

CHAPTER 34

1985

Resurgence

A new era

Bermuda's insurance industry had been in need of a pause for breath in order to contain its rate of growth. That quieter time was now coming to an end. Although the economy experienced its first balance of payments deficit since 1972³⁸⁰ and although tourism was definitely on the decline, international business now began to rise again. On 1 January 1985 the global insurance industry decided to stop offering excess liability cover altogether. This caused the market to collapse, but was in turn the signal for a new era in the Bermuda insurance market, as it opened the way for Bermuda to become a leading international force.

More than 5800 international companies were registered in Bermuda, including captives, underwriting houses, brokers and management companies. They contributed more than US \$200 million a year to the economy.³⁸¹ Bermuda incorporated record gross premium writings of approximately US \$10.1 billion, with net premiums written of approximately US \$8 billion backed by US \$24.5 billion of assets and US \$10.2 billion of capital and surplus.³⁸²

All the same, a dark cloud still hung over the island. E.W. Blanch, an American reinsurance broking and management company, based in Minneapolis, Minnesota, announced that it was closing its Bermuda office, after only three years of operations. Two employees lost their jobs, bringing the total number of redundancies to 19 in just one week.³⁸³

And according to Mr William D. Scaff, managing director of Alexander International Ltd., the captive management unit of Alexander & Alexander Services Inc.—

'The unrelenting Internal Revenue Service attack, very shrewdly managed, continued; the Deficit Reduction Act was passed; the soft marketplace called for a re-examination of captives as a risk funding technique. Some of the premium moved out of captives onshore to traditional markets or perhaps onshore to other captives. The underwriting realities of a nine-year down cycle...became all too clear, and the main reinsurers by and large dropped out one by one.'³⁸⁴

At the beginning of 1985 many observers believed that Bermuda's days as a reinsurance market were numbered. The brokerage community shrank from 30 to 25 members, as companies pulled out because there was not enough business to go around, it was at least arguable that the insurance industry's only hope of survival lay in trying to become again a purely captive market.

³⁸⁰ *The Royal Gazette*, 12 August 1985, 'We're starting to swim!', by Roger Scotton, p.22

³⁸¹ *Financial Times*, 10 December 1985, 'Report on Bermuda'

³⁸² Joe Johnson, Speech, January 1987

³⁸³ *The Royal Gazette*, 11 March 1985, 'Reinsurance firm closes, adding to gloom in international sector', p. 15

³⁸⁴ *Business Insurance*, 15 April 1985, 'Bermuda declining as reinsurance market', by Douglas McLeod, pp. 46 & 47

The adoption of the 'claims made' policy

As a direct consequence of the hard market, the 'claims made' policy was officially adopted in the United States on 1 January 1985. The Insurance Services Office issued a new, comprehensive, general liability form, requiring risks to be written on a 'claims made' basis. A majority of states adopted this revision, which insurers used for primary coverage, chiefly on the largest and most hazardous exposures.³⁸⁵

Looking back three years later, Peter Wilson, Managing Director of H.S. Weavers Agencies, commented on the advent of the 'claims made' policy as follows—

'By the autumn of 1984 and the early part of 1985 the US market was faced with a crisis in the casualty sector, resulting in a severe lack of capacity and massive premium increases. This situation was brought about by four years of intense competition and the culmination of disastrous underwriting results. Every major insurer of casualty business in North America was required to strengthen reserves because of past inadequacy and totally review their underwriting strategy. This action caused underwriters to realise very quickly that the establishment of adequate reserves for incurred but not reported losses was of paramount importance. It was also apparent that past methods adopted for the calculation of these reserves were shown to be entirely unsatisfactory.'

As a result of the reserve deficiencies the risk taking market realised that there was a need for an immediate solution to the problem and the 'claims made' concept emerged, although it was not new, as for many years certain professional indemnity coverages and directors' and officers' liability have been underwritten on this basis.

'The leaders of the underwriting community, not only in the US, but also in Europe for North American primary and excess liability risks, showed great interest in the claims made language and produced many positive arguments in its favour compared with the traditional but questionable occurrence policies. The industry was assisted by the Insurance Services Office (ISO) who gave its support with a recommended primary claims-made liability policy.'³⁸⁶

Later still, in 1995, *The Bermudian* quoted Bob Clements at length on the issuance of the 'claims made' policy in the United States and the lack of capacity available in the excess liability market—

'There had been a lot of other market cycle turns before, but the one in 1985 took place precisely at January 1st...It was the inability to produce a so-called occurrence liability policy, because the companies that had been writing it were dependent upon the reinsurance market, which had suffered cruelly for reinsuring this kind of policy in the past.

'The problem wasn't that there wasn't an insurance company. The problem was a defective product that has been on the market. This occurrence liability policy didn't work for the seller or buyer.

'It didn't mean the policy had never worked—it had simply become unworkable because of the insurance industry's inability to react to the evolution of the United States civil justice system...the insurance industry has changed from a business about damage to property to a business now primarily concerned about protecting bank accounts against lawsuits.

'This development created a structural flaw which has saddled the insurance industry with enormous problems, very significantly because the policy contract through which it used to write liability from 1950 until 1985 was subject to after-the-fact reinterpretation in an adverse tort liability environment. As a result, it had become impossible to assess risks in a way that accurately measured the underlying exposure, and therefore impossible to price them correctly.

³⁸⁵ op. cit., 13 November 2000, '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

³⁸⁶ *The Review - Worldwide Reinsurance*, March 1988, 'The Ultimate Solution?' by Peter Wilson, Managing Director of H.S. Weavers Agencies, pp. 50–52

'Insurance is a product, and it helps to think of products as having three dimensions, and the dimensions of an insurance policy would be the limits of liability or the amount of money the insurance company says it will pay if something happens, a dimension I would call the height... The length would be the time span of the insurance policy, and the width would be the conditions under which the policy would perform.

'The policy might say we will pay you US \$1 million if anything happens in the next 12 months, except if you lied to us or if the loss was caused by war. Once you know these three dimensions, you can put a unit price on the insurance policy. In the case of an occurrence policy, it had been evident for some time that the length was not determinable by words of the policy because claims even today are being brought against occurrence policies that were written in the 1950s.

'Finally, nobody knew what the axis (width) was because every court in the United States had a different interpretation of it, and what the insurance company thought it was and what the insurance buyer thought it was became relevant.

'So here we had this product which could only be sold if it could be priced, but we didn't know how long it was. It was absurd to think that you could go on like that, and absurd to think that you should try to get into this business with a product that could not be measured.'³⁸⁷

'It was', said *The Bermudian* in the same article, 'because of the passage of the "claims made" policy by ISO that Clements decided once again that he needed to find a solution to the "claims made vs. occurrence" problem. His notes...included the specifications for a product that would put these three dimensions back into a place so the product could be priced.'

Mentor pulls out

As the global insurance industry faced the huge task of replacing the old occurrence wording with the new 'claims made' policy form, Bermuda faced the closure of yet another one of its large captive reinsurance writers. As if it wasn't bad enough that Walton, Ancon and Insko had stopped writing business in Bermuda, at the start of 1985 Mentor announced that it too was pulling out of the commercial reinsurance business, as reported in *The Royal Gazette*—

'New Orleans oil group Ocean Drilling and Exploration Company (ODECO) (was) considering selling its loss-making Bermuda subsidiary Mentor and has revealed that Mentor chairman Mr Douglas Higley has handed in his resignation.

'...ODECO senior vice president Mr William Colson, who was Higley's boss, said, the decision to wind down the Bermuda firm's business was more a reflection of ODECO's corporate philosophy than the result of underwriting losses which reached US \$5.8 million in 1983. "I doubt we will ever go back into insurance. We want to stay in the business we understand the best and that is oil exploration not insurance."

'Mr Colson who confesses he knows little about the insurance industry, described Mentor as a "troublesome distraction" which has proven to be a "disappointment" for ODECO...'³⁸⁸

'Mr Colson then went on to say that he understood that runoffs could take a long time and as a result felt that selling Mentor would be a better option. Therefore, Mentor became the fourth oil company subsidiary to be pulled out of the Bermuda insurance scene. Phillips withdrew Walton Insurance in January 1983. It was followed last October by Exxon, who stopped writing non-related business, and a month later by Gulf Oil's Insko, which pulled out of all underwriting.'³⁸⁹

When Walton, Ancon, Insko and Mentor withdrew, over US \$225 million in capacity was lost from the global market place. That alone is a significant indication of the role Bermuda played in the reinsurance industry, during the heyday when Bermuda captives were writing nonrelated busi-

³⁸⁷ *The Bermudian*, Focus on Business, January 1995, 'Fathers of Fortune', by Kevin Stevenson, pp. 2-4, 6-7, 12

³⁸⁸ *The Royal Gazette*, 26 February 1985, 'Mentor may be sold; its former chief quits'

³⁸⁹ *ibid.*

ness. Walton had some US \$103 million capacity, Mentor US \$57 million, Insko US \$51 million and Ancon US \$29 million.³⁹⁰

Mobil Corporation's unfavourable tax ruling

The Bermuda international insurance industry received another blow when the US Internal Revenue Service took another dig at the offshore captive industry in a ruling against Mobil Corporation. *The Captive Insurance Company Review* reported on this as follows—

'The United States Government argues in the Mobil case, successfully too, that premium payments made by a parent company and its affiliated companies to a wholly owned insurance subsidiary should not be allowed as a tax deductible expense because the burden of loss remained with the policyholders. And if risks remained within the "economic family" there could be no risk transfer and therefore by definition, no insurance.

'In the Mobil case, decided in 1985, Judge Merow said, clearly: "Any losses suffered by the insurance affiliates would be reflected on Mobil's financial statements. Conversely any profits realised by the affiliates benefited Mobil."

