Association of Bermuda Insurers and Reinsurers

O'Hara House
One Bermudiana Road
Hamilton HM 08 Bermuda
Tel: 441-294-7221
Fax: 441-296-4207

1445 New York Avenue, N.W.
7th Floor
Washington, DC 20005
Tel: 202-783-2434
Fax: 202-638-0936

April 14, 2015

Comments Submitted by the Association of Bermuda Insurers and Reinsurers
To
The International Tax Reform Working Group and
the Business Income Tax Working Group
Senate Finance Committee
On
Tax Issues Relating to Reinsurance Transactions Between Affiliated Entities

---

The membership of the Association of Bermuda Insurers and Reinsurers, which consists of 21 global insurers and reinsurers that have insurance underwriting legal entities domiciled in Bermuda, supports the objective of U.S. tax reform. ABIR appreciates the opportunity to submit comments for the consideration of the Senate Finance Committee's International Tax Reform Working Group, in support of maintaining full deductibility of reinsurance premiums paid by U.S. companies to foreign affiliates.

The Obama Administration's FY2016 Budget proposes to disallow deductions for property and casualty (P&C) reinsurance premiums paid to foreign affiliates that are not subject to U.S. federal income tax. A substantially identical proposal was included in both (1) the *Tax Reform Act of 2014* introduced by former Chairman Camp of the Ways and Means Committee and (2) former Chairman Baucus's staff discussion draft on international tax reform, published in November 2013. The Administration offers the same "reasons for change" that were stated when this proposed tax increase was included in the FY2013 Budget: "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.….These tax advantages create an inappropriate incentive for foreign-owned domestic insurance companies to reinsure U.S. risks with foreign affiliates.[1]" ABIR respectfully submits that the Administration has failed to offer credible evidence in support of these assertions; in contrast, the information, facts, and data discussed below flatly contradict the notion that U.S. subsidiaries of foreign reinsurers enjoy a substantial competitive advantage. We hope that the International Tax Reform Working Group will take the information set forth below into account if it considers any proposal to limit the deductibility of P&C reinsurance premiums paid to foreign affiliates.

---

[1] *General Explanations of the Administration's Fiscal Year 2016 Revenue Proposals*, Department of the Treasury (February 2015) page 25.

A small group of large and profitable U.S. insurance companies have waged a decade-long campaign to obtain a competitive advantage by pushing for the enactment of the type of discriminatory rule exemplified by the Administration's proposal.[2]

All insurance companies, foreign and domestic, use reinsurance as a way of spreading risk, so when they have to pay out claims, they have an adequate pool of capital to make payments. Many foreign-based insurance companies have U.S. subsidiaries that provide insurance to customers in the U.S. A subsidiary that reinsures a policy with its foreign parent takes a deduction for the reinsurance premium payment, as a business expense—the same as if a U.S. subsidiary engaged in manufacturing were to buy raw materials from its foreign parent and take a deduction for that cost.

The U.S. subsidiaries of foreign-based insurance companies are U.S. taxpayers and their transactions are highly scrutinized on a regular basis by state insurance regulators and the Internal Revenue Service. Under Internal Revenue Code Sections 482 and 845, the IRS has authority to make any allocation, re-characterization, or adjustment deemed necessary to reflect the proper amount, source or character of the taxable income, deductions, or any other item related to a reinsurance agreement. Further, Bermuda-based insurance companies are required to pay a 1% Federal Excise Tax ("FET") on gross reinsurance premiums received with respect to U.S. risks. In our economic analysis, U.S. insurance companies' income tax payments, on average, are equal to 2.3% of premiums, while FET on premiums ceded to a Bermuda affiliate (plus the income tax paid by the U.S. affiliate) equate to 2.0% of premiums. This is equivalent to the difference between an income tax rate of 35% and 30.4%. Thus the Administration's statements in support of its proposal exaggerate the tax benefits of deductible reinsurance premiums paid to a Bermuda affiliate. Moreover, the Administration ignores the fact that when reinsured losses occur, the ceding U.S. subsidiaries do not receive the benefit of business expense deductions for paying the relevant claims.

Foreign-based reinsurers play an important role in the U.S economy by helping U.S. property owners recover and rebuild when catastrophe strikes. For example, to date nearly 48% of Hurricane Sandy losses have been paid by non-U.S. insurance companies. Current reported losses for Hurricane Sandy are over $18.7 billion with U.S. companies reporting an estimated $9.7 billion in losses and non-U.S. companies reporting an estimated $9 billion.

