THE BERMUDIAN JANUARY 1996

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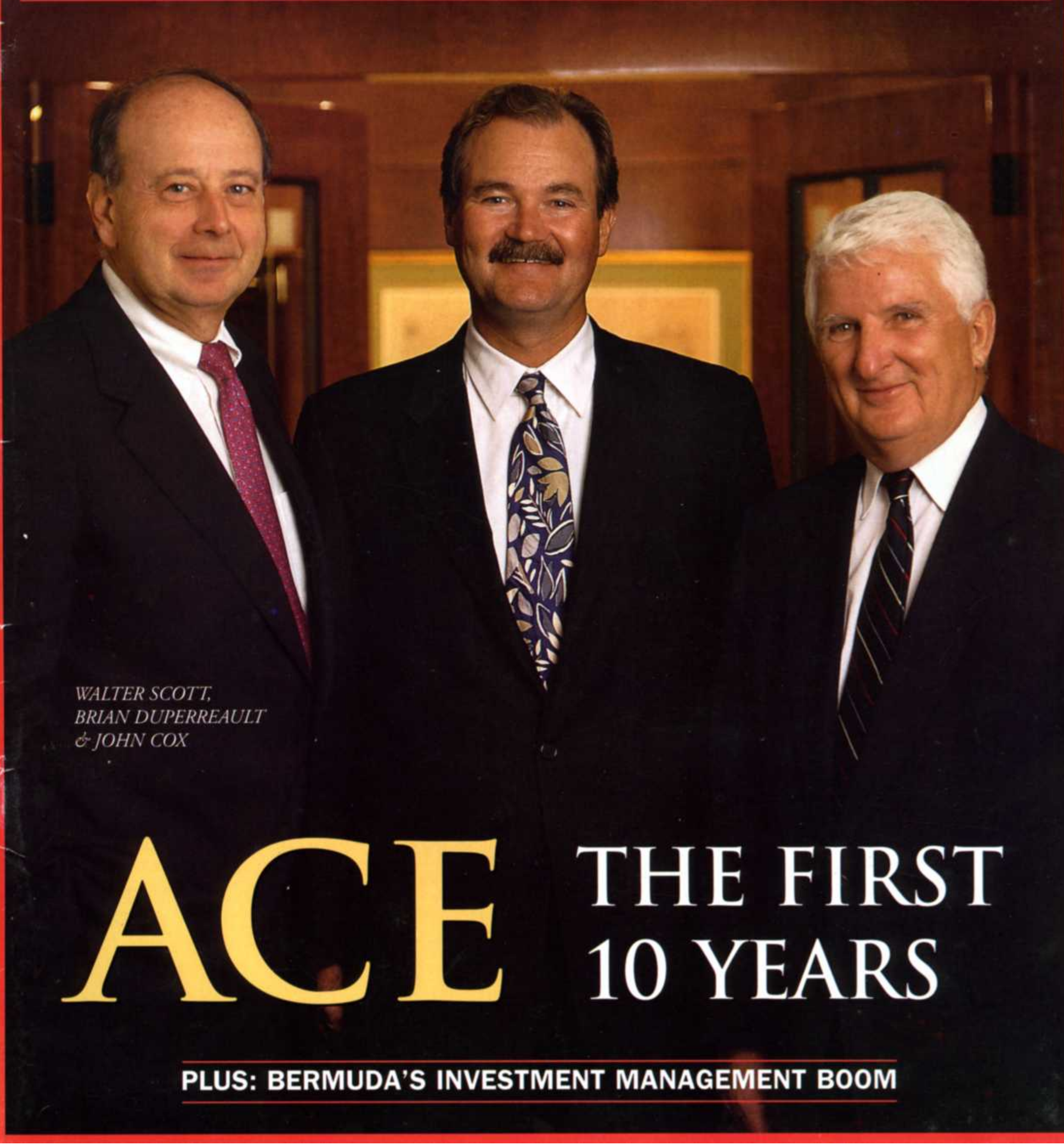

