

# THE COALITION FOR AMERICAN INSURANCE

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July 17, 2017

The Honorable Orrin Hatch  
Chairman  
Senate Finance Committee

The Honorable Ron Wyden  
Ranking Member  
Senate Finance Committee

Dear Mr. Chairman and Ranking Member:

The Coalition for American Insurance appreciates the opportunity to submit comments to the Senate Committee on Finance on the important subject of how to improve and reform the American tax code. The Coalition consists of major U.S.-based property and casualty insurers with more than 100,000 employees throughout the U.S. 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. Many of the Coalition members also operate globally through a direct presence in foreign markets, as well as on a cross-border basis.

As you consider changes to the tax code, we urge you to close an existing loophole that permits foreign-based insurance companies to strip their income into tax havens and avoid paying billions of dollars in U.S. taxes. This Insurance Tax Haven Loophole involves the use of affiliate reinsurance by foreign-based companies to shift much of their U.S.-generated property and casualty underwriting business and investment income outside the U.S., where it is subject to a much lower, if any, tax rate. By contrast, American-based insurers must pay current U.S. tax rates on all underwriting and investment profits from similar policies. This difference in tax treatment provides foreign-based insurers with a significant tax advantage over American insurance companies in attracting capital to write U.S. business.<sup>1</sup> It is the Coalition's position that the U.S. tax system should not favor foreign-based groups over American insurers in selling insurance here at home.

This issue is not new. Previous tax reform discussion drafts developed by former Ways and Means Committee Chairman Dave Camp and former Senate Finance Committee Chairman Max Baucus both included similar proposals to close the Insurance Tax Haven Loophole to level the playing field between U.S. and foreign-based insurers. The previous Administration's Fiscal

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<sup>1</sup> It is due to the combination of the U.S. worldwide system of taxation and specific rules under subpart F of the U.S. tax code which require U.S.-based insurance groups to pay U.S. tax on all reinsurance income, including income derived from transactions related to U.S. business as well as transactions undertaken by our foreign subsidiaries not connected to U.S. business.

Year 2016 budget submission also included a proposal to address the issue. The explanation provided by the Treasury Department at the time stated, “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.” This is one the few proposals that generated consensus between the Camp discussion draft, the Baucus discussion draft and the Obama Administration’s budget.

The goal of these proposals was to create a level playing field in the U.S. market, between American and foreign-based insurance companies, while preserving U.S. jobs and stopping the erosion of the U.S. tax base. The solution would effectively defer the deduction to foreign-owned insurers for reinsurance currently ceded to foreign affiliates until the loss is paid. Or, alternatively, foreign-based groups could elect to be taxed as U.S. taxpayers on the affiliate reinsurance. Thus, the proposals do not disadvantage foreign-based groups, but merely tax them just as U.S.-based companies are taxed on their U.S. generated income. Tax treatment of third-party reinsurance, which adds capacity to the insurance market, is not changed by these proposals.

These proposals were developed over time by the staffs on both tax-writing committees, the Joint Committee on Taxation and the Treasury Department to address various concerns that had previously been raised. We believe that these proposals provide an appropriate, measured and effective remedy to the problems caused by offshore related-party reinsurance.

When the Insurance Tax Haven Loophole was first uncovered, 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.”<sup>2</sup>

In the nearly two decades since, this loophole has caused a significant migration of insurance capital abroad, resulting in an 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 and out of the U.S. In addition, several new holding companies were formed in tax havens.

The migration has also occurred due to acquisitions of U.S.-based insurers by foreign companies operating out of tax havens. In fact, every acquisition of a U.S. insurer from 2014-2016, - sixteen in total - was by a foreign company.<sup>3</sup> These included Switzerland and Bermuda-based Ace’s recent acquisition and re-domestication of Chubb. In each of these acquisitions, foreign-based companies were able to factor a significant tax advantage into their acquisition costs, enabling them to attract capital and acquire U.S. companies or U.S. lines of business, and outbid

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<sup>2</sup> Editorial, *The Baltimore Sun*, May 15, 2000.

<sup>3</sup> IBNR Weekly #49, VOL XXIII, p. 5 (December 22, 2016).

U.S. companies. We are concerned these foreign-based companies will continue to use this competitive advantage to attract capital and acquire U.S. companies or U.S. lines of business.

This migration was easily foreseen. For example, as industry expert Dowling & Partners recently wrote, “ten years ago as part of a research piece on the reinsurance industry highlighting the movement offshore to take advantage of the ‘better mousetrap’ in ‘Bermuda,’ we speculated the primary industry would face similar economic pressures to move offshore...[w]ith the benefit of hindsight, the trends played out as we speculated. **Taxes do matter. It’s not rocket science.** Though less dramatic than the shift in the reinsurance industry (~60% of the top 15 reinsurers by premium are foreign owned vs. 15% in 1989), the trend has been directionally similar with 35% of the Top 25 U.S. Primary Commercial [market]... now controlled by foreign-owned firms – up from just ~6% in 1990.”<sup>4</sup> [*Emphasis added*].

