CHAPTER 43

1994
A Haven in a World of Turmoil

Growth in a time of crisis

After coming off an exciting 1993, the Bermuda insurance industry sailed into 1994 with much optimism. *The Bermudian* described the change in worldwide perception of Bermuda as follows—

> 'For well over a decade now the world's insurance community has watched with growing respect as Bermuda's insurance industry has evolved from an alternative niche market to a global leader in ever-growing lines of insurance business. This growth hasn't necessarily come easy. Bermuda critics have long anticipated that Bermuda's insurance industry would collapse under the weight of what they believed to be its misguided perception of the kind of role it could play in the world arena.
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> 'Certainly, there were years when outside observers rubbed their hands in glee, particularly in the late 1970's and early 1980's when not-so-smart money in Bermuda was handed to even less smart underwriters who trotted the globe in search of business—virtually any business, as long as it was insurable.
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> 'Today those same observers are wringing their hands in worry as it is their markets which are being faced with crises, while in Bermuda, the insurance community continues to grow, each year surprising not just itself but also an increasing number of buyers of insurance and reinsurance who can now come to the Island for everything from excess casualty, workers' compensation, and now property catastrophe. Bermuda is increasingly attractive because it offers one-island, if not one-stop shopping.'[610]

Kevin Stevenson of *The Bermudian* talked to Registrar of Companies Malcolm Butterfield about the reason why Bermuda was so successful in 1993 and Butterfield responded—

> 'What has made Bermuda so attractive in 1993 is that the worldwide reinsurance markets, both buyers and sellers, have a tremendous level of confidence in the security of Bermuda's reinsurance market. Bermuda has proven itself as a stable and secure jurisdiction, and the entry of other specialty insurers and reinsurers—and by that I mean ACE, Exel, and Centre Re—has helped confirm the confidence in the Island.'[611]

Bermuda was clearly on a growth spurt. The *1997 Archer Report* revealed that in 1994 there were 1343 insurance companies and 224 brokers/managers on the register in Bermuda.[612]

A call for Bermuda's secrecy laws to be lifted

Given such an enhanced status in the insurance industry, Bermuda was constantly in the spotlight—sometimes with good news and at other times with bad. The *National Underwriter* magazine ran an editorial comment on 17 January 1994, calling for the secrecy laws in Bermuda to be lifted—

[610] *The Bermudian*, Focus on International Business, January 1994, 'The Property Catastrophe Reinsurance boom, Big Fish in a Big Pond, Bermuda's Newest Reinsurers', by Kevin Stevenson, p. B11

[611] ibid. p. B15

[612] *International Companies 1997 Their Direct Impact on the Economy of Bermuda* by Brian Archer, Report of an independent study carried out by the Ministry of Finance, Government of Bermuda

'With good reason, 1993 could be called the year of Bermuda. Insurance company formations and the introduction of US $3 billion in new property-catastrophe capacity has led some boosters to claim that Bermuda has grown beyond its already established place as the pre-eminent global captive domicile to become a worthy challenger of Lloyd's for many risks.

'However, one cornerstone of a large and dynamic insurance market is missing from Bermuda – the availability of company financial and solvency information.

'Recently, Walter A. Scott, chief executive of ACE Ltd., predicted that Bermuda's strict secrecy laws will be eased. We hope he's right – the sooner Bermuda strikes secrecy provisions from its books, the better.

'Malcolm Butterfield, Bermuda's registrar of companies, has noted that since the signing of a tax treaty with the United States, confidentiality may be less important to US owned companies on the island. He has said discussions over whether to lift secrecy laws will take place this year.

'At present, Bermuda companies must file an annual statutory financial return with the registrar of companies. This consists of a certificate of solvency signed by company officials, an auditor's report certifying company compliance with Bermuda's insurance law and a schedule of three company financial-strength ratios similar to the IRIS ratios used by the National Association of Insurance Commissioners. This report is completely confidential except "for the purposes of any criminal or civil proceedings", according to the law.

'All that is publicly available is a company certificate of incorporation, a certificate of registration—which includes any restrictions on business a company can write—and a certificate of compliance by Bermuda regulators that the company meets minimum solvency standards. Although insurers must prepare annual statutory financial statements, they are not required to file them with any authority and can make them public at their own discretion.

'Bermuda has effectively had a system of self-regulation overseen by the Ministry of Finance and a group of insurance executives and professionals who make up an Insurance Advisory Committee. No regular financial or market-conduct exams are conducted, although the finance minister can investigate if he or she decides it is in the policyholders' interests. When measures need to be taken to rectify financial problems at a Bermuda company, a course of action is decided upon by the Minister of Finance with input from the IAC.

'...Recently, questions arose from the spinning off of the profitable domestic business of Bermuda Fire and Marine from its insolvent international operation. The move, sanctioned by Finance Minister David Saul, allegedly enriched Bermudian directors and shareholders of the new domestic company while cutting loose international creditors. As the head of one of Bermuda's largest global insurance firms put it: "The outcome of this has incalculable ramifications for Bermuda as an offshore financial centre. If the island is perceived abroad as not being able to regulate itself properly, then the repercussions for the future of international business here are huge."

'Money and corporate partners are pouring into Bermuda's insurance industry. Such a sizeable infusion of people and capital inevitably carries with it the potential for mismanagement, even fraud. Foreign carriers doing business with these firms and the regulators overseeing them need access to solvency and other information to judge whether Bermuda companies are legitimate.

'Continuing Bermuda's policy of official secrecy while a new and powerful population of self-interested corporate insurers grows is a recipe for disaster. US regulators have already voiced their displeasure with Bermuda's secrecy laws. All it would take is one large Bermuda insolvency helped along by a cloak of secrecy to swiftly tarnish Bermuda's bright reputation as an emerging insurance power.'[613]

[613] *National Underwriter*, 17 January 1994, Editorial Comment, 'Bermuda secrecy laws must be lifted', p. 22, 43–47

Standard & Poor's (S&P) cautious about Bermuda

Not far behind the editorial in *National Underwriter* calling for Bermuda's secrecy laws to be lifted, Standard & Poor's (S&P) issued a report called 'The New Bermuda Insurance Industry – Risk and Reward go hand in hand'. In this report S&P was critical of Bermuda's regulatory environment and reluctant about the motives of the investors behind the new reinsurers. S&P opened its report by addressing the tremendous growth of the Bermuda insurance industry, citing its great strides from a captive domicile to a major insurance centre as follows—

