CHAPTER 47

1998
Turbulence and a New Bermuda

Heavy weather

1998 shattered all records for economic losses from weather-related disasters. According to preliminary estimates by the Worldwatch Institute, storms, floods, droughts, and fires caused at least US $89 billion in economic losses during the first eleven months of the year—

> 'The 1998 preliminary total represents a 48 per cent increase over the previous record of US $60 billion in 1996—and far exceeds the US $55 billion in losses for the entire decade of the 1980s…During the first three quarters of 1998, the U.S. insurance industry alone had weather-related claims of more than US $8 billion—three times the claims in 1997.
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> 'The direct human impact of this year's weather-related disasters has also been staggering. An estimated 32,000 people have been killed, and another 300 million—more than the population of the United States—have been displaced from their homes or forced to resettle because of extreme weather events in 1998.
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> 'From China to Central America, the evidence is now clear that some of the most damaging weather-related events of 1998 were "unnatural" disasters. Deforestation has left many steep hillsides bare, causing rainfall to run quickly into rivers rather than being absorbed, and often leading to devastating landslides and floods. At the same time, growing population pressures have led many people to settle on vulnerable flood plains and hillsides. While meteorologists connect some of the 1998 disasters to El Niño and its aftermath, no previous El Niño has resulted in such devastating consequences.'[732]

These catastrophes could not have come at a worse time for the global insurance industry, in view of soft rates, terms, and conditions.

Global conditions affect Bermuda

In the Spring of 1998 *Bermudian Business*, together with the *Deloitte & Touche Survey*, published an article entitled 'Bermuda goes Global', in which Standard & Poor's executives Alan M. Levin (Managing Director), Donald S. Watson (Director) and Frederick R. Loeloff (Associate Director) together reviewed the response of Bermuda's insurance industry to the global market conditions. The substance of their discussion and conclusions was as follows—

> 'The year 1997 was one of change for the Bermudian insurance markets and 1998 is already tracking as an acceleration of change with two major consolidations proposed and other acquisitions waiting in the wings. Access to cheap capital has provided insurers the means and declining premium rates have provided the incentive for insurers to diversify. Within the insurance and reinsurance industry in particular, product line and geographic diversification have traditionally been viewed as a key ingredient toward reducing earnings volatility. Diversification enables an insurer to smooth out regional and product line

[732] *Worldwide News Brief*, 27 November 1998 'Record Year For Weather-Related Disasters', by Janet N. Abramovitz and Seth Dunn, www. worldwatch.org

performance with a diversified book of risk. Bermuda has adopted this philosophy with a passion over the past few years with branch offices opening around the globe and more recently, acquisitions.

'...During 1997 acquisitions included EXEL's purchase of GCR Holdings for its nonproportional catastrophe book and separately a Folksamerica shell to directly access the US market; Partner Re acquired SAFR for its proportional book and position within the European and Asian markets; and Terra Nova (Bermuda) Holdings acquiring Compagnie de Réassurance d'Ile de France (Corifrance), to expand upon its European book and market presence.

'As of March 31, 1998, a definitive agreement was signed between EXEL and Mid Ocean for its property catastrophe reinsurance subsidiary and a strong foothold within the London market via the Brockbank Group. ACE also signed with CAT Limited for its tailored underwriting approach.

'Geographical expansion and access to markets has been a primary driver of many of the acquisitions, particularly the more recent move to invest in the US and the slightly earlier investments in London. The London market and Lloyd's in particular, has been a key leg of Bermuda's geographic expansion. The London market provides Bermudians with product diversification and international market access. For 1998, it is expected that the Bermuda insurance and reinsurance market will account for roughly 46 per cent of the £2.3 billion in Lloyd's capacity from corporate members backed by insurance interests. Another good reason for Bermuda's "across-the-pond" flight is that a number of Bermuda's management teams have strong ties to either Lloyd's or the insurance companies within the London market.

'Expansion has its risks and the competitive price environment is beginning to reflect directly the impact of lower pricing with the latest estimates for Lloyd's 1996 and 1997 years of account expected to decline sharply from the record recently reported for 1995. Perhaps more important in the short run is access to the US market. Of the survey's (4th annual *Bermudian Business*/Deloitte & Touche insurance survey with Standard & Poor's) participants, three companies have newly gained a foothold within the US marketplace. In 1997, ACE acquired Westchester Specialty Group (now known as ACE USA) from Talegen Holdings, providing direct writing capabilities and licensing in 50 states, plus a new book of specialty products. In 1998, EXEL acquired shell company Folksamerica General Insurance, now known as XL Insurance Company America, to write directly its own core products, multi-year, multi-line insurance, as well as new lines of business in the US.

'Also in 1998, RenaissanceRe Holdings agreed to acquire Nobel Insurance to expand on the primary side through low-value homeowner's coverage, as well as inherit new lines of business. In addition, RenaissanceRe subsidiary, Glencoe Insurance was set up in 1996 as an excess and surplus lines writer of commercial catastrophe-exposed property business, and has set up DeSoto Insurance in Florida to write "selected" portions of Florida Residential Property & Casualty Joint Underwriting Association homeowners policies. Many of the Island's insurers have long had US underwriting affiliates such as Mutual Risk Management through its subsidiaries that collectively form the Legion Group.

'While change brings new opportunities for growth, change also brings with it uncertainty. For Standard & Poor's, uncertainty clouds our crystal ball making it more difficult to predict operating performance and downside risks as a company profile changes. Corporate mergers may yield far more than one plus one, but on occasion, a merger represents something less than the companies might individually, particularly if the combined entity forgets what made the original companies successful. As with any union, the merger of two distinct corporate cultures and businesses can produce a new entity quite different from either of the parents. In the US, the 1970s was a period for the conglomerates which yielded the unsatisfactory returns of the 1980s which then saw their break-up into more focused business units.

'Relatively cheap capital in the latter past of the 1990s is providing the means to grow accretively, but risks bringing on the same problems of excess as junk debt wrought at the beginning of this decade. The loss of focus and key personnel and changes in underwriting style, while not immediately fatal, can quickly impair management decision-making and lead to sub-par performance.

'Standard & Poor's acknowledges the positive impact that Bermuda provides to the global insurance and reinsurance markets, but also that Bermuda must cope with prevailing market pressures. As both the stock and insurance markets ponder their concerns over how Bermuda will optimise its capital base, intellectual capital is viewed as a staple for Bermuda's success. Innovative thinking, while blending financial disciplines and technological solutions with risk-management strategies, has given Bermuda a product development and marketing edge over most markets.'[733]

The changing role of the regulatory body

In view of global problems and a continued soft market for insurance, the Bermuda industry sought to provide an infrastructure that would allow Bermuda insurers the flexibility and capability to accommodate changing risks around the world. In an article for *Global Reinsurance* Kymn Astwood explained how Bermuda's shared regulatory system continued to adapt so that the interest of policyholders would always be served—

'The Bermuda market is in the midst of a dramatic transformation. New and innovative products are being developed to satisfy the needs of risk managers and insurance/reinsurance companies. In addition, mergers and acquisitions are taking place at an ever increasing rate.

'Bermuda is a spawning ground for new and innovative insurance vehicles that satisfy the needs of customers from around the world. This statement is supported by the fact that during 1997, Bermuda formed 93 new companies, which is the fourth consecutive year that Bermuda has seen formations activity in the 90s. The number of new companies added during 1997 demonstrates the Bermuda market's ability to develop new products that attract business in a time of predominately soft insurance markets.

'The needs of the customers are changing as corporate risk management continues to evolve from managing traditional event risk (fires, accidents) to a broader mandate of protecting corporate assets and earnings from all forms of enterprise risks (event, financial, and business risks). To address this need, the Bermuda market is developing many more products that tailor long term, holistic risk solutions to a customer's specific worldwide enterprise exposures.

'Increasingly, financial institutions such as investment banking and securities firms are growing eager to tap into the potential revenue associated with providing risk management solutions. This development has resulted in significant interest in the convergence of insurance markets and capital markets; a process which is often referred to as the securitisation of insurance risk. Bermuda is positioning itself to become the leading domicile for this emerging market.

'One example of how Bermuda is responding to this challenge is the formation of the Bermuda Commodities Exchange, which is designed to facilitate the exchange of insurance risk in a manner similar to the trading of securities on a stock exchange. Also, various other vehicles have been formed that are designed to act as transformers. Transformers are special purpose vehicles (SPVs) that issue securities to investors on the one hand and provide insurance and reinsurance capacity using these funds on the other. The return on the securities issued is normally linked in some way to underwriting performance. In March 1998, Goldman Sachs, an international investment banking and securities firm, announced that they have formed such a vehicle in Bermuda called Arrow Re.

'To compete effectively in this increasingly global competitive market, where competitors include "global financial supermarkets", certain Bermuda companies have embarked on an aggressive merger and acquisitions strategy. This strategy is based not only on long term corporate survival, but also on the desire for economies of scale and more efficient distribution systems. It also reflects a desire to achieve better spreading of risk, as cited in EXEL's planned merger with Mid Ocean. This deal was widely regarded as a good strategic fit, matching EXEL's long-tail liability insurance with Mid Ocean's predominantly shorter tail catastrophe reinsurance exposures.

'Regulators from around the world are discussing various supervisory issues that arise from the continu-

[733] *Bermudian Business*, Spring 1998, Deloitte & Touche Survey, 'Bermuda goes global', by Frederick R. Loeloff, Donald S. Watson, and Alan M. Levin, pp. 65

ing emergence of financial conglomerates and the blurring of distinctions between the activities of firms in the various financial sectors. In Bermuda, these factors are being looked at very closely. In fact, a special committee has been set up to contemplate the future and make recommendations concerning how Bermuda's shared regulatory system needs to adapt over the next three to five years. A first step to deal with the issue of the convergence of the insurance and capital markets has already been made with the passing of the Insurance Amendment Act 1998.'[734]

Insurance Amendment Act 1998

This Act was considered groundbreaking because it allowed Bermuda to become a centre of innovation at a time when the global insurance industry was striving to redefine itself. Global companies vied for distinct individual recognition but were hampered by burdensome regulations as to what was an insurance contract and what was not. Much of the restriction on growth hinged on what was to be accepted as actual transfer of risk in the new financial products being promoted.

The Bermuda regulatory body had always prided itself on not being bureaucratic and on being able to respond swiftly to change. As Brian Hall, Chairman of the Insurance Advisory Committee said, 'the Insurance Amendment Act 1998 was enacted to recognise the blending and redefining of financial and insurance products.'[735] The Appleby Spurling & Kempe *Guide to the Bermuda Insurance Market 2000* further defined the Act as follows—

'The Bermuda government has amended its insurance legislation in a bid to help the island become the leading market for the convergence of insurance and capital markets. The main purpose of the Insurance Amendment Act 1998, which is believed to be the first of its kind, is to remove any uncertainty as to whether an investor in a securitised instrument is engaging in insurance.

'Uncertainty as to the legal standing of certain contracts under law can adversely affect the ability of companies to raise capital for securitisation deals. For example, linking an investment contract such as a bond to insurance results raises questions about its legal classification. This is important where capital is coming from institutional investors that want to know whether they will be deemed to be conducting business as insurers under law. We view the Insurance Amendment Act 1998 as part of an evolving legislative process which is dealing with an evolving industry.

'The purpose of the 1998 Act is to allow persons who are not registered insurers to invest in insurance derivative products which are offered in the capital markets. These derivative products are themselves innovative ways of risk financing, completely in keeping with the spirit that has fostered the growth of Bermuda's insurance industry. The 1978 Act did not anticipate this development and there existed some doubt as to whether such products constituted "insurance business" under Bermuda law, which can be conducted by registered insurers. The 1998 Act dispels those doubts by expressly stating that being a party to a derivative contract designated by the Minister as a "designated investment contract" will not constitute the carrying on of insurance business within the meaning of the 1978 Act, nor will such a contract constitute an insurance contract or a wagering contract.'[736]

The evolution of electronic commerce

The second important initiative of the Bermuda government was to allow Bermuda to set the pace for electronic commerce. It was widely anticipated that 'e-commerce' was the way insurance business would be conducted in the future. *Global Reinsurance* reported Bermuda's position as follows—

[734] *Global Reinsurance*, Volume 7, Issue 3, Bermuda Edition, 1998, 'The changing face of regulation', by Kymn Astwood, Registrar of Companies, pp. 27 & 28

[735] Brian Hall, personal notes, 1998

[736] Appleby Spurling & Kempe, *Guide to the Bermuda Insurance Market 2000*, 'The Insurance Amendment Act 1998', pp. 3-8

'…It is a harsh fact of modern business life that competition is intensifying in every market, and the Bermuda government in general and the registrar of companies in particular recognise that they have a major part to play in maintaining Bermuda as one of the world's leading insurance markets. How do we do that? We do it in part by providing better value for money, principally by offering greater efficiency through more and better use of computer technology. To ensure that Bermuda maintains its competitive edge, plans are now afoot to implement electronic commerce in the Bermuda insurance industry.

'One piece of the puzzle is the Bermuda Lotus Notes Private Network (or Bermuda Connect), which is a centralised application and mail server that enables an association of trading partners to conduct electronic commerce. The registrar of companies is now communicating with Bermuda Connect members on a secure basis using e-mail. In addition, we are currently testing a custom built Lotus Notes application that will enable us to receive applications for regulatory approvals electronically and process them more efficiently by making greater use of technology. The system also enables the precise tracking of applications through the approval process and compares response times to predetermined targets.

