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WHY PRIVATE INSURANCE IS REFERRED TO AS "CAPTIVE"

By Joseph W Tucciarone, CEO National Network of Accountants

Private insurance, particularly in the form of captive insurance, has become an essential risk management tool for many companies. The term "captive insurance" might sound esoteric, but it has a rich history and specific effects that distinguish it from traditional insurance. To understand why private insurance is referred to as "captive," we will look into its origins, the work of Fred Reiss, and a notable example involving Youngstown Sheet and Tube. Furthermore, we will explore the bipartisan support that captive insurance has garnered from both Democrats and Republicans.

The Origins of Captive Insurance

Captive insurance refers to a form of self-insurance where a parent company creates a licensed insurance company to provide coverage for itself. Unlike traditional insurance companies that offer coverage to the public, a captive insurer only insures the risks of its parent company or related entities. This model allows businesses to better manage their risks and reduce insurance costs by retaining profits that would otherwise go to traditional insurers.

Fred Reiss: The Father of Captive Insurance

Fred Reiss is often credited as the father of captive insurance. In the 1950s, Reiss was an insurance broker working in the United States. He recognized that traditional insurance models were not always the most efficient or cost-effective means for large companies to manage their risks. Reiss's insight was to turn the concept of self-insurance into a more formalized and regulated structure.

In 1953, Fred Reiss founded International Risk Management Ltd., which became the first company to offer captive management services. His innovative approach allowed companies to create their own insurance subsidiaries, which could then provide coverage tailored to their specific needs. Reiss's work transformed the risk management landscape, offering companies greater control over their insurance programs and costs.

Youngstown Sheet and Tube

One of the early and notable examples of captive insurance in practice is the case of Youngstown Sheet and Tube, a major steel manufacturer. In the 1950s, Youngstown Sheet and Tube faced significant challenges with the traditional insurance market. The company had difficulty obtaining adequate coverage at reasonable rates due to the high-risk nature of its operations.

Following Fred Reiss's pioneering model, Youngstown Sheet and Tube established a captive insurance company. This move allowed the company to insure its risks more effectively and affordably. By doing so, Youngstown Sheet and Tube could retain the premiums that would have otherwise gone to a third-party insurer, while also gaining greater flexibility in their risk management strategies.

The success of Youngstown Sheet and Tube's captive insurance company demonstrated the viability and benefits of this model, paving the way for other companies to follow suit. This example underscored the potential for captive insurance to provide more customized and cost-effective coverage compared to traditional insurance options.

Why "Captive"?

The term "captive" in captive insurance refers to the idea that the insurance company is "captive" to its parent company. Unlike traditional insurers that serve a range of clients, a captive insurer is created to serve the specific needs of its parent company or a group of related companies. This captive relationship allows the parent company to exercise greater control over its insurance operations, from underwriting to claims management. The parent company typically has significant involvement in the management and operations of the captive, ensuring that the insurance solutions are closely aligned with the company's risk management objectives.

Bipartisan Support

Captive insurance has gained strong bipartisan support in the United States, reflecting its wide acceptance and recognition as a valuable financial tool. Both Democrats and Republicans have acknowledged the benefits of captive insurance for businesses of all sizes, especially in terms of economic stability and job creation.

The bipartisan support for captive insurance is reflected in various legislative initiatives aimed at promoting and regulating the industry. Both parties have worked together to create a favorable regulatory environment that encourages the growth and development of captive insurance companies in the United States. This collaborative approach ensures that the benefits of captive insurance can be realized by a diverse range of businesses, contributing to overall economic resilience.

Conclusion

The term "captive" in captive insurance aptly describes the unique and close relationship between the insurance company and its parent. The bipartisan support for captive insurance further underscores its significance as a vital component of modern risk management strategies, benefiting companies across the political spectrum and contributing to economic stability.

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