty seconds before Clements finished, Mendoza walked in. English was visibly relieved. He went over to brief Mendoza on the unexpected turn in the meeting. Fresh off a private jet, Mendoza stepped up to the podium and spoke for ten minutes as easily as if he had been there the whole time. For the first five minutes he set forth the reason why Morgan had involved themselves with the formation of ACE and why they also, on their part, would have done so at no charge. The remaining five minutes he devoted to his own belief that the compensation Marsh would receive was no more than was fair. He never addressed the compensation Morgan was getting but by that time the mood of the meeting had changed again. The investors were satisfied with the reasons behind the compensation package. The fire had been put out. Moreover, of course, all the original ACE investors, as well as Marsh and Morgan, did profit handsomely when ACE went public.

Once ACE was up and running, Marsh held a celebratory lunch in its suite at the Mayfair Regent in New York. After the lunch was over, Mendoza opened several boxes and gave to everyone present a sweatshirt. On the front was emblazoned the one word, 'ACE' and on the back was inscribed, 'We would have done it for nothing.'

The formation of ACE, its revolutionary policy form, and the size of its initial capitalisation, brought about fundamental changes in the way that liability insurance was bought. With such an amount of capital, ACE was able to offer large net lines (no reinsurance). Thus, for the first time, clients could buy huge net lines and a user-friendly form designed to provide high severity, low frequency coverage, as contrasted to swapping dollars with a patchwork of insurers and small layers of coverage, the bulk of it reinsured out.

According to Rosenthal, ACE was the first real and true risk-bearing enterprise in commercial general liability insurance. It quickly distinguished Bermuda from other markets because Bermuda could now take on the toughest risks in the toughest classes of business, could bear those risks and could collect premiums commensurate with the risks incurred. ACE introduced the concept of one-stop shopping with a large net line and thereby revolutionised the procurement of insurance.[368]

[368] Interviews with Thorn Rosenthal, 1 November 2002 and 16 April 2003, and with Bob Clements, 10 December 2002 and 16 April 2003

## *Exxon pulls out of commercial reinsurance*

Bermuda was riding high, what with the announcement that Jardine Matheson would be bringing its headquarters to the island, and Bob Clements looking to establish a major new insurance company, not to speak of the glowing reports from *Business Insurance*. Then at the end of September the balloon burst. Exxon announced that it was pulling out of the commercial reinsurance business. *Business Insurance* reported that—'The management of New-York-based Exxon unexpectedly decided late last month to order its three reinsurance operations to stop accepting new or renewal non-related risk insurance business as at October, 1, 1984.'[369]

Exxon withdrew from the market even though it was making a modest profit while other insurers were posting losses. This caused many to question the commitment of parent companies that were not related to insurance. Considering how carefully the underwriters had chosen to accept risks, several brokers reacted with anger and shock at the news of Exxon's withdrawal. *Business Insurance* quoted Jonathan Crawley, President of Aneco Reinsurance Underwriting, a subsidiary of Aneco Reinsurance Co. Ltd., as saying—

> 'If ever a captive had an opportunity to make a killing in unrelated business and to put a seal of respectability on itself, it was Ancon (Exxon's subsidiary, Ancon Insurance Co., see above —*ed.*) and they have blown it. I think it's the death knell for captives forever to have any credibility in unrelated business. You won't find me or other professional reinsurers here with one good word to say about a captive writing unrelated business. Forget it. I won't be tarred by any association with them.'[370]

Crawley went on to explain that—

> 'continuity is important in the reinsurance business, not only because ceding companies feel more comfortable with long-term relationships, but also for financial reasons. Particularly in the excess of loss reinsurance business, ceding companies view the premiums they pay the reinsurers as premiums not only for protection in the current year but as premiums banked against losses in future years. They pay to reinsurers knowing someday the reinsurers will have to pay back. But when a reinsurer withdraws from the business, it is walking away with the ceding company's banked premium. The new reinsurer on the account does not have the benefit of previous years' good experience when it accepts business from the ceding company and, as a result, the first loss will be more damaging for both the reinsurer and the ceding company's future insurance cost.'[371]

Noel Turner, president of Gulf 's Insco Ltd. in Bermuda, worried as to the implications of Exxon's withdrawal, especially since his own captive was likewise owned by an oil company. He was also apprehensive as to how Exxon's withdrawal would affect Bermuda's reputation.