> '…Along the way, Bermuda has attracted a tremendous amount of new capital to its shores. The investors in these Bermuda companies count among them many of the largest, most sophisticated and creditworthy business institutions in the world—Zurich Insurance, J.P. Morgan, Marsh & McLennan, Swiss Re, American International Group, and General Re—just to name a few.
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> 'Clearly recent investors in Bermuda insurance companies believe they have identified tremendous profit opportunities. The island has been chosen as the domicile of choice to set up new operations that specialize mostly in excess property and liability covers and financial reinsurance. So far, the investment experience has generated huge financial rewards for the initial investors.
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> 'But have the investors adequately considered the long term risk in writing these business lines? More importantly, if additional capital is needed to support these risks, will the large, creditworthy investors of the 1980s and early 1990s be willing to step up to the plate?
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> 'S&P believes there is tremendous risk in the new ventures that are being formed in Bermuda. Some enterprises, no doubt, will be successful in the long run. But unless favourable conditions prevail in the short run, many others may cease to exist. Still others may require large infusions of capital to continue doing business.
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> '…On balance, we are not terribly concerned about the near-term outlook for either profitability or results. Basically, we are convinced that, broadly speaking, most of the management teams have a healthy respect for the magnitude of the risks they are accepting and that they will underwrite and price products carefully. In essence, this is not the "naïve capacity" that plagued Bermuda in the late 1970s when captive insurers and reinsurers offered uneconomic terms and prices to lure business to the island where they could enjoy tax benefits. In the new market, a common characteristic among the managers of these insurers and reinsurers is that they are professional insurance people who have some meaningful insurance experience.
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> 'Nonetheless, general liability, special liability forms, and catastrophe reinsurance are among the riskiest coverages any company can write. Many of these new companies are monoline writers, or only write a small number of different coverages. As such, they lack the diversity of business, and in some cases, the geographic dispersion, that many of the more traditional insurers have.
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> 'We have specific concerns about the future of these ventures. Over the next few years, they will either succeed somewhat, or cease to exist because the business they are writing is almost exclusively subject to high severity but low-frequency factors. More importantly, since most companies are the insurers and reinsurers of last resort, they have little, if any, reinsurance or retrocessional capacity supporting them. In other words, they are not sharing or spreading their risks with others…'

The S&P report further stated that if the market had no losses, the new companies should fair well in the short term. But should the market have losses, the insurers and reinsurers would have no 'deep pockets' to recover their losses. The report also discussed the negative effects of a soft market on the new companies because there would be too many carriers to sustain weak prices. It further cited the entrance of the new carriers to the market as cause for premiums to be lowered before the incumbent carriers had the opportunity to recoup their premiums, thereby forcing the market into a soft underwriting cycle before it was ready.

The report highlighted the positive reasons why companies chose Bermuda, including its ideal geographic location, tax benefits, political and social stability, English language, sophisticated infrastructure, use of Canadian generally accepted accounting principals as its accounting convention, and a legal system based on English common law. It stated—

> 'Because of these factors, Bermuda insurers and reinsurers enjoy a significantly greater degree of freedom in establishing reserves versus US regulated companies and even some continental European institutions. …
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> 'The regulatory environment is characterized by low barriers to entry for insurance companies, and government supervision and regulation of the industry through a self-policing Insurance Advisory Council (IAC) made up of industry members... However from the perspective of policyholder security, the regulations are considerably more lax than those in the US. By themselves, the regulations do not protect policyholders from greedy parent companies or investors who may want to take out most or all of a company's earnings.
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> With most of the new insurers writing relatively risky business and their capital bases unprotected by reinsurance or retrocessional capacity, one must question whether this is a catastrophe waiting to happen. In such a situation, it is at least somewhat comforting to know that most of the capital directed at Bermuda insurance operations in the past few years has come from institutions that have staying power. While their commitment to their Bermuda investments must always be re-evaluated and questioned, many at least have the ability to support future losses should they occur.'[614]

And so the catastrophes continued

The industry had just begun to recover from the effects of Hurricane Andrew and other natural disasters in 1993 only to be confronted on Monday, 17 January 1994 by a moderate but very damaging earthquake of 6.7 magnitude in Northridge, California, approximately 32 km northwest of downtown Los Angeles and within the densely populated San Fernando Valley. Thousands of aftershocks occurred during the next few weeks, adding to the devastation. The Northridge earthquake was the third largest insured loss in United States history, estimated to cost US $12.5 billion.

Soon thereafter came the freezing losses in the Northeast of the United States. Kevin Stevenson of *The Bermudian* reported on this catastrophic start to the New Year—

> 'The newest members of the Island's insurance industry, the property catastrophe reinsurers, have survived what has turned out to be their first trial by earthquake, wind, flood, and storm – all within a month of their first collective US reinsurance renewal season.
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> '… "The year 1994 commenced with an intensity of severity for catastrophe losses virtually unseen in recent times. The year began with severe storms in Northern Europe, flooding in continental Europe, brush fires in Australia, a devastating earthquake in Los Angeles, and continuing freeze losses through much of the United States," said Joe Johnson, Chairman of International Property Catastrophe Re.
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> '…"Shortly after the year started, two of the ten worst natural disasters in history occurred," said Mr Donald Kramer, Chairman of Tempest Reinsurance. "It's entirely possible that one or two reinsurance programmes may go through their retentions, but by and large, these disasters are just a reminder that there is real peril out there."
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> '…"The earthquake and winter storms occurred shortly after the renewals closed, and it scared the daylights out of companies which didn't want to buy this stuff," said Tempest's Mr Kramer. "As a result, an after-market has developed at the higher levels…What happened is that the other markets got more aggressive because of Bermuda, and a lot of business stayed in those markets. European capacity devel-

[614] Standard & Poor's (S&P) Insurance Rating Services, Focus/ January 1994, 'The New Bermuda Insurance Industry – Risk and Reward go Hand in Hand'

oped suddenly, and we were signed down on some European treaties. While we might have wanted US $10 million, we got US $5 million, when we wanted US $20 million, we got US $10 million…"

'The other issue is that in 1993, following Hurricane Andrew, companies came back for renewals, couldn't fill their books and had to scale down their needs. Where they wanted US $200 million in cover, they got US $100 million. As a result, they came back in 1994 with the same scaled back expectations and demands. Rather than take advantage of higher limits, because of what they perceived as higher prices, many insurers decided to stay where they were and buy fewer limits.'[615]

Considering the scale of catastrophes that had occurred in a relatively short period of time, the Bermuda property catastrophe players were dismayed to find how much their capacity was signed back as of the 1 January renewal date once the treaties were all completed.

Update by Task Force on Employment/Insurance Industry findings

By and large, however, the Bermuda international insurance industry had grown so far beyond the wildest dreams of its early pioneers that on 22 March 1994, The Task Force had to correct the projections it had made in December 1992. Whereas at that time the Task Force thought insurance industry employment would grow by a mere 20 persons, it now recognised that, with the advent of over US $4 billion in new capital to Bermuda, there would be a 'need for additional people…in all sectors of the insurance industry.' It foresaw 'strains on the infrastructure including housing, compensation, training and the regulatory environment'. It confirmed the need for qualified Bermudians to be employed in the industry but also expressed concern that there be a suitable balance of men and women among them.[616] These modifications of the report highlighted just how fast things were changing. Bermuda could expect a host of new social and economic considerations to follow on the 1992 surge in the number of insurance companies.

Review of the Bermuda regulatory system

Seeing such rapid growth, the government's Insurance Advisory Committee initiated a review in June 1993 of the Bermuda regulatory environment. Feedback was requested from the managers of captives, from underwriters, accountants, and actuaries, from the Registrar of Companies, from local insurers and the representatives of non-resident insurance undertakings, as well as from the new property catastrophe insurers. The results of the review were presented in April 1994, just after the mixed reviews from Standard & Poor's as to Bermuda's new status and the calls from overseas for a lifting of the secrecy laws. The timing could not have been better.

The review found that Bermuda had over 1300 registered insurance companies, the majority of them captives insuring only risks of their parents. However it also found, with respect to excess of loss carriers and finite risk reinsurers, primarily targeted at the international property catastrophe and excess liability markets, that these newcomers were underwriting third party risks and had capital and surplus capacity of US $10 billion. In light of the new entrants, the report indicated that—

'Bermuda's regulatory system was designed primarily for captive insurers writing related party risks of their owners, but made flexible to accommodate other types of insurers…. However, the rules of solvency, reporting and other matters remain largely the same for all insurers.

