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Mr. Chairman, Ranking Member Grassley and members of the Committee, I am pleased to appear before you today to discuss a serious problem in our current tax system that provides a significant unfair competitive advantage to foreign property and casualty insurance groups based in no-tax or low-tax countries. Current law allows a U.S. member of a foreign–domiciled group to avoid paying U.S. tax on much of its domestic underwriting and investment income, merely by reinsuring its business with a related-party reinsurer domiciled in a country such as Bermuda or the Cayman Islands. By contrast, a U.S.-based insurance group must pay U.S. tax on all of its underwriting and investment income derived from writing similar domestic business.

This unfair tax advantage, which began to be exploited around 20 years ago, has already caused a significant migration of insurance capital abroad. If left unchecked, 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.

This is clearly one of the most important issues faced by my company since I founded it nearly 40 years ago. I am the Chairman and CEO of the W. R. Berkley Corporation, the Country's 9th largest commercial lines insurer with revenues over $5 billion. We operate in five major business segments: regional property casualty; specialty lines; reinsurance; alternative markets; and international. Our companies are located in 27 states and write business in all 50 states and the District of Columbia. We also conduct business in the U.K., South America and Asia.

However, today, I am testifying not only on behalf of my company, but also on behalf of a coalition of many of the other largest domestic commercial lines and financial guarantee insurers.

The other members of our coalition are:

AMBAC Financial Group, Inc.
American Financial Group, Inc.
Berkshire Hathaway Inc.
The Chubb Corporation
EMC Insurance Companies
The Hartford Financial Services Group, Inc.
Liberty Mutual
Markel Corporation
MBIA Insurance Corporation
Safeco Corporation
Scottsdale Insurance Company, a Nationwide subsidiary
The Travelers Companies, Inc.
Zenith Insurance Company

Collectively, we have over 150,000 employees, and approximately $1 trillion in assets with offices and employees located throughout the United States.

As competitors, we rarely agree on much. In this case, however, we are united in our belief that this tax inequity must be fixed and soon. Otherwise, the United States is at risk of losing much more of the capital base, and associated tax base, of one of its critical industries.

What is the unfair tax advantage and how does it work?

Current law allows foreign-domiciled insurers with U.S. affiliates to use related-party reinsurance transactions to strip their profits from both underwriting and investment activities out of the U.S. tax base (where the income was generated) to a more favorable tax jurisdiction. This transaction can be done instantly and generally requires only a book-keeping entry.[1] By contrast, U.S.-based insurers must pay current

[1] In such cases, the foreign-domiciled insurance group pays only a one-percent excise tax on the reinsurance premiums paid from the U.S. member to its offshore affiliate. Once those resources are located in the low-tax or no-tax country, any income earned is taxed only at the local rate. In the case of Bermuda, there is no corporate income tax on that income.

U.S. tax on all of their income from these policies. Thus, even though the U.S. income-generating activities are the same, these foreign-domiciled insurers can avoid tax on much if not all of their underwriting and investment income and generate significantly greater after-tax returns than comparable U.S. competitors.

This is an enormous competitive advantage and is particularly advantageous for commercial lines and financial guarantee insurers where loss reserves are held for an extended period of time and generate substantial investment income. Thus, for these "long-tail" lines of business, avoiding U.S. tax on investment income gives foreign-domiciled groups an even greater competitive advantage over their U.S. counterparts.

All of this provides an incentive to locate capital in low-tax or no-tax jurisdictions in order to take advantage of the benefit afforded foreign-domiciled insurance groups. As the premium ceded outside the U.S. increases, the foreign-domiciled insurers will continue to use their tax advantage to gain a greater share of the U.S. insurance market.

Both the Bush Administration and this Committee have previously expressed concern over this inequitable tax advantage and the need for a fix. In written testimony before the Congress in 2003, then Treasury Assistant Secretary Pam Olson stated:

> The Treasury Department is concerned about the use of related party reinsurance to avoid U.S. tax on U.S. source income. In particular, 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 adopting a provision to clarify the transfer pricing rules in section 845 in 2004, the Finance Committee tried to fix the problem and stated "The Committee is concerned that foreign related party reinsurance arrangements may be a technique for eroding the U.S. tax base."