'Mobil's argument that the government's position conflicted with the legal doctrine of separate corporate entities was wrong, the judge said, because disallowing insurance premiums paid to captive insurance companies did not totally disregard the separate nature of corporate entities; it was instead an example of "reclassification of a transaction".

'Anticipating the rebuttal by Mobil's defence that tax payers and their attorneys had been led to the conclusion that the underwriting of unrelated insurance business by the captive is important to establishing the bona fide status of the captive for tax purposes, by private letter rulings from the Internal Revenue Service and a published internal IRS memorandum, the Government said "any informal opinion of the Inland Revenue Service to the contrary is clearly incorrect." (The IRS had, on record, clearly indicated previously that the per centage of unrelated risks was relevant to whether a captive was a legitimate insurance company.)

'The Government brief in Mobil was highly critical of the IRS, several of whose technical memoranda made the claim that an insurance transaction takes place when a captive wholly owned by the parent also accepts "substantial" unrelated business. "The underlying thought is that risk distribution effectuates risk transfer as a matter of insurance theory. This opinion, however, does not withstand close analysis."

'In building its case the Government cited prior revenue rulings, Federal Tax Law and previous court decisions. Its argument balanced two propositions:

- that an insurance transaction must involve risk shifting and risk distribution to constitute insurance;
- that sums set aside for self-insurance plans are not deductible business expenses.

'Mobil's payments to its captives were essentially self-insurance, the Government said, since the company retained risk. "Whether the tax payer retains its exposure merely by a formal accrual on its books and records or engages in an elaborate device through the use of unrelated corporations and wholly owned affiliates, where risk has in reality been retained, insurance does not exist as a matter of Federal Tax Law. And that is precisely the situation in this case."³⁹¹

Although the ruling against Mobil undoubtedly created complications for companies wanting to set up single parent captives, industry sources in Bermuda did not think it would have a negative impact on the island. Their reasoning was based on the fact that the Mobil ruling only reinforced case law established in 1941 when, in the LeGierse case, the United States first defined insurance

³⁹⁰ Speech by Clayton Cormier at the 10th International Captive & Reinsurance Forum, 14 March 1985, "The Outlook for Single Parent Captives"

³⁹¹ *Captive Insurance Company Review*, February 1988, 'The Gulf tax decision—a new direction for captives?' pp. 1–4

as the shifting and distribution of risks. Historically this definition had been a major reason for not citing or looking upon tax advantages as the principal incentive to establish a captive. There were many observers to witness that Bermuda had always viewed tax advantages as a secondary factor.

Bermuda begins to benefit from the hardening market

Despite the unfavourable Mobil ruling on captives and the fact of Mentor pulling out of commercial insurance, Bermuda finally began to benefit from the hard market. Rates were rising and reinsurers were starting to make up for the income they had lost through poor underwriting results and low premiums. Rob Rosser, Chairman of the Bermuda Insurance Underwriters Association (BIUA) and underwriter for the Risk Exchange, said that rates on facultative business were up by 300 per cent and premiums on treaties, which made up the bulk of Bermuda reinsurance, had increased by 40-70 per cent. However it was widely speculated that insurers would remain in the red until 1987. Ken Biersack, general manager of reinsurance company GTE Re, disagreed with Rosser and said—

‘There are some cedants who will probably never accept the security of a Bermuda company, but in general the shortage of capacity has given us a chance to participate in business we have not participated in before.’³⁹²

Jonathan Crawley, the President of Aneco, said—

‘Most of us have been selective. We sought business from other sources and did not trade with the companies that pulled out. Besides a customer does business with a professional reinsurer because he is happy with the company’s financial statement. He is not put off simply because the reinsurer happens to live across the street from Mentor.’³⁹³

Bill Pimm, Chairman of Marsh, said, ‘Bermuda has had bad press as a result of captives underwriting unrelated business. Our advice to companies is always to stay out of it.’³⁹⁴

The United States/Barbados tax treaty

While Bermuda was trying to move on and away from the bad press excited by the failures of insurance captives, Barbados signed a favourable tax treaty with the United States. This exempted American insurance companies based in Barbados from all United States federal excise taxes on premiums channelled offshore. One reporter’s take on the treaty was that it came at a price, that price being an exchange of information agreement with the United States.³⁹⁵

Other sources say that the favour shown to Barbados was in recognition of that country’s support for the American invasion of Grenada in October 1983. Other Caribbean as well as European nations strongly opposed US intervention in the Caribbean. So when the time came for Barbados to negotiate its tax treaty with the United States, a few extras were thrown in, notably the exemption from premium tax on business with Barbados. At once Bermuda faced a serious inequity.³⁹⁶

Former Premier John Swan, who came to office in 1982, later recalled how even in 1983 the United States ambassador to Barbados had set about to get the advance support of President Reagan for the Barbados Tax Treaty of 1986. Swan foresaw that if he did not act quickly the treaty benefits to Barbados could divert all insurance business from Bermuda to Barbados instead.

Bermuda still had a strong relationship with the United States on account of the US Air and Naval Base and also thanks to the goodwill of the American Consul General, Max Friedersdorf.

³⁹² *The Royal Gazette*, 12 August 1985, ‘We’re starting to swim!’, p. 12

³⁹³ *Financial Times*, 9 September 1985, ‘Underwriters now take a more selective approach to business’, by Roger Scotton

³⁹⁴ *ibid.*, 9 September 1985, ‘Underwriters now take a more selective approach to business’, by Roger Scotton

³⁹⁵ *Bermuda Sun*, 11 April 1986, ‘The captive insurance field, Barbados: rival or ally?’ by Roger Scotton, p. 9

³⁹⁶ Interview with Mike Murphy, 29 April 2002

Accordingly Premier Swan met with Friedersdorf to seek his advice and help, on how Bermuda could win over the government in Washington, so that Bermuda should be kept on an equal footing with Barbados. Believing that the Commander of the American Base would have some authority to advise Washington on a matter touching national security, he also met with that officer and discussed the strategic importance of Bermuda to the United States.

Swan further decided to call on relationships he had developed in Washington through the Bohemian Club, formerly known as the Young Presidents Organisation, to get him an audience with the President. His decision to go to Washington met with grave reservations from some of the main players of the Bermuda business community. These players were anxious that Bermuda should keep a low profile in respect of taxation. Arguments back and forth became acrimonious.

Seeing what he was up against, Swan enlisted those who had seen things as he did from the beginning. Their voices, added to his own, gradually convinced the doubters. A plan began to take shape and many more came to understand the significance of the Treaty.

When, through the good offices of Friedersdorf, Swan was at last granted an audience with President Reagan, he went to Washington well prepared. He knew that he would have only this one opportunity to fight for Bermuda's cause, so he played every card that he could. Among them was a letter that he presented to President Reagan.

The writer of this letter had been none other than George Washington and in it he asked the people of Bermuda to support Americans in their fight for Independence, by obtaining for them a supply of gunpowder from Britain and by having two ships stand off Bermuda, ready to be called upon as needed. Washington's letter promised as a quid pro quo that, if the Bermudians complied with his request, the independent American states would always be there to help Bermuda as and when they were needed. The Bermudians had complied with his request, in the belief that Bermuda stood to benefit from a future relationship with the colonies, once these were independent of Britain.

Swan's purpose was obvious. In bringing to light this tiny fragment of history he implied that the time had come to recognise a relationship and to return a favour, by ratifying the proposed United States/Bermuda Tax Convention. Reagan discussed this with his Vice President, George Bush Sr., and also with his senior Cabinet colleagues. Swan later said the Vice President became so strong an ally that words could not express just how vital was the role he played.

After these interdepartmental discussions President Reagan told Swan that he appreciated both what Bermuda had done by helping the United States in the past and what Swan was trying to do for Bermuda now. He would urge Congress to ratify the Convention.

Unfortunately, by the time the executive branch of the United States Government had concluded its negotiations with the Bermuda Government, the Republicans no longer held a majority in the Senate. President Reagan could not determine the fate of his proposal. He told Swan that ratification would be difficult and advised Swan to use his own friends in high places to influence Congress. He also advised that Swan should seek British support, Bermuda being a British Dependent Territory.

With no time to waste Swan went to England, met with Prime Minister Thatcher, advised her of the situation and asked whether, in view of his strong, high-level support in Washington, including that of President Reagan, it might not be more effective if the Government of Bermuda were allowed to continue direct negotiations with the United States, rather than having to observe the standard protocol of going through Foreign Office channels.

Swan and the Prime Minister were well aware that if Thatcher approved his request this would be the first time that the government of a Dependent Territory had authority to negotiate independently with a world power. Fortunately for Swan, Thatcher understood the significance of what he was attempting and was supportive of his endeavours. She accorded him the authority he asked, so that he could secure the Tax Convention.

Upon his return to Bermuda, Swan held several meetings with the business community, to report upon progress and to enlist their support. He set up a large, broad based, special committee, comprised of members from the private sector and from government, as well as representing the concerns of individuals and professionals related to the industry. Swan himself took the chair.

Mike Murphy of American International Group played a vital part in keeping up the momentum and in guiding the committee as to the correct protocols of dealing with Washington. The Bermuda Government also secured the services of a Washington lobbyist who was an essential part of the process. Eventually Bermuda was successful in its efforts to convince the Senate but still had to wait until 1986 for word that the Convention had been ratified.

ACE is formed

While all this was going on Bob Clements, having gained enough client support to form ACE, decided to organise study groups for the sponsors who had given commitments that they would be ready when it came time to invest. In exchange for their commitments, the sponsors were all guaranteed an ACE policy with US \$100 million in limits.

The original design of ACE was chiefly the work of highly skilled brokers within Marsh, a group that included Myra Tobin, Bob Redmond, Tom Keaty, Vince Stahl, Paul O'Donnell, Phil Brown, Paul Goularte, Al Holzgruber, Tom Clarke and Bob Newhouse (whose idea it was to add Directors and Officers to the concept, so as to expand and speed up the number of customers). The group held two or three potential sponsor meetings in Bermuda and every sponsor was promised a Bermuda seat as another incentive to join. Marsh invited critiques from all of them and brought them up to date on the raising of capital. These meetings became very important in getting the concept of ACE under way.