The Administration's reinsurance tax proposal is widely opposed by consumer advocates, insurance regulators and other stakeholders.[3] There is no basis for singling out the global

---

[2] This contingent of U.S. P&C companies call themselves "The Coalition for a Domestic Insurance Industry," but they do not speak for the majority of the U.S. P&C industry: The major insurance trade associations are neutral on the Administration's proposal. The market share of the coalition companies (based on NAIC data) is only about 22% of U.S. industry net premiums written and about 20% of industry direct premiums written. The 13 members of the coalition are: W.R. Berkley Corporation, The Chubb Corporation, AMBAC Financial Group (in receivership) Inc.; American Financial Group; Berkshire Hathaway Inc.; EMC Insurance Companies; The Hartford Financial Services Group, Inc.; Liberty Mutual Group, Inc.; Markel Corporation (which recently purchased Bermuda's Alterra Capital); MBIA Inc. (in reorganization); Scottsdale Insurance Company; The Travelers Companies, Inc.; and Zenith Insurance Company (now owned by Canada's Fairfax Financial).

[3] For example, public opposition to the Administration's proposal was evidenced by letters from the insurance commissioners of the following coastal states: South Carolina, Mississippi, Florida, Georgia, Louisiana, and North

reinsurance industry by enactment of tax legislation that would penalize the U.S. operations of foreign insurance and reinsurance companies, including those based in Bermuda. Particularly in view of continuing uncertainty in the global capital markets, it seems counter-intuitive to advance a legislative proposal that would limit the availability of foreign sources of insurance capital, which would occur under any new rule disallowing deductions for affiliate reinsurance premiums in whole or in part. Increasing the taxes on international insurance carriers will result in reduced insurance capacity and increased costs for U.S. consumers.
There is considerable evidence that foreign affiliate reinsurance serves important non-tax business purposes. The U.S. subsidiaries of foreign reinsurers do not receive preferential treatment; they are subject to the same federal income regime as their U.S.-based competitors. Moreover, foreign reinsurers are already subject to FET on the gross premiums related to U.S. risks, and a proposal to deny deductions for those premiums could be viewed as circumventing the international trade agreement that prohibits an actual increase in the FET. Overseas reinsurance companies are the largest providers of U.S. property catastrophe reinsurance. Denying some or all of the deductions currently available to their U.S. affiliates would have an adverse effect on pricing, capacity and competition in the American insurance market.

<u>There is no evidence that foreign-owned insurers' use of affiliate reinsurance exceeds that of U.S.-owned insurers</u>.

The Administration's proposal is premised on the false assumption that cross-border affiliate reinsurance for foreign-owned U.S. insurers is simply a technique to avoid U.S. tax liability. This is clearly not the case, because *affiliate reinsurance is extensively used within both domestic and foreign insurance groups* for legitimate non-tax business purposes. Affiliate reinsurance involves the real economic transfer of risk between two separately incorporated entities, pursuant to legally binding contracts. In addition to the requirements of the U.S. tax law, arm's length pricing is mandated and enforced by state insurance regulators (*e.g.,* in New York each affiliate reinsurance transaction has to be approved by regulators). Moreover, ample evidence from publicly available data demonstrates that affiliate reinsurance has resulted at times in the ceding of hugely unprofitable business to non-U.S. reinsurers, as it is impossible for P&C insurers to know what their losses will be at the time policies are written.(see Table 2, page 8) U.S. insurance groups and non-U.S. insurance groups use affiliate reinsurance for the same purposes and we have not seen evidence that non-U.S. insurance groups use affiliate reinsurance to a greater degree than U.S. insurance groups.

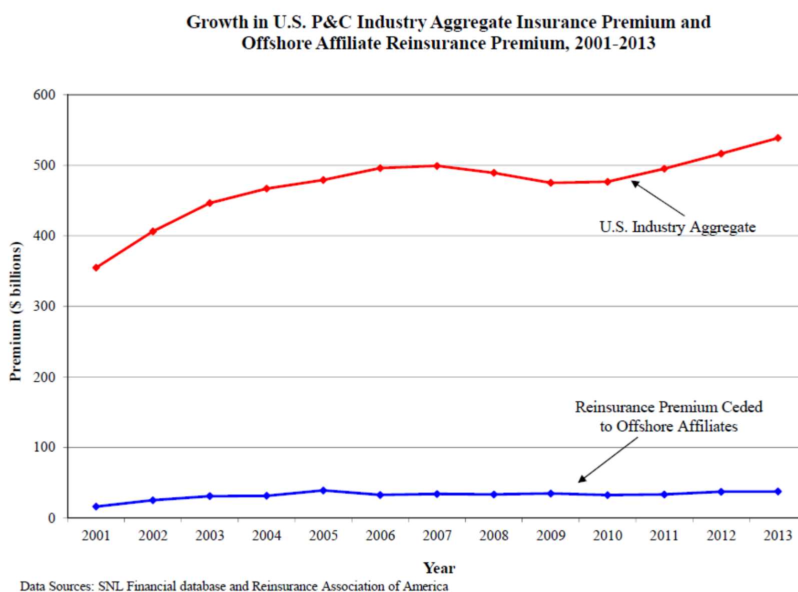
<u>The data does not support the view that U.S.-owned P&C insurers suffer from unfair foreign competition.</u>