Unfortunately, the adjustment to the transfer pricing rules adopted in 2004 failed to stem the tide (as evidenced by Appendix 1), since at

bottom, the core problem is not effectively addressed by transfer pricing rules. As the Joint Committee pamphlet for this hearing acknowledges, it is difficult for the IRS to use transfer pricing rules to police such transactions, because such rules -- as the name suggests -- are limited to arm's length pricing. In this case, the unfair tax advantage causes foreign-controlled insurers to cede more business to foreign affiliates than they would ever cede to an unrelated party. Moreover, because of the numerous variations in the terms and conditions of reinsurance contracts and because the true costs of insurance products are not known until long after prices are established, determining a true arm's length price in this context is exceptionally difficult. Finally, the mere ceding of reserves offshore, even without a shift in underwriting profits, dramatically lowers tax payments because of the requirement in the U.S. to discount loss reserves.

If the transfer pricing rules worked, we would expect that the bulk of the profits would remain in the U.S. and the competitive tax advantage would disappear. However, most Bermuda insurers have exceptionally low effective tax rates, including those groups writing insurance business through U.S. subsidiaries. This demonstrates their success in transferring the bulk of their underwriting and investment income offshore to avoid tax under existing mechanisms. Thus, we do not believe that the provisions of section 845 will effectively prevent or alter the many related party reinsurance transactions that take place under current law.

When Congress became aware of a similar problem with respect to debt, it addressed the problem by curtailing the amount of tax-favored borrowing by U.S. firms from related foreign parties. Congress did not address the problem through the transfer pricing rules, because it recognized that those rules were not capable of dealing with the problem.

Why must we act now?

The migration of capital, which began in the mid-1980s, has continued in earnest. Over the last decade, the U.S. insurance industry has been shifting offshore at an accelerating pace.

Previously, a number of U.S. property and casualty insurance and reinsurance holding companies chose to expatriate to low-tax or no-tax countries with a principal purpose to avoid U.S. taxes. Among the most notable, White Mountains Insurance Group, Everest Re Group, Arch U.S., and PXRe Group LTD all inverted into Bermuda-based parent corporations. More recently, as described more fully below, Argonaut engaged in a partial inversion into Bermuda, avoiding treatment as a domestic corporation under section 7874.

As Appendix 2 shows, companies in Bermuda have been actively acquiring U.S. insurance companies and lines of business. For example, upon completion of their inversions to Bermuda, several of the previously U.S.-based multinationals have aggressively acquired other U.S. insurers and assets to further avail themselves of this unfair tax advantage. These acquisitions of U.S. insurers and reinsurers include ACE's acquisition of CIGNA's former INA companies and XL's acquisition of NAC Re.

The tax advantage also provides an incentive for the formation of new companies in no-tax and low-tax jurisdictions. Once formed, these new companies seek to acquire U.S. companies or lines of business in order to benefit from the tax advantage.

The following are just a sample of the transactions where tax benefits were a principal reason for the transaction:

- **Inversion of Arch U.S.** On November 8, 2000, Arch U.S. inverted, becoming a wholly-owned subsidiary of Arch Capital Group Ltd. (ACGL), a Bermuda holding company. The shareholders of Arch U.S. became the shareholders of ACGL. Subsequently, Arch Insurance Company (AIC), a U.S. subsidiary of ACGL, entered into a quota share reinsurance agreement with its Bermuda-based affiliate, Arch Reinsurance Ltd, whereby AIC generally cedes 80% of its net retained liability to Arch in Bermuda. ACGL has had several substantial equity infusions of capital since its inversion.

- **Inversion of United National.** United America Indemnity, Ltd. was established as a Cayman Islands holding company on

August 26, 2004 to acquire the United National Group's U.S. insurance operations. Subsequently, the Company added the Penn-America Group, Inc. segment to its U.S. operations. United America also includes a non-U.S. operation: Wind River Reinsurance Company, Ltd. in Bermuda, which provides reinsurance to the U.S. operations. United National Insurance Company cedes 60% of its business to Wind River, while Penn-America Insurance Company cedes 30% of its business to Wind River.