'Another component of our strategy is a website designed especially for electronic commerce. Developed using Lotus Notes Domino technology, this site will allow service providers to reserve company names on-line and submit their statutory financial returns electronically. It will also allow service providers to review on-line the status of their applications submitted. This website will initially be deployed on Bermuda Connect only; it will be available on the web once internet security concerns have been fully addressed.

'Another piece of the puzzle is the Bermuda Insurance Data Service or BIDS for short. This service is being promoted by a group of Bermuda reinsurers and is designed to ensure that Bermuda remains time-competitive when bidding on new business. The system would allow brokers from around the world to submit details of their submission to this secure website. The brokers would then have the option of choosing the reinsurers they want to submit bids. These reinsurers would then be sent an e-mail informing them of the existence of the submission, and they would either review it at the site or download the files they want. Once a reinsurer has made contact with the site, the broker would be automatically notified by e-mail.

'Bermuda Connect and BIDS are just two examples of the move to make Bermuda a "technology island". Our ultimate goal is to make the island one of the most technically advanced jurisdictions in the world.

'We expect continued growth in the global insurance and reinsurance marketplace where there is only one constant, and that it change. Indeed, change in the world's insurance markets has been the main engine for the growth in the Bermuda market. As we approach the next millennium, the challenge for Bermuda regulators is to remain alongside the innovators of the industry so that our regulations keep pace with a changing world…'[737]

Bond market enters insurance industry

With the industry diversifying to include financial products and the emergence of the importance of enterprise risks (protecting the entire corporation), the bond market began to make steps to enter the insurance industry. *The Economist* reported on the new breed of insurers as follows—

'Bond buyers are increasingly eager to take on other people's risks. For the insurance business, the implications are enormous.

'The wizards on Wall Street and in the City of London never seem to run short of new ideas. Try this one: a ten-year bond that pays nearly twice as much as a typical low-risk investment —but with a twist. If Tokyo is struck by a serious earthquake during the next decade, the investor forfeits all or part of the principal. Tokio Marine & Fire, a Japanese insurance company, issued USD100m- worth of such bonds in November. Your company's pension plan may well be among the owners.

[737] *Global Reinsurance*, Volume 7, Issue 3, Bermuda Edition, 1998, 'The changing face of regulation', by Kymn Astwood, Registrar of Companies, pp. 27 & 28

'Bonds like this are still an oddball investment. But they herald a revolution in the insurance business. Even ordinary lines such as motor or health insurance will soon be turned into securities that investors can buy and sell in the capital markets. Hannover Re, a German reinsurer, is about to issue the first ever bonds backed by run-of-the-mill life-assurance policies. Similar deals should follow soon. Their effect will be increasingly to blur the distinction between insurance and investment banking. Instead of bearing risks themselves, insurers will concentrate on selecting risks and packaging them for sale to investors who care more about yield than mortality tables and accident frequencies. In the process, insurers will come up against a bevy of new competitors—with names like Morgan Stanley and Goldman Sachs.

'The transformation began with Hurricane Andrew. That storm, which struck Florida in 1992, and the Northridge Earthquake, which rocked the Los Angeles area in 1994, caused enormous damage, not least to insurers' balance sheets. Several property and casualty insurers collapsed under the onslaught of claims. And these were only medium-sized catastrophes. The insurance industry reckons that "the big one"—a repeat of the 1906 San Francisco earthquake, say—might wipe out the entire US $300 billion of capital held by America's insurance industry.

'The answer was catastrophe ("cat") bonds. Also known as "acts of God" bonds, they were designed to spread risk throughout the capital markets rather than keeping it on insurers' own books, and thus to reassure policyholders that they would be protected against even the largest of losses. Since the first "cat" bonds came to market in 1994, six more issues worth a total of US $1.1 billion have been sold, all since 1996.

'A year ago 86% of insurance executives polled by New York's Insurance Information Institute, a trade group, thought that selling insurance risks to investors in the financial markets would prove a fad. That conservative view has proved spectacularly wrong. Instead of fading out, the trend is now moving beyond "cats". Life-assurance bonds of the sort Hannover Re plans to issue are motivated not by fears of catastrophe, but by a desire to make more money.

'If it sounds a bit familiar, it should. Insurers are discovering what bankers know as securitisation: the process of assembling mortgages, credit-card receivables or even business loans into securities that provide reasonably predictable income streams and principal repayments. This sort of financial engineering has been going on for decades in America, and has lately taken root in Europe. Its big advantage is that, once the assets have been sold, the issuer need no longer set aside capital to cover potential losses; instead, the capital can be redeployed more profitably. Insurers are only now waking up to the potential benefits. "Insurers are good at risk selection," says Martin Davis, a director of Sedgwick, a big insurance broker. "That doesn't mean they should sit on the risk all eternity."

'Securitising catastrophic risks can be complicated. Suppose, for example, that an insurer decides it is prepared to cover up to US $400 million in losses from property damage in Florida from its own capital and reserves. It might sell policies with a maximum loss of US $600 million, and then sell "cats" to cover the US $200 million exposure it does not wish to bear. An even more creative way to tap the capital markets uses put options, which entitle the insurer to sell its own share to the investor at a pre-determined price in the event of a catastrophe, guaranteeing access to new capital at critical times.

'Either way, investors are in effect taking on the function of reinsurance. Aside from spreading huge losses more widely, the bonds bring more stability to a reinsurance market known for wildly gyrating rates and for developing sudden aversions to certain types of risks.

'This is not an investment for everyone. Big earthquakes and hurricanes strike so rarely—but with such severity—that the usual risk-and-return formulae are certain. Institutional investors, such as pension funds, have welcomed "cats" because they offer a high return while diversifying a portfolio of other investments. Although the "cat" is risky, and although the investor's loss can be huge if a catastrophe does occur, the risk-return trade-off for the portfolio as a whole improves as long as the risk of the "cat" is not correlated with that of the other investments. Few investors, however, have portfolios big enough to balance the risks of "cats" in this way.

'Life-, health-, and motor-insurance bonds are likely to be easy in comparison. Put simply, investors will pay, up front, for the right to receive a stream of premium and investment income that a group of policies will generate. Unlike "cats", these bonds may well appeal to individual bond buyers. For one thing, each securitised portfolio can easily include enough individual policies to make the ratio of losses and the rate at which customers will cancel their policies highly predictable. For another, with life and health insurance there is much less chance of a cataclysmic event that could cause the bonds to lose their value altogether.

'All of this is starting to force insurance companies into unfamiliar territory. Today, an insurer's financial strength is one of the most important determinants of the business it draws. In future, though, the insurer's soundness may matter less than its skills at consumer marketing, its ability to separate good risks from bad, and its system for shuffling those risks into the hands of investors. Revenues may come less from premiums and more from servicing and origination fees, just as has occurred in America's mortgage industry. "An ultimate scenario would be that insurers become distributors and packagers of risk rather than bearers of risk," says Alan Punter of Aon, an insurance broker.

'This will bring the giant insurers into direct competition with another industry that specializes in financial packing: investment-banking. While the likes of Swiss Re and Allianz, a big German insurer, have set up their own capital-markets divisions, Wall Street firms such as Goldman Sachs have launched insurance arms. Financial groups that own both insurers and investment bank—such as Prudential of America; AXA, which is based in France, ING of the Netherlands; and Credit Suisse—may eventually be well-placed to peddle securities issued by their insurers directly to investors.

'A brave new world? Maybe. But in a surprising way, the insurance industry is going back to its roots. Securitisation separates the act of selecting risk from the provision of capital and brings the two functions together in a marketplace. This is more or less how the modern insurance business began—in 1688, when merchants and shipowners began haggling hull rates with their risk brokers in a London coffee house owned by Edward Lloyd.'[738]

Investment bankers open insurance companies.

Following the news of the bond market entering the insurance industry, Bermuda began to make headlines with investment bankers opening insurance companies. When Arrow Reinsurance Co. Ltd. opened its doors in Bermuda in 1998 another new era in the Bermuda international insurance industry began. Arrow Re was the first Bermuda reinsurer to be owned by an investment banker. However, it did not remain the only one for long because shortly after, Lehman Bros established Lehman Re.

Arrow Re was created by Goldman Sachs as a Class 3 insurer to act as a 'transformer' by facilitating the transfer of reinsurance risks to the capital markets by issuing securities or entering into derivatives contracts.

Lehman Brothers invested US $500 million into Lehman Re, a Bermuda-based Class 4 reinsurance unit that will underwrite and accumulate insurance and reinsurance risks, which it will ultimately channel to the capital markets either through securitisation or structured derivative products.

39 year old Michael Gelband was selected to head up the new Lehman Re office in Bermuda after having been with Lehman Brothers in several departments since 1983. As Kevin Stevenson reported in *Bermudian Business*, Gelband said they chose Bermuda as their domicile because—

'"It is the world's third-largest reinsurance centre, has a talented pool of industry executives and a solid infrastructure. Not only is there the appropriate regulatory environment", he says, "but the recent amendment to the Bermuda Insurance Act encourages the securitisation of risk.... Many reinsurers are nervous about our getting into the market and I've received many calls to this effect. My view is that there will be some overlap, but it will be relatively small. I believe over time we will end up having a mutually beneficial relationship."'

[738] *The Economist*, 26 February 1998, 'An earthquake in insurance'

'Stevenson commented that "Gelband like many others at the cutting edge of the convergence of the risk and capital markets is unsure where the securitisation of risk will end up. But he agrees the market is undergoing a fundamental transition."'[739]

Advent of investment bankers causes some concern

Many viewed the capital markets entering the Bermuda insurance industry as purely speculative and as having very little chance of success unless they were willing to offer something radically different to what was already being offered in the Bermuda marketplace. *National Underwriter* printed the following comments by an analyst about investment bankers entering the insurance industry—

'…Unlike those past periods of capital infusion into Bermuda, today's trend appears to be an attempt to take advantage of Bermuda's unique position as a tax haven and the nexus for the insurance and reinsurance markets.

'S&P's Mr (Donald) Watson (a director for Standard & Poor's), said that although these most recent start ups think they are bringing something new to the table, it remains to be seen how the markets will respond. "Hanging a shingle up isn't going to bring in the business," he said. "The new startups will have to offer something more, such as lower cost through better investment returns and a tax-free environment…" Mr Watson said the difficulty these investment banks have had getting into the reinsurance business stems from the low cost of traditional reinsurance. The cost of capital market transactions is high, he said, which depresses demand.

'In addition, Mr Watson said investment banks also have to get over the hurdle of educating the capital markets on the nuts and bolts of the new transactions. Unlike traditional reinsurance transactions, which are well understood, he said capital market transactions are quite complicated and everything has to be spelled out.'[740]

Brian O'Hara, President and chief executive of XL reinforced these views, as quoted by Kevin Stevenson in *Bermudian Business*—

'"…They're (investment companies) coming into the market at the lowest ebb that one can ever remember," says O'Hara. "To get that risk in their door, they have to buy it at the lowest level which would, one would have to guess, be unprofitable. They have to start from scratch at the worst possible time, and there is no real prospect of any improvement in market conditions.

'"What magic can they do to wave a wand to ensure the capital markets aren't going to lose money? That's the US $64, 000 question.

'"They keep saying this is going to happen and they are going to be the leaders in it. They keep equating it to the creation of the mortgage secondary markets. But it's not the same, and they're going to have to go through a learning curve to find out that it's more different than similar.

'"The irony is that the most commodity-type risks are more like auto physical damage on big fleets of autos where you have high actuarial credibility and confidence levels. State Farm and Allstate would be in a better position to transform auto physical property damage into the capital markets.

'"But the only area that everyone's working on now is catastrophe where there are indices that have been developed. But nobody knows how well the models work and our experience is that they are not precise. So, in the beginning it's going to be hit and miss and we won't make any real progress until there is an event. Things will get refined as we go forward.

'Ironically, investment bank JP Morgan has stayed clear of the convergence of the risk and capital markets, instead electing to become a direct and founding investor in virtually all the major Bermuda companies.

[739] *Bermudian Business*, Fall/Winter 1998, 'Lehman commits to new reinsurer', by Kevin Stevenson, pp. 30–34

[740] *National Underwriter*, 15 February 1999, 'Analysts sceptical about Bermuda reinsurer startups', by Dan Lonkevich, pp. 3 & 22

'"Morgan, through Vice-Chairman Roberto Mendoza, was one of the first to explore this area (securitisation) from an investment bank perspective, and they concluded that it wasn't workable…It wasn't broad enough."

'One of the driving forces fuelling the creation of cat bonds is that in theory, they aren't correlated with the stock and bond market…

'"It was Mendoza who eloquently stated that if you want to get uncorrelated risk, buy the stock of a property cat company…He termed it (securitisation) an eloquent solution in search of a problem."

'Stevenson further reported O'Hara as saying that Mendoza concluded it wasn't necessary for the capital markets to enter the cat business because its needs were already being looked after —except at the very peak risks.