By this time they had produced a very strong prospectus, in compliance with the regulations set down by the United States Securities and Exchange Commission (SEC), to help prospective clients and investors to understand the premise of ACE. Even more important and effective than the prospectus itself was the decision to develop *The ACE Program, a Marsh and McLennan Idea*, this being a booklet of questions and answers concerning the details of the formation of ACE. Clements himself emphasised that this booklet became an integral part of the promotional campaign.

ACE was finally incorporated in August 1985 with US \$280million, of which US \$10 million came in unexpectedly, by wire transfer from Dupont, who had not till then shown any interest at all. The mission statement of ACE was to provide high-level protection and stability of cost for general liability, Directors and Officers (D&O) liability and fiduciary liability insurance, following the withdrawal of capacity from the conventional markets.

All of the original sponsors were issued with a policy on the opening day of ACE. The original sponsors were 34 of the largest United States companies. Despite not having reached the targeted US \$400 million in capital, it was decided to raise the remaining capital by allowing non-sponsor companies to buy US \$1 of stock for every US \$1 of premium that they paid as an ACE policyholder. Clements recalled that none of the original sponsors thought they would earn money off the ACE concept and therefore had all expensed the funds invested in ACE as a cost of insurance! In the beginning they sold stock at US \$100 per share. As it became more evident that ACE was going to be a success, they raised the share price to US \$200 per share and then to US \$240 per share because they wanted to create value for the initial investors.³⁹⁷

Clements stresses that the decision to put ACE in an offshore domicile had nothing to do with income taxes. In fact, as confirmed by the Insurance Information Institute, the net federal income tax paid by the entire insurance industry in the 10 years preceding 1985 was US \$ zero! The deci-

³⁹⁷ Interview with Bob Clements, 10 December 2002

sion was justified by the fact that an onshore United States domicile would have made it impossible to use the new policy form and this would have required subjecting the company to an approval process that could have taken several years. The problem in the global insurance industry was acute and urgent, too much so for it to be held up by bureaucracy. Hence the decision to set up ACE offshore.

Because of the convenience of travel to Bermuda and because of its infrastructure, Clements wanted to set up ACE in Bermuda. However when Clements enquired about headquartering the company on the island, he discovered that Bermuda had exorbitant stamp duty requirements. Since ACE would be investing many more times the capital than had ever been invested in Bermuda before, Clements assumed that there would be some recognition to reduce the tax burden. Therefore he asked CD&P, Bermuda's large law firm, what the discount on stamp duties would be for a company with US \$400 million in capital. They checked and came back with word that there was no discount! Clements then told Ike Kohn, of Cahill, Gordon & Reindel, to incorporate the company in the Caymans. Kohn went to ask the Finance Ministry of the Caymans what their stamp duties were and was told there were none.³⁹⁸

So Bermuda lost out to the Caymans, because in 1984 its stamp duty for incorporation was, in the words of *The Royal Gazette*—

'...based on a quarter of one per cent of a company's capital. At that rate, ACE would have been liable for duty of US \$500,000...The Caymans by comparison are believed to charge a nominal duty plus a registration fee of up to US \$2,300.'³⁹⁹

Once Clements had the green light from the Caymans, he advised the Bermuda government that he did not wish to complete the application for Bermuda incorporation because ACE could not afford the stamp duty and would therefore incorporate in the Caymans. The Bermuda government then called CD&P and told them that if ACE was really going to incorporate in the Caymans, it would reduce ACE's stamp duty to US \$25,000 instead of the US \$500,000. However Clements was afraid of what the Bermuda government could do to ACE, once it was domiciled there, if it could change its stamp duties around so quickly and in such an arbitrary fashion. He also wanted to keep flexibility by having ACE incorporated in two different jurisdictions, just in case one should become unstable. He elected to incorporate in the Caymans, with a branch office in Bermuda. A further advantage, from a risk management point of view, was that by being in both jurisdictions he was hedging his bets, since it was highly unlikely that the Caymans and Bermuda would act together in unison. He also ended up with a foothold in Barbados, the only country south of the border that had supported the United States invasion of Grenada.⁴⁰⁰

The decision to incorporate ACE in the Cayman Islands came as no surprise to the Bermuda International Business Association (BIBA). This is the body that represents Bermuda's bankers, accountants, lawyers and other professionals who service international companies registered there. BIBA had been working to revamp the current stamp duty requirement, on the grounds that it was losing Bermuda valuable business. John Campbell, chairman of BIBA and a partner at Appleby Spurling and Kempe said—

'the whole issue of stamp duties must be addressed with some priority. Stamp duties have a substantial impact on the cost of doing business in Bermuda and can act as a disincentive to incorporating here. But it is difficult to prove that a business has decided not to come here. All that happens is that we hear that a company has formed outside of Bermuda.'⁴⁰¹

³⁹⁸ *ibid.*

³⁹⁹ *The Royal Gazette*, 20 August 1985, 'Island loses out on big insurance firm'

⁴⁰⁰ Interview with Bob Clements, 10 December 2002

⁴⁰¹ *The Royal Gazette*, *op. cit.*

At that time the Minister of Finance for Bermuda had the power to lower stamp duties but could not raise them. Faced with ACE's decision to go to the Caymans he decided that Bermuda could not afford, simply on account of stamp duties, to lose any more such reputable companies to other jurisdictions. In 1985 regulations were introduced in Bermuda whereby insurance companies need pay only US \$25, 000 in the aggregate for stamp duties. A far cry from half a million!

Then in 1990 the Stamp Duty Relief Act was passed, which relieved all exempted companies from stamp duties, so as to put Bermuda on the same footing as other jurisdictions elsewhere. Not only did ACE change the way insurance would be purchased around the world, it also changed the Stamp Duty requirements of Bermuda for all companies coming in after 1985.

Although ACE was incorporated in August of that year, it did not write its first piece of business until the November. According to Rosemary Jones of *The Bermudian*—

‘The first Chairman of ACE Limited well remembered writing his first official policy in temporary headquarters at the Hamilton Princess Hotel. It was November 1, 1985 and John R. Cox was a one-man-band, exhorting blue-chip clients to help him forge a corporate legacy. “The hotel room was 348,” recalls the jocular, snow-thatched New Jersey resident, the first and only employee of ACE for several months after it was incorporated. “We had quite a few customers and all of them obviously wanted policy number one. I decided no one should get it, so the first policy I issued was number 348...People say I was the father of ACE, but I tell them, ‘No, Clements was the father—I was the mother,’ quips Cox. “I raised the brat!”’⁴⁰²

Although John Cox was at first a one-man show, he received vital technical and clerical support from Marsh's Bermuda office, which supported every one of Clements' operations ever since and which, according to Clements, provided a remarkable flow of employees to the Bermuda international insurance industry.

Once ACE was in business, and the sponsors were given their quotes so that they could get their policies as promised, ACE decided to hold briefings for brokers to help them understand the ACE concept. All of the brokers reacted supportively except Sedgwicks, who announced that ‘this shaky company in Bermuda does not meet our requirements and therefore is not on our approved list for clients’. However, once big clients of their own, namely ICI Pharmaceutical, Beecham Pharmaceuticals and British Oil, left them for Marsh, which offered access to ACE, it turned out that Sedgwicks did not find ACE so wanting after all.

Trenwick redomesticates to the United States

By the end of 1985, when the senior management of Trenwick drew up their business plan, they realised that they had not done as well as they had anticipated. The captive market was not significant enough for them to grow. They concluded that a better place for them would be found in the United States, specifically in the treaty and facultative business. They implemented their decision to redomesticate by buying a shell company called Trenwick America.⁴⁰³

Bermuda starts to grow up

Stuart Grayston, president of Hanna Insurance Management and Bermuda Independent Underwriting Association (BIUA), saw the silver lining through the dark cloud that still hung over the island. ‘Bermuda,’ he said, ‘has started to grow up. It has come of age and it is a real honest to goodness insurance centre. It has come through its first crisis, it has come through its first series of insurance failures.’⁴⁰⁴

⁴⁰² *The Bermudian*, Focus on Business, January 1996, ‘ACE, the First 10 Years by Rosemary Jones’, pp. B25–B32

⁴⁰³ Interview with Bob Cooney, 13 March 2002

⁴⁰⁴ *Financial Times*, ‘Report on Bermuda’ 10 December 1985, in *Financial Times* survey

Despite the initial bad press that Bermuda had received as the result of the several company failures, by the end of the year Verbena Daniels, Registrar of Companies, reported that gross premiums for the international insurance industry were up by 33 per cent over 1984. The industry had gross written premiums in excess of US \$10.134 billion. Net premiums were up by 48 per cent over 1984 at US \$8.08 billion. Total assets rose modestly by 11 per cent to US \$24.54 billion and capital and surplus rose three per cent to US \$10.2 billion. The island also reported a total of 72 new insurance companies incorporated as compared to 37 voluntary liquidations.⁴⁰⁵

As reported in *The Royal Gazette*, in 1986, Mr Rob Rosser, head of the Risk Exchange Association and Chairman of the Bermuda Independent Underwriters Association, took the position that there was no such thing as a 'Bermuda market' in itself, that while Bermuda might be exceptional, it was not unique, and that its problems were not peculiar to Bermuda alone. He went on to describe the state of the market as follows—

'There may have been a Bermuda market when our captive companies were writing a lot of non-related business, back in the late seventies, and it was beginning then that we grew too fast, too soon and at the wrong time. Bermuda is now as it should be. It is a place where there are companies in the business of reinsurance and insurance—just like Chicago, just like Los Angeles, just like New York or London...'