Reports of the demise of the U.S. insurance industry have been greatly exaggerated. Indeed, the growth of the *on*shore U.S. P&C insurance industry has dwarfed the growth of offshore affiliate reinsurance. A fundamental problem with a comparison of growth rates is that the comparison of two quantities is misleading when the two quantities start from vastly different levels. For example, an increase from $1 to $2 represents a 100 percent rate of growth, but in most instances

---

Carolina, copies of which are included as attachments to this submission. Opposition letters were also written by insurance regulators from Nevada and Pennsylvania.

that 100% increase would be considered much less significant than a 50% increase from $100 to $150. Similarly, as shown by the chart below, premium ceded to offshore affiliates and U.S. industry aggregate premium are substantially different in scale.



While premiums ceded to offshore affiliates grew by $21.5 billion from 2001 to 2013, industry aggregate premiums grew by $184 billion. The *percentag*e rate of growth for premiums ceded to offshore affiliates was higher largely because they started from a very small base. Moreover, two thirds of the growth in premiums ceded to offshore affiliates occurred during the two-year period from 2001 to 2003, when premiums increased by $14.8 billion (while U.S. industry aggregate insurance premiums increased by almost $100 billion). The increases in premiums during this two-year period occurred against the backdrop of capacity shortages within the U.S. P&C insurance market, and consequent high insurance prices, caused by losses from the 9/11 terrorist attack and adverse loss development in liability business. Increasing affiliate reinsurance allowed foreign-based insurance groups to quickly deploy insurance writing capacity into the U.S. market in response to these market conditions. Without this ability, these insurance enterprises might have had to cancel substantial amounts of U.S. insurance business. Over the subsequent ten-year period from 2003 to 2013, premiums ceded to offshore affiliates increased by a total of only $6.7 billion (while U.S industry aggregate insurance premiums increased by $92.4 billion). The time pattern of growth in premiums over this period is not consistent with the argument that the U.S industry is moving offshore due to a tax advantage – or that it is moving offshore at all.

Finally, if Bermuda-based insurance groups had a large tax advantage over U.S.-based groups, one would expect the Bermuda groups to steadily increase their U.S. market share. The following chart presents the market share of Bermuda-owned U.S. insurance groups among the largest 50 U.S. insurance groups (as measured by premiums received from third-party

customers). You will note that between 2004 and 2013 the market share of Bermuda-owned groups within the top 50 did not increase.[4]

Top 50 US Property-Casualty Insurance Groups
Market Share of Bermuda-Owned US Insurance Groups Has Not Grown
($ billions)

	2004	2013
Total Premiums of Top 50 Groups	401.7	440.1
Bermuda-Owned	11.5	9.3
Bermuda-Owned as % of Total	***2.9%***	***2.1%***

Note: Premiums equal direct premiums plus reinsurance premiums assumed from unaffiliated insurers. Insurance groups are ranked by this measure of premiums to determine the top 50 groups in each year.

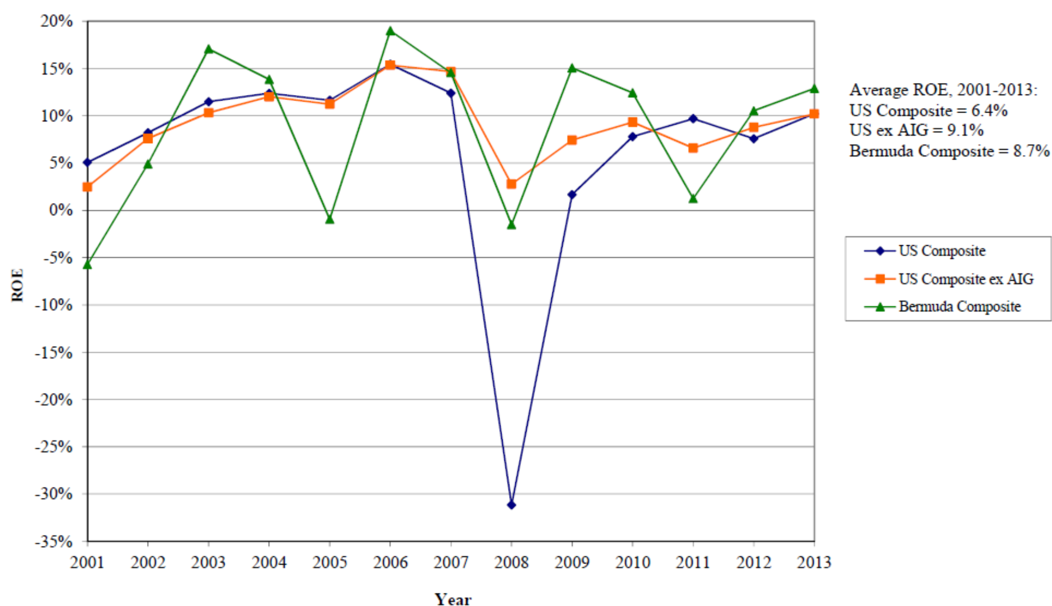
Data source: SNL Financial database

A comparison of the return on average equity ("ROE") of U.S. P&C insurance companies to that of a composite of Bermuda insurance companies does not support the view that Bermuda-owned companies have an after-tax profitability advantage over U.S. companies.