'"They are under-served at the top and that's where you're finding the capital markets apply their solution first," says O'Hara. "Whether that will migrate down the risk curve remains to be seen, but we want to be a part of it if it does. We want to be in a leadership role."'[741]

Life and health insurance begins to take root

Bermuda also began to see a new wave of life and health business after the initial forays of companies in 1997 because, as stated by Michael Butt, 'Life (business) has been a quiet corner of the reinsurance business—but quiet corners don't get left alone any more. We shouldn't take for granted that the way things have been done will continue to be the way.' Mr Michael Butt, director of XL Capital muses, 'Many things change. I think we will see the brokers play a more substantial role in life reinsurance.'[742]

According to the AXCO (in operation for 30 years and provides detailed insurance, healthcare and pension market information for 145 countries) November 2000 report, Bermuda appealed to the life insurance companies because of—

'Freedom from regulatory restraints such as statutory reserving

'Freedom from investment regulations (Bermuda's liquidity ratios requirement does not apply to long-term insurers).

'Freedom from corporate taxes

'Greenfield operations allowing the formation of small, multi-disciplinary teams with integrated computer-modelling facilities.

'Life companies are becoming increasingly aware of balance sheet issues as a result of demutualisation and the convergence of different financial services providers. Companies are therefore anxious to re-deploy their capital from traditional lines of business to investment-related areas where they can achieve a greater return on equity. Bermudian reinsurers offer the capacity and expertise to accept transfers of unwanted block of business such as fixed annuities and long-term disability policies.'[743]

Bermuda's first reinsurer to specialise in annuity and life reinsurance, Annuity and Life Re (Holdings) Ltd. (ALRe) was cleared by the Securities and Exchange Commission to raise US $250 million in an initial public offering…Annuity and Life Re began operating…business was based on the belief that insurance payouts would come later than most insurers expect. The AXCO report gave the following overview—

[741] *Bermudian Business*, Summer 1998, 'EXEL', by Kevin Stevenson, p. 39

[742] *Reinsurance*, November 1999, 'Bermuda: company strategies, Thinking outside the triangle', by Adrian Leonard, pp. 24 & 25

[743] *AXCO, Market Insight Report, Bermuda*, November 2000, 'Life and Annuity reinsurance', p. 56

'The company has already raised US $80 million from strategic investors Prudential Insurance, the largest US life insurer; EXEL, Bermuda's largest insurance and reinsurance operation; financial reinsurer Risk Capital Re; and insurance investor Insurance Partners. The company expects to begin underwriting, through wholly-owned Annuity & Life Reinsurance. It will have a capital base of US $314.8 million, and will be listed on NASDAQ. "The company is unique to Bermuda in that it is the first one to specialize in annuity and life reinsurance," says Lawrence Doyle, President and Chief Executive of both the holding and operating companies. Doyle previously brought Global Capital Re to Bermuda in 1993, which was subsequently sold to EXEL for US $67 million.'[744]

The Royal Gazette gave the following summation of why ALRe was set up—

'By focusing on annuity and life reinsurance, the company will seek to participate in what it believes to be a market with significant growth potential, the company's prospectus states.... Management believes that annuity reinsurance presents an attractive opportunity because of the large potential size of the market coupled with the limited number of companies currently providing such reinsurance on a third party basis.

'The company cites studies which state that new life reinsurance business production grew at a compounded annual rate of about 28 per cent from 1993 to 1996.

'Other studies show that at year end 1996 US annuity assets under management totalled about US $919 billion, and about US $17.6 trillion of life insurance was in force.

'Annuities are a form of insurance policy guaranteeing a fixed or variable payment to a holder over time.

'The principals state that the demand for annuity and life reinsurance is growing due to the trends such as the increasing risk-based capital and reserve requirements set by regulatory bodies and rating agencies, consolidation in the industry, the divesting of large blocks of business to reinsurance, and the trend toward demutualisation by mutual life insurers.

'...Annuity states that it will begin business with ten employees. Marsh & McLennan Management Services (Bermuda) Ltd. will provide claims processing and administrative services. The company intends to keep costs down by focusing on large blocks of business, rather than on going after a large number of policies. Annuity will also limit the maximum aggregate risk on any one life to US $1 million and require the purchasers to retain at least ten per cent of the risk.

'President and CEO Lawrence Doyle, chief underwriter Robert Reale, chief financial officer William Atkin and chief actuary Robert Mills will be the four main senior managers of the company.'[745]

It was also in 1998 that Centre Re, after dabbling in the life industry by conducting standalone disability transactions in 1996 and 1997, decided to formally establish a life and health team in Bermuda.

ACE and XL continue to diversify

More than a decade after their founding in response to the United States liability insurance crisis, ACE and XL expanded their operations to the United States, ACE by acquiring Westchester Specialty Group and XL by acquiring Folksamerica.

After ACE had made several significant investments in London, allowing it to control eight per cent of Lloyd's capacity, acquiring Tempest Re, and opening an office in Dublin, its management then decided to turn its sights to the United States for a company that would allow it immediate access to a customer base there. ACE settled on the US $333 million acquisition of the US insurer Westchester Speciality Group Inc., a subsidiary of Xerox Corporation's Talegen Holdings. The Atlanta based company provided specialty property, umbrella and excess casualty cover.

[744] *Bermudian Business*, Spring 1998, Insurance Update, 'Annuity and Life gets green light', p. 46

[745] *The Royal Gazette*, 11 March 1998, 'Bermuda company plans to tap life reinsurance market', by Ahmed ElAmin

In the *Global Reinsurance* Magazine, Ahmed El Amin commented on ACE's acquisition of Westchester Speciality as follows—

'...In lockstep with EXEL's moves into the US, early this year ACE acquired Westchester Specialty Group, Inc. now operating as ACE USA. ACE will use its US company to target smaller companies with more frequency-oriented products, says Brian Duperreault. In April, ACE USA established two new product divisions: warranty and E&O (Errors and Omissions Coverage) and announced that it could offer large blocks of capacity for excess liability and property in combination with its parent company.'[746]

Kevin Stevenson of *Bermudian Business* commented on ACE's expansion into the United States—

'(Brian Duperreault, Chairman, President and Chief Executive of ACE said:) "Let's take ACE USA. We had no other US operations. They were a well-managed group and when we sat down with them, it was as if they were already a part of us—we shared the same approach to business. They had similar personalities and there was a culture there." Unlike ACE's other acquisitions, it made the first move in the Westchester Specialty Group deal, approaching the operation previously owned by Xerox's Talegen Holdings, which had been on the market for some time. "It was an interesting story because they had come to Tempest looking for cat coverage and one of our underwriters, John Young, looked at the company and said. 'Boy, wouldn't this be a great company to buy? They are terrific people.' He saw the commonality and so we went and knocked on their door. They were a part of a group that had announced all the parts were being sold, so it wasn't out of the question for us to walk in and suggest it."'[747]

As for XL's expansion into the United States, *Bermudian Business* quoted the following—

'...purchase of dormant Folksamerica General Insurance (formerly Great Lakes American Reinsurance) for US $10 million, now renamed XL America and EXEL's primary platform in the US. The company is licensed as a property and casualty insurer in 20 states and as a reinsurer in 11 states.'[748]

Brian O'Hara, President and CEO, explained the reason for purchasing Folksamerica in the *Bermuda Market Digest*—

'Our strategic assessment has determined that we should establish a presence in the United States...While it is not clear what the final form of the US "presence" will take, the intention is to enable XL to expand into customer segments that have not previously been shown to the Bermuda market and, therefore, (are) not likely to be shown in the future.'[749]

More consolidations and changes

The insurance industry continued to consolidate in the wake of a very soft market as companies sought ways to diversify their books of business. In Bermuda, the first major announcement came when American International Group acquired 100 per cent of privately held SELIC Holdings, owner of Bermuda-based Starr Excess Liability Insurance Company. AIG Chairman Maurice Greenberg stated, 'By acquiring full ownership of Starr Excess, AIG will be able to better position the company to participate in the US market while it continues as a leading excess carrier in the Bermuda market.'[750]

The second major announcement came when XL decided to buy Mid Ocean Re and Brockbank. The following press release described the intended merger—

[746] *Global Reinsurance*, Volume 7, Issue 3, Bermuda Edition, 1998, 'Bermuda's excess liability companies', by Ahmed ElAmin, pp. 51

[747] *Bermudian Business*, Summer 1998, 'ACE', by Kevin Stevenson, p. 31

[748] ibid. 'EXEL', by Kevin Stevenson, p. 36

[749] *Bermuda Market Digest*, November 1997, Volume 3, Bermudian Business, 'XL set for US presence', pp. 1 & 6

[750] *Bermuda Sun*, 30 January 1988, 'AIG acquires Starr Excess' by Marina Esplin-Jones

'EXEL Limited and Mid Ocean Limited announced today that the two companies have signed a definitive agreement to merge, creating an organization with assets in excess of US $9.12 billion, shareholders' equity of approximately US $4.8 billion and an estimated market capitalization of more than US $8 billion. EXEL will be the holding company for the new organization. EXEL and Mid Ocean plan to combine their reinsurance operations which will operate as XL Mid Ocean Reinsurance Company, Ltd. and be headquartered in Bermuda. The combined organization, based on market capitalisation, will rank as one of the 20 largest U.S listed property-casualty insurance companies. "The combination of EXEL and Mid Ocean creates one of the pre-eminent insurance and reinsurance organizations in the world for excess property and casualty business," commented Brian M. O'Hara, President and CEO of EXEL Limited. "Our reinsurance businesses are complementary," added Mr O'Hara. "Mid Ocean's reputation as a market leader and brand name, coupled with their significant presence at Lloyd's, through their ownership of the Brockbank Group PLC, provides the platform for substantial growth internationally. Reflecting the fact that both organizations are already lean we anticipate only a nominal cost savings. I am pleased to note that the combination of our two companies should be accretive to EXEL's earning on both a GAAP and cash basis excluding any one time charges associated with the transaction. We were a founding shareholder of Mid Ocean more than five years ago and have participated in its growth into a major reinsurance company. As the largest shareholder of Mid Ocean, it is the natural culmination of our investment, and more then doubles EXEL's presence in the reinsurance market," Mr O'Hara added.'[751]

However, news of EXEL's decision to purchase Mid Ocean Re was not met favourably by Standard & Poor's (S&P). As a matter of fact, the large rating agency in the US as reported by the *Bermuda Sun*, 'revised its outlook for the company from "stable" to "negative". S&P analyst for EXEL and Mid Ocean, Don Watson, speculated that another major acquisition could diminish their financial security—

'...Mr Watson also noted EXEL's previous "stable" rating was based on assumptions that the company would be growing organically and conservatively by making minor investments in companies. But EXEL appears to have changed to a more aggressive track now, he said. "EXEL has been nibbling a lot in the last year or two, buying relatively small companies," Mr Watson said. "They purchased Mid Ocean right on the heels of Global Capital Re in October and it is not clear what Mid Ocean brings to the table that Global Capital Re did not already have. We expect some redundancies and overlap there."

'...Insiders say redundancies would probably be in the areas of corporate administration, financial products and finance. The *Bermuda Sun* was told there was a hiring freeze by EXEL about a week before the merger was announced.

'...Despite S&P's concerns about how integrating the two companies will play out, Mr O'Hara said he believed it would not be a problem. "Our cultures are very similar," he said, adding, their reinsurance businesses were "complementary".

'However, Mr Watson said: "There could be an integration problem. These companies do have a difference in corporate cultures. Essentially, Mid Ocean is a British shop. Michael Butt (President & CEO), Mr Newhouse (Chairman) and Henry Keeling (Chief Operating & Underwriting Officer) are all from the UK. When you go to EXEL, you've got a lot of Americans there. There is a possibility they won't get along. Maybe what you are buying today will not be the same if they lose a few key personnel. It may impair their ability to write business."'[752]

Shortly after XL's announcement to acquire Mid Ocean, ACE announced that it would acquire CAT as reported by *Bermudian Business*—

'Bermuda's merger frenzy continues with the announcement that ACE Limited will acquire privately-held CAT Limited for US $711 million in cash. What is particularly interesting about the deal is that

[751] *EXEL News Release*, 16 March 1998, 'EXEL Limited and Mid Ocean Limited announce merger agreement'

[752] *Bermuda Sun*, 20 March 1998, *EXEL's Hearty Appetite*, by Marina Esplin-Jones

CAT CEO Paul Hasse and President Charles Kline will become co-chief executives of a new company, ACE Capital Products. ACE Capital Products is being formed to exploit the convergence of the capital and insurance markets. Its formation is considered extremely timely in light of just-enacted changes to Bermuda's insurance legislation designed to put the Island on the cutting edge of the securitisation of risk. ACE Capital Products will provide clients with innovative financial instruments designed to bridge asset management and risk-transfer needs. "We believe the future of the insurance and reinsurance industry may very well lie in the creation of integrated insurance and investment products to address clients' total risk-transfer and risk-management needs," says Hasse. "We look forward to helping ACE and Tempest lead the industry in product innovation and growth in this area, and to providing specialised asset-management capabilities to ACE clients and others in a worldwide basis."