Rosser warned that what went on in the rest of the world was of vital importance to Bermuda and that the local problems were not to be viewed in isolation. 'We are no different,' he said. 'What affects them affects us. And I am darned tired of the Bermuda-under-the-microscope syndrome.' He noted that 12 professional reinsurers had pulled out of the United States market in the past year, that underwriting rooms at Lloyd's had been closing in London 'by the day' and that just the previous week four syndicates had withdrawn from the New York Insurance Exchange. 'Innocent and incompetent capacity are not to be found only in Bermuda, but in all the major insurance centres of the world... We've had our Mentors, and our Waltons, and our Cambridge Re's,' he said, referring to three of the more controversial withdrawals from the industry over the past three years. 'We've had our troubles. Just like everybody else. And just like everybody else, retrenchment is the order of the day.' The underwriter said the past seven years had been bad, but they had created opportunities for those companies that were still around and also for the newly formed companies that were unencumbered by the emergence of unknown losses still lingering from the last cycle. '...If we have the strength and the stamina to absorb whatever tail (the after effect of previous business—*ed.*) is out there and the willpower to disregard cash flow underwriting... and to aim at an underwriting profit no matter how far in the future, then we can only be the beneficiaries of current developments.'⁴⁰⁶

Ironically perhaps, Bermuda's social atmosphere was by contrast uneventful. There had been a violent armed robbery and the murder of a shopkeeper in the summer of 1985 but thereafter the rest of the year was spared unrest or any more incidents.

⁴⁰⁵ *The Royal Gazette*, 27 November 1986, 'Insurers top \$0 billion mark', p. 33

⁴⁰⁶ *op. cit.*, 21 November 1985, 'Insurance industry came too far, too fast, too soon'

CHAPTER 35

1986 Excess

Captives on the rise again

In 1986 and 1987 the Risk and Insurance Management Society (RIMS) in the United States surveyed its members to evaluate current market conditions. For 1986 28 per cent of the respondents indicated that they had experienced premium increases of over 500 per cent for umbrella/excess policies, 18 per cent had undergone a 75 per cent reduction in policy limits and 17 per cent had been obliged to accept claims-made coverage. The position for Directors and Officers liability and environmental impairment liability was even more dramatic and in many cases coverage was unavailable.⁴⁰⁷

1986 proved to be a year for excess liability company formations in Bermuda because it was then that several heavily capitalised excess liability companies were formed to take advantage of the significant price increases available to this segment of the business.⁴⁰⁸ 125 new international insurance companies were formed in 1986, more than in any other year except 1977 and 1976.⁴⁰⁹

Ironically, such news came at a sad time, because one of the most visionary men of international business in Bermuda, Sir Henry Tucker, Bermuda's first government leader, died on 9 January 1986, just when Bermuda was about to take off as a true centre of international insurance. Sir Henry did not live to see the fruit of all his hard work and effort.

In the rest of the world, clients and brokers around the globe complained that the January 1986 commercial property and casualty renewals were the most difficult ever. All clients felt the effects of rate hikes across the board. In a market like that, clients seek to self-insure through the use of captives and Bermuda was more than ready to respond to this renewed interest in captives, indeed was thankful that the four-year decline in captive formations had finally come to an end. This turnaround showed just what a difference even one year can make!

Consequently, captive insurance company formations were on the rise again, despite fears that Barbados heralded growing competition among offshore domiciles. Verbena Daniels, Registrar of Companies said, 'It's the state of the insurance market in the United States and elsewhere. People have not been able to get cover.' Brian Hall, President of Johnson and Higgins (Bermuda) Ltd., said Bermuda was seeing substantial incorporations because of the constraints in the conventional market, and the continuing need for alternate ways in obtaining coverage. 'It is my feeling that Bermuda has matured and reached certain established standards. We continue to be seen as a premier, if not the premier, offshore environment.'⁴¹⁰

⁴⁰⁷ *Captive Insurance Company Review*, October 1987, 'A Market Review', p. 1

⁴⁰⁸ *Review of the Bermuda Insurance Regulatory System by the Filings & Acts Subcommittee of the Insurance Advisory Committee*, December 1993, revised 5 April 1994

⁴⁰⁹ *The Royal Gazette*, 19 February 1987, 'Island can stay in front, says insurer', p. 17

⁴¹⁰ *op. cit.*, 20 May 1986, 'Strong growth in the formation of captive insurance companies', p. 20

Insurance Advisory Committee revamped by Brian Hall

In 1986 Bob Baker announced his intention to retire and therefore a new Chairman of the Insurance Advisory Committee (IAC) was needed. By that time, the Bermuda underwriting scene had shrunk dramatically, as many Bermuda markets stopped underwriting, and some went into voluntary or involuntary liquidation. Baker recommended that his successor be from the captive management community, which was still growing. As a result, the Financial Secretary, Mansfield 'Jim' Brock, approached Brian Hall, the captive managers' representative on the IAC, to take over at the end of the year. Hall confirmed that he was interested in this but he wished to propose amendments to the whole system before he formally accepted the position. He felt strongly that it had become a bureaucratic nightmare, with some 50-60 private sector representatives involved and meetings some three times a month. On top of that attention had to be paid to the Official Secrets Act, which forbade the members to discuss with their peers what was happening in the meetings. Hall presented his proposals for a reformed IAC and the Ministry of Finance accepted it. Accordingly, on 1 January 1987, Hall became the second Chairman of the IAC.

His first task was to reduce the membership and disband some of the committees that he thought redundant, among them the Insurance Executive Council. 'The revised system includes the IAC, half a dozen working groups each consisting of four members and each with its chairman on the IAC, and an industry think tank chaired by Brian Hall that will be able to call on four standing review committees for advice.' Hall's reasons for making drastic changes to the system were that 'with the recent reductions that have taken place and the important changes the industry has undergone, we needed to alter the system and make it far more flexible and responsive.'⁴¹¹

With Hall's changes, the industry sector was represented by the IAC member and his alternate, who observed the Official Secrets Act, and the Executive of the Sector Association namely managers, underwriters, brokers, et cetera, and dealt with the sector's business agenda and representation. Several specialty committees were established from within the IAC membership, dealing with such things as Acts and Regulations (amendments), Insolvency, and later Marketing. Hall also proposed that the IAC needed a full trusting exchange with the industry. Therefore he established an Annual General Meeting of all industry representatives to review progress and gained benefit from industry input for new agenda items. This structure still prevails today.⁴¹²

IAC enquires into reason for failures

In the mid 1980s, the Insurance Advisory Committee enlisted the services of Bob Steinhoff, of Butterfield & Steinhoff, to research and analyse the reasons why companies had failed in Bermuda. Steinhoff determined that most of the failures came as a result of companies under-reserving their losses and underpricing their risks, rather than from poor investments. As a result of these findings, Bermuda became one of the first countries to require actuarial certifications/opinions as a part of the regulatory process, instituting this requirement well in advance of Canada and the United Kingdom. Along with the United States, Bermuda was a pioneer of the concept.

One of the features of the insurance regulations was that an actuary had to be involved in estimating loss reserves for insurance companies wishing to incorporate in Bermuda. Using historical experience an actuary projects ultimate losses as a way of estimating the appropriate price for undertaking a risk. In other words, actuaries determine incurred but not reported losses (IBNR).

Because it was determined that the failures of insurance companies on the island had nothing to do with their investment choices, the regulatory authorities in Bermuda decided to avoid dra-

⁴¹¹ *Bermuda Sun*, Business, 14 February 1986, 'Insurance watchdogs shake up', by Roger Scotton, p.9

⁴¹² Notes from Brian Hall, 29 May 2002

conian regulations of premium investment, with the result that Bermuda is able to give insurers more freedom as to how they invest their assets.

Before reaching conclusions, Bermuda looked at the various approaches of foreign regulators to investment, particularly regulators in New York. After studying the regulations, the Bermudian drafters decided that it was inappropriate for the types of companies that had established on the island. They found that the foreign regulations often involved long processes but did not involve what they considered to be regulatory value. The foreign regulations limited the choice as to where companies could invest and controlled the wordings of insurance policy. This process did not suit Bermuda's drafters at all. They then looked to the United Kingdom where they found that insurance companies needed to file an annual return with pages and pages of statistics, which was very costly to prepare but again was without much regulatory value. They decided against this system also. Instead, they focused the regulations on external audits and actuarial reviews and that approach did prove to be fruitful.⁴¹³

Pinnacle offers new coverage in light of market conditions

Pinnacle, the leading specialist in financial reinsurance, decided to offer a new coverage to desperate ceding companies, called 'prospective timing risk' contracts. Under these contracts, Pinnacle agreed to pay losses up to an aggregate limit, as claims covered by the contract arose, and priced the contract in the expectation that it would pay up to the aggregate limit. If it did not, then the ceding company received a commutation with a profit commission.

Jonathan Crawley redefines the Bermuda reinsurance industry

In the aftermath of Bermuda's reputation having been severely damaged by the activities of third party underwriters of the late 1970s and early 1980s, Jonathan Crawley, President of Aneco, redefined the reinsurance industry. In a speech delivered to the 10th Annual Risk Planning Group Forum on 13 March 1986, he described the 'new' Bermuda reinsurance industry as a 'Captive Insurance Company Servicing Industry' (CICSI) and said—

'We all of us who work here and have anything to do with captive companies are providing them, the captives, with services—we are serving and servicing them—whether we are Bermuda Government providing legislation to create the right legal and fiscal environment, or Bermuda's three full-service commercial banks; banks providing banking for exempt(ed) company business: three profitably and conservatively run banks, deposit-rich suppliers of funds to the interbank markets; three banks with combined total assets of over five billion dollars, creating an international investment centre, three banks which are sophisticatedly computerized to provide a broad spectrum of corporate and trust services;—or whether we are Bermuda's 50 management companies or accounting and auditing firms or Bermuda's law firms or Bermuda's insurance brokers or Bermuda's reinsurance underwriters—we all of us, in varying degrees, literally depend upon servicing exempt(ed) companies and especially captive insurance companies, for our livelihood.

