February 25, 2009

United States Senate Committee on Finance
Attn: Russ Sullivan
Democratic Staff Director
219 Dirksen Senate Office Bldg.
Washington, DC 20510

Mr. Sullivan,

Ceteris US LLC appreciates the opportunity to provide comments and observations on the Staff Discussion Draft to amend the Internal Revenue Code of 1986 to disallow the deduction for excess nontaxed reinsurance premiums paid to affiliates (hereinafter "Draft"). We are an independent consulting firm specializing in transfer pricing, valuation and intellectual property analysis and perform a significant amount of work for firms in the financial services industry, including insurance and reinsurance companies.

Although we support the Senate Committee's efforts to eliminate tax-induced competitive disadvantages for U.S. insurers and reinsurers, we believe the Draft as written does not necessarily meet this objective and conflicts with existing tax regulations designed for a similar purpose. Specifically, we are concerned that the Draft runs contrary to the arm's length standard governing intercompany transactions (including the payment of cross-border reinsurance premiums among affiliated companies) under Treasury Regulation Section 1.482, and that the application of an industry fraction as defined within the Draft ignores facts and circumstances surrounding a reinsurance arrangement that could have significant impacts on what a "fair" price would be for such an arrangement.

The Treasury Regulations set forth under Section 1.482 ensure that taxpayers clearly reflect income attributable to related party transactions, and prevent the avoidance of taxes with respect to such transactions. Under these regulations all transactions must be priced under the "arm's length standard", which means that in the case of a company paying premiums to an affiliated corporation in a non-US jurisdiction these regulations already require those premiums to be consistent with what would be paid if the offshore entity were a third party (uncontrolled). Further, Treasury Regulation Section 1.6662 compels US taxpayers to perform and document an economic analysis supporting the arm's length nature of related-party transactions.

The Section 482 regulations specifically prohibit the use of industry averages to determine arm's length pricing for the reason that such averages ignore several factors that may impact the amount of reinsurance premiums that an insurance company would pay to nonaffiliated corporations. For example, despite the Draft's mention of applying separate industry fractions for each business line, even within the same business any given reinsurance arrangement should be analyzed on its own terms. Two reinsurance arrangements in the same business line (say, workman's compensation)

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and for the same total amount reinsured will not necessarily have the same premium rate. An unaffiliated reinsurer would evaluate several factors before pricing such an arrangement, including historical losses experienced on the underlying business, the industry involved, additional terms to the contract, financial risks associated with the market, and the interest rate environment.

It should also be noted that the use of industry averages would be difficult in many cases where risk is ceded through non-proportional 'excess-of-loss' reinsurance contracts. These arrangements often involve the assumption of risk at different levels, or layers, relative to the risk retained by the original insurer. Consequently, it is unclear how robust industry averages would be established given the lack of uniform structures and terms for such contracts.

In addition, the fact that the industry average would be calculated with a two-year lag most likely misaligns macroeconomic and market factors that would be relevant to benchmarking a particular reinsurance arrangement. Consider the time period immediately following September 11, 2001, when rates for property and casualty reinsurance were extremely volatile. If data from 1999 were used as a guideline for how reinsurance arrangements should be priced in this period the results would not be reliable.

Fortunately, the rules under Treasury Regulation Section 1.482 contemplate all such factors and outline a framework that takes into account the relevant facts and circumstances of a company's related party reinsurance arrangement. Our recommendation to the Committee is the following: instead of issuing new regulations that conflict with 1.482 and lack the specificity needed to ensure proper arm's length pricing of related party reinsurance arrangements, consider directing efforts toward enforcing compliance with Section 1.482.

We thank the Committee for its consideration of our comments and would be pleased to discuss these issues in more detail if the Committee so desires.

Sincerely,

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