'Following the completion of the acquisition, CAT will be integrated with ACE's existing property catastrophe reinsurer, Tempest Reinsurance, where Donald Kramer will continue as President and CEO. ACE, through Tempest, will become one of the leaders in the global property catastrophe market in terms of premium volume. "...The proposed acquisition of CAT provides ACE with a strategic advantage in the highly-competitive property catastrophe reinsurance sector," says Brian Duperreault, Chairman, President and CEO of ACE. "Tempest Re has established its underwriting expertise in the more traditional property cat product lines. CAT is an acknowledged leader in the application of proprietary modelling techniques to the non-traditional lines of business. Together, they comprise a strong and technically advanced team. Our continued success in what is admittedly a most challenging market is enhanced by the companies' common commitment to underwriting excellence, rigorous investment discipline and superior financial rating."

'(CAT President Charles) Kline says there is little expected overlap in clients, programmes and specialist skills. "The combined property catastrophe company's balance sheet will permit the largest possible share of traditional programmes and maximum flexibility in the creation of customised programmes," he says.

'Initial reaction from analysts was positive. AM Best affirmed the "A+" (superior) rating of ACE and "A" (excellent) ratings of Tempest Re, with both companies ratings outlooks stable. "Merging the two property catastrophe reinsurers—CAT and Tempest—will benefit both," said AM Best. "The companies have complementary strength, and there is little overlap between CAT's focus on regional accounts and Tempest's focus on national accounts with greater diversification. CAT also brings a technical skill base with emphasis on third party models, while Tempest's focus was on proprietary internal models for national accounts. Following completion of the acquisition, ACE will have assets in excess of US $7 billion and shareholder's equity of more than US $3 billion."'[753]

Shortly after the CAT purchase, ACE then acquired Tarquin making it according to *Bermudian Business*—

'...The largest managing agency group in the Lloyd's market in terms of capacity under a single management. With the completion of the acquisition of Tarquin, for about US $500 million in shares, ACE will manage about 9.3 per cent of the total underwriting capacity in London....As for Tarquin, it only employs 30 people and its business is significantly different to ACE's other Lloyd's investments. John Charman, Tarquin's managing director, will become CEO of ACE UK, replacing Leslie Goodman, who will assume the role of CEO of a strategic development unit within the ACE group. "John is a great underwriter and has an excellent spread of clients around the world," says Duperreault. "The Tarquin acquisition not only accomplishes diversification, it also solidifies our position in Lloyd's itself."'[754]

And in the United States, news of Berkshire Hathaway's acquisition of General Re Corporation in a US$ 22 billion stock deal was the talk of the town. The new acquisition gave the large US reinsurer General Re access to vast new resources and removed the burden of having to respond to the pressures of being a public company by becoming a part of the Berkshire Hathaway Empire.

[753] *Bermudian Business*, Spring 1998, 'Hasse, Kline head new ACE Capital', pp. 104 & 108

[754] ibid. Summer 1998, *ACE* by Kevin Stevenson, pp. 30–32

Seeing the trend of expansion into the United States, later in the year Partner Re made the decision to further its presence there by pumping US $100 million of capital into its US operation, Partner Re United States and purchasing the reinsurance operations of Swiss-based Winterthur for US $780 million. *Bermudian Business* reported on the Partner Re changes as follows—

> '"The acquisition of Winterthur's reinsurance operations accomplishes two things," says Partner Re President and CEO Herbert Haag. "It changes our weak position in the US and makes us more viable for the broker market. It also changes our worldwide presence, adding strength in specialty lines, areas where Winterthur has been very strong."
>
> "Significantly for Partner Re US, which was renamed from SAFR US in the wake of PartnerRe's US $970 (million)-acquisition of French reinsurer SAFR, 57 per cent of Winterthur Re's 1997 annual premiums originated from the Americas…
>
> 'Haag says the Winterthur Group approached PartnerRe regarding buying its reinsurance operations, and that it was one of three companies in the bidding process. He says it is a very significant and balanced diversification on a worldwide basis, and that the two companies are a good fit because they share a very similar, conservative philosophy.
>
> 'The acquisition of Winterthur cannot be seen in isolation. It needs to be set in context of Partner Re's earlier purchase of SAFR. "Through the acquisition of SAFR we clearly upgraded the company in terms of products that we can offer," says Haag. "We greatly enhanced our positions in Europe and solidified our position in Asia. However, we saw we could not give the same level of service to our clients in the US because SAFR was just not very important in the United States. We had to say, either we leave our US clients one-legged—they can only get 'cat' protection through Partner Re in Bermuda, and we can't help them much on the multiline business—or we have to upgrade our service and technical capabilities in the US to the same extent we have in Europe or Asia."
>
> 'Part of the reason Partner Re elected to upgrade its US presence was the belief there was an opportunity to capture more business in the wake of consolidation in the direct reinsurance market which is dominated by General Re, American Re, Munich Re, Employers Re and to a lesser extent Swiss Re. "These companies occupy more than half of the reinsurance business in the US," says Haag. "There is a feeling among insurance companies that the direct writers have become too powerful and there is a sense that they don't want to give more business to direct writers."
>
> 'Haag says Partner Re will compete with the established giants through the broker market by offering an alternative. "I'm comparing ourselves more to the direct writers rather than the rest of the reinsurance market because I think we are considerably better in terms of technical capabilities and in terms of financial strength."
>
> '…Haag believes Partner Re brings an additional advantage—the US operations will be run as an American company. "European reinsurers tend to run their United States operations like a European Company, and the United States (is) very different. The social environment is different, the legal system is different and the employees are different."
>
> 'European reinsurers have also tended to get cold feet in troubled times. Haag cites the example (of how) when the US casualty market turned in the mid-1980s foreign reinsurers retreated from the US, taking with them steep losses. That left the big US reinsurers, American Re, Gen Re, and Employers Re, to reap the benefits of the following hard market, thereby recouping their earlier loss.'[755]

Then came the news that Oil Casualty Insurance (OCIL) shareholders had voted unanimously to replace the ownership structure of OCIL by recapitalising the company along the lines of a mutual, with future ownership calculated on cumulative premiums paid over time.

[755] *Bermudian Business*, Fall/Winter 1998, 'PartnerRe deploys strategic plan, Winterthur purchase speeds up incursion', by Kevin Stevenson, pp. 36–39

Meanwhile there were mournful tidings for those who had known and worked with Fred Reiss, the man credited with starting the captive wave in the 1960s, when Hopewell International Insurance Co., one of the oldest Bermuda captive reinsurers, was put into runoff and filed for bankruptcy protection, in the face of a lawsuit threatened by a captive it had reinsured. After restructuring the company in 1988, the better to deal with the escalating losses in the industry following the staggering Hoechst Celanese Pampa explosion, it was nevertheless decided in the end to put Hopewell in runoff. Despite price increases of 20 to 25 per cent, despite the introduction of a cap of US $1 billion on the total insured value at any one location, and despite a US $250,000 self-insured retention for each captive, Hopewell had never been able to regain a profitable position. Conceding defeat at last, the company declared bankruptcy. Anna Summers, who remained to wind everything down, bore witness to a profound sense of grief at the thought of the Reiss empire, in time past a pioneer in putting Bermuda on the path to fortune, now fading away with barely a sigh and a whimper.

Marsh & McLennan and Sedgwicks merge

After the massive mergers in 1997 of Aon and A&A and of Marsh and J&H, Aon and Marsh seemed to stand in competition as to which would become the largest brokerage firm in the world. They began to look to Europe as the new base for expansion, now that all the large brokerage houses in the United States were no more. However, Kohlberg Kravis Roberts & Co., with five American and British insurers, beat them to the Willis Corroon Group PLC when they bought it for US $1.4 billion in July 1998. The insurance industry was growing alarmed by the emergence of the mega brokers and wanted to do something to enable the smaller brokers to survive, which was why the Travelers Property Casualty Corp., Chubb Corporation and Hartford Financial Services were amongst the five American insurers to sign on with Kravitz to buy out Willis.

However, Marsh was not to be outdone. The lone survivor of the large brokers, UK based Sedgwick Group PLC was acquired by Marsh & McLennan in August of 1998, changing the brokerage market landscape forever and thus solidifying the emergence of the mega brokers.

Bermuda insurance stocks outperform the market

Bermuda's insurance industry's stock values were lauded for their performance when Vincent Farrell told CNN's financial network 'Bermuda's insurers and reinsurers are an overlooked investment sector'. In the process he gave a thumbs up to the innovative companies for 'doing it right' and placed 'prop cat' insurer Partner Re at the top of his stock picks, as reported by the *Bermuda Sun*—

> 'The Bermuda-based companies are referred to as one group even though they are not necessarily that similar,' he told CNN's 'Business Day'. 'They were created offshore to provide property and casualty insurance after Hurricane Andrew some years ago when there was a real dearth of coverage in that arena. Now there is plenty of capacity, but these companies have done it right. Instead of writing bad business, they are buying their own stock back and/or buying other companies. Now a couple of the big ones like ACE and EXEL have done very well over the years and they are trading about 16 times this year's earning. Compare that to 22 times for the broader market and compare it also for the big US based companies trading at about 20-21 times. These look attractive.'[756]

...which leads to Bermuda being called a tax haven once again

The favourable performance of the Bermuda insurance marketplace also began to attract bad news as evidenced by the following *New York Times* article—

[756] *Bermuda Sun*, 3 April 1998, 'CNN pundit recommends Bermuda insurance stocks'

'Here's a pleasantly rebellious thought for this tax season: After you pay the I.R.S., invest in some companies that don't have to.

'Just ask Harry Rosenbluth, a portfolio manager and partner at Boston Partners Asset Management in Greenbrae, Calif., about such investments. His US $15 billion fund owns hefty chunks of several insurers, including Exel Insurance, Terra Nova, Partners Reinsurance and Ace Ltd. These enterprises are innovative, well managed and have not been faced with payouts for heavy losses in several years. But those facts only partly explain why they had average returns of 63.9 per cent for the 12 months ended March 31, compared with 45.5 per cent for the Standard & Poor's 500-stock index.

'Another reason is that these companies are based in Bermuda, which imposes no income taxes. "There is a real advantage to the investor," Mr Rosenbluth said of the stocks, all of which trade in the United States. Freedom from taxes, he said, "permits the compounding of earnings much faster."

'Consider Exel, the 14th-largest insurer in the North American property and casualty market. The company, which provides liability insurance for corporations, paid only US $5 million in income taxes worldwide last year on US $677 million in pretax income, while many of its competitors in the United States paid an average tax rate of 40 per cent. (Most accounting experts use that admittedly imprecise number as an average American corporate tax rate, adding state and local taxes of about 5 per cent to the 35 per cent Federal rate.)

'Gavin R. Arton, senior VP of Exel, said this tax freedom means more than just extra income. "If we get into a competitive situation," he said, "we can lower our pricing structure by 40 per cent."

'Exel and other companies that pay little or no income tax get an advantage in their investments, too. They can keep all the earnings they get, say, on a 7 per cent taxable bond, while their competitors must either pay tax on those earnings or opt for the lower dividends they would receive from a tax-exempt investment.

'Bermuda-based insurers are not the only companies traded in the United States that benefit from these various tax advantages. Cruise, construction, engineering and oil-exploration companies do so, too. And although the strategy is most practical and lucrative for companies, like these, with much non-American business, many other corporations use this tactic to at least some extent. For example, multinationals from a variety of industries have regional headquarters in countries like Ireland or Luxembourg in order to minimize their European taxes.

'Sometimes, the advantages can be great. The Carnival Corporation, a cruise company with headquarters in Miami, is incorporated in Panama, which imposes no income tax on businesses. In fiscal 1997, Carnival had pretax income of about US $672 million, yet it managed to pay just a bit more than US $6 million in taxes. (Those taxes were due on work the company did in the United States; even if incorporated in a no-tax nation, an enterprise must often pay tax on business it conducts in other countries.) Carnival's bill amounts to a tax rate of less than 1 per cent—a far cry from the US $269 million tax bill that a 40 per cent rate would bring.

'For other companies, the tax rate is higher, but the savings are still huge. Consider Schlumberger Ltd., the largest oilfield-services company and one of several in the field that employ tax havens.

'Incorporated in the Netherlands Antilles, Schlumberger racked up about US $1.67 billion in pretax income last year yet paid just US $373 million in taxes. "Schlumberger pays taxes in the low 20 per cent range while its competitors, like Halliburton and Baker Hughes, pay taxes in the mid-30 per cent range," said Jeffrey Freedman, an oilfield-services analyst at Prudential Securities. "So it clearly has an advantage in attaining earnings per share. And you have to say that the lower tax rate pushes up the stock price."

'Of course, this tax benefit is only one reason that Schlumberger's stock trades at 28.9 times its earnings per share, one of the loftiest ratios in the oilfield-services industry. "Schlumberger has the most technically sophisticated product lines, such as its formation-evaluation technology, which is among the most profitable in the industry," Mr Freedman said. "That is why it has been dominant."

'The tax advantage is blunted in fields like the cruise industry, where most or many enterprises get similar breaks. While Carnival paid less than 1 per cent in taxes, for example, one of its main rivals did even better. Royal Caribbean Cruises, which is incorporated in tax-free Liberia, paid no taxes last year on profits of US $175 million.

'Nevertheless, many analysts agree with Mr Freedman that tax advantages, while not the most important factor in stock evaluation, can enhance a company's attractiveness. Thomas Driscoll, a research analyst at Salomon Smith Barney, played down the advantage of low taxes for Triton Energy, an oil-exploration company that is based in Dallas but incorporated in the Cayman Islands. But when Triton's Thailand operations begin to produce oil, "the tax savings will be huge," Mr Driscoll acknowledged, adding, "I suspect that the buy rating I have on the stock would not be as aggressive if they had to pay taxes at the US rate."