'It is the view of the Committee that the significant changes that have taken place in the Bermuda market place require a fundamental change in the Bermuda regulatory system. It is no longer appropriate to apply one set of regulations to all Bermuda insurance companies. Companies writing varying amounts of

[615] *The Bermudian*, Focus on Business, April 1994, 'Bermuda Insuring the Globe, Catastrophe Reinsurers cover the globe', by Kevin Stevenson, pp. B9–B15

[616] Task Force on employment—insurance industry, Report to Cabinet—22 March 1994

third party business need to be more effectively regulated, whereas the current regulatory system continues to be effective for companies writing purely related party risks of their owners or affiliates…The regulatory system should stratify Bermuda insurers based on the level of protection that is needed by policy holders. History suggests that companies writing the related risk of their owners or affiliates, as self insurers, do not require significant changes in regulations, as they are dealing with their own risks or risks within a group that does not affect the public. On the other hand, those companies which write substantial third party (unrelated) business should be the focus of more rigorous standard(s) and regulations. In addition, the excess liability and property catastrophe companies are unique and require special regulatory requirements. The best way to achieve the diversity in regulation is through a multi-license system.'[617]

Introduction of multi-licensing

As a consequence of the review, four separate classes of license were recommended—

Class 1 included wholly owned captives writing only related party risks of their owners or affiliates.

Class 2 included most group or association captives (multi-owned captives writing only the risks of its members—including direct policies), wholly owned or group captives writing limited third party business (no more than 30% of gross premiums written), and reinsurers writing third party programmes all fronted through licensed carriers in other jurisdictions.

Class 3 included reinsurers writing significant third party business (but did not include those writing only fronted programmes). Mostly this would consist of direct insurers and third party reinsurers, companies writing direct policies with third party individuals or corporations other than related parties.

Class 4 included insurers and reinsurers writing net retentions of high layer excess liability and catastrophe property risks, which basically encompassed significant excess of loss casualty and property catastrophe reinsurers.

In addition the amendment was also to—

- set higher minimum levels of capital and surplus for all companies in the Bermuda market, except those so called 'pure' single parent captive insurers writing only the risks of their owners;
- introduce controls over excessive or unreasonable distributions or reductions of insurers' surplus;
- adjust solvency margins to a level consistent with international standards and, in some cases, well in excess of other countries' standards;
- broaden requirements for actuarial loss reserve options, especially for those companies with large books of third party commercial programmes;
- impose strict reporting requirements on all licensed companies and a system of penalties for late filers.[618]

New horizons

As of February 1994 ACE entered the satellite business. Very soon thereafter it was estimated to be at a level anywhere from US $500 to US $700 million in annual premiums. Chuck Rudd, Senior Vice President and underwriter of the satellite division of ACE, spoke with *Bermudian Business*—

'One of the reasons satellite insurance is attractive to ACE is that it doesn't accumulate within any of the other business ACE writes. We could add a new product line without adding exposure to our existing business. And, of course, it fits into the high severity, low-frequency profile that is characteristic of our other lines. Also, our existing liability business is long-tail and this is very short-tail, so it was considered complementary in balancing the equation out.'

[617] *Review of the Bermuda Regulatory System*, revised as of 5 April 1994

[618] *The Bermudian*, Focus on Business, October 1994, 'A New set of Rules, updated insurance regulations aim to strengthen Bermuda's world role', by Kevin Stevenson pp. B9 & 10

Bermudian Business continued—

'The satellite market is relatively new, having developed only over the past 15 years, beginning in the early 1980s with the tremendous growth in the commercial telecommunications industry. Like any other immature product, the early years were characterised by pricing that varied dramatically, and capacity that might be US $300 million in one year and contract to US $90 million the next. Capacity would vary so much because satellite insurance was built on reinsurance, which in bad years would simply disappear…

'Obviously what the market lacked was the long-term commitment of financially strong insurers, which were able to offer satellite insurance on a net basis. It wasn't long before word got back to Bermuda. "There were rumblings through the marketplace as to what satellite owners needed," says Rudd. "They needed protection in a stable marketplace that wasn't dependent upon reinsurance. And people said ACE should be in the satellite business. We're a bit of a Rock of Gibraltar. ACE's capacity is completely net because whatever we take we don't reinsure with anyone else. To these satellite owners we are known as people in for the long term with relatively stable capacity."'[619]

COAXL (Commercial Accounts Excess Liability)

A second major change in the market came when XL decided to introduce a new policy, effective 1 April 1994, to meet the increasing worldwide competition for the softer risks. The form was designed to appeal to 'commercial' or 'middle market' accounts. COAXL was a simplified version of the standard XL policy aimed at attracting the next tier of business behind *Fortune 500* companies. By simplifying the form and taking out some of the traditional bells and whistles, XL was able to offer cheaper premiums to clients purchasing this form. It was offered only to accounts with revenues of US $500 million or less. The maximum limit offered was US $50 million with a minimum limit of US $10 million. The minimum attachment point offered was US $25 million.

A marriage of science and insurance

Michael Butt was President of Mid Ocean Re, and later recalled in an interview for this book that when he came to Bermuda in 1992 he had looked around the island to figure out which charities were the best for his company to support. He decided rather than just throw money at the first thing to come through the door, he wanted to support those efforts that added value on a global scale and in some way related to insurance.

He met with Dr Tony Knap, director of the Bermuda Biological Station, and discussed with him some major ecological concerns, including global warming. Out of these talks came the proposal that if Knap could somehow bring the findings of the Biological Station to a business platform, then Mid Ocean Re would commit to a project for a long-term basis if four other companies signed on. There followed a very constructive conversation about how this could be achieved. Knap and his colleague Tony Michael set out to find a response to the challenge. What ultimately came about was a joint undertaking of collaboration between scientists and insurance executives that was to be known as the Risk Prediction Initiative (RPI). It is unique in that it was the first time that such an initiative had been launched on a formal basis.

According to Susan Howard, Science Liaison Operations Manager for RPI, after Hurricane Andrew it had become apparent to the insurance industry that there was very little science involved in the risk models they had been using. The scale of destruction showed the risk rating models to be inaccurate, with no effective correlation between meteorologists, climatologists and the numbers that came out of the models. Not wanting to be caught out again, the industry welcomed RPI as the best path to predicting where the next big loss was likely to occur and what would be adequate rates for a particular geographic location.

[619] *Bermudian Business*, Premier Issue, Insurance Special, Spring 1996, 'ACE in Space', by Kevin Stevenson pp. 76 & 77

The brains behind RPI made a conscious decision not to spend research money on the study of earthquakes because adequate research was being done on this exposure already. Instead the focus would be on tropical cyclones, specifically at the request of many insurance companies, to determine patterns and where they were likely to hit. RPI also focuses on hurricanes, European weather patterns, windstorm forecasts and other areas of prediction that are identified as not having sufficient government funding.

Among the first companies to sign on to the initiative were Mid Ocean Re, Cat Ltd., ACE, XL, Renaissance Re, Chubb, American International Group, State Farm and Swiss Re. Butt had more than the four signatory companies he had required and RPI was born. According to Knap, this was a ground-breaking initiative for scientists and the Bermuda Biological Station because it allowed them to connect climate risks with the business world. RPI has been hailed as a major success story and has been featured in *Nature*, the premier science magazine.