Lower after-tax cost of capital and higher after-tax profits are an important competitive advantage for foreign-based reinsurers. 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 rates well below 10% on average for the years 2012-2015. 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 the Insurance Tax Haven Loophole. If effective legislation to close this loophole is not adopted, a leading insurance industry analyst has predicted that much more of the U.S. insurance capital base will migrate abroad, stating that “re-domestication offshore will be a competitive necessity for many U.S. primary ‘specialty’ insurers.”<sup>5</sup>

Opponents have argued that closing the Insurance Tax Haven Loophole would be protectionist. However, proposals to close the loophole do not favor American companies over foreign competitors. Instead, closing the loophole would merely create similar treatment and a level playing field for companies doing business in the U.S. Likewise, these proposals are fully consistent with our tax treaties and our trade obligations.<sup>6</sup>

Opponents have also argued that these proposals would adversely affect capacity or pricing in the U.S. catastrophic insurance market. However, these are just scare tactics meant to obfuscate the real issues. The proposals affect only reinsurance profits ceded to foreign affiliates. These transactions add no additional capacity to the market because the risk remains within the same overall enterprise. The proposals expressly do 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

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<sup>4</sup> IBNR Weekly #25, Vol. XXIV, p. 1 (June 22, 2017).

<sup>5</sup> IBNR Weekly #7, Vol. XVII, Dowling & Partners, p. 1 (Feb. 26, 2010).

<sup>6</sup> 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).

experts on insurance at the LECG group,<sup>7</sup> this fact alone makes opponents' claims regarding potential adverse effects on capacity and pricing untrue.

Also, contrary to the rhetoric by foreign-based insurers, affiliate reinsurance – which uses the loophole that must be closed – plays little, if any, role in providing catastrophic coverage in U.S. coastal markets. As evidence of this, Dowling & Partners recently published an article “dissecting” the Florida homeowners insurance market.<sup>8</sup> It shows that the direct homeowners business in Florida is dominated by domestically-controlled businesses. Twenty-four of the top-25 direct writers are domestically-controlled. The only exception to this is Chubb, which was just acquired by a foreign parent (i.e., ACE) and has a 2% market share. Thus, other than Chubb, the use of affiliate reinsurance is not prevalent with respect to direct business in this market.

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 taxes like U.S. companies and compete on a level playing field. In fact, the U.S. catastrophic market is already shifting away from Bermuda and to alternative sources of funding. In 2016, the market share for alternative catastrophe vehicles (e.g. catastrophe bonds, collateralized reinsurance) was 19% of total reinsurance catastrophe limits, up from 8% in 2008. As a result, “Bermuda’s capital is arguably less ‘needed’ than at any other point in recent history.”<sup>9</sup>

Moreover, given the fact that the proposals to close the loophole impact 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 closure of this loophole.

Beyond closing the Insurance Tax Haven Loophole, the Coalition would also encourage further discussion on how to effectively level the playing field for U.S.-based global insurers throughout the tax code. Existing legislative proposals continue to penalize U.S.-based global insurance groups by retaining the subpart F provisions relating to insurance or reinsurance of global risk (even if risk is wholly foreign-source). Foreign-based insurers are not subject to the same taxation. This disparity allows foreign-based insurers to operate globally and in the U.S. on a more competitive basis and should be addressed in any comprehensive reform.

Our Coalition thanks you and your staff for the Finance Committee’s efforts to improve the tax system and restore U.S. competitiveness in the global marketplace. We are hopeful that the Insurance Tax Haven Loophole will finally be closed and the unfair competitive advantage for foreign-based companies operating in the U.S. will be eliminated. We are happy to address any concerns that may arise and are available at any time to discuss this important issue.

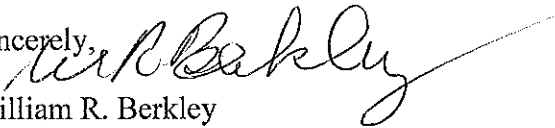
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<sup>7</sup> See “The Impact on the U.S. Insurance Market of H.R. 3424: A critique of the Brattle Study,” LECG (January 2011).

<sup>8</sup> IBNR Weekly #13, Vol. XXIII, Dowling & Partners, p.15 (April 7, 2016).

<sup>9</sup> IBNR Weekly #24, Vol. XXIV, p. 2 (June 15, 2017).

Sincerely,



William R. Berkley

Executive Chairman

W.R. Berkley Corporation

*On behalf of the Coalition for American Insurance*

Alleghany Corporation

American Family Mutual Insurance Company

American Financial Group, Inc.

Berkshire Hathaway

CNA Financial

EMC Insurance Companies

Liberty Mutual Insurance

The Hartford

The Travelers Companies, Inc.

W.R. Berkley Corporation, Inc.