'Of course, some people see red when they look at tax-haven companies. "'This is ridiculous," fumed Marc Perkins, Chairman of Perkins Capital Advisers in Delray Beach, Florid., speaking about the tax status of Carnival, for which Micky Arison serves as Chairman. "I don't like people like Micky Arison dipping in my pocket. He already has better basketball seats than I do, since he owns the Miami Heat." Even so, Mr Perkins does not blame Mr Arison. "It's the guys in Washington who are letting him get away with this," he said.

'At least while you labour over Form 1040, Carnival may seem pretty smart.'[757]

The *Bermuda Sun* reported on the implications of this article for Bermuda as follows—

'The article is worrying to EXEL and other Bermuda insurers because US lawmakers have been looking more towards national regulation of the insurance industry rather than state regulation. Along with that may come efforts to eliminate some companies' strategic advantages.'[758]

Bermuda Stock Exchange (BSX) continues to grow and expands into insurance

With the favourable press that the insurance companies' stocks in Bermuda were receiving, despite the unfair labels attached to it as a tax haven, the Bermuda stock exchange began expanding into the insurance arena, as reported in the following article by *Bottom Line*—

'The Bermuda Stock Exchange (BSX) has positioned itself as a niche exchange focused on adding value to Bermuda's thriving international business industry, in particular the insurance and reinsurance markets.

'The BSX has developed a four-part strategy to assist in the continued development of the Bermuda insurance industry, which today boasts total assets in excess of US $100 billion.

'The strategy includes—

· Listing insurance companies

· The development of the first electronic risk exchange—CATEX International—in Bermuda

· Listing of Special Purpose Vehicles (SPVs) such as Act-of-God or CAT bonds

· The design of a new equity index of Bermuda-based insurance companies

'The BSX has been in operation as a domestic exchange for 27 years, but in the past three years has developed rapidly as the world's first fully electronic securities market. More than 200 equities, funds, debt issues and depository receipts currently list on the BSX with a total market capitalization (excluding investment funds) in excess of US $47 billion. In 1996, the BSX was granted "Designated Offshore Securities Market" (DOSM) status from the US Securities and Exchange Commission and is currently seeking other international recognition.

[757] *The New York Times*, 5 April 1988, 'Investing it; profiting from tax-proof companies', by Paul Sweeney

[758] *Bermuda Sun*, 15 April 1998, *Tax status publicity worries Exel officials*, by Marina Esplin-Jones

'The BSX, with its strong focus on technology, is perfectly placed to complement the Bermuda insurance industry and to help in the securitisation process whereby the traditional capital markets are increasingly converging with the traditional insurance market.

'Already the BSX has had success in the implementation of its insurance strategy. Three insurance companies, ACE Limited, EXEL Limited, and Mutual Risk Management, are cross-listed on the BSX.

'In addition, the BSX together with FTSE International, the London-based indexing company, is set to launch the first insurance index to track the performance of the leading publicly traded, international insurance companies which have mind and management in Bermuda.

'The index seeks to demonstrate the "Bermuda effect"—a widely-held concept that insurance companies operating in Bermuda's tax-free environment perform better than those based in the United States and Europe. Initial research appears to prove that theory: a back history calculated from early 1990 shows the Bermuda insurance index has consistently outperformed the NASDAQ Insurance Index (comprised of approximately 100 companies).

'The Bermuda Insurance Index currently consists of 10 companies: ACE Limited, EXEL Limited, IPC Re Holdings Ltd., LaSalle Re Holdings Limited, Mid Ocean Limited, Mutual Risk Management Limited, PartnerRe Limited, Renaissance Re Holdings Ltd., and Terra Nova (Bermuda) Holdings Limited. The index has been constructed using prices taken from the primary markets, while all mergers and acquisitions are factored into the index as they occur. The design and management of the index will be supervised by an independent committee of market practioners.

'It is intended that the index will eventually be tradable in the form of an index option contract. This will enable investors to invest in the offshore insurance market in a single transaction.

'The BSX has also signed Heads of Agreement with the Catastrophe Risk Exchange, Inc (CATEX) to develop an offshore insurance risk exchange in Bermuda called CATEX International. CATEX International will provide a fully electronic trading and communications systems which will augment the existing business of Bermuda's traditional insurance market and through which the members of the exchange can:

- 'Access the unique new distribution mechanism of an electronic posting system;
- 'Cede, exchange or purchase risk in predefined packages with different geographic locations and different perils. There will be no limitations on the types of risk or the geographic locations that can be offered;
- 'Trade risk-related derivative products such as put and call options, on industry standard indices. The business model envisages that traditional capital market players like banks and hedge funds will also be able to utilize this market—thus bringing risk issuers and the traditional capital markets closer together; and
- 'Communicate with the other members through the e-mail and collaborative message tools in the system over a secure, encrypted intranet.

'Though CATEX has not yet been launched in Bermuda, it has more than 40 subscribers onshore, including its newest customer, Lloyd's of London, with its 120 syndicates.

'The most recent addition to the BSX insurance strategy is the listing of Special Purpose Vehicles also called Act-of-God or CAT bonds. To date, SPVs are the most successful form of insurance securitisation and have been developed primarily by the large US reinsurers. The BSX, given Bermuda's preeminence in specialty insurance and reinsurance, is an obvious place for the listing of these vehicles.

'Though still in its development, the BSX is already positioned to add value to this thriving market, especially in the listing of SPVs. The BSX, as a recognised international exchange with a wide information dissemination network, adds marketability and visibility to securities which are listed. The Exchange also offers a secondary market trading mechanism for investors, because many capital market institutions are strictly limited in the extent to which they can invest in unlisted securities.

'The BSX has a clear mission to participate in the development of the offshore insurance market. As the only stock exchange in Bermuda, The BSX is perfectly placed to assist in the design and launch of innovative insurance products. This only serves to enhance the reputation of Bermuda as a leading international business centre.'[759]

Centre Re celebrated its tenth anniversary

1998 marked the tenth anniversary for Centre Re, a very different company from the one that was originally formed in 1988. Even the name of the company was change—to Centre Solutions—because, according to David Brown, company president and CEO, in an interview with *Bermudian Business* magazine, 'when we started, ten years ago, the company was formed on reinsurance, as an insurer of other insurance companies. By 1997, less than half our business was reinsurance. So we wanted a name which reflected the changes. We chose Centre Solutions because, more than anything else we are a provider of solutions.'[760]

The company had been sold to Zurich Financial Services and many of the key players had relocated to New York. The notable presences of Stephen Gluckstern and Michael Palm were to be felt no more in Bermuda. None the less, President and CEO David Brown continued to shock outsiders with the eccentric annual reports for which Centre Solutions became renowned.

At a more personal level, cofounder Michael Palm announced he was withdrawing from Centre Solutions' day-to-day activities in order to focus on interests other than business. That spring he told Kevin Stevenson that he intended getting his "intellectual life back" and giving both time and money to charities—he had already given away half his net worth…[761] He retired, as planned and then, before even the summer was out, on the seventh of August he died, of heart failure. He was 47 years old.[762]

EMLICO—the epic saga's final encore

The battle over Electric Mutual Liability Insurance Company's move to Bermuda in 1995 swung back and forth during 1998. In January a Massachusetts court ruled it illegal. State regulators then filed to place EMLICO in receivership, Bermuda liquidators countered with a suit in federal court to keep control, a state court gave yet another ruling in September but by then all the plaintiffs had settled one way or another so that the challenge to the redomestication by EMLICO was effectively at an end. Even so, many maintained that the trial should not be dropped so easily. On 5 October *Business Insurance* published an article by Douglas McLeod, entitled, 'Regulators lose grasp of EMLICO', that provided an overview of the situation as follows—

'The Electric Mutual Liability Insurance Co. insolvency, which spawned one of the messiest reinsurance and regulatory disputes in recent memory, is about to grow much quieter. 'Barring an appellate victory, the Massachusetts Insurance Division has lost its effort to retrieve the EMLICO estate from liquidators in Bermuda, which is where the General Electric Co. insurer redomesticated in 1995. All of the reinsurers that originally challenged the redomestication in court have settled, including London market insurers that may have agreed to pay GE and EMLICO as much as US $500 million. Several reinsurers—including Commercial Union Insurance Co.—are still disputing GE claims, but they are doing so in arbitrations out of public view. 'With the storm subsiding, then, observers last week debated the extent of any damage to the various parties involved, from GE to EMLICO's reinsurers to the Massachusetts

[759] *Bottom Line*, April 1998, the BSX Report, 'Adding Value: The BSX insurance strategy contributed', by BSX and members, p. 18

[760] *Bermudian Business*, Spring 1998, 'Holding the Centre', by Roger Crombie, pp. 42 & 44

[761] op. cit., 'Centre Stage', by Kevin Stevenson pp. 33, 34, 36, 38, 40 & 44

[762] *The New York Times*, 14 August 1998, 'Michael Palm, 47, Innovator in method of reinsurance', by Joseph B. Treaster

Division itself, was a source of speculation among observers..'Reinsurance lawyers and others familiar with the case differ over whether GE emerged a victor in its agreement with London insurers and earlier settlements with Kemper Reinsurance Co. and other reinsurance companies. Most agree on another point, though—both GE and Massachusetts regulators have suffered embarrassing black eyes in the insurance and regulatory communities as a result of the EMLICO controversy. "It was an embarrassment, and I think there were significant lapses of judgment both on the part of GE and on the part of the insurance commissioner in Massachusetts," said a regulatory source not involved in the case, who requested anonymity. "This was a very unpleasant case for all of the parties," agreed David Spector, a reinsurance lawyer with Hopkins & Sutter in Chicago who is not directly involved in the matter.

'EMLICO, a long time GE liability insurer, won Massachusetts's regulators' permission to move to Bermuda in 1995. Within months, it declared itself massively under reserved for GE asbestos and pollution liabilities and filed for liquidation. Several reinsurers, unaware of the move until the liquidation filing, charged that EMLICO and GE had fraudulently conspired to hide the insurer's insolvency to take advantage of Bermuda liquidation laws that would accelerate reinsurance recoveries. An international legal war followed, drawing in EMLICO, GE, several reinsurers and regulators in Bermuda and Massachusetts.

'Massachusetts Insurance Commissioner Linda Ruthardt tried to resolve the conflict last year with a proposed deal in which she would have become ancillary receiver to EMLICO's Bermuda liquidators, partners of Coopers & Lybrand L.L.P., now PricewaterhouseCoopers. Reinsurers led by Kemper Re objected to the deal, though, and the Massachusetts Supreme Judicial Court threw it out in January, ruling that the insurance division never had the authority to allow the redomestication in the first place and that EMLICO—regardless of its corporate status in Bermuda—remained a Massachusetts insurance company.

'The Insurance Division responded by filing a receivership petition, but Supreme Judicial Court Justice John M. Greaney rejected it in a ruling last month (*BI*, Sept. 28). "I am satisfied that EMLICO Ltd. is a lawful Bermuda corporation...and that the assets which would have been the subject of a Massachusetts receivership are in control of the (Bermuda) joint liquidators of EMLICO Ltd. and are being administered in accordance with Bermuda law," Justice Greaney wrote. "It follows in my mind that Bermuda has lawful jurisdiction over the liquidation...There is, to be sure, a seriously disputed question whether EMLICO and General Electric engaged in fraud or other wrongdoing in obtaining approval from the commissioner to redomesticate EMLICO to Bermuda. This question, if it is to be resolved at all, is to be answered in other proceedings in other *fora*," the judge also wrote. Noting that practicality weighs against a Massachusetts receivership, Justice Greaney also said the Insurance Division may seek the Bermuda liquidators' permission to act as ancillary receiver and that he would consider another petition from Ms Ruthardt if she gets that permission.

'Several observers speculated that the outcome of the receivership case didn't disappoint Massachusetts regulators. "In many ways, I think the Massachusetts Division of Insurance felt they were obligated by the (January Supreme Judicial Court) ruling to file the receivership petition, and I'm not sure that they don't welcome this resolution," Mr Spector said. "She got what she wanted. She got rid of it," a regulatory source said, referring to Ms Ruthardt. David Leslie, a lawyer representing the division, denied this, however. "We aggressively pursued the US receivership for EMLICO. I don't think we pulled any punches," he said.

'The Insurance Division has not decided whether to appeal to the full Supreme Judicial Court. Mr Leslie, with Rackemann, Sawyer & Brewster in Boston, added that regulators also are weighing whether to proceed with an investigation into the fraud allegations against GE and EMLICO, possibly as part of an examination of Electric Insurance Co., a former EMLICO unit that remains in Massachusetts.

'Several lawyers, meanwhile, say that Justice Greaney's ruling may have been heavily influenced by the fact that all of the reinsurers that originally sued to reverse the redomestication —London market insurers, Kemper Re, General Re Corp. units and Allstate Insurance Co.—had reached settlement agreements with GE and EMLICO. London insurers, the last to settle, informed Justice Greaney of their intended deal shortly before a hearing on the receivership petition last month. "This is not mere happenstance that this settlement was announced just before oral arguments were scheduled to begin," said one lawyer familiar with the case. In fact, among several reasons for rejecting the receivership, Justice Greaney noted that "no Massachusetts party or interest will be harmed by the ongoing liquidation in Bermuda. The reinsurers which previously appeared in this proceeding have settled, or are in the process of settling, their disputes with EMLICO Ltd."

