The Coalition For A Domestic Insurance Industry

April 15, 2015

The Honorable Orrin Hatch
Chairman
Senate Finance Committee

The Honorable Ron Wyden
Ranking Member
Senate Finance Committee

The Honorable John Thune
Co-Chair
Business Tax Reform Working Group
Senate Finance Committee

The Honorable Ben Cardin
Co-Chair
Business Tax Reform Working Group
Senate Finance Committee

The Honorable Rob Portman
Co-Chair
Business Tax Reform Working Group
Senate Finance Committee

The Honorable Charles Schumer
Co-Chair
Business Tax Reform Working Group
Senate Finance Committee

Dear Sirs:

The Coalition for a Domestic Insurance Industry appreciates this opportunity to submit comments to the Senate Finance Committee Working Groups on Business Tax Reform and International Tax Reform. The Coalition consists of major U.S.-based domestic commercial lines and financial guarantee insurers with 150,000 employees located across the United States. Collectively, we pay substantial U.S. taxes, invest significantly in the municipal bond market, and offer millions of U.S. individuals and businesses financial protection from unpredictable risks.

We are writing to urge you to close a current law loophole that permits foreign-based insurance companies to strip their income into tax havens and avoid paying billions of dollars in U.S. taxes annually. This loophole involves the use of affiliate reinsurance by foreign-based companies to shift their U.S. business overseas, thereby avoiding U.S. tax on much of their underwriting and investment income. By contrast, domestically-controlled insurers must pay current U.S. tax on all underwriting and investment profits from similar policies. This difference in treatment provides foreign-controlled insurers a significant tax advantage over their domestic competitors in attracting capital to write U.S. business. Our tax system should not favor foreign-owned groups over domestic insurers in selling insurance here at home.

The recent tax reform discussion drafts developed by former House Ways and Means Committee Chairman Dave Camp and former Senate Finance Committee Chairman Max Baucus both included similar proposals to close this loophole in order to level the playing field between U.S. and foreign-based companies. And earlier this year, the President's budget once again included a similar proposal to address this problem. The explanation provided by the Treasury Department states, "Reinsurance transactions with affiliates that are not subject to U.S. federal income tax on insurance income can result in substantial U.S. tax advantages over similar transactions with entities that are subject to tax in the United States." It appears to be one of the few proposals where there is a consensus among the Camp discussion draft, the Baucus discussion draft and the President's budget.

To begin leveling the playing field and to preserve both jobs and the tax base, the legislation would effectively defer the deduction to foreign-owned insurers for reinsurance ceded to foreign affiliates until the loss is paid. Alternatively, foreign-owned groups can elect to be taxed as U.S. taxpayers on the affiliate reinsurance. Thus, the proposed legislation does not disadvantage foreign-based groups, but merely taxes them similarly to U.S.-based companies on their U.S. generated income. Third party reinsurance is left unaffected by the legislation.

This proposed legislation was developed by the staffs on both tax-writing committees, the Joint Committee on Taxation and the Treasury Department to address various concerns that have been raised with prior versions of the bill. We believe that the proposed legislation provides an appropriate, measured and effective remedy to the problems caused by offshore related-party reinsurance.

When this loophole was first uncovered in the late 1990s, it was described as the foreign-controlled insurance companies' "own Bermuda Triangle... Instead of ships and planes vanishing without a trace, these companies have figured out how to make their federal tax burden disappear."[1]

In the decade-plus since, it has caused a significant migration of insurance capital abroad, resulting in erosion of U.S. tax revenues. Early on, several U.S. insurance groups "inverted" into tax havens to take advantage of this loophole, moving their capital and tax base offshore. In addition, several new holding companies have been formed (and several U.K.-based companies have re-domesticated) in tax havens. In either case, these foreign-based companies have sought, and will continue to seek, to use this competitive advantage to attract capital and to acquire U.S. companies or U.S. lines of business.