WALTER SCOTT,
BRIAN DUPERREAULT
& JOHN COX

ACE THE FIRST 10 YEARS

PLUS: BERMUDA'S INVESTMENT MANAGEMENT BOOM

ACE

The First 10 Years

Pioneer giant finds nothing succeeds like excess

THE FIRST CHAIRMAN OF ACE Limited well remembers writing his first official policy in temporary headquarters at the Hamilton Princess Hotel. It was November 1, 1985, and John R. Cox was a one-man-band, exhorting blue-chip clients to help him forge a corporate legacy.

"The hotel room number was 348," recalls the jocular, snow-thatched New Jersey resident, the first and only employee of ACE for several months after it incorporated. "We had quite a few customers and all of them obviously wanted policy number one. I decided no one should get it, so the first policy I issued was number 348."

As head of what would become one of the largest insurance companies in the world, Cox, 63, brought with him 17 years' experience at AIG (where he reached the number-three post) and what his 1991 successor Walter Scott describes as "immediate form and substance.

"He dealt with ACE in its infancy," Scott notes. "He was the first employee. And because of his stature in the industry, he gave ACE instant credibility."

During its early days, ACE was located at Craig Appin House, Wesley Street, where the company opened an office in January, 1986, with a half-dozen employees. The first few years, the numbers stayed small. "We used to run it in a family style," says Cox. "We were a team of 19 and I used to joke and say when we got to 20, I would retire so we'd be back to 19!"

But while Cox guided the innovative protégé through its formative years, he credits friend and colleague Robert Clements for having the foresight to dream up the concept of an excess liability insurer in the first place. It happened a decade ago when coverage in the U.S marketplace disintegrated. Fortune 500 companies were clamouring for help and Clements (today, the Connecticut-based chairman of Marsh & McLennan Risk Capital) along with J. P. Morgan's Roberto Mendoza came to the rescue. Together, they brought on board 34 firms that contributed to a total capitalisation of more than $200 million.

"People say I was the father of ACE, but I tell them, 'No, Clements was the father—I was the mother,'" quips Cox. "'I raised the brat!'"

The story of the creation of ACE—Clements' brainchild—is now industry legend, a textbook example of what can be accomplished when fate smiles on innovation and entrepreneurial chutzpah. The successful result—a Cayman Islands holding company called ACE Limited, and its Bermuda-based insurance subsidiary, A.C.E. Insurance Company Ltd.—proved a lightning rod both to the industry at large and to the Bermuda market in particular. Providing high excess liability coverage—$100 million of insurance coverage excess of $100 million—ACE created a lucrative niche in the Island's insurance sector, bringing in billions of dollars and scores of new jobs. Notably, the company's arrival also proved a magnet for the influx of other excess liability insurers (XL, Starr Excess) and the property catastrophe companies that followed.

By Rosemary Jones

JOHN R. COX:
"We had all the plusses"

WALTER S. SCOTT:
"We take a long-term view"

BRIAN DUPERREAULT:
"Our record speaks for itself"

As a pioneer, ACE couldn't have enjoyed better timing.

"The reinsurance industry had collapsed and there was no support for catastrophe liability risks," explains Cox. "If you take the largest corporations in the world, most of them could sustain a routine loss—$10-, $20-, $30-million—because it's not important in their earnings stream. But they couldn't afford to absorb a loss that would cause a blip in their own earnings and therefore kill their stock. Bob Clements got them to invest in this venture to create an underwriting capacity to deal with those risks."

"The industry was in turmoil," remembers Robert Hernandez, 51, vice chairman and C.F.O. of USX, the Pittsburg-based conglomerate that owns Marathon Oil and U.S. Steel—and one of a steady parade of companies that came to visit Cox in Bermuda to become the first ACE shareholders. "Companies like ours couldn't renew our programme in 1984. The layering of our programme looked like Swiss cheese, it had so many holes in it."