- **Partial Inversion of Argonaut**. On May 14, 2007, Argonaut Group, Inc., a San Antonio, Texas specialty insurer merged into PXRE Group, Ltd., a Bermuda-based property reinsurer in a partial inversion transaction. The combined entity is doing business as Argo Group International Holdings Limited ("Argo Group"), a Bermuda holding company. Upon completion of the transaction, approximately 73% of Argo Group's outstanding common stock continued to be owned by Argonaut's shareholders. Management and the board are predominantly made up of the former members of management and the board of the U.S.-based Argonaut Group, Inc. While the business will continue generally to be U.S.-based, the transaction will allow the combined entity to shift much of the capital base and tax base offshore through related-party reinsurance to Peleus Re, a Bermuda-based reinsurance affiliate. While not specific, Argo Group has indicated that it will utilize internal reinsurance.

What are the consequences?

Such transactions have already resulted in billions of dollars of lost tax revenue to the federal government. At the end of 2006, over $70 billion of assets held offshore were owed by affiliated foreign reinsurers to related U.S. insurers as a result of affiliated reinsurance. In addition to the related underwriting income, these assets generate significant investment income outside of the purview of U.S. taxing authorities each year.

In addition, these transactions have caused significant migration of the U.S. capital base. For example, Bermuda companies and other

offshore enterprises have received the vast majority of new capital raised by insurance companies in the past ten years.

Also, there has been significant growth in the amount of related party reinsurance written to foreign affiliates. In 2006, of the total $54.7 billion of U.S. premiums ceded to foreign insurance companies, $32.5 billion in premiums, or nearly 60 percent, was ceded to related foreign reinsurance companies. By contrast, in 1996, only $4.0 billion or 27.2 percent of the total $14.7 billion of premiums ceded to foreign reinsurers was ceded to related foreign companies. Thus, the amount of premium ceded to affiliated foreign reinsurers has increased at a 23.3 percent compound annual growth rate. If this growth rate continues, by 2012, premiums ceded to foreign affiliates will surpass $100 billion.

The data also demonstrates that the principal incentive for this increased related-party reinsurance activity has been the avoidance of U.S. income tax. As shown in Appendix 1, the bulk of this offshore activity is centered in low-tax or no-tax jurisdictions and such activity has increased more than eight-fold during the ten-year period from 1996 to 2006.[2]

Bermuda, which is a no-tax jurisdiction, accounts for over half of the total related party reinsurance of U.S.-based insurance in 2006. Since 1998, the number of major Bermuda-based reinsurance companies with U.S. affiliates has increased from three to over twenty. Related party reinsurance ceded to Bermuda companies by U.S. affiliates has increased ten-fold from $1.8 billion in 1996 to $18.5 billion in 2006.

This rapid growth in related party reinsurance means a concomitant loss of tax revenue in the United States. In addition to the negative impact on tax revenues, the movement of U.S.-based insurance capital offshore has other adverse consequences as well. For example, there will be significantly less demand for municipal securities, which are one of the industry's principal investments. In addition, as capital migrates offshore, ensuring that the insurance

[2] Two countries, Bermuda and the Cayman Islands, have no corporate tax while Ireland, with a 12.5 percent corporate tax rate, can be considered a low-tax jurisdiction. Switzerland generally has a higher statutory tax rate than Ireland; however, possible special relief may apply that could make the effective tax rate of a company located in Switzerland significantly lower than the statutory rate.

needs of the U.S. market are met may become more problematic in the long run.

What has changed?

Historically, offshore reinsurers served a narrow market in the United States, offering primarily catastrophe and high excess reinsurance protection. Today, however, offshore companies have expanded beyond these areas and into nearly all lines of the direct insurance business, including excess and surplus lines as well as standard market business. Much of this direct business is reinsured to offshore affiliates in low-tax or no-tax jurisdictions.

According to Dowling & Partners, "U.S. domiciled (re)insurers owned by Bermuda based holding companies wrote $30 BB+ of gross written premium in 2005 or more than 6% of U.S. commercial property/casualty premiums versus nothing a decade ago." Dowling then predicts, "ceding premium to offshore affiliates will continue to rise given recent/planned startups and the growing success of the Bermuda Class of 2001 (Arch & AXIS write nearly $3BB of primary insurance in U.S.). In addition, the recent Lloyd's expansion has a Bermuda Angle from a tax perspective."[3]

As Dowling & Partners notes in the same report, the reinsurance industry has already been lost to Bermuda as a result of the tax advantage, stating "there are no remaining independent publicly traded U.S. based reinsurers." We should not sit idly by and let the same migration occur with our primary domestic insurance industry.