'...I believe that over the past eight years Bermudians became temporarily confused by the move into international reinsurance business by a large number of large captives. Bermuda's position as the captive company capital of the world seemed for those years to be obscured or even to be being replaced by what was to some an even dizzier label—the worlds' third reinsurance centre.

'Underwriters and brokers with famous names settled here or paid frequent visits here—the international insurance and reinsurance world came to chinwag in the coffee shops of Lime Street and John Street about the capacity of the so-called Bermuda market and spokesmen for the so-called Bermuda market were invited to speak at international conferences on both sides of the Atlantic.

⁴¹³ Interview with Bob Steinhoff, 4 April 2002

'Drawn by the new label and the presence of new capital and surplus, Bermuda's shores became plundered and pillaged by a breed of adventurers new to Bermuda—adventurers called brokers, a lot of whose ancestry ran straight back to those sixteenth century pirates Blackbeard and Henry Morgan, who had also sailed to this part of the world in search of booty.

'As more brokers opened offices here and more captive companies employed underwriters, and deputy underwriters, and assistant underwriters, and other underwriters and took on books of international business, new office space in Hamilton started to spring up around City Hall car park—people even discussed alternative locations in Hamilton for an underwriting room on the lines of Lloyd's—the executive housing market went through the roof—in short it seemed that Bermuda might indeed have become the world's third reinsurance centre and its role might indeed have changed.

'But change it had not and Bermuda had perceived that the steady light and the rude health in which the industry had so flourished prior to, say, 1977, is a light and health which for some eight years came temporarily to be eclipsed by a much cruder spotlight which the outside world beamed onto a few of Bermuda's captive companies as they burst into international business. It was in fact the very intensity of that cruder spotlight which (a) hastened the burning out of those few companies, and (b) frightened away many more companies and (c) caused the spotlight to burn out as suddenly as it had lit up.

'The burning out of that crude spotlight, that is to say the cessation by a few large captive companies and by brokers from both sides of the Atlantic of trying to make Bermuda into something that it never asked to be, nor wanted to be, today finds the various elements of Bermuda's captive company servicing industry looking at each other with smiling nods of quiet relief and of warm recognition.

'There is a marked atmosphere here of revitalized interdependence and of renewed self-confidence amongst today's generation of leaders brought about by their having been able to put the comings and goings of the last eight years firmly into perspective.

'So Bermuda's fundamental role had not fundamentally changed at all.

'And from that fundamentally unchanged base, Bermuda's matured captive company servicing industry is now into a new era...'⁴¹⁴

ACE—the new market leader

The new era came into being differently from the way Crawley had predicted, but come it did. Despite Bermuda's tainted image ACE Insurance, registered in the Cayman Islands but managed from Bermuda, proved to be the market leader in providing liability insurance. ACE saw its writing of premiums jump from US \$300 million, with 50 policyholders who were also shareholders, to between US \$460 million to US \$470 million and 125 policyholders, all in just a few months. Fifteen of the Dow Jones 30 were insured with ACE.⁴¹⁵ The company was in the right place at the right time to take advantage of the lack of reasonable coverage that was available to clients.

Although it was originally chartered in the Cayman Islands, ACE opened a Bermuda headquarters the following year. According to John Cox, the company's first Chairman, ACE chose to come to Bermuda 'for more than economic reasons. Very simple—enlightened regulation. Everybody in the world said taxes—that we came here because there were no taxes. But taxes had no bearing on it. The reasons were regulatory.'⁴¹⁶

According to Bob Clements, Marsh had the most clients by far because of its client list. However it was difficult even for their clients to get an appointment at ACE at that time, because Cox was so overwhelmed that to get an appointment brokers had to add their clients' names to the

⁴¹⁴ Speech by Jonathan Crawley to the Risk Planning Group 10th annual forum, 13 March 1986

⁴¹⁵ *The Royal Gazette*, 19 March 1986, 'Shortage proves to be a boom'

⁴¹⁶ *The Bermudian*, Focus on Business, January 1996, 'ACE, the First 10 Years', by Rosemary Jones, pp. B25–B32

waiting list. Clements recalled that it was like a 'waiting list for liver transplants'—it was so difficult. Competition for appointments was so intense that a client would offer to switch his account from his regular broker to another if the rival broker could get him a meeting with ACE in time for a policy renewal. Marsh had the longest list of appointments.⁴¹⁷

When Joe Rego began working at Reed Stenhouse in 1986, XL and ACE were just starting up on the island. Because there was relatively speaking no international brokered business in Bermuda at that time, the brokerage department at Reed Stenhouse consisted of only two people—Rego himself and Bob Barclay. Within a short period, however, the brokerage environment in Bermuda changed so dramatically that Barclay and Rego were inundated with business before they knew what had hit them. The global insurance market was facing one of the toughest markets it had seen in years. Clients were desperately looking to find a home for their risks and because many United States insurers were not too keen to write certain exposures, Bermuda became overnight the place to go.

Rego says his introduction to the brokerage world was definitely through 'trial by fire'. He was thrown into the deep end. All types of submissions were coming in—from D&O to Excess Liability and mostly from large *Fortune 500* companies. He says that he and Reed Stenhouse were totally unprepared for the large amount of business that was coming their way, especially since Reed's book of business had consisted mainly of medium sized corporations and not of clients the size of the *Fortune 500*. He also says that few in the industry took Bermuda seriously in those days. Many saw Bermuda as a short-term affair, a way to take advantage of the US hard market, nothing that would last. Even his own head office had no wish to build up a brokerage office inside a bubble, just for a nine days' wonder. As a result, Rego and Barclay did all the broking themselves, for years.

Then, after Rego had been barely a month on the job and as if to step up yet faster the pace of his introduction to the insurance world, his boss went away for a six-week holiday! Rego says sure, someone came down from New York as support but that still left him with a hefty workload. All the same, there are worse ways to learn a business than the tough old way of doing it yourself.

He recalls lining up outside room number 348 at the Hamilton Princess to have underwriting meetings. There were no handsome buildings for ACE and XL then, no well appointed offices, no teams of skilled supporting staff. To the outside world John Cox was all of ACE Insurance then. Business was conducted from hotel suites, from Cox's number 348 in particular, using just the old insurance principle of 'utmost good faith.'⁴¹⁸

John Cox and Bill Loschert were the main underwriters for ACE. They saw clearly that they could not handle the workload on their own. Ancon had announced it would be leaving Bermuda and this prompted Cox and Loschert to invite Larry Lombardo over from Ancon to ACE. Lombardo was willing but at the same time was so much valued by Ancon that they asked him to give them another six months. This was agreed with ACE and Lombardo moved over in May 1986 as the first Bermudian underwriter to work at ACE Insurance.

There was a frenzy of business coming in. Sometimes, when Lombardo looks back, he doesn't know how he managed it all, particularly since he was also studying to become Bermuda's first Chartered Property and Casualty Underwriter. Submissions piled up at the door. There were lunch meetings, dinner meetings and clients meetings, all through the first year in which he started working. At the same time, there was the need to develop systems and get things organised.⁴¹⁹

Lombardo recalls how Cox had a rule that he would write four medium to light accounts, such as hotels or universities, before writing one heavy one, such as pharmaceuticals. Brokers used to call to find out if ACE had reached its quota for softer accounts, to see if they could submit a tough

⁴¹⁷ Interview with Bob Clements, 10 December 2002 and 16 April 2003

⁴¹⁸ Interview with Joe Rego, January 2002

⁴¹⁹ Interview with Larry Lombardo, 19 March 2002

account. ACE moved from the suite at the Princess Hotel into the Craig Appin Building and John Cox would post up stickers as scorecards, showing how many of each different type of account had been written so far. Every time that ACE wrote a new account from the medium to light risks, Cox would put up the new number and so brokers would come regularly to check the scorecard, seeking to know if it was yet an opportune time for another tough submission.⁴²⁰

According to Bob Clements, at the end of its first year in operation, ACE had raised US \$400 million in total with no claims reported and expenses were very low. As a result, ACE had a huge pot of retained earnings, a loss ratio of zero per cent, a combined ratio of 16 per cent, and yet still had no competition. Moreover, in the outside world beyond the confines of ACE and Bermuda, the conventional market was continuing to shrink. Clients were having great difficulty buying US \$100 million in limits to reach the ACE attachment points. Once again, Clements was faced with yet another client problem because, as market capacity began to shrink, which caused major problems for policyholders and brokers.

Government joins with international sector to promote Bermuda at RIMS

The Bermuda economy felt the benefits that the new international insurance companies brought to the island. Lombardo of ACE said that Cox, Chairman of ACE, kept track of potential policyholders coming to the island during the months leading up to the formation of ACE. His tally averaged about 60 people a week. *The Royal Gazette* quoted Cox as saying that such visitors were a valuable source of income to the hotels, restaurants and retail stores of Bermuda and that although his company was not labour intensive its policyholders did spend a lot of money and would be returning each year for renewal. 'This invisible trend could contribute substantially to the Island's Gross Domestic Product, foreign exchange earnings and help counter the recent downturn in tourism.'⁴²¹

After the great success of ACE during its first months in Bermuda, more companies looked to establish on the island. *The Royal Gazette* reported that Bermuda had become, '...one of a handful of domiciles being considered for the setting up of an insurance company that would provide big corporations with hard to get higher liability insurance.' The *Gazette* quoted Andrew Carr, president of Marsh & McLennan as saying, 'Without the recent lowering of stamp duties, Bermuda would not have been in the running.'⁴²²

After the intense scrutiny to which the island had been subjected as a result of the failures in the captive industry, and given the advent of ACE and its peripheral support companies, the business community, led by Brian Hall, Robin Spencer-Arscott and Bill Thomson of the Bank of Bermuda, convinced the Bermuda government that, in partnership with the private sector, they needed to establish a presence at the Risk and Insurance Management Society (RIMS) Annual Conference. This is a worldwide organisation with thousands of members, primarily risk managers, who meet to discuss trends in the global insurance industry. And in 1986, the effort paid off.