'While GE may have won the Bermuda liquidation it wanted, the question of whether it emerged the victor in its deals with reinsurers is a matter of debate. US and London sources say that London market insurers, including Equitas Ltd. on behalf of Lloyd's of London underwriters, have reached an agreement in principle—still to be finalized —to settle direct insurance and reinsurance claims with GE and EMLICO for about US $500 million. GE officials have said that London market insurers represent about half of EMLICO's recoverables, and lawyers familiar with the case say that the US $500 million represents a fraction—perhaps half—of what GE and EMLICO had demanded from the London market.

'The proposed deal follows the June announcement of a settlement among GE and EMLICO and Kemper Re and the August announcement that Kemper Re was being acquired by a unit of GE Capital Corp. The unit, GE Global Insurance Holding Corp., will pay US $463.5 million in cash for Kemper Re, according to Securities and Exchange Commission filings. Some EMLICO observers say that GE's concerns about ongoing litigation, bad publicity and the prospect of a US receivership allowed London market insurers and Kemper Re to win better deals than they could have hoped for in either a US or Bermuda liquidation. "I think this was all damage control on GE's part," one regulatory source said. "The real economic beneficiaries of it are the two reinsurers that (complained) the loudest," Kemper Re and the London market.

'A GE spokesman refused to comment on terms of the settlements, and a GE official said he could not comment on other issues involving the deals. David Lines, a PricewaterhouseCoopers partner and EMLICO liquidator, could not be reached. Some observers aren't so sure the deals—particularly the London market agreement—are so bad for GE. Kemper Re's earlier settlement may actually have pushed the London insurers to the bargaining table, one reinsurance lawyer familiar with EMLICO said. One thing most observers agree on is that the reputations of both GE and the Massachusetts Insurance Division have suffered throughout the EMLICO débâcle. "GE has been a big loser. They have taken a bloodbath in the court of public opinion and in the regulatory community, and they're one of the biggest insurance groups in the US," according to one reinsurance attorney. "It will take GE a while to get over this," the source said. "Everybody in the regulatory community knows what happened."

'Another reinsurance lawyer, however, said that the insurance market and regulators generally view GE's other insurance operations—principally Employers Reinsurance Corp.—as unconnected to the EMLICO controversy, and he predicted that any residual bad feelings between GE and regulators will disappear. "My guess is that regulators will say it's all litigation and posturing, and they'll forget about it," he said.

'Massachusetts regulators' reputations have also taken a beating. "This is just one more fiasco for state insolvency regulation," a reinsurance attorney said. "They allow this huge redomestication after a 30-minute hearing without hearing from other parties." The Massachusetts Division "went along with the suggestion that (EMLICO's redomestication) be done virtually invisibly," a regulatory source in another state agreed. A coalition of consumer groups in Massachusetts last week called on acting Gov. Paul Cellucci to fire Ms Ruthardt, citing EMLICO and several other actions that have attracted controversy. A spokeswoman for Ms Ruthardt dismissed the groups' charges as a "rehash," according to a story in *The Boston Globe*. Ms Ruthardt's spokeswoman could not be reached.

'Another thing most observers agree on is that the circumstances of the EMLICO saga are so unusual that regulators are unlikely to see another such case again. "It's been one of the longest-running soap operas in the business," one reinsurance official said.'

Business Insurance followed up on Douglas McLeod's article two days later with an editorial entitled, 'Don't Drop EMLICO Inquiry' that had this to say—

'Nearly three years after Electric Mutual Liability Insurance Co. jumped offshore and closed up shop, the Massachusetts Supreme Court has ruled that state insurance regulators have no standing to undo the move to Bermuda and assume control of the insurer. The ruling may seem moot to many, as the reinsurers that cried foul over EMLICO's redomestication and pressured regulators to try to regain control of the General Electric Co. insurer have since settled their claims with EMLICO and withdrawn their opposition to the move.

'The reinsurers' basic charge, from the start, was that GE and EMLICO engineered the redomestication to take advantage of Bermuda's winding-up procedure, which allegedly would make the reinsurers liable for claims much faster than under Massachusetts law. However, the settling reinsurers no doubt ultimately decided that the huge legal costs and uncertainties involved in fighting the move outweighed the potential gains, and they made a business decision to cut their perceived losses. Any of the time savings from a slower liquidation quickly evaporated in the face of the long-running legal battle. The liquidators and GE no doubt are relieved that the estate's assets will no longer be depleted by litigation, leaving EMLICO's remaining funds for their intended purpose, which is meeting claims. But while the Bermuda liquidators and GE may be pleased, or at least willing to live, with the outcome, there is a key question left unresolved: Did EMLICO and GE subvert state regulation in their original petition seeking to redomesticate offshore, in which EMLICO claimed solvency, or did regulators merely exercise poor judgment in not questioning its liabilities? That is an issue that has yet to be satisfactorily explored and laid to rest. While several reinsurers leveled allegations of fraud over EMLICO's petition to move to Bermuda as a solvent company, their settlements effectively put the matter aside. Other reinsurers still challenging EMLICO claims will surely raise the fraud charge themselves, but their disputes will be handled in private arbitration. As a result, any evidence they present or defences offered by the insurer will be sealed from public view. Is there a public interest in resolving these questions about EMLICO's and GE's conduct? We believe there is: It is to ensure that a regulatory system intended to protect policyholders is not undermined by parties gaming the system for their own advantage.

'EMLICO is unique in that it has a single policyholder: General Electric, its owner. With the insurer's owner also the only policyholder at risk, some might question whether there is any point to continuing to seek the truth about what happened. But the precedent set by this case is one that could have harmful ramifications if other companies with many more policyholders seek approval for similar wholesale reorganizations without first acknowledging their liabilities.

'We urge the Insurance Department to conduct a full and open investigation into the circumstances of the move to Bermuda from Massachusetts and its aftermath. Just as important is that Insurance Commissioner Linda Ruthardt issue a full and public report. The inquiry should not become part of a confidential examination of former EMLICO unit Electric Insurance Co., as Ms Ruthardt earlier proceeded to do. The charge that EMLICO and GE subverted state regulation should be publicly proved or publicly laid to rest. Given Massachusetts insurance regulators' role in approving the move, we think they should hire an independent investigator. This is particularly important given Commissioner Ruthardt's assertion last year that she was pressured by her boss to keep her hands off EMLICO after the controversy erupted.

'We don't deny that Bermuda offers an attractive option for a company looking to run off an essentially captive book of business— the creditor control and relative speed of its winding-up procedures. US liquidations are slow by comparison, and attempts to accelerate them have either failed —as in the Mission Insurance Co. case—or become bogged down in litigation. Even so, if EMLICO knew it was underreserved and planned to take advantage of the Bermuda regime, it should have forthrightly described its plans to state regulators. If EMLICO and GE instead withheld pertinent information to avoid a Massachusetts liquidation, they should be publicly held to account and sanctioned in a way significant enough to deter similar conduct in the future.'

Business Insurance received a swift response from Robert N. Risch, the Manager of Government Relations at General Electric in Boston, in which Mr Risch said—

'Your October 7 editorial, "Don't drop EMLICO Inquiry," about EMLICO's 1995 reorganization and redomestication from Massachusetts to Bermuda, misses the mark. It misstates the history of the EMLICO redomestication, ignores its most salient facts and recommends a course of action that only lawyers could love.

'The editorial calls for an "independent" investigation into whether the insurance regulatory process was "subverted" in connection with the redomestication or whether the Massachusetts insurance "regulators merely exercised poor judgment in not questioning (EMLICO's) liabilities."

'In 1997, however, the Massachusetts House of Representatives Post Audit and Oversight Committee conducted an extensive independent investigation into the Insurance Commissioner's role in approving the EMLICO redomestication. On the very issue on which this editorial is focused, the committee found unequivocally that "the filings and statements provided by EMLICO clearly raised and placed before the division and, ultimately, the commissioner," the company's likely insolvency.

'The committee's conclusion is fully supported by the irrefutable evidence in the record of the proceeding. The principal purpose of the EMLICO reorganization was to separate EMLICO's current and profitable policies from its long-tail General Electric Co. environmental and asbestos policies and to send the business entity that retained the latter to Bermuda to run off its assets against its claims for as long as possible. The material provided both to the Massachusetts and Bermuda regulators expressly informed them of hundreds of millions of dollars of GE environmental claims that could well put EMLICO into insolvency.

'Moreover, it was precisely because the Massachusetts commissioner was so concerned about the possibility of EMLICO's insolvency in Bermuda that, before she approved of EMLICO's redomestication to Bermuda, she sought and obtained from General Electric a waiver of its right to file claims against the Massachusetts and US insurer insolvency funds in the event that EMLICO became insolvent in Bermuda.

'Finally, in the commissioner's 1995 ruling approving EMLICO's redomestication, she specifically considered and anticipated the insolvency of EMLICO and concluded "that the failure of EMLICO after redomestication to Bermuda would not be adverse to the policyholders of the commonwealth."

'Indeed, the commissioner has acknowledged in a letter written to the House Post Audit and Oversight Committee on November 17, 1997, that the "division recognized the significant exposure presented to EMLICO by its many years of GE coverage and used the leverage of the application to redomesticate to obtain GE's waiver of any possible claim against US guaranty funds."

'She wrote: "We concluded that the failure of EMLICO after redomestication could not be adverse to the policyholders of the commonwealth."

'The editorial pays lip service to the fact that the Massachusetts insurance commissioner's responsibility in redomestication matters is to ensure that Massachusetts policyholders are protected. But the editorial ignores the fact that the commissioner did protect the interests of Massachusetts policyholders when she approved the redomestication, and the fact that the Massachusetts Supreme Judicial Court, in a September 1998 ruling, rejected an effort by the commissioner to set up a parallel EMLICO receivership in Massachusetts because it would be duplicative and wasteful and because "no Massachusetts party or interest will be harmed by the ongoing liquidation in Bermuda."

'The course your editorial recommended would waste both Massachusetts taxpayer dollars and the assets of the EMLICO estate and would further pointlessly prolong a case that a Massachusetts federal court recently described as a "case which only lawyers could love."

So there ended the EMLICO struggle. But as David Fox questioned in the following article for the April 1998 edition of *Bottom Line*—

'Did one of America's largest and most influential companies use fraud and deceit in a bid to hide dirty secrets and save hundreds of millions of dollars? Or are notoriously recalcitrant reinsurers practicing misdirection and a tactic delay of meeting their contractual obligations? Did a large corporation pull a fast one on unwitting insurance regulators in both Massachusetts and Bermuda? Or did the reinsurers of Electric Mutual Liability Insurance Co. (EMLICO) spend millions of dollars simply to delay paying hundreds of millions to EMLICO?

'For nearly three years there have been more questions than answers over the presence of General Electric Company's (GE) liability insurer in Bermuda. It's a tale of jurisdictional confrontation that has placed judicial and insurance regulatory structures in the US and Bermuda on opposing sides. A legal battle of brinkmanship—one US federal judge called it a case that "only lawyers could love"—has been fought in Bermuda's Supreme Court and Court of Appeals, the Privy Council in Bermuda's Supreme Court and Court of Appeals, the Privy Council in London, England and both state and federal courts in Massachusetts.

'Above all, it's a story about the power of money.

'Arguments in favour of redomesticating outside the United States were given by GE spokesman Larry Rasky, "The first lesson to be learned here is that Bermuda (insolvency) laws work a lot better than those in Massachusetts. Bermuda law allows claims to be processed in a rather efficient and precise way. The Massachusetts system lends itself to delay and legal manoeuvring."

'GE lawyer, Peter Robertson, pointed out that, "The United States system, not just in Massachusetts, is inefficient and very expensive in administering insurance insolvencies. If this is dealt with in Massachusetts, there would be tremendous delays because it would be prolonged litigation. Assuming this goes into the insolvency fund, there would be litigation over coverage and applications of the statute itself, and that would happen in multiple states."

'The EMLICO case significantly tested the vetting process of the Bermuda regulatory system. There were many holes that were discovered and many lessons that were learned. Bermuda is a jurisdiction that prides itself on knowing who is behind the business that comes here, one reason they discount unsubstantiated allegations of financial shenanigans. But even Grant Gibbons (Finance Minister) has conceded that there may be lessons learned from this affair. He is quick to add that decisions such as that from the Supreme Judicial Court that the commissioner of insurance had no authority to approve a redomestication to a non-US jurisdiction made it difficult for Bermuda officials. The rules that purportedly created EMLICO's Bermuda domicile appeared to change in mid-stream. Gibbons states: "This type of case breaks new ground and probably improves the ability of a jurisdiction to handle things. When you are looking for solutions the next time something like this comes along, you have experience which may make it easier to solve it. That's the thing about a mature jurisdiction. You'll always have to handle things that are outside the normal realm, particularly with more companies and innovative solutions coming up. In the short term there may be a sense that there is conflict. But I think in the longer term, the whole trend we are seeing is for jurisdictions to cooperate, particularly through international bodies, more closely. This will probably, in the medium to longer term, highlight the need for a closer working relationship," says Gibbons. He claims the press has been less than kind, and often inaccurate, in describing Bermuda's unique regulatory structure as lacking. He adds, "That is the burden that small jurisdictions have to endure. There is always a sense out there that bigger is better and more sophisticated. But the success and growth of the Bermuda insurance market is a testament to how well the regulators, Government and the private sector have worked together. There is always going to be a certain degree of condescension toward smaller jurisdictions. We have to work that much harder."