Given the environment, Clements' idea to get Marsh's biggest clients to insure their own risks, starting with $10-million, was not a hard sell. "We frankly viewed it as what we had to pay to fix the problem, and it turned out to be one of the best investments we ever made," says Hernandez, an ACE director and member of the board's executive committee. "None of us could have imagined what ACE would become."

Success came easily. "Within the first year, ACE had an instant spread of business and the best companies in the United States as its client base—that's a great way to start," notes ACE's current chairman, president and chief executive officer, Brian Duperreault, 48.

"Effectively," adds Cox, "we had all the plusses and the other side had none of them. So we had absolute control. We had willing investors, willing buyers of insurance, and our role was basically to create something that would be lasting."

The effort paid off. Today with about 90 employees and more than $1.4 billion in capital and surplus, ACE is the world's leading provider of excess directors and officers (D&O) liability insurance, and one of the leading providers of high-level excess liability insurance—a huge success story reaping the benefits of careful strategy and forward thinking. With a host of new business, including satellite, aviation and excess property insurance and financial lines, the company reported net income for 1995 of $238 million.

Notably, since its inception a decade ago, most of the initial shareholders have remained policyholders of the company, loyal subscribers to the tenets of ACE's success: "Close relationship with clients; clients looking for stability of coverage, continuity of coverage—it's all important," in Duperreault's words.

"ACE was not looked upon as just another provider of capacity," he says, "and that remains the same."

WHAT MAKES ACE DIFFERENT FROM OTHER insurers, observers say, is a corporate philosophy dedicated to pleasing the client and improving the industry.

"Unique" is a word often used by staff and clients to describe the company, and while a cliché, it does hold certain relevance. ACE's mission from the start was to set higher standards for the industry, while steering clear of pitfalls that plagued traditional insurance companies over the past decade. Until ACE's arrival, the industry zeitgeist had always been "bigger is better."

"The way you made money then was to have the best marketing and sales people," Cox explains. "And the more sales people you had, the more money you made." But the formula came crashing down between the late 1970s and mid-'80s, as companies spent themselves into bankruptcy. "Some companies were no longer able to deal with the changing environment," Cox says. "They just kept adding expenses and most of the companies that followed that model became history. ACE never had to deal with that."

ACE prides itself on listening to its clients—a source of many innovations it has been able to bring to the industry. Case in point was the drafting of an unprecedented form, or policy contract, which, based on input from directors, clients and brokers, was successful in navigating the shortcomings of previous industry paperwork.

"We came up with a new policy form that made writing the kind of risks we write doable," explains Scott, chairman from 1991–94. "The ACE contract is now a standard in the industry. It has been used by Lloyd's and European underwriters; XL and Starr Excess have a variation of the same thing."

Essentially, the policy form more clearly defined the limits of coverage to avoid massive industry losses caused by ambiguous wording. Previous forms left companies subject to enormous losses due to long-term events like asbestosis and pollution. A hypothetical company that thought it had been selling a $5-million policy every year for 30 years, for example, could find itself liable for far more.

"The theory was that each year somebody was breathing in asbestos fibres triggered each one of these policies," Scott explains. "So the company woke up one morning to find that each one of its $5-million policies over the past 30 years had been triggered and it was facing a $150-million loss."

Pollution coverage was another area open to interpretation in many older contracts. "What we said was, we'll cover pollution, but we'll only cover sudden and accidental pollution," says Scott, "and we clearly defined what sudden and accidental was.

"What we sell," says Scott, "is as close as you can get to insurance in its purest form—many people paying a relatively small premium for the very few that actually have a loss."

With about three decades' worth of history of large losses analysed, "we think we know basically how many of these things are going to happen in the world every year, and how many of them are likely to happen to ACE insureds," Scott adds. "Then we try to find some fair and equitable way to allocate that among our customers by the risk profile they present."

The question of sufficient capital had to be dealt with as ACE grew.