Bermuda-based groups write more catastrophe-exposed business than the typical U.S.-based insurance group. Greater catastrophe exposure can be expected to generate more volatile results: Large losses from catastrophes in some years are expected to be offset by high returns in other years.

[4] While these figures are limited to the largest 50 U.S. insurance groups, data from other sources confirm that, in the aggregate, U.S. subsidiaries of Bermuda insurance groups have experienced little premium growth over the past five years.

Rate of Return on Average Equity ("ROE") for US and Bermuda Insurers



Data: Thomson Financial Worldscope database supplemented where necessary by Standard & Poor's Compustat Global Vantage database

The chart above presents an ROE comparison in which consistent data sources and methodology were used in the calculations for the Bermuda-based and U.S.-based insurers[5] and more than a decade of data was used. The Bermuda composite is an aggregate of Bermuda-based insurance groups with U.S. subsidiaries,[6] while the U.S. composite is an aggregate of the one dozen largest publicly traded U.S.-based P&C insurance writers.[7] The chart presents results for the U.S. composite including and excluding AIG. The results excluding AIG provide a more reliable basis for comparison given the unique circumstances surrounding AIG in 2008 and 2009.[8] These results indicate that there is no evidence of an after-tax profitability advantage for Bermuda-based insurance groups over their U.S. competitors. In fact, when AIG is excluded from the analysis,[9] overall the U.S.-based groups earned a higher average ROE than the Bermuda groups. In addition, the above chart demonstrates the greater volatility of the results for the Bermuda

[5]Nearly all the data was drawn from the Thomson Financial Worldscope database. In a few cases, the Thomson data was supplemented with data from Standard & Poor's Compustat Global database. The ROE is measured as net income as a percent of the average of beginning and end of year shareholder's equity.

[6] The Bermuda composite includes ABIR members having U.S. subsidiaries that wrote more than a *de minimis* amount of premiums plus White Mountains Insurance Group Ltd. and Everest Re Group Ltd.

[7] The U.S. composite consists of the following corporate groups: AIG, Allstate, American Financial Group, Assurant, Berkshire Hathaway, Chubb, Cincinnati Financial, CNA, Hartford, Progressive, Travelers, and W.R. Berkley

[8] AIG booked approximately $100 billion of net losses in 2008, which would have bankrupted the company but for federal government intervention. Those massive losses were largely attributable to AIG's credit default swap business and not to its traditional insurance businesses.

[9] Or if 2008 is excluded from the analysis.

groups, and how excluding catastrophic losses (*e.g.,* the large losses in 2001, 2005, and 2011) would distort the comparison.

<u>Proposals to disallow or limit deductions for reinsurance premiums paid to foreign affiliates would have the effect of a (prohibited) increase in the 1% FET applicable to foreign affiliate reinsurance transactions; an actual increase in the FET may breach international trade agreements</u>.

In 1994, Treasury's Assistant Secretary for Tax Policy (Leslie B. Samuels) wrote a letter to the Reinsurance Association of America, explaining that there was a "reservation from the national treatment obligation" [of the United States] that permitted the FET to continue at its current rate [of 1%]; however, the letter noted that "future increases would be subject to trade discipline." Similarly, a Background Memorandum released by the Senate Finance Committee Chairman on December 10, 2008 in connection with former Senate Finance Committee Chairman Baucus's Staff Discussion Draft of an affiliated reinsurance proposal acknowledges that an actual increase in the current FET would breach international trade agreements.

The Administration's proposal would effectively impose a gross-basis tax on foreign affiliate reinsurance premiums, because no deduction would be permitted for such expenses. It is thus essentially equivalent to the FET, except that its effective rate on reinsurance premiums would be substantially higher than 1%.

Former Ways & Means Committee Chairman Dave Camp's H.R. 1, The Tax Reform Act of 2014, also contained the reinsurance tax proposal which included new language that effectively would have required that non-US business income generated from affiliated reinsurance business be taxed at US income tax rates or higher. This provision raises additional international trade policy concerns.

<u>Foreign P&C companies sustained substantial losses arising from the terrorist attacks on September 11, Hurricane Katrina in 2005 and Hurricane Sandy in 2012</u>.

