The Coalition For A Domestic Insurance Industry

February 27, 2009

The Honorable Max Baucus
Chairman
Senate Finance Committee
511 Hart Senate Office Building
Washington, DC 20510

The Honorable Charles Grassley
Ranking Member
Senate Finance Committee
135 Hart Senate Office Building
Washington, DC 20510

Dear Chairman Baucus and Ranking Member Grassley:

We are writing in strong support of the discussion draft released by the Senate Finance Committee staff on December 10, 2008 (the "Discussion Draft") and similar legislation introduced in the House last year by Congressman Neal (H.R. 6969).

Our coalition consists of 14 of the largest domestic commercial lines and financial guarantee insurance groups. Collectively, we have over 150,000 employees with offices located throughout the United States.

Plain and simple, it is untenable for the United States tax code to favor foreign-owned insurance companies over domestic insurers in selling insurance in the United States. The problem arises because a loophole in current law allows foreign-controlled companies to avoid tax on much of their U.S. underwriting and investment profits merely by reinsuring this business with a foreign related party located in a low-tax or no-tax jurisdiction.

This is not a new problem. The Federal Government has recognized the concern with related party reinsurance for many years. In 2003, the Bush Administration expressed concern with the use of offshore related party reinsurance to avoid tax on U.S. source income. In written testimony, then Treasury Assistant Secretary Pam Olson stated, "the use of related party insurance may permit the shifting of income from U.S. members of a corporate group to a foreign affiliate. Existing mechanisms for dealing with insurance transactions are not sufficient to address this situation." In 2004, the Congress passed legislation intended to give Treasury and the IRS authority to address the concerns, but it has proven to be ineffective.

In its hearing pamphlet for a Senate Finance Committee hearing in 2007, the staff of the Joint Tax Committee stated that "...the effects on the U.S. tax base of [a foreign-controlled company] that reinsures U.S. risks with its foreign parent companies or foreign related parties is the same as earnings stripping."

We believe the approach taken in the Senate Finance Committee staff discussion draft and H.R. 6969 is a measured and effective remedy to the problems caused by offshore related party reinsurance. Similar to the earnings stripping rules under section 163(j), the bill strikes a balance and only targets "excessive" related party reinsurance transactions that are being used to strip income out of the U.S. tax base and avoid U.S. tax.

Opponents of the draft legislation will likely argue that the bill will harm insurance capacity, increase prices to consumers, and interfere with free trade. Each of these arguments is spurious. First, the draft provision only applies to "reinsurance" from a U.S. affiliate to a non-U.S. affiliate. These transactions are essentially book entries and do not add capacity or spread risk outside of the holding company structure. The provision does not apply to any reinsurance transaction that actually shifts risk to an unrelated third party.

Second, the tax advantage enjoyed by foreign insurance companies historically has resulted in higher profits for their shareholders, not in lower prices to consumers. For example, when pricing softened in the market, the head of the Association of Bermuda Insurers and Reinsurers stated that the profits Bermuda companies are making "[are] going back to shareholders. It's not contributing to the downward spiral [in commercial insurance pricing]." In other words, pricing in the U.S. property and casualty insurance market – whether in a soft market or a hard market -- has not been impacted by the tax advantage or where the capital is raised.

Because of the increased profits to shareholders, this unfair competitive tax advantage has already caused a significant migration of insurance capital abroad and erosion of the U.S. tax base. A number of U.S. property and casualty companies have expatriated to low-tax or no-tax countries to take advantage of this loophole. Also, new P&C holding companies have been formed in no-tax and low-tax jurisdictions and raised significant capital from U.S. investors. In either case, these foreign-based companies have sought, and will continue to seek, to leverage this competitive advantage to acquire U.S. companies or U.S. lines of business. Such transactions have already resulted in billions of dollars of lost tax revenues to the Federal Government. If left unchecked, we believe this could cause much more of the U.S. insurance capital base to migrate abroad and ultimately could threaten the future of our domestic insurance industry. Given that the U.S. constitutes in excess of 40% of the global demand for P&C insurance, it seems axiomatic that we would want to preserve our domestic industry.

Moreover, it is important to note that, even if the opponents' arguments were true, any purported effect on pricing or capacity would arise from an unfair competitive tax advantage for foreign-based companies at the expense of their U.S. competitors and other U.S. taxpayers. There is simply no policy reason why the U.S. tax system should favor foreign-based insurers over U.S. companies writing insurance covering U.S. risks. ***Put another way, is it possible that Congress would ever pass a tax incentive only applicable to foreign-based companies in order to reduce insurance prices or provide additional capacity? The answer is clearly no.***

Finally, the discussion draft is not protectionist and does not violate U.S. trade or treaty obligations. The bill does not favor domestic companies over foreign competitors. The fix merely would level the playing field by similarly taxing U.S.-owned insurers and their foreign-based competitors in writing U.S. business. We do not believe we should receive special treatment in accessing foreign markets relative to our foreign competitors, nor should our foreign-based competitors be advantaged in the U.S. market relative to us under the tax code.

I want to thank you and your staffs for your efforts to address this unfair competitive advantage. Our coalition looks forward to working with you to help ensure quick passage of this legislation and to address any legitimate concerns that may arise. We very much appreciate the opportunity to comment on the legislation. We may respond further after reviewing other submitted comments. Please feel free to call on us at any time to further discuss this issue and the proposed legislation.

Sincerely,

William R. Berkley