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Ohio Agent Credited With 'Captives'

By Christopher L. Kramer March 10, 2003

Not since a coffeehouse in London in 1688 was used to transact insurance business has a concept been so instrumental in transforming an industry. "Captive" is a word now used so frequently in our industry that almost everyone has heard of it.

We hold conferences to discuss captives, seminars on how to use them, tradeshows for all the firms that provide services for them, and panel discussions on every risk they can be used for.

There are more than 35 domiciles throughout the world where a captive can be formed and more than 100 captive management firms to help us deal with them.

The number of consultants, brokers, agencies, actuaries, accountants, investment houses, and state and country officials that devote their entire careers to them is staggering.

In less than 50 years, captives of all shapes and sizes generate more than $50 billion in premiums and manage assets of more than $225 billion. Captives are so popular, in fact, that everyone from bowling alley owners to Fortune 500 conglomerates now use them. According to a recent Swiss Re report, captives will become even more accepted in the years ahead.

So I am sometimes asked, who's responsible for all this? If Edward Lloyd became famous for his coffeehouse, who is famous for captives?

Would you believe it was an insurance agent from Ohio?

Frederic Mylett Reiss, a former property insurance engineer who became an insurance broker in Youngstown, Ohio, is widely credited with popularizing the captive concept, and with it, its most popular domicile, Bermuda.

While captives were already in use by several church and fraternal organizations, it was not until 1955 when Mr. Reiss, confronted by an inflexible insurance marketplace and in danger of losing his largest client, solved his problem. And with the solution, he started an industry that would forever change how we buy insurance.

Some readers have heard Fred's many stories and successes (and disappointments, too), but this is not about how he helped Bermuda or contributed mightily to foster a new industry.

No doubt, Fred could not have accomplished his dreams without the help of good friends and colleagues. No, this is a story about how one man can make a difference.

After his hitch in the Navy he attended college on the GI Bill. Fred then accepted a position with the Ohio Inspection Bureau. Conducting safety and loss prevention inspections on large, highly protected risks, Fred became thoroughly familiar with identifying and managing the risks that can confront a large manufacturing plant or steel mill.

Later, as a property underwriter for a Cleveland, Ohio, insurance company, he learned how to develop premiums and reinsurance contracts. When the lure of finally setting his own hours and establishing his own business seemed more attractive than sitting behind a desk, he accepted a job in Youngstown working as an agent, selling insurance like tens of thousands of people do every day.

Like the rest of us, he was confronted with the vagaries of the insurance cycles, which in the specialty property market were wild.

Starting in the late 1940's, the fire and allied lines market was experiencing mounting losses and overly competitive rate making, driving down premiums.

While most of the market benefited from price reductions, it was not so for large buyers of insurance coverage like steel mills, food processors, distillers and auto manufactures. The large risk market was considered the specialty market, and there was a limited pool of talented underwriters and capital to properly insure such large exposures.

Most often, London was used to provide capacity for these large risks. The situation almost sounds like the one that exists today, with pockets of tightening terms and lack of markets for medical malpractice, worker's compensation and other hard hit lines.

When the insurance policies came up for renewal for one of Fred's largest clients, a large sheet and tube manufacturer located in the heart of the Mahoning Valley (an area that had a large concentration of mills and blast furnaces along the Mahoning River), Fred expected, and got, the worst news.

Premiums had gone up dramatically.

Rather than accepting his current situation as final, he met with his client and discussed various ways to mitigate the impact of the premium increase.

Upon learning that because of the rise in premiums his client's research and development budget would be slashed, thus perhaps giving competitors an edge in a highly competitive industry, Fred sought to have U.S.-based insurance companies give up part of their premium in exchange for his client paying a deductible. When repeatedly denied, he sought out other sources of capital, including the London market.

Using his considerable skills in sales, loss prevention engineering and networking, Fred succeeded in having London offer him coverage at a reduced premium. All he had to do was provide loss prevention and risk management, and provide a "front" in the US, as Lloyd's was unable to provide one.

After conferring with his client, it was agreed that an Ohio-based insurance company, specifically formed to provide the front, would be capitalized to issue policies and act as the legal insurance entity to insure its only client. The insurance company would then "self-insure" a percentage of all claims and reinsure any losses above their retention with London.

While the very foundation of insurance is to draw upon large numbers to "smooth" losses among all, Mr. Reiss's concept was in direct contrast to that theory. His new insurance company, Steel Insurance Company of America, had only one client.

Like the steel mills that owned mines, called "captives," that produced coke and iron ore for only their owners, Fred had succeeded in producing his own "captive," an insurance company that insured only the risks of its owner.

Thus, Fred Reiss is often credited with the idea of forming the first pure "captive" insurance company, born in Ohio in 1955.

The result of this groundbreaking application did not sit well with conventional insurance companies of the day. They made their profits on investment income and underwriting skills, not operational efficiencies.

Captives, on the other hand, were far less expensive to manage and offered more opportunities for a return on investment and underwriting, and, perhaps most importantly, gave captive owners direct access to reinsurers.

Of course, in just a handful of years, a 37-year-old Fred Reiss would realize that Bermuda, a tiny island in the Atlantic whose main economy was tourism, but rich in creativity and risk taking, would be a most valuable partner in promoting his captive concept. So, in 1962, Fred, with just one client in hand and two others in line, started his quest in Bermuda to change the way we do insurance.

More than 50 years and 4,300 captives later, Fred Reiss's indomitable spirit has indeed made an unfathomable impact all over the world. He simply couldn't accept what the market had given him, so he changed it. Don't we all wish we could?

Though he was a man brimming with self-confidence and charisma, I doubt that Fred—who died in 1993 and was posthumously honored as the first recipient of the Bermuda Insurance Institute Lifetime Achievement Award in 1999—would have dared to have thought his humble beginnings in Ohio would have such worldwide impact.

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