The Bermuda government joined the private sector in helping to promote Bermuda at RIMS in Toronto. The government jointly hosted a Bermuda reception, had a Bermuda booth, distributed a Bermuda booklet and sent top representatives of the island to make a mark. Premier the Hon. John Swan, Finance Minister Clarence James, Permanent Secretary Mansfield Brock, as well as leaders of industry, and 25 Bermuda insurance companies, in short some 100 representatives of insurance and government, were all in attendance at RIMS.

⁴²⁰ Interview with Larry Lombardo, 19 March 2002

⁴²¹ *The Royal Gazette*, 19 March 1986, 'Shortage proves to be a boom'

⁴²² *ibid.* 'Top insurers eye Bermuda as stamp duties are lowered'

Said Brian Hall, Chairman of the Insurance Advisory Committee and President of J&H, 'The feeling is that we should take off our corporate hats and put on our Bermuda hats and present a united front. The private sector is delighted with the commitment Government is making.'⁴²³

It was indeed this gathering at RIMS that firmly established the link of partnership between the Bermuda government and the international sector. Both groups became aware of how essential it was that they work together in unity for Bermuda so as to negate the threats of other jurisdictions that were trying hard to eat away at Bermuda's business sector. Barbados was of particular concern at the time, given its tax treaty with the United States.

The XL idea

It so happened about then that Phil Brown of Marsh and Bob Clements had offices next door to each other. Whenever the two men had a break they would go over to the University Club and play squash. After a match they would chat for a while, as often as not talking about the state of the industry.

On one such occasion they were sitting in the locker room of the Club, talking about ACE and American Professional Excess (APEX), the company that was supposed to write professional liability, and the fact that the market was still shrinking.

Brown commented on the number of professional liability clients who were finding it extremely difficult even to get insurance coverage. There was an urgent need to address the requirements of those who were going bare (without insurance) between US \$25 million and US \$100 million attachment points—across the board moreover and not just in the professional liability sector.

At some time around December 1985 the two friends began working systematically on the concept of a company that would meet this need. They concluded however that it would be impossible for ACE to drop down below the US \$100 million attachment point without raising significantly more capital to fund the lower level of attachment. They decided to explore the possibility of doing so.

So as to discuss the issue in a sufficiently wide forum, they invited all the original sponsors of ACE to a meeting in Toronto. Ike Kohn, of Cahill, Gordon and Reindel, went with Clements and Brown to talk about the problem. They explained to the meeting that ACE would need additional capital of US \$500 million in order to write the US \$75 million in excess of US \$25 million limits and so reach the current ACE attachment point.

Clements and Brown wanted opinions as to the feasibility of raising the money but those opinions proved to be divided. Many of the very large companies that had been the prime movers at the beginning thought that, instead of reducing the attachment point, it was better for ACE to direct retained earnings and any new capital towards raising the limits offered to clients. The higher excess capacity would require the lesser amount of capital and thus would yield a better return on investment.

Eventually, after much discussion, the group came together and reached a unanimous decision. Rather than trying to bridge the gap of US \$75 million in excess of US \$25 million by reconstructing its own financial limits, ACE would give help and support to a new company created for the specific purpose of addressing the gap.

Many offered to invest separately in such a company and for Clements and Brown this was encouraging. The funding for the new company, known as XL Capital or commonly just as 'XL', was easy by comparison with the funding of ACE. Many potential policyholders actually volunteered to become sponsors of what they now saw to be a good investment as well as a sensible solution to a problem of insurance.⁴²⁴

⁴²³ *The Royal Gazette*, 11 April 1986, 'Business, Insurance chiefs gear up for RIMS'

⁴²⁴ Interview with Bob Clements, 10 December 2002

Not a good year for Premier Swan

The Bermuda Convention was finally ratified on 11 July 1986, when the US Treasury signed it into effect. However, its signing was not without complications. Because of the Bermuda connections, this bill had bypassed the House, and that proved to be a major *faux pas*. Dan Rostenkowski, then Chairman of the Ways and Means Committee, was incensed that a close friend of his, who was a lobbyist for Bermuda, should have acted with no reference to him, as Chairman of the Committee, nor to the House.

After the Convention had been signed, and under the guidance of Rostenkowski, Congress passed the 1986 Deficit Reduction Bill, which removed the benefit of excise tax by inserting a third level tax, thereby nullifying the benefits that would otherwise have accrued to the industry. Swan had no choice other than to announce that Bermuda's request had been denied. In a press release to the *Bermuda Sun* he said that—

'Despite a high level of support for our position, we regret that we have not been able to reach an agreement which would put Bermuda-based companies on the same footing as exempt(ed) companies in Barbados.'⁴²⁵

This announcement gave rise to a tide of disenchantment within the Bermuda business community and in Bermuda's print and broadcast media. As to the manoeuvres in Washington, there was a sense of betrayal. As to the performance of Premier Swan, his critics said that the whole charade had been nothing more than his personal pipe dream, this notion that Bermuda would get the benefits of a tax convention equal to what the Americans had granted to Barbados. Daily the media broadcast further reproaches of how the Premier was supposed to have blundered.

Swan was faced with a difficult juncture in his political career. Personal animosity might be shallow and contrived but he knew that in truth he was about to be tested and judged, not just by others but by himself, as to whether he really was a man of substance, whose beliefs and professions had foundation in fact, or whether he was just a 'wandering minstrel'.

At such a juncture, a man must observe a fundamental lesson if he is to survive. He must have faith in his own judgement and in his own strength. Swan determined that the aim of getting the Bermuda convention modified must not be abandoned. Rather he must fight harder than ever to get the legislation amended so as to throw out the third level of tax that nullified the benefits of the Convention. On this now depended not only the betterment of Bermuda's business endeavours but also his own sense of self-respect and determination of purpose.

With new drive and refreshed enthusiasm, Swan sat down to work out a strategy. He now saw clearly that if he wanted to get any modifications to the Convention he had to appeal to the House of Representatives, which was controlled by the Democrats. At the same time he had to work out an arrangement with the British government and lay out a plan with the assistance of people he knew in the US Congress to gain support to reverse the legislation that had been passed. And meanwhile the everyday burdens of Government must be carried on.

Dan Rostenkowski was still Chairman of the Ways and Means Committee. He continued to object to any legislation that would restore any benefits to the Bermuda Tax Convention. Rostenkowski still held a grudge because he believed that any arrangements with Congress affecting money matters must first meet with the approval of the Ways and Means Committee, even if merely as a formality or only in principle. The initial convention process had not followed this procedure. Senator Metzbaum joined Rostenkowski's fight to prevent any alterations to the convention, trying to use 'patriotism' as a lever for boosting voter support in his district.

⁴²⁵ *Bermuda Sun*, 11 April 1986, 'Tax Concessions—it's no deal', by Roger Scotton

Therefore members of the Senate and House of Representatives objected to removing any obstacle to convention benefits. Realising that he faced an uphill battle in the United States, Swan decided he needed to map out a strategy to keep up the fight for his cause in Washington as well as to be an effective Premier in Bermuda. For three years he led a double life. He did so to shield his efforts from the level of cynicism that had built up within the community about anything that John Swan might be trying to do. He would chair the Cabinet meetings on Tuesday nights, then fly out Wednesday morning on the seven a.m. flight to New York, take a shuttle to Washington and continue his fight there unbeknownst to the people back home. He felt he just could not tell his country, not even all his colleagues, what he was doing on Wednesdays. He would simply fly back on Wednesday nights and take the Chair for the Caucus meetings on Thursdays. He continued in this way until 1988, when he was at last able to reach an agreement with the United States.⁴²⁶

Not long after the announcement of the favourable concession being denied to Bermuda, Johnson & Higgins (Bermuda), at the behest of a major association captive client, established an office in Barbados to take advantage of the favourable tax treaty that allowed United States companies to set up in Barbados without having to pay federal excise taxes. The *Bermuda Sun* reported as follows—'J&H president Brian Hall and Shaun Reape set up a United States manufacturing group captive company, which would save one million dollars by setting up in Barbados instead of Bermuda.'⁴²⁷ When Swan learned of this, he became even more driven to make sure Bermuda did not lose its whole international business sector to Barbados because of the lack of a favourable Bermuda/US tax convention.

1986 United States Risk Retention Act

As if the growing problems with the tax convention were not bad enough for the island, in 1986 President Reagan signed into law a Congressional expansion of the Risk Retention Act. This allowed US risk retention groups to write directly for their members all commercial liability risks except for workers' compensation.⁴²⁸ Once this Act was passed, companies were exempted from many of the state laws that normally apply to insurance organisations. It also allowed a captive insurance company with a charter in only one State to provide liability coverage throughout all the other United States. The main intent of this provision was to ease the difficulty clients had in getting liability insurance and also to broaden the powers of US companies to handle their own liabilities within the borders of the United States. However there were many in Bermuda's international insurance industry who feared that the passage of this bill would be detrimental to Bermudian interests in that it would remove much of the incentive for US companies to set up offshore in order to handle those liabilities. This could in turn deplete Bermuda's largest customer base.