'EMLICO also raised many questions in the reinsurance industry with accusatory fingers being pointed across many borders. "The law does not even provide for reinsurers, as debtors in an insurance insolvency court even though, as in EMLICO's case, often reinsurance recoveries are the bulk of the insolvent insurer's estate."

'Said GE's Bob Risch, "The lesson learned is when the stakes are high, things change. We have this huge dance between these large companies, a big money feud. And now it is time to pay the piper and we want to collect and they don't want to pay. All the rest is smoke and mirrors.'

'GE argues that United States regulators are looking to systems like Bermuda to improve their model of insolvency practice. They also pointed out that reinsurers were over US $100 million in arrears to EMLICO before the redomestication.

'Said GE's Rasky, "One of the lessons the reinsurers have learned is that before you try to stiff somebody, you'd better be sure they don't have the resources to defend themselves. I don't think they anticipated there would be someone who would fight them to the mat when they engaged in their usual tactics of delay. We are simply looking for a process that will allow the claims to be resolved.

'Added Risch: "Lloyd's, it appears, has a business plan to stretch this out as long as they can to keep Equitas as healthy as they can, using the money they don't spend. (Equitas is the vehicle created by Lloyd's to deal with long-tail liability claims).

"You buy insurance and you figure you'll be able to collect. And when you don't, then you do go to the mat, if you have the resources to do that. That's why we will fight this case in three jurisdictions. But if I was Bermuda, I would be pretty proud of what I have going. There are highly developed insurance systems that other people are trying to emulate.

"When insurers go to collect from reinsurers, there is always some arbitration or some dispute. Rarely do the two sides shake hands on the first sentence and pay off."

'Bermuda has faced negative publicity over EMLICO. There have been numerous suggestions from various media, especially in Boston, that the Bermuda regulatory positioning in this dispute was less than it should have been. But in all fairness, Bermudian authorities have been reacting (or not reacting) to events that were often outside of their control. It is strange, on balance, that they appear little concerned at the allegations that GE and EMLICO played them, and their Massachusetts counterparts, for fools.

'It is surely time they realized that legislation never envisioned the type of circumstances that would see a heavily counselled corporation go so far as to break up the business of an insurer for a strategic purpose. They couldn't have foreseen how such a company would end up as the sole creditor of an insolvent insurer in Bermuda where creditors rule.

'Surely, the legislators never meant, in establishing the current structure for insolvency practice, to leave the fox in charge of the henhouse.'[763]

EMLICO, the case that threatened to upset the whole credibility of Bermuda's regulatory process, went out with a whimper when all was said and done. It was never proven that Bermuda acted in anyway unscrupulously but many believe that Bermuda was duped into allowing a company to domesticate there that had alternative plans to those disclosed in its application to incorporate. However, EMLICO forced Bermuda to review once again its regulatory process so as to try to prevent other companies from creating such high profile drama for the island. No country will ever be without insolvencies because of the nature of insurance— the transference of risk from one entity to another. All a country can hope to do is put into place adequate controls to reduce the number of insolvencies and when they do occur to ensure the process of closing out a business is handled in the most prudent manner possible.

The Progressive Labour Party (PLP) is elected

After decades of waiting, of trying to find the pulse of the people, the PLP secured a major victory in 1998. Under the leadership of Jennifer Smith, after the untimely death of Fredrick Wade in 1996, the party had been redefining itself as a government of the people, a government of inclusion and a government for 'a new Bermuda'. The make-up of the PLP had changed significantly, with many of the old guard replaced by young, well-educated, smart and sophisticated black Bermudians. The party had high hopes. People were looking for change. The PLP capitalised on a certain sense of restlessness by promising a new tomorrow.

[763] *Bottom Line*, April 1998, 'Playing for high stakes, the lessons Bermuda learned from the EMLICO case', by David Fox, pp. 56–58, 82, 84

The political race of 1998 was very different from any previous campaigns. Both parties spent unprecedented amounts on advertising. Some said the politics of Bermuda were taking on an American flavour. The PLP looked more polished than ever before. Their candidates appeared confident and very sure of their ability to run the country, while the United Bermuda Party appeared nervous and without direction.

The PLP had managed to win the support of many big businesses that in the past had wholeheartedly supported the UBP and therefore were able to amass election funding such as they had never known. This large purse enabled them to lead a highly organised and well directed campaign.

When Election Day at last came round on 9 November, Bermudians turned out in record numbers to cast their votes. Employers respected the need to vote and gave their employees the extra time they needed to get to the polling stations. The atmosphere in Bermuda was one of expectation. The island seemed poised for change. And change it got. The PLP won decisively, with 26 seats to the UBP's 14. After 30 years in opposition, the PLP had become the ruling party.

As news of the victory spread throughout the island, a feeling of jubilation rose in the hearts of many black Bermudians, who had never thought to see the day when a black government would run the country. Visibly moved by this historic victory, people gathered in front of the PLP headquarters, Alaska Hall, on Court Street.

Premier Jennifer Smith expressed a sense of relief that her party had at last been given the chance to put into place what was needed to turn the country from becoming a society of dependence to becoming once more as self sufficient as it had been in the past. It seemed to her that Bermuda had created a generation of people who thought it the duty of Government to take care of them—a generation that expected to give them a house and a livelihood without their working for it. The PLP did not want to perpetuate this mindset because they did not like to see Bermuda change from being people who were justly proud of themselves to being a people that expected handouts. The message now to be conveyed must be that government does not make money out of thin air and cannot just give it away. At the end of the day it is the money of the Bermudian people that collectively pays for government. Hence it must be given to those who are truly in need and not to those who could otherwise look after themselves.

As far as anxieties in the international business community were concerned, Premier Smith said the PLP had started to canvass that community in 1996, in order to develop an understanding. She said her party recognised the integral role that industry plays in the socio-economic welfare of Bermuda. Therefore they had tried to meet with as many companies as they could so that when they did come to power a rapport would have been established and there would be no mass exodus of companies from the island. Accordingly, as Premier, she intended to show support for industry by getting out in the world as much as she could so that she and her party might establish relationships with the international industry.[764]

Disasters and bizarre events around the world

The impact of weather related disasters had increased dramatically over the previous year, as reported by Swiss Re in its 'Sigma' report (The Sigma publication series provides comprehensive information on the international insurance markets and in-depth analyses of economic trends and strategic issues in insurance, reinsurance and financial services, covering life and non-life business. It is published approximately eight times a year by Swiss Re's Economic Research & Consulting team based in Zurich, New York and Hong Kong)—

[764] Interview with Premier Smith, 26 March 2003

'In 1998 insured losses resulting from natural and man-made disasters amounted to US $17.5 billion (of which) 14 billion was attributable to natural catastrophes and 3.5 billion to man-made disasters. This is over two-and-a-half times the 1997 figure. (The Sigma insured losses in 1997 totalled US $6.8 billion). The main reason for this increase is the billion-dollar losses each resulting from three major natural catastrophes.

'Altogether, the 1998 insured losses were again at the level of the record years 1989-1996, amounting to almost twice the average for the years 1970-1998.A total of 44,700 people died in 342 events recorded in 'sigma'. The overall losses from disasters in 1998 totalled US $65.5 billion, an increase on the previous year's figure of almost 130%. Almost all the total losses recorded were the result of natural catastrophes.

'The most costly event by far was hurricane Georges with losses of US $3.5 billion in the USA and the Caribbean countries. In second place came the hailstorm in Minnesota in mid-May, the extent of the losses caused— US $1.3 billion—only coming to light at the end of 1998. Third place was taken by the ice disaster in Canada and the USA with losses of US $1.2 billion. Thus the USA once again headed the insurance loss tables.

'Almost 35,000 people died as a result of natural catastrophes: Hurricane Mitch alone claimed over 9000 lives. The enormous Yangtze floods caused more than 3500 deaths, two earthquakes in Afghanistan 6,300. A gigantic tidal wave in Papua-New Guinea swept over 2,300 people to their deaths.

'Man-made disasters at 3.5 billion US $accounted for a good 20% of all insurance losses recorded. Of this, 40% was caused by large fires and explosions. The space industry had an extremely bad year, with losses of over US $1 billion.'[765]

1998 will certainly go down as one of the worst years for the frequency of disasters. Just to review once more some of the disasters for 1998— Hurricane Mitch devastated the Caribbean Coast, Hurricane Georges caused the worst damage to the Florida coastline since 1992, tornadoes did a lot of damage in the Southeast of the US, severe heat storms in the US killed almost 90 people and recorded temperatures as high as 120° Fahrenheit. All in all over US $1 billion worth of damage was attributed to El Niño. Swissair flight number 11 crashed en route from New York to Geneva, killing all 220 people on board as it tried to make an emergency landing in Canada. Then there was the outlandish disaster of an American military jet severing the cables of an aerial ski gondola in Italy, killing 10 people.

Costs resulting from the disasters were staggering—flooding, Yangtze River, China, US $30 billion; Hurricane Georges, Southeast US, Caribbean, US $7 billion; flooding, India, Nepal, Bangladesh, US $4.7 billion; ice storm, Canada, Northeast US, US $2 billion.[766]

According to the Swiss Re 'Sigma' report—

'At US $3.5 billion, hurricane Georges heads the list of insurance losses. Whereas its nine days of devastation in the USA and the Caribbean at the end of September were minutely observed by the media, the serious hailstorm in Minnesota and Iowa in mid-May largely escaped the attention of America and the international community. Not until the end of 1998 did the full extent of the losses caused become apparent, in the amount of US $1.3 billion, of which the greatest part was sustained by Minnesota. Finally, at US $1.25 billion the third billion-dollar loss event was the ice catastrophe in Canada and the USA at the beginning of the year, which brought power failures over several weeks to parts of Quebec and Ontario.'[767]

Although insured losses were abnormally high in 1998, the remaining catalogue of bizarre events in the world at large maintained a semblance of historical regularity. The highest level of American government was demeaned by a sexual scandal so tawdry and banal as not to deserve even the dignity of an impeachment process. The release of a potency pill for men aroused excitement

[765] *Swiss Re, Sigma No. 1/1999*, Summary p. 3

[766] *Business Insurance*, At the Millennium Special Edition, 'Worst Catastrophes of the past 2000 years'

[767] *Swiss Re, Sigma No. 1/1999*, 'Catastrophe year 1998 Devastating natural events', p. 6

on a more enthusiastic scale, though at a more commonplace level. Racial riots in South East Asia led to the usual resignations. The Chancellor who had reunited Germany was forced from office on less weighty grounds than that achievement. Eleven European countries set themselves to launch a common currency that however well intended looked so drab as to invite the abandonment of paper money altogether.

Closer to home, Bermuda once again came under the scrutiny of international regulators, forcing its Government to go to the Bahamas to defend its reputation as far as white-collar crime and financial regulations were concerned. Late night violence in nightclubs dominated the headlines, prompting some to say that youth should be subject to curfew. Closed circuit television cameras were installed in the City of Hamilton, in hopes of making the streets safer. A battle between the Government and Cable & Wireless broke out. A prominent hotel made headlines when a blocked sewage pipe contaminated the water and made hundreds of people sick. These latter events may not have been the stuff of stirring history but at least, if the world at large was in its usual state of disarray, with strange comings and goings everywhere, Bermuda was not going to be left out.

In a more serious, indeed at the grimmest social level, and in a matter that did arouse strong anxieties, not to say outrage, the year ended with an ugly cliff hanger. A highly publicised prosecution, for the brutal and allegedly premeditated murder of Canadian teenager Rebecca Middleton, came to a controversial end when trial Justice Meerabux ordered the jury to find the last defendant not guilty. The first defendant had been sentenced to jail as an accessory after the fact. As a result, no one was found guilty of the heinous crime. The people of the island reacted with shock and in horror. This was one of the worst murders ever perpetrated in Bermuda. Many feared the worldwide publicity would hurt the island. Canadians, angered by the verdict, set up websites encouraging people to boycott Bermuda. To this day, the truth as to who killed Rebecca Middleton is still in question. Allegations have been made of a botched up investigation by the police, of a feeble presentation of the case by the prosecution, and criticism regarding the role of the former Attorney General, but still there are no answers.

Meanwhile Bermudians were given the right to hold full UK citizenship passports. However, this came with certain conditions from Britain, one being the abolishment of capital punishment, and that did not accord well with the views of all Bermudians.

More constructively, on 2 July, Bermuda introduced the new National Pensions Scheme (Occupational Pensions) Act 1998 which was to enable every Bermudian to save for retirement. The Act required that every employee aged 23 and above, who works more than 720 hours a year, or 60 hours a month, should enter a pension plan managed by the employer. Employees would have to contribute a small percentage of their earnings to a company-managed pension plan and employers would match, dollar for dollar, their employees' contributions. Money paid in by employer and employee to the scheme would be invested through a recognised provider of pension investment programmes, such as a bank or an insurance company. Employee pension plans are unaffected when they move to other jobs, as the plan transfers with them. The new scheme was to come into force on 1 January 2000 and it was intended that by 2004 every employee in Bermuda would be enrolled in such a pension plan. At that time the former Government pension scheme will cease to exist. However, it will continue to pay those who are already receiving pensions from it. As a corollary to such general reforms, long-term residents who had been in Bermuda for more than 20 years were given the right to reside in Bermuda after retirement.