Interviews with the principal players highlighted the following recollections—

> 'One beauty of RPI is that the Bermuda Biological Station is the oldest marine laboratory in the world and therefore has front rank global status. Its prestigious reputation attracts some of the best scientists, who in turn appreciate the Biological Station's desire to expand science into society. Tony Knap says that these scientists want to be a part of that endeavour, not as stars in a media spotlight but in an environment where real work gets done. In this way RPI acts as a link and a channel between science and business. Susan Howard is the facilitator who oversees the funding from insurance companies and distributes it to worthy research projects. She also acts as the translator of scientific terms for lay persons and interprets the scientific work of RPI to the outside world, so that the public shall understand what discoveries have been made or are in progress.
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> 'RPI is also privy to first hand discoveries before they have been announced to the general public. Members of RPI have access to these findings and therefore have a leading edge over non-members because that allows them to know ahead of time where science is going. This inside information also enables companies with specific needs to select scientists who can carry out research exclusively for them, a benefit which is especially helpful to companies that are looking for specific data but do not necessarily want the world to know what are their concerns.'[620]

Two disappointments—at Stockholm Re and at Mid Ocean Re

The encouraging news of the insurance industry and the science world working together was somewhat overshadowed, first by the sad news that property, marine and aviation reinsurer Stockholm Re (Bermuda) was in runoff, as reported by *Bermudian Business*—

> 'Directors of the company's Swedish parent, Lansforsakringsbolangens (LF-AB), made the decision to stop taking new business in early March. Stockholm Re (Bermuda) President and CEO Mr Jim Parkinson resigned along with several other top officers.
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> 'Eastney Investments headed by Mr John Williams has been appointed manager of the run-off...Mr Williams said that LF-AB, a Swedish-based farmers' mutual insurer, had long decided that it would withdraw from reinsurance. Stockholm Re (Bermuda) was the last reinsurance subsidiary within the group.[621]
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> 'Compared with the new large reinsurers on the island, Stockholm Re (Bermuda) was a very small reinsurer who lost its place in the industry once the mega-reinsurers arrived..."With such a small size, they were not a viable entity," said Mr Williams. "Unfortunately, they have not been able to raise new capital, and therefore those restructuring options are not available any more. The decision was made that they would put the company into run-off, and not accept any more business...As Stockholm Re (Bermuda)

[620] Interviews with Michael Butt, 29 November 2002, Tony Knapp and Susan Howard, 24 June 2002

[621] *The Bermudian*, Focus on International Business, April 1994, 'Insurance in brief, Stockholm Re (Bermuda) placed in run-off', p. B37

lost about two-thirds of its portfolio, there seemed to be little point in continuing with the company as the parent had no wish to increase capital, which left the alternative of run-off."'[622]

The industry was further disappointed when Mid Ocean Re reported its first drop in net income—

'... a 30 per cent drop in net income to US $13 million during the second quarter of 1993 over the same period last year. The loss was attributable to the Northridge earthquake in California. Mid Ocean has set aside US $72 million for claims arising from the earthquake—US $35 million in the first quarter and US $37 million in the second quarter.'[623]

These results from Bermuda's first property catastrophe reinsurer Mid Ocean Re demonstrated the volatility of the business given the scale of possible losses.

Two new formations—Lexington and Stockton Re

Hope was on the horizon when Lexington announced it was forming a subsidiary in Bermuda. Lexington Insurance Company, a US subsidiary of AIG Group, opened a Bermuda branch in May 1994, specialising in excess liability cover in excess of US $25million with policy limits of up to US $25 million. 'This new branch puts Lexington in a position to take advantage of the need for strong financial capacity in Bermuda as it grows as an alternative to the London market,' said Lexington President Kevin Kelly.[624]

Shortly after that announcement came news that Stockton Re was formed. *Bermudian Business* reported—

'Unlikely as it might seem, the roots of finite reinsurer Stockton Reinsurance began 29 years ago as a result of a PhD thesis by a student whose dissertation committee included Paul Samuelson, author of the infamously rigorous textbook which is a standard for introductory economics courses. Today, Samuelson, 83, a founding shareholder of Stockton Re's predecessor, Commodities Corporation, remains on the board of directors and, much as he did decades ago, continues to be an imposing presence especially for Stockton Re President and CEO of six months Dan Malloy.

'...The company was the brainchild of Helmut Weymar, whose PhD thesis regarding the inefficiencies of the commodities market led him to found Commodities Corporation. The New Jersey-based asset management company was established in 1969, specializing in the trading of futures and options. "...The founding premise of this company has been that you can actually achieve attractive returns by managing and spreading your risk across as many non-correlated classes as possible," says Malloy.

'Given this background, it shouldn't come as much of a surprise that Bermuda and the advent of finite risk insurance and reinsurance caught the attention of senior management of Commodities Corporation in the early 1990s. "The interesting thing was that the economic theories and rules of managing and evaluating performance that applied to this very diversified asset trading strategy mirrored almost exactly the way finite risk was managed," says Malloy, referring to the fact that each finite risk contract has an aggregate limit of liability (with profit sharing for favourable results), and is underwritten using underwriting, actuarial, legal, accounting and investment skills to analyse potential risks according to strict internal guidelines. "The idea of creating separate cells of self-contained exposures where you manage those exposures over time, rather than just creating a large homogeneous portfolio is very similar to our underwriting philosophy. So the mindset, theory, risk management and execution associated with this trading company allowed for a very smooth transition to an insurance and reinsurance company, because the way we think about risk on the liability side and the way they think about risk on the asset side are very similar, very compatible."'[625]

[622] *The Bermudian*, Focus on International Business, April 1994, 'Insurance in brief, Stockholm Re (Bermuda) placed in run-off', p. B37

[623] ibid. July 1994, 'Insurance Update, Mid Ocean Reinsurance', p. B21

[624] ibid. 'Lexington Insurance Company', p. B21

[625] *Bermudian Business*, Fall/Winter 1998, 'Stockton Re joins the big league, Company roots go back 29 years to a PhD thesis', by Kevin Stevenson, pp. 40–44

Changing the Guard at ACE

As news of companies going into runoff, of others beginning after Andrew and of changes in market direction became commonplace in Bermuda, even bigger announcements followed. First came word that Brian Duperreault was taking over at ACE from Walter Scott. After taking ACE public and realising that his five year commitment to ACE had come to an end, Walter Scott, Chairman, President and CEO of ACE decided to retire. However, Scott was surprised by how long it took to find his replacement. It took 13 months for ACE to find the candidate they were looking for.

The board at ACE felt that the insurance marketplace had changed so much that they needed someone who was well versed in strategic operation and had the foresight to move ACE into the global insurance marketplace as well as diversify its product mix. Scott said they found Brian Duperreault as they were nearing the end of their search. After not finding a suitable candidate, they interviewed twenty people to find out who they thought was good in the market and Duperreault's name came up repeatedly. They then had a search firm go after him. The board decided not to go after Duperreault directly because they did not think it would be possible to lure him away from AIG. Duperreault had been with AIG since 1973 and was considered to be one of the heir apparents if Greenberg decided to retire. Fortunately for them the 'golden handcuffs' AIG had always used to keep key employees had been loosened a bit which meant there was a possibility that they could get their man. Not only that, Maurice Greenberg, the chief executive officer and chairman of AIG, was still going strong and had no intentions of retiring soon. Therefore, they went for Duperreault.[626]

Brian Duperreault said despite his high profile job at AIG, he had reached the stage in his life where he wanted to run his own company. When he was approached about running ACE, he was thrilled because he thought ACE was a jewel of a company with good business and great relationships with clients. He also knew that the company was narrowly focused, which was both a strength and a weakness but saw it as an opportunity to work with the company to take it to a different level.