Tax Reform Act 1986

Closely following on the heels of the Risk Retention Act came yet another statute with ominous implications for Bermuda's offshore industry. The Tax Reform Act 1986 eliminated the tax break for United States association captives (captives set up by groups of US companies in response to high domestic insurance coverage or lack of insurance coverage). *The Captive Insurance Company Review* reported on the Act as follows—

'No longer could shareholders in the group or association captives who held less than 10 per cent of the stock defer taxes on their share of the captive's profits until it was actually paid out as dividends. The problem provision in the Act made the shareholders liable, irrespective of the size of their shareholding,

⁴²⁶ Interview with Sir John Swan, 19 November 2002

⁴²⁷ *Bermuda Sun*, 11 April 1986, 'The captive insurance field, Barbados: rival or ally', by Roger Scotton, p. 11

⁴²⁸ *Business Insurance*, Millenium Special Issue, 'A Timeline of Key Events in Risk Management'

for current year taxes on the offshore captive's income from insuring risks. Before the 1986 Tax Reform Act was passed shareholders who owned less than 10 per cent of an offshore group-captive's stock could defer taxes on the captive's profit until the profit was remitted home to the shareholders, an important incentive to go offshore.⁴²⁹

The Royal Gazette reported that the major difficulty surrounding the Tax Reform Act of 1986 was the definition of what constituted a Foreign Controlled Corporation (CFC) and how much of its income was taxable—

'Until the Act was passed, companies where United States shareholders (had) more than 10 per cent of voting stock were considered to be CFCs – and liable for taxation. The 50 per cent figure (see following paragraph) was reduced to 25 per cent if the company received 75 per cent or more of its premiums from United States risk premiums.

'United States shareholders avoided being in a foreign controlled corporation by having eleven shareholders—each holding less than 10 per cent of the voting stock—but with some shareholders holding large amounts of non-voting stock, or preferred stock. The law now makes companies CFCs if American shareholders own more than 50 or 25 per cent (see above) of the actual value of the company. This means companies that previously were exempt from United States tax must now re-structure their shareholdings or become liable to pay tax.

'Captive insurance companies could also avoid taxation if no shareholder held more than 10 per cent of the company—this no longer applies because any company which is owned 25 per cent by Americans is now liable to be taxed on income from premiums of United States risks.

'According to Peat, Marwick & Mitchell partner, Mr Ranson Jones, many United States shareholders of captives who fitted this description considered moving their companies back “onshore” with the arrival of this legislation because moving to the United States would exempt them from excise tax.⁴³⁰

Mike Murphy of American International Group said, “The 1986 Tax Reform Act eliminated a lot of the benefits for any insurance company that was operating in Bermuda to be here.”⁴³¹

The Captive Insurance Review had the following comments on the Tax Reform Act of 1986—

'With the passage of the Tax Reform Act 1986, technical corrections and the new “domestic” election, Bermuda captives are finding themselves playing more and more on the proverbial “level playing field” with United States insurance companies and captives. The decision of where to domicile a captive is being less driven by tax motives and more by purely economical and business reasons.

'Bermuda still has a strong competitive advantage over United States domiciles through less restrictive regulatory requirements, no premium taxes (which may range from .08 per cent to 10 per cent depending on the United States locale), established insurance infrastructure, and the professional expertise to service the industry.⁴³²

At first the Tax Reform Act of 1986 did force many United States companies to postpone establishing association captives in Bermuda because of the draconian wording proposed. Many feared it was to be the death of association captives in Bermuda and other offshore jurisdictions because the benefits of establishing offshore would be eliminated and companies would therefore be forced to move back to the United States. In addition, Vermont, Delaware and Colorado had all established legislation for captives to form in their states. Many feared the days of captives coming to Bermuda were over.

⁴²⁹ *Captive Insurance Company Review*, 16 June 1988, 'Exel's US \$60 million buy-back', p. 15, published by Risk & Insurance Research Group, London

⁴³⁰ *The Royal Gazette*, 11 December 1986, 'Moment of decision for captive companies', p. 35

⁴³¹ Interview with Mike Murphy, 29 April 2002

⁴³² *Captive Insurance Company Review*, December 1988, 'Limited Benefits for Bermuda from ratification of US treaty', p.4

The Bermuda government was also very concerned about the impact of the Tax Reform Act on the island. Therefore, in an impassioned plea to the Bermuda international insurance industry, Premier Swan told them to stick with Bermuda. Swan told the business community that Bermuda was serious about maintaining its position as ‘the insurance captive centre of the world’.⁴³³ Swan’s statement marked the first time that the Bermuda government had publicly acknowledged the gravity of the challenge that Bermuda now faced.

On the other hand, Fred Reiss was not too worried about the Tax Reform Act or the Risk Retention Act of 1986 and had the following take on them—

‘The tax reform act was not well thought out and the risk retention act does not include workmen’s compensation, D&O, or banker’s blanket-bond covers. Also, all States have the right to examine capital adequacy and that opens up lots of potential reporting requirements in the United States.’⁴³⁴

Why captives even after tax reform?

Just as Fred Reiss had refrained from endorsing the ‘doom and gloom’ scenario so likewise, once the final wording of the Tax Reform Act was available, Art Deters added his voice of reassurance. There were, he said, still several prime and incontrovertible reasons why the future of offshore captives looked good. Deters was President and CEO of International Risk Management Group, formerly the Reiss Group, now Swiss Re, and owner of Bermuda’s second largest captive insurance management group, with 90 captives and US \$600 million in annual premiums under management. He knew what he was talking about.

Reporting on an interview with Art Deters *The Captive Insurance Company Review* put forward the reasons for optimism as follows—

‘Captives should be viewed as long term solutions to insurance needs, a positive factor in considering an offshore domicile;

‘offshore centres have developed sophisticated infrastructures;

‘offshore centres such as Bermuda are considered ‘politically’ neutral, an important factor for the parent organization;

‘the issue of taxation remains an important consideration despite all efforts to minimise tax advantages by going offshore.

‘On the last, perhaps controversial point, Mr Deters said,

“Using a captive for tax avoidance (tax avoidance not tax evasion—the latter is illegal, the former is quite legal) is a “tactical” consideration for its owner, and it’s a sound approach...Forming a captive for tax avoidance reasons, a strategic consideration, underscore strategic, is unsound in my view.”

‘Mr Deters was unequivocal about captives set up principally to avoid tax. In his opinion they are doomed to failure.

‘The main tax issue for United States owners arises from the 1986 Tax Reform Act, of which Mr Deters said:

“Its impact was and is very widespread. Incorrectly, a lot of people in the insurance industry—but not deeply involved in the captive insurance segment of that industry—overestimated the impact on captive insurance companies. For example, they erroneously assumed that virtually all such companies were literally ‘tax-free’ from the United States point of view. The facts of the matter are that most captive insurance companies have seen tax advantages they may have enjoyed during the 1960s steadily eroded by a steady series of changes in tax laws, regulations and procedures during the 1970s.”

⁴³³ *The Royal Gazette*, 17 April 1986, ‘Stick with us, Premier tells insurers’, by Kevin Stevenson, p.1

⁴³⁴ *Bermuda Sun*, 7 November 1986, ‘An audience with the king of captives’, by Roger Scotton

'Since the early 1980s single parent offshore captives with United States owners have been in the same federal tax situation as domestic captives, Mr Deters said. The Tax Act had, however, drawn multi-owned captives into this same net, with the effect that some of them—those formed for the wrong reasons—have now disappeared.

Interestingly, Mr Deters pointed out that the effect of the Act in not allowing full deduction of loss reserves and unearned premium reserves will be much worse for conventional insurers because many of them have never paid and never anticipated having to pay significant taxes. The worst, for them, is yet to come, according to Deters.⁴³⁵

The American Excess Slip (AEIA) and XL?

At around the same time that XL was being formed in the Sandy Lane Hotel in Barbados by Brian Walford, on a consulting contract from Marsh & McLennan's Barbados office, AEIA was formed in the United States. Originally XL and AEIA (backed by the Hartford Insurance Group) were to be combined. AEIA was to be the United States affiliate of XL.

Clements recalled that AEIA presented Marsh with an odd situation because they originally thought that if they combined AEIA with XL they would have found the perfect way to form XL without alienating the rest of the insurance world. It also seemed like a quick way to put XL in business with a consortium of insurance companies behind it such as the Hartford, Aetna, Chubb, CIGNA and Crum & Forster. Clements talked to this consortium about forming a company to be called the American Excess Slip (AEIA) that would be reinsured by XL, which would allow XL to have access to huge distribution in the United States. If it had been formed in this way, XL would have been the passive player, while AEIA would have had the dominant presence. XL's only business would have been to write treaty business for AEIA, with XL assuming 75 per cent of the risk while AEIA would have 25 per cent.

Finally Aetna, the largest potential participant, agreed to discuss the concept, but only if Aetna itself were to be the lead underwriter. At the same time Aetna requested that Marsh appoint a co-broker in order to avoid any appearance of favouritism. Clements selected Johnson & Higgins for this role 'out of respect and admiration for Chairman, Bob Hatcher and Executive Vice President, Dick Meyer.' Johnson & Higgins was delighted to accept.⁴³⁶

However the joint effort fell apart when XL and AEIA could not agree on the definition of what constituted above ground and below ground pollution. The XL policy wording required claimant's awareness within seven days of a pollution incident with a limit of 20 days thereafter within which to report it to the insurer. The AEIA was very reluctant to cover underground pollution incidents especially in light of the growing number of gradual pollution claims in the United States, the advent of Superfund and the results of the Love Canal contaminations. The AEIA wanted 'named perils' pollution wording and not the '7/20' wording proposed by XL.

In the course of these discussions, Al Holzgruber, a Marsh & McLennan senior executive, picked up a glass full of water and poured the whole lot on the table. As the pool spread out wider and wider and soon was all over the table, he asked if that spill would have been covered as a pollution incident? Everybody said yes. He then said, 'Okay, but now the water's dripping down and spilling out beneath the table! Is this spill still covered?' No one answered. Al Holzgruber had demonstrated in a very simple way how difficult it was to separate an above ground pollution incident from a below ground pollution incident. The lingering question remained—just when does above ground pollution stop and when does below ground pollution begin?