"I dealt with ACE's adolescent years," says Scott, 58, a Pennsylvania native who graduated from the state's Lafayette College with an engineering degree. Now a director, he also serves as a consultant to ACE. "We were trying to figure out what ACE wanted to be when ACE grew up. We dealt with the normal type of problems you have to deal with in adolescence."

Under Scott's chairmanship, ACE changed its reserving technique, establishing I.B.N.R. (Incurred But Not Reported) reserves to bolster the company against losses. The bigger question was how much capital was needed to run the company given its high-severity but low-frequency losses.

"The conclusion was we could run the company with less than a billion dollars in capital and surplus. But after talking to our client base, brokers and the like, the billion-dollar number became very important," says Scott. "That separated, so to speak, the men from the boys."

The company felt it needed more than $1 billion, even after a setback. Last year, fiscal 1994, was a case in point, when ACE had to make a $200-million adjustment to its breast implant reserves. The decision was made amid one of the worst bond markets in recorded history.

"The market value of bonds in our portfolio dropped dramatically, so we fundamentally took two significant hits to our balance sheet last year, and our capital was still in excess of a billion dollars," Scott says. "Nobody's ever questioned security of the commitments made by ACE because of our solid capital position."

The move to go public was another big milestone in ACE's development. While it was established as a for-profit company, some directors felt ACE should focus on its role as a risk-sharing company, set apart from traditional insurers. "There were a lot of people who were very concerned that if ACE were to go public, we would forget our roots and we'd treat our clients just like any other insurance company," says Scott.

Fellow insurance company EXEL Limited and its Bermuda insurance arm, XL, took the public leap first, in July, 1991. At that time, ACE was opposed to such a move. "We went back and polled our shareholders again roughly one year after XL had gone public," says Scott. "By that point in time, the sentiment had changed."

In March 1993, ACE successfully completed its first public offering and was authorised for listing and trading on the New York Stock Exchange, under ticker symbol ACL. Among other things, it provided liquidity to investors who wished to access their money, while appeasing shareholders who wanted a return on their original investment.

"I think going public was the right thing for ACE to do, but it made life around here a lot more challenging," says Scott. "We still take a very long-term view, and that view has to be explained to Wall Street with its own focus and expectations."

ACE'S GROWTH HAS MIRRORED, AND INDEED propelled, that of the entire Bermuda market. Duperreault, himself a Bermudian who grew up in the United States, takes pride in the number of Bermudians at ACE and the company's role in what has evolved into a dynamic marketplace.

"When ACE was started, there was not much else going on in terms of real risk-taking," says Duperreault, named chairman, president and chief executive officer last October, after 20 years at AIG.

"The market in which ACE was established is a lot different than the one today," he says. "The Bermuda market has really evolved, and ACE was a major reason for it. Whether it's brokerage infrastructure or finite reinsurance companies setting up here, or even the cat companies, Bermuda reestablished itself after ACE's presence. Now there's a credibility in the marketplace."

Today many people in senior positions at ACE are Bermudian—in all areas of business, from underwriting to accounting to information technology. "I think our track record speaks for itself," notes Duperreault. "We hope the next time we start a new product line, we'll be able to draw on talent from Bermuda to fill it. But, if not, eventually we'll be able to train Bermudians in those lines of business. It makes a lot of economic sense."

Cox says Bermuda was chosen as offshore headquarters back in 1985 for more than just economic reasons. "Very simple—enlightened regulation," he says. "Everybody in the world said taxes—that we came here because there were no taxes. But taxes had no bearing on it. The reasons were regulatory."

Ten years later, Bermuda's regulatory environment—having been overhauled last year—is still praised by international business.

"U.S. regulation, in particular, is strong, some say onerous, and consumer-oriented," says Duperreault. "There's nothing wrong with that, but it doesn't fit the major buyers' point of view and all our buyers are massive corporations, Fortune 500 companies. They require a different kind of regulation. Here, you have regulation that is pro-business. It is more concerned about the solvency of the companies and less concerned about the precise nature of the contract."