Duperreault also felt it was in his destiny to return to Bermuda as he had been born there in 1947 and had spent a lot of time trying to connect to the island. As a matter of fact he got a Bermuda passport in 1989 feeling that somehow he would need it one day. Then in 1994 he discovered while talking to Mike Murphy, Director and General Consul at AIG, that just because he had a Bermuda passport did not make him Bermudian and that he needed to apply for status. Duperreault had no idea there was a distinction between being a status Bermudian and someone who had just been born on the island until Murphy explained it to him. Duperreault then said he wanted to apply for status. To which Murphy replied he would try for him but did not believe he would gain status at that time. To their surprise Duperreault was granted Bermudian status without any problems. A few months after gaining his status, ACE approached him about running the organisation. Duperreault felt that with the way everything had worked out about him gaining status on the island, then being approached by one of its major insurance companies to run their operations, he had been born to be a CEO based in Bermuda. However, Duperreault decided not to tell ACE that he was Bermudian because he wanted to get the job based on his merits and not because he was Bermudian.

When ACE offered Duperreault the job, it was only then that he told them that he was Bermudian. Duperreault said no one believed him and went to the Bermuda Immigration Department to check to make sure he was a legitimate Bermudian. Even Scott said he was pleasantly surprised to find out Duperreault was Bermudian after meeting with him the third time. Duperreault recalled when he returned to Bermuda to take up the post, he was embarrassed to

[626] Interview with Walter Scott, 19 November 2002

answer the question on the Immigration form, which asked, "if Bermudian how long have you been off the island", because he had been off the island for 47 years!

When he first returned to Bermuda, Duperreault also had to explain to everyone he met how he got his Bermudian roots because Bermudians love to know where new comers fit into the Bermudian scene. However now that he has been on the island for sometime, he no longer gets grilled about his Bermudian status. He feels that he is accepted as a Bermudian now.

When he took over as Chairman, his major task was to expand and diversify the company, as many directors were concerned about the narrow focus of ACE. Duperreault set about his task with great fervour because he was head of his own company in the country he was born in. He had come full circle and was living the dream he always knew he was capable of living. Duperreault also exercised caution with the people he brought on board because he knew they were faced with a huge challenge to diversify the company in a prudent manner.[627]

When Brian Duperreault took over the helm at ACE in 1994, he was reported by *Bermudian Business* magazine, as beginning "ACE's 'modern era' with diversification as he was given the mandate to establish the company as a premier global insurance organisation. Less than seven years later, his clearly articulated strategy of growth by acquisition and diversification has transformed the company from a catastrophic insurer writing a few lines of business to its current status as a global property and casualty enterprise with unparalleled geographic and product diversity. Soon after his arrival, Duperreault guided the company through a diversification policy that added strategic and alternative risk products with the formation of a Financial Lines Division."[628]

Duperreault also came into Ace at a very transitional point in its history because for the first time, Ace "had to make a USD200million adjustment to its breast implant reserves. The decision was made amid one of the worst bond markets in recorded history."[629]

Brian O'Hara replaces Michael Kevany at EXEL

Shortly after Scott handed over the management of ACE to Duperreault, EXEL chief Michael Kevany announced he was retiring from his position as President and CEO of EXEL Ltd. and as Chairman of the wholly owned subsidiary, XL Insurance Company. (It was known that Kevany's health was deteriorating.) 46-year-old Brian O'Hara replaced Kevany. *The Royal Gazette* reported on the change as follows—

> '...With regard to the appointment of Mr O'Hara, Mr Kevany said, "I am very pleased that I am able to turn the management of EXEL over to Brian O'Hara, who has been with the company from its beginning and who has been instrumental for much of its success. Brian is without question viewed as one of the most talented people in the insurance business today." Mr O'Hara said, "We will miss the management of Mike Kevany, who has led EXEL to its prominent position in Bermuda and in the global insurance market today. He has steered the company through a period of tremendous growth and development, including two public stock offerings. We are pleased that he will be staying on as Chairman"...'[630]

An upsurge in captives

Despite the signs of a softening in the market, Roger Gillett, senior VP of J&H, forecast that in 1995 Bermuda would again see an upsurge in captives. His overview was reported by *Lloyd's List*—

[627] Interview with Brian Duperreault, 2 December 2002

[628] *Bermudian Business*, Fall 2001, 'Driving Force', by Duncan Hall pp. 39–44

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

[630] *The Royal Gazette*, 3 October 1994, 'Kevany steps down as chief of EXEL', by David Fox

'"There's been a huge surge of interest in new captives. Most of the interest is not coming from the minority of American *Fortune 500* companies who have not yet seen the advantages of having their own captive, but from large, privately-held companies in the upper-middle market class of business who are not household names.' Further interest was being generated by existing captive owners who were, 'reviewing how their captive could be better used within their corporations."

'Mr Gillett said there had been a sharp increase in the formation in captives in all of the world's domiciles in the first quarter of 1994. Nineteen new international insurers, thought to be mostly, if not all, captives, formed in Bermuda during the first quarter of 1994, compared with nine for the same period of 1993. In total, 59 new international insurers, the overwhelming majority of which are believed to be captives, were formed in offshore jurisdictions during the first quarter, almost double the last year's figure.

'"If it had been just Bermuda, it could have been put down to just a blip in timing, but it's more widespread than that," Mr Gillett said. He attributed the renewed interest in captives to the end of the recession, a more positive tax environment in the United States, a concern among insurance buyers that their insurance premiums are about to rise in the not too distant future. "With the recession now over, companies have more confidence and are looking to put capital into ventures like captives. This represents a change in recent business philosophy. Companies have been reluctant to commit any capital over the last few years. Captives were looked upon as a non-essential expenditure and consequently, any plans companies did have in relation to captives were not proceeded with."

'Mr Gillett also indicated that a few legal victories for the taxpayer against the Internal Revenue Service in test cases over the last few years had also simulated more interest. First, there was the Humana decision in the Sixth Circuit Court of Appeals, (which covers Kentucky, Michigan, Ohio, and Tennessee). In summary, a parent corporation (Humana Inc) established a captive (Health Care Indemnity Inc) in Colorado. The captive provided insurance coverage for the parent's risks as well as for the risks of operating subsidiaries. In turn, the subsidiaries were assessed proportions of the overall premium through an internal allocation system.

'Although the US Court of Appeals in the Sixth Circuit ruled that the parent company was not permitted to take a tax deduction for its premiums paid to the wholly-owned captive as a result of the "parent-subsidiary" relationship, the subsidiaries (recognised as separate legal corporate entities) were permitted to deduct their premiums paid to the captive because of their 'brother-sister' relationship. "The Humana decision was hailed by many insurance pundits as an important victory for captives," said Mr Gillett.

'On December 14, 1993, there was another ruling in favour of the taxpayer that may have helped lead to the rush of interest in offshore captives. The US Tax Court ruled in favour of Malone & Hyde, a captive owner also operating in the Sixth Circuit. The court was asked to review whether the principles laid down in the Humana case also applied to Malone & Hyde. In ruling in favour of Malone & Hyde, the court applied the Humana principle on a much different set of facts. The court rejected the argument that the capitalisation, domicile, number of subsidiaries and existence of parental guarantees were significant factors in applying the Humana ruling to other cases. Mr Gillett said: "Malone & Hyde comes much closer to the structure of many existing captive programmes than did Humana."

