

Origins: Fred Reiss, Ohio and Bermuda

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Self-insurance by industrial companies is an old practice, since some trading companies in Europe established their own insurers in the nineteenth century. The modern captive, however, is associated with Frederic M. Reiss, a fire protection engineer from Youngstown, Ohio. In the 1950s Reiss advised the Youngstown Sheet and Tube Company on the insurance of its mining towns and set up a subsidiary to insure the risks. The term "captive" is said to derive from the "captive mines" whose output supplied the steel works of their owners. In the early 1960s Reiss moved his activity to Bermuda, where he founded a company to manage captives for American groups.¹

Bermuda offered a stable British legal system, proximity to the United States, an absence of income tax and a government willing to accommodate insurance companies. American groups found that a captive in Bermuda could accumulate premiums free of tax while the premiums paid by the American parent were deductible as business expenses. This advantage did not last unchallenged. The Internal Revenue Service took the view that premiums paid to a wholly owned captive were not insurance premiums at all, because no risk was transferred outside the economic family of the group. A long series of court decisions from the 1970s to the 1990s refined the conditions under which a captive arrangement qualifies as insurance for tax purposes, with risk shifting and risk distribution as the decisive criteria.² The Subpart F rules on controlled foreign corporations, introduced in 1962, also brought the income of offshore captives into the American tax net in many cases.

Bermuda adapted its legal framework with the Insurance Act 1978, which created a system of classes of insurers with different capital and solvency requirements. It became the leading captive domicile in the world and later the home of a large reinsurance and specialty insurance market, which grew after the hurricanes and liability crises of the 1980s and 1990s.³ The

Bermuda regime received recognition as equivalent under Solvency II for commercial insurers in 2016, while its captive classes were carved out of the equivalence assessment. American states, beginning with Vermont, enacted captive laws to bring the business home. Vermont adopted its captive statute in 1981 and became the largest captive domicile in the United States, followed by Utah, Delaware, North Carolina, South Carolina, Hawaii and others.⁴

The number of captives worldwide has grown steadily. Industry surveys put it at several thousand, commonly estimated at about six to seven thousand in the 2020s, although the figures depend on the definitions used and on whether cells are counted separately. Most of the largest groups listed on the stock exchanges of Europe and North America own at least one captive, and many own several in different domiciles for different lines of business.⁵ Hard insurance markets, in which premiums rise and capacity shrinks, have regularly produced waves of new captives, as in the liability crisis of the mid-1980s, after the attacks of 11 September 2001 and again in the years from about 2019, when property and liability premiums rose sharply.

1 Notes

1. On Frederic M. Reiss (1921–2016), the Youngstown Sheet and Tube Company and the origins of the term "captive", and on his International Risk Management firm in Bermuda (founded in the early 1960s), see the obituaries and historical accounts in the trade press, for example *Captive Review* and *Business Insurance*. Dates to be verified. ↩
2. On the treatment of captive premiums under United States federal income tax law, see Revenue Ruling 77-316, the "economic family" doctrine and its later abandonment in Revenue Ruling 2001-31, and the case law on risk shifting and risk distribution (for example *Humana Inc. v. Commissioner*, 881 F.2d 247 (6th Cir. 1989)). To be verified. ↩
3. Insurance Act 1978 (Bermuda) and its subsequent amendments; on the development of Bermuda as a captive and reinsurance centre, see the publications of the Bermuda Monetary Authority and the historical literature on the Bermuda insurance market. To be verified. ↩
4. Commission Delegated Decision (EU) 2016/309 of 26 November 2015 on the equivalence of the solvency regime for insurance and reinsurance undertakings in force in Bermuda (excluding captive classes); Vermont captive insurance law, 8 V.S.A. chapter 141, enacted 1981. On the number of captives in the United States domiciles, see the

annual reports of the state regulators and the trade press. Figures to be verified. ↩

5. On the number of captives worldwide (estimates in the order of 6,000 to 7,000 in the 2020s) and their distribution across domiciles, see the annual surveys published by the major captive managers and the trade press, for example Captive Review and Business Insurance. Figures to be verified. ↩

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