The attacks on September 11, 2001 produced the largest insured loss known at the time, and it fell across all lines of commercial business: property, workers compensation, business interruption, commercial auto, general liability, and aviation. Sixty percent of this loss was paid by foreign insurers and reinsurers, including ABIR members that paid $2 billion of the loss from the September 11 attacks. ABIR is not aware of any foreign reinsurers who failed to pay reinsurance claims. Similarly, nearly 48% of Hurricane Sandy losses will be paid by non-U.S. insurance companies.

<u>Bermuda is sometimes the biggest loser.</u>

Sometimes, Bermuda is the biggest loser. For example, in 9 of the last 16 years (1998-2013), the U.S. affiliates of Bermuda-based insurance companies had unprofitable business that was ceded to reinsurers (both affiliate and non-affiliate) because they had to pay out significant claims due to major catastrophic events, such as hurricanes and storms.

Table 2

Loss Ratio and Implied Combined Ratio of Business Ceded to Reinsurers
Statutory Data
1998-2013

Line		1998	1999	2000	2001	2002	2003	2004	2005	2006	2007	2008	2009	2010	2011	2012	2013
	Loss Ratio																
	U.S. Subsidiaries of ABIR Members:																
1	ACE American Insurance Company (Combined)	105.7%	105.1%	116.8%	119.8%	79.4%	63.7%	72.3%	75.2%	49.9%	41.8%	67.4%	53.1%	59.0%	64.3%	85.4%	65.0%
2	Allied World Assurance Holdings Group (Combined)	N/A	N/A	N/A	83.4%	50.2%	45.2%	56.4%	43.6%	45.8%	29.6%	46.4%	51.6%	63.8%	80.2%	83.5%	66.3%
3	Alterra Capital Group (Combined)	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A	88.6%	54.9%	59.0%	67.4%	88.1%	N/A
4	Arch Capital Group (U.S.) Inc. (Combined)	N/A	N/A	N/A	133.9%	80.5%	61.1%	58.1%	71.9%	53.5%	59.8%	67.6%	59.5%	61.0%	64.7%	72.8%	53.8%
5	Argo Group US, Inc. (Combined)	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A	50.3%	77.0%	153.5%	68.7%	67.1%	63.3%	59.7%
6	Aspen American Insurance Co. & Aspen Specialty Insurance Co. (Combined)	N/A	N/A	N/A	N/A	N/A	69.6%	644.8%	312.3%	65.1%	72.0%	186.2%	37.0%	43.0%	55.9%	83.3%	50.5%
7	Assured Guaranty Municipal Corp. (Combined)	2.0%	96.1%	15.2%	0.0%	33.7%	1.4%	3.1%	-0.1%	7.3%	289.2%	164.5%	102.7%	22.5%	36.3%	6.8%	7.7%
8	AXIS Specialty Insurance Company (Combined)	N/A	N/A	N/A	N/A	115.4%	32.9%	84.5%	100.2%	40.4%	52.1%	76.0%	60.7%	58.9%	68.4%	73.6%	65.8%
9	Catlin Insurance Co., Inc. & its affiliates (Combined)	N/A	N/A	N/A	N/A	N/A	N/A	N/A	13.5%	21.6%	39.1%	68.6%	62.3%	70.0%	69.2%	61.2%	61.5%
10	Endurance Group (Combined)	N/A	N/A	N/A	N/A	N/A	79.6%	105.4%	128.9%	99.8%	85.4%	117.7%	127.1%	206.2%	119.2%	116.5%	101.3%
11	Hiscox Insurance Company Inc. (Combined)	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A	73.2%	47.5%	44.7%	53.8%	68.8%	60.8%	58.1%	N/A
12	Partner Reinsurance Co of the U.S. (Combined)	37.4%	135.0%	841.7%	925.0%	6.8%	1.6%	76.5%	63.1%	45.7%	47.8%	60.8%	49.9%	78.0%	66.4%	90.0%	68.4%
13	Platinum Underwriters Re Inc.	N/A	N/A	N/A	N/A	N/A	48.6%	95.8%	123.1%	53.8%	57.5%	89.4%	47.9%	19.9%	442.9%	N/A	3.7%
14	Tokio Marine Holdings, Inc. (Combined)	167.0%	192.2%	47.0%	116.5%	58.5%	83.1%	49.1%	80.0%	65.6%	39.2%	101.3%	47.6%	44.6%	105.1%	263.7%	82.3%
15	XL Reinsurance America Inc. (Combined)	125.5%	123.7%	115.5%	163.2%	72.8%	54.8%	58.4%	81.0%	57.3%	61.4%	71.2%	65.4%	67.6%	81.9%	69.6%	62.6%
	U.S. Subsidiaries of Major European Domiciled Insurance Companies																
16	Allianz Global Risks US Insurance Company (Combined)	101.1%	162.5%	164.5%	501.0%	34.6%	33.2%	36.7%	136.4%	36.9%	30.0%	85.2%	13.7%	23.0%	85.7%	68.6%	73.9%
17	Munich Reinsurance America, Inc. (Combined)	197.6%	286.9%	328.5%	359.3%	80.6%	53.2%	50.8%	27.4%	38.9%	55.1%	59.2%	41.4%	77.6%	160.3%	26.3%	21.6%
18	Swiss Reinsurance America Corporation (Combined)	160.5%	224.6%	171.5%	152.5%	38.6%	38.2%	49.4%	95.1%	40.6%	37.9%	51.8%	37.8%	60.3%	41.4%	64.9%	52.4%
19	Zurich American Insurance Company (Combined)	114.4%	141.0%	126.3%	151.9%	74.6%	59.3%	66.1%	78.6%	51.5%	52.7%	68.9%	60.8%	64.5%	69.4%	72.9%	61.8%
20	**Wtd Avg Loss Ratio: ABIR**	**107.5%**	**116.8%**	**114.0%**	**135.8%**	**74.5%**	**58.1%**	**66.1%**	**80.5%**	**52.8%**	**56.1%**	**73.8%**	**62.6%**	**62.4%**	**71.2%**	**81.3%**	**64.4%**
21	**Wtd Avg Loss Ratio: ABIR + Major European**	**132.3%**	**165.3%**	**149.3%**	**176.1%**	**67.2%**	**53.9%**	**61.4%**	**69.0%**	**50.0%**	**52.1%**	**69.5%**	**57.0%**	**62.5%**	**70.9%**	**74.4%**	**60.6%**
22	**Implied Combined Ratio - ABIR**	**138.5%**	**147.8%**	**145.0%**	**166.8%**	**105.5%**	**89.1%**	**97.1%**	**111.5%**	**83.8%**	**87.1%**	**104.8%**	**93.6%**	**93.4%**	**102.2%**	**112.3%**	**95.4%**
23	**Implied Combined Ratio - ABIR + Major European**	**163.3%**	**196.3%**	**180.3%**	**207.1%**	**98.2%**	**84.9%**	**92.4%**	**100.0%**	**81.0%**	**83.1%**	**100.5%**	**88.0%**	**93.5%**	**101.9%**	**105.4%**	**91.6%**
	Simple Avg Loss Ratio: ABIR	87.5%	130.4%	227.3%	220.3%	62.2%	49.3%	118.6%	91.1%	52.2%	69.5%	88.5%	68.5%	66.1%	96.6%	86.9%	57.6%
	Simple Avg Loss Ratio: ABIR + Major European	112.4%	163.0%	214.1%	246.1%	60.5%	48.4%	100.5%	89.4%	49.8%	63.8%	83.8%	62.1%	64.0%	95.1%	80.5%	56.4%
	Implied Combined Ratio - ABIR	**118.5%**	**161.4%**	**258.3%**	**251.3%**	**93.2%**	**80.3%**	**149.6%**	**122.1%**	**83.2%**	**100.5%**	**119.5%**	**99.5%**	**97.1%**	**127.6%**	**117.9%**	**88.6%**
	Implied Combined Ratio - ABIR + Major European	**143.4%**	**194.0%**	**245.1%**	**277.1%**	**91.5%**	**79.4%**	**131.5%**	**120.4%**	**80.8%**	**94.8%**	**114.8%**	**93.1%**	**95.0%**	**126.1%**	**111.5%**	**87.4%**