'He added, "The tax environment today is much more positive than at any time since 1977. There have been a number of cases now decided in favour of the taxpayer, giving clients, for the first time in several years, the confidence that there is the potential for a significant tax advantage in having a captive." The third reason—fear of a further hardening of the insurance market—has also almost certainly played a big part in the renewed interest in captives, said Mr Gillett.

'"The perception by clients is that they do not want to be caught unprepared again and many of them are taking their insurance needs into their own hands...Creating a captive will enable them to control their own destiny. They can allocate and plan for retention levels rather than have to keep reacting to the requirements of an uncertain insurance market at any one time. I believe these three factors are creating a sudden surge of interest. There has been none of the old reasons like a regulatory change or sudden hardening of the market. Our feeling at J&H is that they are not just looking for traditional reasons any more. They are looking much more at core product enhancement, meaning they want to provide an insurance product of the company or enhance profits by attaching an insurance product to the sale of their core product."'[631]

The Bermudian magazine also reported on the upsurge in interest in captives as follows—

'...Bermuda is already seeing significant growth in the captive insurance sector after several anaemic years caused by the prevailing soft market. The factors (behind) this recent growth are as diverse as the companies that manage the captives, according to a survey of Bermuda-based captive managers by *The Bermudian* magazine's *Focus on Business*. Of the 95 new insurers and reinsurers incorporated in 1994, almost half were captive insurers. The previous year, captives accounted for little more than a third of new formations. Notably, of the 95 new companies, a fifth originated outside Bermuda's traditional markets in the US, UK, and Europe. Indeed, 22 per cent of the new companies came from Africa, the Middle East, the West Indies and Latin America. The previous year, these accounted for eight per cent of all new incorporations.

'...The US economic recovery has also played a role in spurring captive formations. "Perhaps after the recession, the corporate restructuring, downsizing, mergers and acquisitions, and the turmoil in the insurance and reinsurance industry—where catastrophes, competition, and new capital inflows have resulted in hard and soft markets in different sectors—the average risk manager found a breathing space in which to focus attention on important but less pressing issues such as the role of a captive in their insurance programmes," says Rory Gorman, senior VP of Marsh & McLennan Management Services (Bermuda) Ltd... "The last 12 months have been one of our busiest in terms of captive activity...Because of the exceptionally high level of interest we encountered when meeting many prospective clients, we anticipate that a significant number of other captives are in the pipeline. Coming after a couple of fairly quiet years, this activity is especially pleasing to us."

'...(John) Weale (VP of offshore management services at AIG Insurance Management Services), says 1994 was one of the best years for captive formations, both in Bermuda and abroad. "...These days, captive owners, like everyone else, are looking for more bang for the buck, and so are looking to use their captives in more and different ways than people who are setting up captives 10 or more years ago...This is undoubtedly a trend that will continue and will require captive managers to be more pro-active and less reactive to change. As in prior years, the main contributing factors to current captive trends are any new challenges that face risk managers (and how their captives can provide alternative means of dealing with those challenges), also the changing face of businesses themselves. For example, re-engineering, downsizing, and outsourcing have all become buzzwords of the past three to five years. Out of those activities has come the rapid growth of employee-leasing companies, whether they be temporary or permanent employees. These companies have found captives to be a great way to provide workers' compensation coverage for large numbers of employees at a reduced cost," says Mr Weale.

'...David Ezekiel, President and managing director of International Advisory Services Ltd. (IAS), says, "The contributing factors in current captive insurance trends are a combination of an improvement in the United States economy and the growth of Bermuda as an insurance market."'[632]

First Line and Shoreline formed

The end of the year saw Bermuda add another feather to its cap, in respect of its ability to meet worldwide demands and respond to short falls in the global insurance industry. *The Royal Gazette* reported that—

[631] *Lloyd's List*, Bermuda, June 1994, 'Captives enjoy a renaissance', by David Marchant, pp. 14–16

[632] *The Bermudian*, Focus on Business, September 1995, 'Target 2000 Bermuda captives poised for surge into the next century', by Kevin Stevenson, pp. B28–B30, B34–B35, B43, B48

'The US Coast Guard on Friday approved the First Line scheme for the writing of Oil Pollution Act financial guarantees for up to US $300 million. A week ago, First Line announced it had won approval from the Coast Guard in principle to be the only commercial facility that had the right to provide such guarantees. Now, they have the backing to provide guarantees for most ship owners. The rival schemes for obtaining certificates of financial responsibility for trading in US waters, Shoreline Bermuda and OPACLUB, are mutuals. The First Line programme is promoted by Johnson & Higgins, and will be run by J&H Intermediaries in Bermuda.

'...(Johnson & Higgins managing principal and senior VP, Mr D. Darby Duryea said), "Submissions are coming in from ship owners around the world in large quantities... This will answer the needs of the large majority...They will be able to comply with the COFR requirements of the Coast Guard, to operate in the United States...We're real excited about it, and excited that it is happening here and that the relationships that we're developing with ship owners have been wonderful. They are really supportive of what we've done."'[633]

Shortly thereafter Shoreline Mutual was approved to provide the same services as First Line in Bermuda. According to *Bermudian Business*—

'The competing facilities offer different solutions to the same problem. Ship owners can avoid being members of a mutual association subject to direct action in US courts by signing with First Line, which offers a fixed-cost, non-assessable approach to obtaining a COFR, or companies can join Shoreline Mutual and have their COFR guaranty issued by a mutual association which agrees to direct action in US courts.'[634]

London casts doubt on Bermuda

As Bermuda's status rose in the global insurance industry, so the London insurance market, in an effort to take the focus away from its own shortcomings, went to great lengths to discredit the Bermuda insurance industry. The Insurance Advisory Committee took exception to this and came out with the following refutation—

'...London has attempted to undermine our credibility and criticism has been levelled at Bermuda's perceived inadequate regulations. Our insurance regulations are constantly reviewed by a subcommittee of the IAC, and for the past nine months much effort has been expended in redrafting the Bermuda Insurance Act & Regulations. This was particularly initiated as a direct result of the new high capacity market developing in Bermuda. Our aim is to create a visible, effective regulatory environment, which demonstrably tightly regulates our insurance industry. Meetings have been held with all sectors of the industry to ensure that an industry-wide consensus is reached, and it is hope that new laws will be introduced before the end of the year, 1994....

'In a recent *Lloyd's List* article the DTI (Department of Trade & Industry) were alleged to be concerned about Bermuda's reinsurers, issuing a "health warning" to London companies utilising these companies. We discovered that the DTI were not about to publicise any concerns, and several articles subsequently appeared attempting to put the London position into perspective. The final editorial narrowed the focus to concerns over Bermuda's regulatory inadequacies—reported above, and the Bermuda Fire and Marine liquidation. Though Bermuda Regulators have co-operated with the DTI regarding BF&M, a response to this publicity cannot be made until (a) the release of the liquidators report, and (b) the court rules on the liquidators' findings and creditors' petitions. Because of our current visibility and the fact that we are now a significant global marketplace, we anticipate other "cheap shots" in the months to come.'[635]

Growing frustrated by London's pointed attacks as to Bermuda's regulatory environment, Brian Hall, Chairman of Johnson & Higgins and Chairman of the Insurance Advisory Committee

[633] *The Royal Gazette*, Business, 12 December 1994, 'Coast Guard gives green light to First Line guarantees to US $300 m.'