A year of worldwide consolidations

Uncertainty in the global economy caused withdrawals from a flagging stock market to exceed investments, with the result that the stock market dived and August of 1998 became the first negative month since 1990. Corporations everywhere sought ways to cut costs. By 1998 the Asian currency crisis of 1997 had spilled over to Russia, Latin America, and the rest of the world. So severe was the effect of the instability of overseas markets that credit in the US dried up, forcing the Federal Reserve to cut interest rates three times in hopes of getting business on the move again. Heavily dependent on investment income, the insurance industry found 1998 to be a challenging year for favourable results, especially with the number of huge catastrophes that had dragged it down.

Insurance Day reported on the consolidating market as follows—

'Any doubt over whether the pace of consolidation in the global insurance industry would continue during 1998 was dispelled in just the first month of the year.

'The United States industry started the action when St Paul Companies tried to buy Baltimore-based USF&G Group in a deal worth US $3.5 billion. The buy created the eighth-largest property/casualty insurer in the United States, with net written premiums of US $7 billion, total assets of US $36 billion and a combined market capitalization of US $10 billion.

'In terms of consolidation in the global financial services industry as a whole, the US $140 billion merger between Travelers Group and Citigroup, announced in April, was ground-breaking. Citigroup's market capitalisation ranks it as number one among the world's financial service companies.

'It was followed in June by the announcement that takeover legend Warren Buffet's massively successful takeover vehicle Berkshire Hathaway was to buy General Re, America's largest reinsurer, for US $22 billion. The deal created a company with a market capitalization of US $120 billion and second only to the nascent Citigroup among global insurers.

'The pace of consolidation among United States reinsurers was further accelerated by GE Capitals' acquisition of Kemper Re for US $500 million. All three deals underlined the radical reshaping of the United States financial and reinsurance markets.

'One deal which took the industry by surprise came in March when Bermuda-based EXEL and Mid Ocean agreed to merge in a non-cash deal valued at US $2.88 billion. Creating an entity with assets of US $9.1 billion and a market capitalization of US $8 billion, the combination of the two companies formed another organization of formidable strength in the world for property catastrophe business.

'Soon afterwards, ACE responded with the US $711 million purchase of property catastrophe reinsurer CAT.

'In Europe, Germany's Allianz succeeded in its takeover bid for Assurances Générales de France (AGF). The merger combined the number one and number two players in credit insurance in Europe.

'Meanwhile, state-owned French insurer Groupe des Assurances Nationales (Gan) eventually fell to the mutual insurer Groupama.

'United Kingdom composites Commercial Union and General Accident also succumbed to consolidation fever in a merger creating the latest United Kingdom mega-insurer. Expansion in the life and savings sector and in Europe was cited as the main strategic opportunities arising from the merger.

'CGU would be the United Kingdom's largest broadly-based insurance group with a combined market value of 14.9 billion pounds sterling, the group said. Some 5,000 job cuts and annual savings of 270 million pounds sterling are coming through the deal.

'Meanwhile, Guardian Royal Exchange (GRE) more than doubled its United States premium volume by acquiring the United States property/casualty operations of Dutch bancassurance group ING for US $775 million net. At the same time, ING bought GRE's Canadian p/c (property and casualty) operations, valued at US $775 million net.

'Long favouring the independent approach, GRE has since entered the consolidation rumour market. As the year draws to a close, the group has confirmed it is considering its position, which may or may not lead to a bid for the company.

'The broking sector has also seen its fair share of action during 1998. Aon started the year as it had ended 1997, first entering into an agreement to buy leading Spanish retail and reinsurance broker Gil y Caravajal Group. Within days, the United States giant made its second acquisitive strike, revealing an agreement to acquire French broker Le Blanc de Nicolay.

'However, from then on attention shifted to the world's third and fourth ranked brokers Sedgwicks and Willis Corroon.

'Both eventually succumbed to the pressure over the summer. On July 23, Willis Corroon unveiled its plans to go private, after agreeing to a cash buyout valuing the company at around 851million pounds sterling. The bid was led by United States management buyout specialist Kohlberg Kravis Roberts (KKR) and backed by five major insurance groups.

'Just weeks later, Sedgwick finally went to Marsh & McLennan in a deal which valued the London-based group at 1.25 billion pound sterling and reinforced Marsh & McLennan's position as the world's largest broking group.

'However, there were also some deals which did not come to fruition, probably the most memorable of which was United States-based. In January, Cendant Corp. unveiled a US $2.7 billion bid for American Bankers Insurance Group, already the subject of a US $2.2 billion offer from American International Group. This led to a lengthy battle between AIG and Cendant, one which eventually Cendant won. However, the deal was later terminated.'[768]

Had the Bermuda market peaked?

With so many bizarre events occurring across the globe in 1998, it was a year of repositioning for the entire global insurance industry, including the Bermuda marketplace. Because of the Bermuda industry's positive performance in a declining economy, overseas analysts and journalists placed the industry under the spotlight. Below are some excerpts of what was being said about Bermuda at that time.

Global Reinsurance reported as follows—

'Activity in the Bermuda market during 1997 and the early part of 1998 has further strengthened the prominence of this offshore domicile within the global insurance market. In the context of insurance markets in the developed world, however, Bermuda is still young. Recent discussion has resulted in reflection on whether the upward trend can continue or whether the Bermuda phenomenon is temporary and the island's role will not have been so significant in the context of the insurance and reinsurance scene in the long term...

'Given its geographical constraints, will Bermuda be different enough and strong enough to endure as a meaningful part of the world's insurance and reinsurance markets? Certain characteristics tend to suggest that it may:

'Bermuda remains attractive as a holding company headquarters for diverse, world-wide insurance groups as recent consolidations, notably ACE and EXEL, demonstrate. To some extent, the tax status of these companies creates an effective "poison pill" which renders them less attractive to takeover by some onshore predators.

'Thanks to its relative youth, Bermuda is both well capitalised and unencumbered by some of the past problems other markets have had to deal with in the 1990s. The rapid deployment of up to date risk analysis and capital utilization tools together with relatively low overhead costs and a beneficial tax regime enhance their ability to leverage their returns.

'The market continues to demonstrate its talent for innovation through new products and new initiatives, for example, risk securitisation, offshore life reinsurance, credit enhancement and political risk coverage.

[768] *Insurance Day*, 5 January 1999, Issue No. 561, 'Consolidation stays in fashion – and how', by Claire Wilkinson, p. 5

Bermuda's flexible regulatory environment encourages and nurtures innovation.

'The industry-wide soft market may be slowing the development of mechanisms for bringing the massive resources of the capital markets into insurance and reinsurance. We see these developments as inevitable and attractive in the longer term. Recent changes in Bermuda law make this arena increasingly attractive for non-insurance, offshore investors, as well as for Bermuda-based insurance companies.'[769]

Best's Review reported—

'...Bermuda's prominence has become even more evident during the current soft market. Confronted by the prospect of idle capacity and moribund returns, Bermuda-based insurers embraced diversification and global expansion. As a result, Bermuda can never again be categorized simply.

'....Although competitive pressures increased in 1997, Bermuda's insurers remain optimistic and plan to compete aggressively. In general, these insurers and reinsurers have resisted downward pressure through product innovations, diversity in their underwriting portfolios and capital management through acquisition, merger, and share repurchase and dividend plans. The recent formation of speciality reinsurers Annuity and Life Re and Ram Re are evidence of the confidence investors worldwide have in Bermuda....'[770]

Business Insurance reported—

'In light of competitive conditions, several Bermuda insurers and reinsurers spread their nets farther afield by becoming part of larger groups or by expanding themselves. Some have been sold to Bermuda rivals, while others have pursued growth strategies abroad.

'Ironically, the two main markets where the Bermuda companies have expanded—the US and London—were the ones whose changes in appetite for catastrophe risks allowed the Bermuda market to flourish. "It was because of deficiencies in the English and American markets that Bermuda was born, and now Bermuda is entering the US and London markets," said William J. Kelly, a managing director of J.P. Morgan & Co. Inc. in New York.

'In another twist, while the Bermuda market used to absorb new capital, it is now providing new capital, said Roger C. Gillett, senior VP of ACE Insurance Co. Ltd. in Bermuda. "One of the things that you are seeing now is that we are not just importers of capital, we are exporters of capital. We believe that, with all the people we are attracting to the island, we are innovating here and exporting ideas."'[771]

And lastly, Standard & Poor's stated the following—

'The expansion and diversification into new lines of business has shown positive short-term results upon certain Bermuda market members. However, Standard & Poor's believes it will be several years before any long-term economic benefits will be recognised from Bermuda's current growth strategies.

'The recent wave of acquisitions in Bermuda raises the question that many observers of the global insurance and reinsurance community have considered: Has the Bermuda insurance and reinsurance market peaked? We think not...Bermuda has had to recover from many shocks to its financial system over the last 20 years, including the Carnation decision, the era of naive capacity and the Tax Reform Act in the US in 1986. Through all these events, the creativity of the Island has remained intact and the industry has been able to re-invent itself, always stronger and capable of taking advantage of its unique strengths. Standard & Poor's expects the industry will be able to come through the current turbulence as well.'[772]

[769] *Global Reinsurance*, Volume 7, Issue 3, Bermuda Edition, 1998, Price Waterhouse survey, 'Bermuda – swimming with or against the current?' by Richard Patching, pp. 34 & 35

[770] *Best's Review*, P/C, June 1998, 'The Fourth Wave', by James Wynn, pp. 53–57

[771] *Business Insurance*, 15 February 1999, 'Bermuda acquiring a global presence', by Gavin Souter, G1, G4, G6

[772] *Bermudian Business*, Spring 1998, Bermuda Insurance Survey 1998, with analysis by Standard & Poor's, 'Reconfiguring the Market', p. 50

After initially casting some doubt at the start of the year on the continued stellar performance of the Bermuda insurance marketplace, Standard & Poor's was, by the end of the year, 'cautiously optimistic' about it—

'Standard & Poor's has witnessed a market transformation as most of Bermuda's insurers and reinsurers expanded their risk profiles from the predominant mono-line to a multi-line structure. All under the auspicious guise of increased earnings diversification, product distribution, and geographical spread of risk.

'Behind this movement, the Bermuda (re)insurance markets have stepped up to the podium to let themselves be heard. Brand identity, advertising and technological advancements, are just a few of the marketing tools utilized in selling Bermuda as a (re)insurance "global supermarket". In addition, Bermuda insurers and reinsurers are poised for the next evolution as the gap between capital and (re)insurance markets is bridged through non-traditional (alternative risk transfer; ART) coverages such as risk securitisation, holistic (or integrated) risk solutions, and financial reinsurance.

'Bermuda has been a haven for the intellectual capital needed for such product structuring, and Standard & Poor's believes that such capital, rather than financial capital, is a critical ingredient in achieving success. Also, because such intellect is in demand, Bermuda continues to attract new firms and fresh capital. For 1998, the entrepreneurial culture fostered in Bermuda was alive as 12 new companies—with an impressive capital base of more than US $2 billion—joined the scene.

'For 1998 in review, the Bermuda insurance market was given a dose of earnings reality as loss-event frequency and severity during the year, coupled with an Asian collapse late in the third quarter, served as a reminder that its earnings prowess should not be taken for granted.

'Bermuda has historically been the birthplace of some well run organisations, however their independent life span was minimal. Expectations are that not all the current merger and acquisition activity over the last three years will live up to the market's hype, and that some new start-ups may not survive. However, the Bermudian insurance sector is a resilient one. Through all these events, the creativity of the island has remained intact, and the industry has been able to reinvent itself by taking advantage of its unique strengths.'[773]

Bermuda now boasted impressive statistics for the number and type of insurance companies that continued to be set up on the island. The Registrar of Companies reported that 96 new companies were added to the register, bringing the number of insurance companies to 1493. A record 41 per cent of companies represented Class 3 companies, made up of rent-a-captives, finite reinsurers, third party reinsurers and the like, with classes 1 and 2, principally captives, making up the other 40 per cent.

Simply stated, Bermuda had grown into a diversified, global marketplace, much more complex and much bigger than anyone had ever expected. As though in recognition for all the resilience, versatility, and responsiveness to challenge, the virtues that characterised the leadership generation which had made this possible, one of the most experienced veterans among them, Brian Hall, was made an officer of the Order of the British Empire (OBE) in the Queen's New Year's Honours List on 31 December 1998, in recognition of his services to the industry. This was at the same time as his retirement from the Chairman of the Insurance Advisory Committee (IAC), a position that he had held since New Year's Day of 1987 and one in which he had done so much to invigorate and develop an essential instrument of Bermuda's international insurance industry.

The question presenting itself to that industry as it went into 1999 was—could Bermuda maintain its newfound status in the world or would it buckle under all the pressure?

[773] *Bermudian Business*, Summer 1999, 5th Deloitte & Touche Annual Bermuda Insurance Survey 1999, with analysis by Standard & Poor's, 'Bermuda outlook optimistic', pp 58–73