Over the past several years, for example, Bermuda-based insurance companies have enjoyed significantly lower effective tax rates than U.S.-based companies, with many of the foreign-based companies having effective tax rates well below 10% on average for the past three years. In fact, in many cases, the pretax return on equity ("ROE") and the after-tax ROE are virtually identical for these Bermuda-based insurers. The 1% reinsurance excise tax is insufficient to offset the competitive tax advantage provided by

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[1] Editorial, The Baltimore Sun, May 15, 2000.

the loophole. Moreover, the excise tax is often waived by treaty. If effective legislation is not adopted, a leading industry analyst has predicted that much more of the U.S. insurance capital base will migrate abroad, stating that "redomestication offshore will be a competitive necessity for many U.S. primary 'specialty' insurers."[2]

Opponents argue the proposed legislation is protectionist, but it does not favor domestic companies over foreign competitors. In fact, an election is provided to ensure similar treatment. Likewise, it is fully consistent with our tax treaties and our trade obligations.[3] The proposed fix merely would level the playing field in taxing U.S. insurers and their foreign-based competitors similarly 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.

Opponents also have argued that the proposal will adversely affect capacity or pricing in the U.S. market with respect to catastrophe insurance. However, these are just scare tactics meant to obfuscate the real issues. The proposed legislation only affects reinsurance ceded to foreign affiliates. These transactions add no additional capacity to the market because the risk remains within the same overall enterprise. The proposed legislation expressly does not affect third-party reinsurance that enables the U.S. to manage volatile, catastrophic insurance risk -- those arrangements that add overall capacity to the market by shifting risk to unrelated parties. According to a report by leading experts on insurance at the LECG group,[4] this fact alone causes opponents' claims regarding potential adverse effects on capacity and pricing to be untrue.

Also, contrary to the rhetoric by the foreign insurers, affiliate reinsurance – the loophole targeted by the legislation - plays little, if any, role in providing catastrophe coverage in coastal markets. Use of foreign affiliate reinsurance to shift reserves and the attendant investment income overseas provides little tax benefit with respect to catastrophe-exposed property coverage because claims are paid out quickly before much investment income can accrue. Use of this ploy is far more advantageous and hence more prevalent in non-catastrophic, "long-tailed" lines of business, where claims are paid out more slowly. As evidence of this, LECG found that the top 20 writers of homeowners insurance in Florida – who make up roughly 75% of the Florida private market -- cede less than one percent of their aggregate direct business premium to offshore affiliates.[5]

The LECG report also concluded it is highly unlikely that foreign groups would stop providing coverage in the U.S. market if they were required to pay tax like U.S. companies and compete on a level playing field. Even if they did, the rest of the market

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[2] IBNR Weekly #7, Vol. XVII, Dowling & Partners, p. 1 (Feb. 26, 2010).

[3] See H. David Rosenbloom, "Practitioner Responds to Criticism of the Neal Bill," Tax Notes, pp. 703-4 (May 10, 2010); Memorandum from Covington & Burling, LLP (BNA TaxCore July 8, 2010).

[4] See "The Impact on the U.S. Insurance Market of H.R. 3424: A Critique of the Brattle Study," LECG (January 2011).

[5] See "The Neal Bill and the Florida Homeowners Multiple Peril Market," LECG (July 13, 2010).

would quickly replace any capacity. Moreover, given the proposal impacts only foreign-owned groups, it would be difficult for them to effectuate a price increase unilaterally, given their market share. Thus, the rates for and availability of catastrophe insurance will remain unaffected by the proposal.

And even if opponents' claims were true (which they're not), any purported effect on pricing or capacity would arise from closing an unintended tax subsidy for foreign-based companies. We do not believe that Congress would ever intentionally pass a tax incentive only applicable to foreign-based companies in order to reduce domestic insurance prices or provide additional capacity.

In closing, we are hopeful that, at a time of possible tax increases on U.S. workers and businesses, Congress will act to close this unintended loophole allowing foreign-based insurers to avoid U.S. tax on their U.S.-based business. We note that options are being explored to prevent base erosion aimed predominantly at U.S. multinationals, both in the context of tax reform and the OECD base erosion and profits shifting ("BEPS") project. We believe it is important that the United States also addresses base erosion by foreign companies that are seeking to strip their domestic earnings out of the U.S tax base. Thus, it is time to close this loophole to protect our tax base and place U.S. and foreign-based insurers on a level-playing field.

Once again, our coalition wants to thank you and your staffs for the Finance Committee's efforts to improve the tax system and restore competitiveness. We are hopeful that Congress will close this loophole and eliminate the unfair competitive advantage for foreign-based companies operating in the U.S. We are happy to help address any concerns that may arise and are available at any time to discuss this issue.

Sincerely,

William R. Berkley
Chairman and CEO
W.R. Berkley Corporation
On behalf of the Coalition for a Domestic Insurance Industry

cc:

Members of the Business Tax Working Group
Members of the International Tax Working Group