Opinions differed widely as to the likely overall impact. Thus several brokers, including Mike Foulger, manager of the E.W. Blanch office in Bermuda, thought it would have little practical effect, because Exxon had never been seen as a major player like Walton. *Business Insurance* reported that, 'Despite any negative reaction to the decision, Mr Turner and Mr Foulger expect Bermuda to see more business because reinsurance capacity is shrinking worldwide.'[372]

However, as regarding captives that wrote non-related business, on 8 October 1984 *Business Insurance* ran the following editorial, questioning their longevity and commitment—

> 'We're beginning to believe the veteran reinsurers who warn that captive insurers getting into the reinsurance business will be here today and gone tomorrow. Now that Exxon Corp., of all companies, has decided to bail out of commercial reinsurance business, you have to question the commitment of non-

[369] *Business Insurance*, 8 October1984, 'Exxon stops underwriting commercial reinsurance', by Kathryn McIntyre

[370] ibid.

[371] ibid.

[372] ibid.

insurance company parents to their reinsurance subsidiaries. Exxon had everything going for its reinsurance operations. It was making a modest profit, considering investment income, on a book of unrelated risks it built slowly and carefully over the last five years during the worst conditions in the reinsurance business. It had recruited professional reinsurance underwriters for its Bermuda-based Ancon Insurance Co., S.A., Ancon Insurance Co. (U.K.) and Anex Syndicate on the New York Stock Exchange, And, with reinsurance capacity shrinking and rates going up, the operations were ready to write better risks at better rates for a larger profit... Exxon's move can make you believe in the veteran reinsurers' admonition: Only reinsurance pros have the stomach for the reinsurance business.'[373]

Larry Lombardo, a Bermudian and former underwriter at Ancon, went so far as to say that Exxon's announced withdrawal from third party business immediately caused the underwriting of such business in Bermuda to be thrown out of the window. In his opinion Bermuda's hope of becoming the third reinsurance centre in the world vanished overnight as a result of Ancon's decision to withdraw from third party business.[374]

Varied as the forecasts and the reactions of the moment may have been, it did seem to many observers that a cloud of uncertainty had come to hover over the Bermuda insurance industry.

## *Insco follows*

Days after Exxon made the decision to shut down, Fordingbridge International announced that it was cutting five out of nine jobs.[375] Then, within months of Exxon's decision to shut down its underwriting operation in Bermuda, the concerns of Noel Turner, President of Insco, proved to have been well founded when Insco announced out of the blue that it too would pull out of underwriting. *The Royal Gazette* reported—

'Insco, one of Bermuda's biggest offshore insurance companies, is to close and will axe 48 jobs, 30 of them held by Bermudians. The loss making company has been pulled out of insurance by its American oil company parent, Gulf, and has been told to "cease further underwriting of all insurance risks." The closure will be phased out over the next three to eight years during which time Insco will wind down its business commitments, with more than US $83 million in annual reinsurance premiums.

'Gulf yesterday explained the decision resulted from the US $13.3 billion takeover of Gulf Oil group by Chevron, another major United States oil company. Gulf's official statement stated, "The decision to cease writing insurance business results mainly from a corporate decision arising out of the recent Chevron/Gulf merger. Chevron already has a captive in Bermuda, namely Bermaco Limited, and as such there is a duplication of operations in Bermuda."'[376]

Although Insco's withdrawal was hailed as a further blow to the Island's reputation as a reinsurance centre, Mr Turner was quick to argue that such criticism was not justified. In a complete reversal from his concerns about Exxon's announcement that they were no longer accepting non-related business, Turner said—

'The Insco withdrawal does not relate in any way to its Bermuda location which has no direct bearing on the decision. It should not affect Bermuda's reputation as a reinsurance market because it's not as if we are moving to another location. Nor should it have a significant effect on local brokers. Insco's main production sources were United States brokers and the London market.'[377]

Whatever the reason for shutting down, Insco suffered a staggering loss of US$ 16.2 million in its 1981 underwriting year.

[373] ibid.
[374] Interview with Larry Lombardo, 19 March 2002
[375] *The Royal Gazette*, 11 March 1985, 'Reinsurance firm closes adding to gloom in international sector', p. 15
[376] op.cit., 1982, 'Insco's surprise shutdown move', by Roger Scotton
[377] op.cit.

## *Union Carbide at Bhopal*

While the Bermuda international insurance industry was concerned with its own local problems, there occurred on the other side of the world an industrial disaster of a kind and on a scale until then so unprecedented that it would focus worldwide concern as to the manufacture, concentrations and use of lethal toxins. This event is now most commonly known just as 'Bhopal'. On the night of 2-3 December 1984, in the city of Bhopal, in central India, some 40 tonnes of highly poisonous methyl cyanate gas, along with hydrogen cyanide, exploded and burst out of tanks at a Union Carbide chemical plant. They enveloped an area of 40 kms.

