



NAUTILUS INSURANCE GROUP®

Nautilus Insurance Company

Great Divide Insurance Company

February 26, 2009

VIA OVERNIGHT MAIL

Via email: reinsurance@finance-dem.senate.gov

Mr. Russ Sullivan
Democratic Staff Director
Senate Finance Committee
219 Dirksen Senate Office Building
Washington, DC 20510

- We are a United States property and casualty (“P&C”) insurance companies incorporated in the States of Arizona and North Dakota. Our companies, Nautilus Insurance Company and Great Divide Insurance Company are located primarily in the State(s) of Arizona, California, Connecticut, Georgia, Illinois, Minnesota and Texas with over 372 employees located in the US. We write approximately \$484 million insurance premiums primarily in the commercial general liability and commercial property lines of business.
- We wish to express our support for 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).
- This legislation is needed to eliminate an untenable situation where the tax code actually favors foreign-owned insurance companies over domestic insurers in selling P&C insurance in the United States. The problem arises because foreign-controlled companies can 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 unfair competitive tax advantage has already caused a significant migration of insurance capital abroad and erosion of the U.S. tax base. First, a number of U.S. property and casualty companies have expatriated to low-tax or no-tax countries to take advantage of this loophole. (Arch U.S. and Everest Re Group are among the most notable.) It also provides an incentive for the formation of new P&C holding companies in no-tax and low-tax jurisdictions. As a case in point, in the wake of the 2005 hurricanes, over \$30 billion of capital was raised to establish offshore vehicles to provide capacity to the U.S. market. U.S. investors funded the majority of these offshore companies based in tax-advantaged locations, yet the majority of both their business and employees came from either the United States or the United Kingdom. In either case, these foreign-based companies have sought, and will continue to seek, to use this competitive advantage to acquire U.S. companies or U.S. lines of business. Already, acquisitions of U.S. insurers and reinsurers include ACE’s acquisition of CIGNA’s former INA companies, XL’s acquisition of NAC Re.
- Such transactions have already resulted in billions of dollars of lost tax revenues to the Federal Government. Since 1997, the amount of related party reinsurance written to foreign affiliates has grown eight-fold from \$4.2 billion to \$33.8 billion. Most of this activity is centered in low-tax or no-tax jurisdictions, demonstrating that the increase in activity is largely tax-motivated.
- If the unfair advantage is left unchecked, significantly more of the U.S. insurance capital base is likely to migrate abroad to tax-havens. Ultimately, this could threaten the future of our domestic insurance industry.

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- This is not a new problem. The Federal Government has recognized the concern with related party reinsurance for many years.
 - In written testimony in 2003, then Treasury Assistant Secretary Pam Olson expressed concern with the use of offshore related party reinsurance to avoid US tax on US sourced income and 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 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 an appropriate 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.
- We commend you and your staff for your efforts to address this unfair competitive advantage and urge quick adoption of this legislation. Passage of this bill will help restore competitive balance to the marketplace and prevent the costly erosion of the domestic P&C insurance industry, as well as the attendant US tax base.
- We very much appreciate the opportunity to comment on the legislation. Please feel free to call on us to further discuss this issue and the proposed legislation.

Respectfully,
Nautilus Insurance Company (AZ)
Great Divide Insurance Company (ND)

A handwritten signature in black ink, appearing to read "T.M. Kuzma". The signature is fluid and cursive, with a large loop at the end.

Thomas M. Kuzma
President & CEO