Source: Tabulations of most recent data available in NAIC combined filings data, from SNL Financial database.
Note: N/A indicates years in which group did not have significant U.S. operations.
Note: Loss Ratio is equal to ceded premiums earned divided by ceded total losses and loss expenses incurred.
Note: Implied Combined Ratios are equal to the sum of (1) weighted average loss ratio and (2) 31%, the estimated average underwriting expense ratio for Bermuda reinsurers (source: ABIR).

The tax increase under the Administration's proposal would adversely affect pricing in the American insurance market.

The preeminent academic authority on the global insurance industry, Professor David Cummins of the University of Pennsylvania's Wharton School, co-authored an economic analysis with the Brattle Group of a similar affiliated reinsurance proposal contained in earlier Obama Administration budgets that would have disallowed deductions for reinsurance premiums paid to foreign affiliates (referred to as the "Brattle Study").[10] This is the only economic analysis of this issue that is grounded in the academic and professional literature.

The Brattle Study estimated that the 2009 Administration proposal to deny deductions for certain reinsurance premiums would cause American consumers to pay $11 to $13 billion more for their current insurance coverage, primarily due to a 20% reduction in available reinsurance capacity. That is why the stakeholders who are most concerned about pricing (such as the Risk and Insurance Management Society, the Florida Consumer Action Network, the Consumer Federation of the Southeast, the Florida (CFO's) Office of Insurance Consumer Advocate, and insurance regulators from Florida, Georgia, Louisiana, Nevada, North Carolina, Pennsylvania, South Carolina and Mississippi) have all strongly and publicly opposed this type of legislation.