Conservative official estimates of immediate deaths were in the 2500 range. Some half a million people suffered symptoms of acute poisoning in the following few hours. Subsequent exposure related deaths are estimated to be more than 10,000. The long-term health effects from such an incident remain difficult to evaluate. The International Medical Commission on Bhopal estimated that as of 1994 upwards of 50,000 people remained partially or totally disabled and disabilities. It should be noted that delayed mortalities, severe physical, mental and neurological disorders, persist a full generation later, affecting tens of thousands of people, including the unborn and the newly born.

The event had serious implications for US based multi-national corporations, both at home and abroad. The US-based Union Carbide Corporation was the parent company to the Bhopal plant operator, Union Carbide India Ltd., commonly referred to as UCIL. Three days after the disaster, a lawsuit was initiated in the US courts.

Questions that would be addressed in the ensuing trial included—

- Should Union Carbide be held responsible for the design, maintenance and personnel training relative to the Bhopal plant?
- Should Union Carbide be held responsible for informing the local government and community of the hazards associated with the plant?

Both Union Carbide and the Government of India sponsored investigations into the incident. However both were also parties to the associated lawsuit. As a result, there are very few issues about the event that were not in dispute. For example, both parties agreed on what actually happened to trigger the runaway chemical reaction and explosion, but why that happened and what was the capacity of the plant to withstand such a reaction were issues subject to dispute.[378]

The Bhopal catastrophe was recognised as one of the worst industrial accidents in history. Although the contentions of accountability and compensation may never be fully resolved, the disaster did draw attention around the world to the hazards inflicted by mega-technology when it gets out of control, and to the social responsibilities of corporations and governments in that regard. Coupled with the nuclear meltdown at Chernobyl in 1986, the Bhopal event sounded a terrible warning. Although Bhopal was not in itself a nuclear catastrophe, its effects were of a similar and comparable nature, both in the short and long term.

One local side effect of that heightened awareness was the expansion of Nuclear Electric Insurance Limited (NEIL), a captive nuclear insurance facility that had been established in Bermuda in 1980.

## *End of an era*

It did not take long before a domino effect resulted from the contraction of third party captive reinsurance in Bermuda. After Insco's surprise decision to shut down was announced, many more followed. This unravelling of third party business began almost overnight.

[378] United States Chemical Safety and Hazard Investigation Board web page 29 July 1999, 'Bhopal Disaster Spurs US Industry, Legislative Action'

By the end of the year Reinsurers Brokers Ltd. had closed, Dover Medical Malpractice Insurance had been liquidated, Ajax Insurance had been declared insolvent, Insco had shut down after suffering a US $16.2 million loss, leaving 48 people jobless, and Exxon had restricted the business written by its Bermuda captive Ancon.

Overall, 1984 was both a sweet and sour year for the Bermuda insurance marketplace. Given the growing number of Bermudians and local expatriates wishing to learn more about insurance, the Bermuda Insurance Institute was incorporated by the Bermuda Insurance Institute Act 1984, with a mandate to maintain a central organisation for persons engaged or employed in insurance, holding meetings for discussions on insurance matters and encouraging and assisting individuals in the study of insurance. The decision to incorporate was intended also to enable the Institute to register as a charity, so that it could raise funds to formalise its programs and seminars. And although the year ended on a sour note with several insurers pulling out, there were new possibilities on the horizon, such as the intention of ACE to set up on the Island and also the advent of companies from Hong Kong.

Yet just as the Bermuda market was again beginning to change, so the retirement of one individual did of itself signal the end of an era, as eloquently as any corporate decision could have done. The very man who has been heralded as the Father of Bermuda's Reinsurance, Leslie Dew, bowed out of the insurance industry. His parting words were these—

> 'I am convinced that the Bermuda market will display sufficient ingenuity and enterprise to remain an important factor in international insurance. The disappointing results of the last two or three years have stimulated tremendous criticisms from other markets. The immediate future is dictated by the need to develop in those classes of business which are not run-of the-mill.'[379]

In 1984 a phase began during which, despite the number of international insurance companies that were curtailing their activities, the industry and Bermuda in general were yet regaining their strength. In March of that year, the World Bank ranked Bermuda as the ninth richest nation in the world, in terms of gross domestic product per capita. A new political party, called the National Liberal Party, was formed in August. Shortly thereafter on 30 October another election was held. The gap between the United Bermuda Party (UBP) and the Opposition widened tremendously, as the UBP won 31 seats in the House of Assembly, the PLP seven and the NLP two. In a time of change the people of Bermuda were striving hard to restore that level of prosperity, harmony and social stability for which their country had become reputed around the world.

[379] *The Royal Gazette*, Business, 24 April 1984, 'Mr Reinsurance stepping down'