⁴³⁵ *Captive Insurance Company Review*, October 1988, 'Good future for offshore captives', pp. 1–2

⁴³⁶ Interview with Bob Clements, 10 December 2002

After that demonstration, AEIA and XL went their separate ways. Marsh felt XL had the better wording. From that day on, AEIA and XL became competitors.⁴³⁷

Association captives continue to form

Despite all the alarms caused by Tax Reform and Risk Retention it was soon to be noted that the sky above Bermuda had not fallen after all. There had been rather more hot air around than was seasonal but several new companies were formed meanwhile and later in the year a group association captive, Corporate Officers and Directors Assurance (CODA) was established. The founders of CODA decided to set up in Bermuda despite the Tax Reform and Risk Retention Acts because they believed the benefits of operating in Bermuda far outweighed the disadvantages.

Fifty-three major United States corporations established CODA in response to restrictive coverage and increasing premiums for Directors and Officers liability risks. It was jointly sponsored by Johnson and Higgins and by Chase Manhattan Capital Markets Corporation. It was managed by Johnson & Higgins Bermuda Ltd. and was capitalised at US \$100 million.

After CODA had been established on the island, the next to arrive was the sister company to the property association captive OIL, which had been started in Bermuda in 1970. Kevin Stevenson of *Bermudian Business* reported as follows about the opening of Oil Casualty Insurance Limited (OCIL) in Bermuda—

‘The five-year period beginning in 1977 presented significant challenges to the entire petroleum industry, including the oil companies that comprised the membership of OIL. Despite a worldwide environment of inflationary pressures coupled with double-digit interest rates, in many respects it was the best of times for oil companies.

‘Unrest in the Middle East drove crude oil prices from US \$13 to US \$34 a barrel during 1977-1981. The increased profitability of oil companies resulted in boom times for the industry. Capital expenditure levels soared with oil companies investing in both traditional oil and gas projects as well as embarking in aggressive capital programmes of diversification outside the petroleum industry.

‘Despite the industry’s strong financial performance, participants in the stock markets severely undervalued the equity securities of various oil companies. As a result, oil company executives conclude it was cheaper to replace oil and gas reserves on Wall Street as opposed to using drill bits. An ensuing merger binge was set off in the early 1980s, which impacted many members of OIL.

‘In the mid-1980s, changes were taking place within the commercial insurance industry, which had broad implications for the major oil companies. Many United States companies and key Lloyd’s underwriters began to realize the full implications for their balance sheets of long-tail liability products and environment exposures in the United States. Also, ever-increasing litigation was taking place against the officers and directors of American corporations.

‘As a result, an insurance crisis developed in the mid-1980s, which led to a sharp contraction in the availability of affordable excess liability and directors’ and officers’ (D&O) liability insurance. With strong leadership and support from petroleum companies, new capital was invested in start-up insurance facilities in Bermuda, including ACE and XL Capital. OCIL was established by sixteen OIL members in 1986 specifically to provide both excess liability and D&O insurance to members of the petroleum industry.’⁴³⁸

Not far behind OCIL came School, College & University Underwriters, Ltd. (SCUUL) to provide excess liability cover for United States education. SCUUL was formed by fifty-eight educational institutions after they failed to find in the United States commercial insurance market the

⁴³⁷ Interview with Bob Cooney, 13 March 2002

⁴³⁸ *Bermudian Business*, Spring 1999, ‘OIL’, by Kevin Stevenson, pp. 66–77

coverage they needed for excess general liability and educators' legal liability (the educational profession's equivalent to Director's and Officer's).

Then at the end of the year the world's first satellite mutual insurance association was formed in Bermuda to insure Arianspace Agency launches. *The Royal Gazette* reported on this most unusual captive as follows—

'Mr Giles Plowden, a partner with Charles Taylor (Space Risks) Ltd., said the company was formed after insurance capacity in the commercial market and through Lloyd's dried up. Satellite launches have traditionally been covered by a Lloyd's syndicate or on the commercial market, he said, but with a series of space disasters and satellite losses in the last year, premiums have increased and capacity has shrunk in traditional insurance markets. "The object of the Association (was) to provide capacity additional to that available in the commercial market to those seeking to launch satellites with Arianspace," a Charles Taylor press release said. Mr Plowden said there (were) no plans to insure launches by either the National Aeronautics and Space Administration (NASA) or the Chinese Government. The high cost of premiums and the cuts in insurance capacity follow a series of satellite losses, which hit the traditional insurers badly, including the loss of two satellites when an Arianspace rocket exploded earlier in the year. Instead of a single syndicate of the satellite taking the burden of the loss, a group of mutual members share the loss.⁴³⁹

The Mentor saga

Just as Bermuda was setting out at large in the global insurance industry, the wind was again taken out of it sails when the details emerged of events that led to the controversial collapse of Mentor Insurance the previous year—events that prompted liquidators to sue Mentor's parent company and its directors for about US \$500 million.⁴⁴⁰

Allegations were rife that Douglas Higley, Mentor's former boss, and his immediate superiors at Ocean Drilling and Exploration Company (ODECO), Mentor's parent company based in New Orleans, had become involved in a fraudulent scheme by putting a series of reinsurance contracts on Mentor's balance sheet which were merely cosmetic improvements and even then were only good for a while.⁴⁴¹

Sources say that Higley had once been regarded as 'Mentor's saviour and was for a time the blue-eyed boy in ODECO's boardroom.'⁴⁴² However Higley was believed to be under tremendous pressure to come up with a solution to Mentor's unimpressive results during the early 1980s. So he devised the fraudulent reinsurance contracts, allegedly with the full approval of his boss, William Colson, who is said by some to have praised him for coming up with the idea. But when the nature of the contracts emerged, Higley was told he was to become the fall guy and was dismissed from the company. Colson was later to deny any knowledge of the contracts.⁴⁴³

When in due course the liquidators of Mentor brought suit against Pinnacle Reinsurance, the Bermuda subsidiary of Lloyd's broker C.E. Heath, it emerged that Pinnacle also had taken part in the scheme to defraud Mentor Insurance and ten other defendants for hundreds of millions of dollars. What really stunned the Bermuda insurance market was to find that the suit was being brought in a United States court and in the state of Louisiana, which is notorious for giving large awards. The suit accused Pinnacle, Mentor Holding Corporation, parent Ocean Drilling and Exploration Company (ODECO) and eight Mentor directors of devising a scheme to defraud Mentor and, ulti-

⁴³⁹ *The Royal Gazette*, 9 December 1986, 'Satellite insurance blasts off in Bermuda', p. 21

⁴⁴⁰ *Bermuda Sun*, 21 March 1986, 'The Fall Guy', by Roger Scotton

⁴⁴¹ *ibid.*

⁴⁴² *ibid.*

⁴⁴³ *ibid.*

mately, its policyholders and creditors. The suit continued that Pinnacle aided and abetted Mentor by participating in fraudulent balance sheet deals, which allowed Mentor to conceal its true financial position from its shareholders and creditors.⁴⁴⁴

Bermuda and other offshore domiciles watched the Mentor affair closely because they were worried about the precedent that this case could set. The key concern centred upon the authority claimed by a Louisiana court to try a company that was incorporated under the laws of Bermuda and had its principal place of business in Hamilton, Bermuda. In order to have the jurisdiction of the case moved to Louisiana the liquidators' suit had gone to great lengths to prove that Pinnacle, regardless of its principal base, was deeply involved with business dealings in the state of Louisiana.⁴⁴⁵

Economic or Indirect Liability losses

Then, as if someone was looking over the shoulder of the new start-up companies in Bermuda that were seeking a place in the global insurance industry, rulings in the United States, Canada and Australia provided them with clients. The excess liability insurance industry saw another surge in the number of clients seeking additional limits. All around the world, in jurisdictions that shared a common legal ancestry with the precedents of English law, such as the United States, Canada and Australia, activist courts were developing positions that would greatly expand the concept of liability for negligence. The rulings of these courts could eventually bind professionals and corporations, accountants, contractors, and the like, in sweeping and indefinable obligations, to third parties with which they might never have had direct dealings and which could be grouped into classifications so broadly drawn as to leave open the true extent of economic or indirect legal liability losses.⁴⁴⁶

A good ending to the year for Bermuda

Despite the Tax Reform Act, the Mentor Affair, and other trials sent to tarnish Bermuda's international insurance industry, the *Captive Insurance Company Review* was able to report that 1986 ended with—

'...gross premiums written up by 22 per cent to US \$12.4 billion for its offshore insurance industry. Bermuda also still remained the world's offshore insurance capital with 1,330 insurers and reinsurers. The insurance industry contributed US \$125.6 million of the total US \$232.6 million spent there by international companies.'⁴⁴⁷

The reason for the success of Bermuda's international insurance industry was well expressed by Kevin Stevenson in his report from the 1986 Risk and Insurance Management Society (RIMS) Conference in Toronto —

'The hardening insurance market has led risk managers to look for alternative means of finding insurance—risk-pooling groups, captives, self-funding mechanisms—which has spelled substantial growth for Bermuda.

'...The current crisis in liability insurance has been compounded by an explosion in liability insurance awards, and has spawned a growing call for tort reform in the United States. Insurers and reinsurers throughout the world have isolated the civil justice system as a root cause for the crisis.'⁴⁴⁸

⁴⁴⁴ *Bermuda Sun*, 21 March 1986, 'The Mentor Affair: Pinnacle denies charges', by Roger Scotton

⁴⁴⁵ *op. cit.*, 'The Fall Guy', by Roger Scotton

⁴⁴⁶ *New York Times*, 14 October 1986, 'Theories expand concept of liability', by Nicholas Kristoff, p. A14

⁴⁴⁷ *Captive Insurance Company Review*, January 1988, 'Bermuda Offshore premiums up 22 per cent', p. 3

⁴⁴⁸ *The Royal Gazette*, 17 April 1986, 'Insurance problem means growth here', by Kevin Stevenson, p. 23