Such an environment has fostered a creative approach to business by the whole Bermuda market. "That is what separates the Bermuda industry overall," says Scott. "We've taken unique approaches to solve the problems and used leading-edge technologies, and have been extremely focussed in what we do."

As ACE looks to the future, it is using such creative vision to shape its own destiny through careful diversification. While its two core business—excess liability and D&O—continue to drive the company, new products added recently include excess property, aviation, satellite insurance and financial lines. The diversification began in November 1993, when ACE purchased Corporate Officers & Directors Assurance Ltd. (CODA), whose creation and operation it had been involved in since inception.

"I think the outlook for ACE is extraordinarily bright. We've just barely begun to scratch the surface of what ACE can do and the types of things we can get involved in," says Scott, who adds diversifying has also brought criticism. "I have heard the expression voiced that ACE is going to lose its focus, we're going to get into things that we don't know, that we're going to have our head handed to us.

"The answer is that in each of the new products that ACE has entered, we've hired the best underwriting talents available in the world. Before we've written one piece of business in any of these new areas, we have insisted upon having industry-recognised, world-class underwriting talent on board." (Among other personnel acquisitions, ACE has hired satellite underwriting expert Chuck Rudd, Gary Cooke for aviation liability underwriting, Patrick Mitchell for excess property and Dominic Frederico for financial lines.)

Last fall, ACE reached across the Atlantic, opening a London representative office and, in doing so, securing a niche in the vital European market.

"We didn't feel we were getting the kind of visibility we should in the London market," says Duperreault. "The London market is a world market. Our target wasn't just the Europeans, but also the U.S. business that runs through London. It was important for us to get the message out to them that we are a viable organisation and can satisfy their needs."

ACE enters Europe at a time when the exportation of U.S. liability culture is making it an increasingly important market. Events like the North Sea Piper Alpha oil platform explosion that killed 176 people in the late 1980s underscore mushrooming liability settlements. (Piper Alpha settlements totalled well over $1 million per person—roughly five times the amount that would have been received had U.S. firms not been involved.)

"In addition, governments don't have the money to clean up all the pollution they're beginning to find," says Scott. "There will be liability that will be borne by a lot of the major corporations in Europe. They're going to be looking for someone else to pay the bill."

D&O remains the single fastest-growing line of business in Europe, fuelled by events such as Britain's Barings Bank collapse. Says Scott: "It's becoming very apparent to directors internationally that the amount of insurance coverage they historically purchased is insufficient."

ACE's expansion into new territory, say insiders, is geared toward fitting the corporate mould it established at birth. Notably, diversification into new lines is tailored to few transactions, high risk-reward, and targetted at clients already buying other lines (50 percent of those who buy satellite coverage, for example, are already ACE customers).

"We've been very methodical about our expansion plans," adds Duperreault. "I don't think we've grown too fast. What we've done, we've done right. We've picked things to get into that have long-term staying power. And I expect that when we have our 20th anniversary, everything we're doing today, we'll be doing then."

"Any good idea needs two things—capital and good people—and ACE certainly had both of those," says ACE director Hernandez, of USX. "It turned out none of our initial projections were right, but the good news is that's because the projections were overly-optimistic. Now we're looking at ways to grow."

Surrounded by scores of industry bigwigs, Bermuda government dignitaries and his peers at ACE's anniversary party last November, the company's first chairman admits he doesn't know 25 percent of the staff anymore—"and I've only been away for one year," he chuckles.

"But that's a good thing," adds Cox, who retired from the board of directors last year. "ACE has to grow. It has to expand its lines of insurance. I think the company's going in the right direction."

"There are changes in the industry," admits Duperreault. "and we definitely want to be a part of it. You can't change the fundamentals of the insurance business—risk selection and proper pricing. But you may be able to make those same selections through a different medium.

"In any case," he adds, "whatever's going to happen will be happening here in Bermuda. And ACE will be right in the middle of it, leading the charge." ■