[634] *Bermudian Business*, Premier Issue, Spring 1996, 'Breaking with tradition', p. 26

[635] Insurance Industry Report, 27 April 1994

(IAC), decided to defend the island's reputation. Hall's response to London's criticisms was sent to *Lloyd's List* and appeared in full in *The Royal Gazette* on 8 April 1994.

'*Bermuda—The new jewel in the reinsurance crown?* asked the headline on a *Lloyd's List* feature published in September last year. That article discussed the rapid restructuring needed to meet the worldwide shortage of catastrophe capacity and argued that new, Bermuda-based capacity could have the most significant effect on the long-term health of the catastrophe excess of loss market. But there, it seems, the romancing of this particular stone stopped. "DTI in Bermuda health waning" was how *Lloyd's List* headlined its latest offering about the jewel, published last month.

'This report claimed that the Department of Trade and Industry was so concerned about the financial strength of certain Bermuda reinsurers that it was apparently about to warn UK insurers not to rely on their protections. Though the DTI later declared it was not about to issue any public guidance on this matter, *Lloyd's List* insisted that DTI officials were concerned about the security offered by "certain" reinsurance companies in Bermuda. It was not stated just who these companies were, though there was repeated reference in the article to the liquidation of a company called Bermuda Fire and Marine, which the newspaper said was worrying the DTI.

'What happened between the two articles to trigger such a striking about face? Has the jewel been found to contain a fatal flaw? The truth, as those intimate with the workings of the Island's market well know, is that this jewel is neither flawed nor flawless. It is functioning in much the same way as any successful commercial insurance market—attracting capital and resources needed to service a growing customer base.

'And it will survive not because it is in some way protected from the ups and downs of commercial reality and the vagaries of global economics or other threats, but because it is exposed to them and able to take them in its stride in the same way as other legitimate commercial markets. And it will have its share of winners and losers.

'The non-captive, commercial base of the Bermuda market now exceeds US $10 billion, with total capacity and surplus standing at more than US $25 billion. Many of Bermuda's companies are far more soundly capitalised than their counterparts elsewhere. And it is worth remembering that it is not so much the location of new capital that counts but the fundamental nature of new capital, wherever it is located, against old capital, which carries with it the cost of servicing the past.

'But the much-publicised flow of billions of dollars of capital to Bermuda's new catastrophe reinsurers last year was by no means gratuitous. This very public vote of international confidence, in the Island's ability to sustain a vibrant market, was no mere product of good fortune. It was earned, and it was earned the hard way—by putting years and years of hard work into building Bermuda's reputation as a sound, well-regulated international insurance domicile.

'Indeed, as Chairman of Bermuda's Insurance Advisory Committee, a statutory body which advises the Minister of Finance on the discharge of his insurance regulatory duties and other matters related to the industry, I can tell you that this work is continuing. Bermuda's authorities go to great lengths to satisfy themselves about the financial standing of the companies they allow to be domiciled here. Our regulatory environment is under constant review. Right now, discussions are taking place about the scope of new insurance regulations and licensing requirements, which have been proposed by the Insurance Advisory Committee.

'These are not the acts of an irresponsible jurisdiction more concerned with attracting business than with one carefully putting measures into place that will help protect distant policyholders. Bermuda's particular economic perspective is also worth taking into account in any review of Bermuda's security. Remember, we cannot afford to get things wrong! Our insurance industry is of much greater economic significance to Bermuda than, say Britain's is to its national economy or, for that, matter, insurance is to the economy of the United States.

'In Bermuda's case, the insurance industry is a vital irreplaceable pillar of a fairly fragile economy. So for these and other reasons, the insurance sector receives particularly close supervision and attention from the industry itself, from our financial authorities and from the newly strengthened insurance division of our Registrar of Companies. That does not mean to say that insolvency is unheard of in Bermuda.

'As with any commercial marketplace, insolvency is a fact of business life. And buyers looking at the Bermuda market need to differentiate with whom they're going to do business, just as with any other market in the world. The difference in Bermuda's case is that because ours is still a relatively young market, an insolvency can and often does receive much more than its fair share of publicity.

'So it has been with the controversial liquidation of Bermuda Fire and Marine, a Bermuda company whose London branch wrote business on the failed H.S. Weavers stamp between 1968 and 1993. However, it would be grossly unfair and misleading to generalise from the particular and condemn the entire Bermuda market on the basis of problems experienced by one company.

'The fact is that Bermuda is one of the best-capitalised markets in the world with by far the greatest concentration of unencumbered capital. And this fact is well known in London. Our new capital is largely a result of the world's leading brokers such as Johnson & Higgins and Marsh and McLennan and respected, professional carriers such as Swiss Re, CNA, Gen Re, Zurich Re and Chubb, teaming up with Morgan Stanley, J.P. Morgan, Goldman Sachs, Lazard Freres and other highly reputable investment houses. These are the kind of gilt-edged organisations that attract top credit ratings; not health warnings.

'The new, dedicated and highly professional capacity now available in Bermuda is nothing like the old, so-called innocent capacity of 20 years ago. Indeed, the quality of security of Bermuda's major insurers and reinsurers is amongst the highest in the world and the track record of our regulatory authorities is arguably as good as or better than any other jurisdiction's. Capital will always seek out its most efficient home. And for businesses that are capital, rather than labour intensive, Bermuda has been found to be the optimum choice of domicile.

'However, despite the fact that Bermuda's aim is to supplement rather than replace capacity elsewhere, there are those who feel threatened by a market that has successfully fought free of its earlier tax haven image and now ranks with the leading commercial insurance markets of the world. Indeed, the common thread, linking much of the media criticism now being levelled at Bermuda, stems from nothing more culpable than the undeniable fact that Bermuda has acquired, to quote a recent Morgan Stanley analyst's report, "prominence in the insurance world" and "will continue to expand, further increasing investors' interest in the leading companies in this important underwriting market."'[636]

A haven in a world of turmoil

By the second quarter of 1994, Bermuda was proving to be just that as it became looked on as a legitimate contributor and stabiliser to the global insurance industry. *Risk & Insurance* said as much—

'Bermuda saw a substantial increase in the number of new international insurance companies formed on the island during the first six months of 1994, reversing a return to a declining trend in the total number of insurers registered there. Figures released by the office of the Registrar of Companies showed that there were 40 new insurers incorporated in the six-month period, January through June, while only seven insurers were removed during the same period. This compared with 33 new insurers and 24 removals during the same period last year. The total number of insurers registered in Bermuda at the end of June was 1,348 up from 1,315 insurers in 1993...The fact that premium volume declined while assets and equity increased underscores the island's reputation for conservative underwriting, say industry analysts. "In particular, the ratio of net premiums written to capital and surplus, which is less than 1:1, demonstrates the continued conservatism of Bermuda's insurance and reinsurance companies", says (Malcolm) Butterfield (Registrar of Companies)....'[637]

[636] *The Royal Gazette*, 8 April 1994, 'Bermuda's jewel neither flawed nor flawless'

[637] *Risk & Insurance*, Bermuda, Special Report, October 1994, 'Insurance Growth Continues', by Kevin Stevenson, p. B21

But what was more impressive than just the number of companies forming on the island was the fact that Bermuda had seen astonishing growth since 1992 because of its ability to respond to worldwide insurance problems. And in direct response to Bermuda's ability to reinvent itself time and time again, Kevin Stevenson reported in *Risk & Insurance* that Norman Rosenthal, managing director, Morgan Stanley & Co., Inc said of Bermuda—