The Brattle Study consequently estimated that the earlier version of the Administration's proposal would lead foreign-based insurance groups to virtually eliminate the reinsurance they provide to their U.S. affiliates, a development that would impose substantial economic costs on U.S. consumers because it would lead to the withdrawal of a substantial amount of insurance capacity that is made possible by the support of that affiliate reinsurance.

The tax increase would negatively impact the economy.

A recent economic study by the Tax Foundation[11] found that the Administration's proposal would cost the U.S. economy more than four dollars for every dollar raised. In addition, the study also projects that over the long term, the United States' GDP would experience $1.35 billion in losses. The report states, "over the long term, the tax provision reduces GDP by about twice the revenue it collects directly. As a result, about 40 percent of the intended revenue from the provision ends up being lost through lower collections of other taxes." The Tax Foundation concludes its report with the following commentary on tax reform:

> "Eliminating the deduction for foreign reinsurance premiums ultimately creates more problems than it solves. It redefines the corporate tax base to effectively ignore legitimate

---

[10] The Brattle Study was authored by Dr. J. David Cummins, the Joseph E. Boettner Professor of Risk Management, Insurance and Financial Institutions at the Fox School of Business at Temple University and the Harry J. Loman Professor Emeritus of Insurance and Risk Management at the Wharton School at the University of Pennsylvania; Dr. Michael Cragg, a Principal, and Dr. Bin Zhou, a Senior Consultant of The Brattle Group. The original Brattle study The original Brattle study was released in 2009 (http://www.brattle.com/Publications/ReportsPresentations.asp?PublicationID=1038) and updated in 2010 (http://www.brattle.com/Publications/ReportsPresentations.asp?PublicationID=1179).

[11] *Incorrectly Defining Business Income: The Proposal to Eliminate the Deductibility of Foreign Reinsurance Premiums,* by Alan Cole, Economist, Tax Foundation. February 18, 2015. Report number 452.

> business transactions. It is poor for growth because it increases the cost of capital. And it doubles down on a dubious corporate tax system in need of broader reforms.
>
> "Congress should not go through the tax code industry-by-industry, legislatively redesigning the definition of corporate income on an ad-hoc basis in an attempt to find more corporate revenue from overseas firms. Instead, it should look to larger reforms that make the U.S. more attractive as a domicile for corporations."

The Administration's proposal would *"adversely affect the provision of crop insurance products that protect America's farmers*."

As pointed out by a crop insurance company (Agro National), in a February 26, 2009 letter submitted to Chairman Baucus of the Senate Finance Committee, although the Federal government provides some support for the crop insurance program, crop insurance companies still remain exposed to substantial risks. As a result, all Standard Reinsurance Agreement (SRA) holders cede a portion of their risk to commercial reinsurers. Agro National's submission concluded that *"[i]ncreasing costs [resulting from an earlier variation of the Administration's proposal] would likely increase the general upward pressure on reinsurance rate.,"* Moreover, precisely because the Federal government sets crop insurance rates, SRA holders would not be able to distribute the increased cost of crop reinsurance to policy holders. Thus, as stated by Agro National, the proposal provides "*incentives to exit the market*" and may "*reduce the number of insurance companies providing crop insurance.*" To put things in perspective, in the early 1990s, over 60 companies participated in the Federal crop insurance program.[12] In 2013, only 25 companies participated—10 of which were foreign owned.

Conclusion

Fundamentally, affiliate reinsurance is essential to match risk with capital. This affords the added benefits of diversification, which provides enormous advantages to insurance consumers. The United Kingdom tax authority acknowledged this in its March 2015 published guidance for its new Diverted Profits Tax (DPT). The agency published an illustration of a standard quota-share, intra-group reinsurance contract and noted it would be excluded from the DPT due to the non-tax financial benefits of the affiliate reinsurance. The agency identified regulatory capital reductions that result from the diversification of risk from global pooling of loss as the reason for the DPT exemption.[13] Affiliate reinsurance is highly regulated and promotes competition in markets, which provides additional insurance capacity and puts downward pressure on prices paid by the ultimate consumers.

Reinsurance plays a vital role in spreading risk in the global marketplace. *All* insurance companies, U.S.-based and foreign-based, use affiliate reinsurance, because it is part of the business model. The Administration's reinsurance tax proposal would unfairly penalize foreign-based insurers, and would arguably violate U.S. obligations under the World Trade

[12] *Financial Status of the Crop Insurance Industry Hearing Before the Subcomm. on Gen. Farm Commodities & Risk Mgmt. of the H. Comm. on Agric.,* 108th Cong. 34 (2003) (statement of Ron Brichler).