What should be done?

To begin leveling the playing field and to preserve the U.S. capital and associated tax base, legislation needs to be enacted to prevent foreign-based insurers from stripping their income derived from U.S. business outside the U.S. taxing jurisdiction merely by reinsuring to a foreign affiliate. Only legislation can correct the unfair competitive advantage available to foreign-based groups.

[3] IBNR Weekly #46, Dowling and Partners (November 20, 2006)

Some essential points about eliminating the unfair competitive tax advantage:

- The fix should be limited only to affecting reinsurance ceded to foreign affiliates (i.e., from a U.S. member to a non-U.S. member of the same foreign group). Thus, offshore groups reinsuring risks for unaffiliated U.S. insurers should not be affected by the legislation.

- Fixing this problem should not adversely affect insurance capacity because any corrective legislation should be limited to related party reinsurance and not affect reinsurance transactions that spread risk among unrelated parties. The affected related party reinsurance transactions add no additional capacity to the market, but rather require a mere bookkeeping entry to move premium from the U.S. company's pocket to the foreign parent's pocket of the same corporate family.

- The fix will not adversely impact the creation of meaningful jobs where underwriting and sales are actual components of writing the reinsurance abroad. Because the tax-driven transactions generally require only a book-keeping entry and merely shift revenue from one pocket to another, they require little in the way of additional facilities or personnel in the low-tax or no-tax jurisdiction.

- Fixing the unfair tax advantage is not protectionist, as our competitors have argued in the past, because it does not favor domestic companies over foreign competitors. The fix merely would level the playing field by similarly taxing U.S. 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.

In closing, I believe that legislation addressing this problem is critical to the continued existence of a robust domestic insurance industry. I want to thank Chairman Baucus, Senator Grassley and the other Members of the Committee for inviting me to express my views

regarding this important and complex issue. I would welcome the opportunity to answer any questions that you may have.

Appendix 1 – Related-Party Reinsurance Ceded Activity
Top Jurisdictions
Reported from 1996 to 2006
Source: Reinsurance Association of America
(In Millions of Dollars)

Country	1996	1997	1998	1999	2000	2001	2002	2003	2004	2005	2006
Bermuda	1,783	1,799	3,704	5,192	6,225	8,829	8,825	14,199	17,031	18,590	18,474
Switzerland	660	609	728	466	670	3,173	6,168	7,480	7,795	7,664	7,991
Germany	264	326	355	421	484	799	6,253	4,269	3,294	9,401	2,005
Barbados	230	317	258	229	219	382	841	1,064	925	917	965
Sweden							38	37	38	90	518
Ireland			86	-111	25	218	273	203	177	165	451
Cayman Islands	73	256	583	951	884	998	1,072	894	629	646	435
United Kingdom	292	326	336	381	417	428	489	1,470	300	252	346
France	103	101	92	115	216	590	422	403	198	293	338
British Virgin Islands							28	38	49	72	327
Other	596	481	299	1,205	579	442	485	606	704	726	620
Total	4,001	4,215	6,441	8,849	9,719	15,859	24,894	30,663	31,140	38,816	32,470

- Includes two significant one-time affiliated loss portfolio transactions.