> '"No foreign market poses as great a tentative threat to the [US] domestic insurance marketplace as do underwriters on this island." He added that Bermuda had become the world's leading market for captive insurance companies, excess liability, directors and officers coverage, catastrophe and finite reinsurance coverage. Its success had attracted leading worldwide underwriters to establish wholly-owned or sponsored companies in Bermuda. Some of the biggest names in insurance now had significant operations in Bermuda. "Furthermore, the Bermuda market is, in my opinion, significantly under leveraged, writing at a premium to surplus of only about 0.5 to 1, with additional writing capacity in my view of about US $6 billion," says Rosenthal. "The competitive advantages that Bermuda insurers and reinsurers possess *vis-à-vis* US-based insurers and reinsurers are compelling, and highlight the advantages that foreign carriers in general bring to the insurance marketplace." Rosenthal believes advantages include the fact that Bermuda companies are not burdened by the complex and extensive state regulatory system; insurance contracts issued in Bermuda limit their exposure in the US judicial system; and brokers' commissions are typically lower for business placed in Bermuda. "We believe these features give Bermuda underwriters a significantly lower cost structure compared to their US counterparts, and this expense benefit should permit these entities to rapidly expand their business in certain harder business lines, particularly high-ticket commercial coverages," says Rosenthal.'[638]

Casualty Market remains soft

While the property catastrophe market was growing by leaps and bounds as it sought its middle ground, the casualty market was still in a huge trough. Casualty rates were very soft, coverages were being extended and all held their breath hoping there would be no major losses to add to the woes of the casualty writers. *Risk & Insurance* commented on the state of the market as follows—

> '..."Never in my experience of general cycles since coming out of the army in 1953, have the property and casualty fields swung in such opposite directions and stayed there," says Mr (Jonathan) Crawley, President of Sphere Drake Underwriting Management (Bermuda) Ltd. "Traditionally, the change from soft to hard and hard to soft has either been led by property reinsurance underwriters or casualty reinsurance underwriters. Whichever has led, the other has pretty well followed, usually within six months. The softening in the casualty market started in 1987-8 and it hasn't changed. The property market hardened two years ago, leaving casualty in the doldrums of softness from which it has yet to emerge." Crawley postulates that the softness continues "because companies are not hurting enough, and because they have not adequately addressed the inadequacy of their reserves for liabilities incurred in the 1950s and 1960s, a nettle which sooner or later they are going to have to grasp. It is said in the casualty arena that they are under reserved by 10 to 15 per cent for such household name horrors as pollution coverage and asbestosis." Crawley says the only sensible way to increase business volume and reserves is through increased rates – but nobody wants to take the lead in the present climate.'[639]

A banner year for Bermuda

A record number of international companies was registered in Bermuda by the end 1994. '...Registrar of Companies Mr Malcolm Butterfield said yesterday that the number of internation-

[638] ibid. 'Bermuda Bedevils Competition by Kevin Stevenson, p. B3

[639] *Risk & Insurance*, Bermuda, Special Report, October 1994, 'Bermuda Bedevils Competition', by Kevin Stevenson, pp. B1–B7

al insurance and reinsurance companies on the Bermuda register had risen to 1357, a net increase of 42 from the 1315 total a year ago. In the 12 months to the end of December, a near-record 95 new companies were registered and 53 left the register. The 95 registrations are second only to 1986 when there were a record 125 incorporations. This year's 95 new companies represent a 56 per cent increase over 1993 when there were 61 new companies.

> '...He (Butterfield) partly attributed the growth to greater awareness of the secure Bermuda market with US $29 billion in capital and surplus. "Almost half of last year's formations were captive insurance entities, while over a fifth of the incorporations originated from countries located outside of Bermuda's traditional source markets in the US, UK, and continental Europe," he added. Mr Butterfield continued: "Our statistics tell us that 22 per cent of our new insurance and reinsurance companies came from countries such as Africa, the Middle East, Mexico, the West Indies and Latin America in 1994, compared to eight per cent from those countries in 1993."'[640]

The United States continued to dominate the concentration of business represented on the island. And to no one's surprise, captives still represented a strong percentage of the new formations, representing 48 per cent of the new registrations in 1994. Recognising the growth of the Bermuda insurance industry, the Registrar's office decided to add two more members to its staff to enable it to effectively regulate the companies on the island.

Bermuda's infrastructure tested

With the number of companies that came to the Island in 1993, one behind the other, a huge strain on Bermuda's infrastructure was felt. *The Bermudian* reported—

> 'Such has been the speed with which these companies have set up in Bermuda that not only have they played havoc with the residential market—pushing up rents to hitherto unimaginable heights—but they have also placed a heavy load on the Island's infrastructure, particularly office space and the domestic employment pool.'[641]

The Insurance Industry Report took further note of the strain on Bermuda—

> '...The advent of new companies—not only in the insurance industry—has imposed strains on our infrastructure. Accommodation, both office and houses, are at "premium" rates, with more suitable accommodations being sought. Qualified people are being sought, at "premium" prices if Bermudian, and the need to bring people to the Island to service this industry is paramount. The opportunity for Bermudians and Bermuda residents to further develop their skills through in-house and external insurance related courses has never been greater, with the BII & ICAB offering a wide array of professional courses. Statistically, per the 1993 Manpower Survey, total people employed in our industry reached 1,807 (1,357 Bermudians (+ spouses) and 450 non-Bermudians). This represented an increase of 105 people over 1991 (+ 172 Bermudians, -67 non-Bermudians). We anticipate these numbers to continue to automatically increase for the next several years as new companies mature.[642]

Recognising that they must try to expand without putting excessive strain on the Bermuda infrastructure, exempted companies invited teachers in, to introduce them to the insurance world, so that they could educate their students about the opportunities in the international business sector. Top executives assured teachers that exempted companies are committed to recruiting locally. *The Royal Gazette* reported on the initiative as follows—

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[640] *The Royal Gazette*, 27 January 1995, Business, 'Bermuda-based insurers set record', by David Fox, p. 13

[641] *The Bermudian*, Focus on International Business, January 1994, 'The Property Catastrophe Reinsurance boom, Big Fish in a Big Pond, Bermuda's Newest Reinsurers', by Kevin Stevenson, p. B15

[642] *Insurance Industry Report*, 27 April 1994

'..."There is a misconception that we want to run the companies on our own with experts from the outside," International Chamber of Commerce Chairman, Mr Adolf Luttke told teachers and career consultants...Senior VP of ACE Insurance, Mr Keith White, said the number of Bermudian employees in his company has doubled over the last five years. And as the insurance industry continues to expand, he predicts the number will double again in the next five years...Mr Wayne Morgan, senior VP for Johnson & Higgins said it is vital for companies to raise awareness levels of the job opportunities available to Bermudians. "It is in everyone's interests that our companies are staffed as far as possible with Bermudians who will aspire to top positions in the industry," he said...This year, companies are trying a more hands-on approach so career counsellors can see for themselves the job opportunities that exist for their students in the business sector...But some teachers expressed concern at the lack of Bermudian males who have made careers in the sector. In one company, 75 per cent of Bermudian employees were women.'[643]

Along with the positive benefits to be derived from the growing financial importance of the international insurance industry, its presence brought a growing social problem also, and this Bermuda was finding difficult to keep in balance.

[643] *The Royal Gazette*, 2 December 1994, 'International firms want Bermudians'