Appendix 2 – Selected Transactions		
Group	**Quota Share Details**	**Initial U.S. Acquisition or Entry into U.S.**
White Mountains Insurance Group Ltd.	No business Quota Shared from One Beacon to Bermuda.	*Redomesticates in Bermuda*, October 1999
Everest Re Group Ltd.	35% of Everest Reins Co's casualty business & 20% of property ceded to Bermuda. Everest Reins. Co assumes 85% of net business from Everest National, Everest Indemnity and Everest Security.	*Redomesticates in Bermuda in* 2000
Arch Capital Group Ltd.	90% of net U.S. business ex. alternative market profit center and lenders product.	Capital infusion (October 2001); Arch Re Bermuda (formed May 2001
Endurance Specialty Holdings Ltd.	Endurance Re Corp of America (NY) cedes 50% to Bermuda. Traders & Pacific (DE) cedes approx. 60% to outside reinsurers and 90% of remaining to Bermuda.	Endurance Re of America formed 2002
Platinum Underwriters Holdings Ltd.	75% of Platinum U.S. business ceded to Bermuda.	Redomesticated in Bermuda, 2002 IPO.
United American Indemnity, Ltd.	60% of United National Ins Co business; 30% of Penn-America Ins Cos business ceded to Bermuda	Formed United National Bermuda 2003
RenaissanceRe Holdings Ltd.	Glenco (Bermuda) provides 50% QS to Stonington (TX), which reinsures 80% of Lantana, Newstead and Inverness and 100% of Stonington Lloyds	DeSoto Companies formed in 1997; Acquired Nobel 1998
Allied World Assurance Company Holdings Ltd.	Cedes 85% of ultimate net liability to AWAC Bermuda.	Formed November 2001; Formerly AIG subsidiary
PXRE Group Ltd.		*Redomesticates in Bermuda*, October 1999
Lloyd's Syndicates	Various	*Redomesticates in 2007* Amlin, Hiscox, Omega Specialty, Kiln, Advent
ACE Ltd.		Westchester (acquired 1998); CIGNA P&C (1999)
XL Capital Ltd.	XL Re America cedes 75% of pooled business to XL Re Ltd (Bermuda) after placement of specific reinsurance	Folksamerica General (acquired 1998); NAC Re/Intercargo (1999)
PartnerRe Ltd.	Partner Reins Co of U.S. cedes 25% of all lines to Bermuda	Safr Re (acquired 1997); Winterthur Re (1999)
Axis Capital Holdings Ltd.	Axis Specialty cedes 50% of all U.S. business to Bermuda.	Royal & Sun Personal (acquired 2002); CT Specialty (2002)
Alea Group Holdings Ltd.	N/A – runoff	Acquired Seven Hills Insurance Company (2001)
Quanta Capital Holdings Ltd.	N/A – runoff	Chubb Financial Solutions (acquired 2003); NFU (2003)
Aspen Insurance Holdings Ltd.	50% of net U.S. casualty business ceded to Bermuda. No QS on property.	Dakota Specialty (acquired 2003)
Max Capital Group Ltd.	Started writing E&S in first half 2007.	Formed in Bermuda in 2000; Acquires U.S. Based excess and surplus lines company, renamed Max Specialty Insurance Company (April, 2007)
Argonaut Group, Inc. and PXRE Group Ltd.	New- no information available.	Signed a definitive merger agreement; combined entity will do business as Argo Group International Holdings Limited; (March 2007)
James River Group	New – no information available.	D. E. Shaw reached an agreement to acquire James River Group, Inc. through a Bermuda holding company in 2007. D.E. Shaw will create and capitalize a new Bermuda reinsurer after the close.
Tower Group Inc./ CastlePoint Holdings	Tower cedes 30% of brokerage business and traditional program business to CastlePoint Re.	Castle Point formed in Bermuda in 2006 by management and shareholders of Tower Group
Ironshore Inc.	Writes E&S business direct in U.S.	Ironshore Ltd formed in Bermuda and approved for surplus lines in certain states in 2007.
AmTrust Financial Services, Inc. / Maiden Holdings Ltd.	40% QS of AmTrust Group business to Maiden	Principal shareholders of AmTrust form Maiden Holdings and Maiden Insurance Company Ltd. 2007
Montpelier Re	New- no information available.	Received Coverholder approval from Lloyds for U.S. MGU to write property brokerage facultative business in the U.S.. Purchased surplus lines shell company from GAINSCO in August 2007 and will write primarily excess and surplus lines insurance in the U.S.
Ariel Holdings Ltd.	New- no information available.	On September 20, 2007 Ariel Holdings announced its intention to acquire Valient Ins. Co., a licensed admitted carrier in 47 states. Will serve as the operating platform for a new specialty P&C initiative.

Source: Dowling & Partners, IBNR Weekly #46, Vol. XIII November 20, 2006; Dowling & Partners, IBNR Weekly #15, Vol. XIV April 13, 2007; company press releases.