[13] UK HM Revenue & Customs, Diverted Profits Tax: Interim Guidance, DPT 1360, Intra-Group Reinsurance, p. 51.

Organization's (WTO) "National Treatment" principle, which ensures equal access to the U.S. market[14].

Foreign-based reinsurers play an important role in the U.S. insurance marketplace— they help the U.S. recover and rebuild when catastrophe strikes. For example, 47% of Hurricanes Katrina, Rita and Wilma claims were paid by international insurers. In addition, 48% of Hurricane Sandy losses were paid by non-U.S. insurance companies.

We urge you to maintain the current law treatment of deductions for reinsurance premiums paid by U.S. companies to foreign affiliates.

Sincerely yours,

Bradley Kading
President and Executive Director
Association of Bermuda Insurers and Reinsurers

Attachment

[14] April 15, 2013 Letter from former U.S. Trade Representatives Mickey Kantor and Susan Schwab (attached).

MAYER•BROWN

Mayer Brown LLP
1999 K Street, N.W.
Washington, D.C. 20006-1101

Main Tel +1 202 263 3000
Main Fax +1 202 263 3300
www.mayerbrown.com

April 15, 2013

The Honorable Dave Camp
Chairman
Committee on Ways and Means
U.S. House of Representatives
Washington, DC 20515

The Honorable Sander Levin
Ranking Member
Committee on Ways and Means
U.S. House of Representatives
Washington, DC 20515

The Honorable Devin Nunes
International Working Group
Committee on Ways and Means
U.S. House of Representatives
Washington, DC 20515

The Honorable Earl Blumenauer
International Working Group
Committee on Ways and Means
U.S. House of Representatives
Washington, DC 20515

Dear Chairman Camp, Ranking Member Levin, Congressman Nunes, and Congressman Blumenauer:

We are submitting this letter in response to the House Ways and Means Committee's request for comments on tax reform proposals. We write to underscore our policy and legal concerns with a number of proposals to dramatically increase taxes on the use of foreign affiliated reinsurance, including the proposal contained in the Administration's FY 2014 Budget. We believe that such proposals violate U.S. obligations under the World Trade Organization's ("WTO") General Agreement on Trade in Services ("GATS"). Many such proposals are discriminatory in nature, thus violating U.S. National Treatment obligations (Article XVII), or impose conditions on access to the U.S. market that are incompatible with U.S. commitments. Enacting such proposals would leave many critical U.S. export sectors vulnerable to WTO-authorized retaliation. It would also damage the ability – and credibility - of the U.S. in its efforts to open foreign markets to U.S. insurance and reinsurance services. Finally, restricting the supply of reinsurance products would cause harm to U.S. insurance consumers in certain regions of the country and key sectors of the U.S. economy.

It is possible for the U.S. to utilize the exception in the GATS from national treatment obligations if the measure is merely to safeguard the member's tax base. However, to qualify for the exception, any measure cannot apply (as the GATS states) "in a manner which would constitute a means of arbitrary or unjustifiable discrimination between countries where like conditions prevail, or a disguised restriction on trade in services."

As a practical matter, this means that a proposal cannot arbitrarily restrict competition and protect domestic servicers; it must be targeted at the problem. Any proposal must legitimately distinguish (via a safe harbor, or other means) between normal risk management practiced by all insurance companies and activity driven solely by inappropriate tax behavior. It must also take

Mayer Brown LLP operates in combination with our associated English limited liability partnership
and Hong Kong partnership (and its associated entities in Asia) and is associated with Tauil & Chequer Advogados, a Brazilian law partnership.

into account taxes paid, and the overall tax regime, in the home country of the foreign reinsurer, so as to actually determine whether any inappropriate tax incentives actually exist. And because any reinsurance is the movement not only of premiums but also risk (i.e., the future possibility of profits or losses), any proposal must account for claim payouts in a non-discriminatory fashion.

Some have argued that the election contained in the Administration's proposal mitigates any WTO inconsistency. But the election does not cure the violation, it exacerbates it. This is because the election violates U.S. market access commitments (GATS Article XVI(2)(e)), which states that "[i]n sectors where market-access commitments are undertaken, the measures which a Member shall not maintain or adopt… are defined as… measures which restrict or require specific types of legal entity… through which a service supplier may supply a service." Thus, the U.S. cannot condition access through the requirement that an overseas-based company pretend to be a U.S. company for the IRS in order to make cross-border reinsurance sales. The election provision also violates GATS National Treatment obligations, by applying a discriminatory additional level of taxation at the corporate level – unlike their U.S. counterparts. This also does not qualify for the exception, for many of the same reasons as the main provision.

At a time when the U.S. is rightly pressing a number of emerging markets to maintain competition in the insurance sector, meeting our WTO commitments in the financial services arena is critically important. In addition, these are the export markets the U.S. needs to meet the President's goal of doubling U.S. exports.

In short, now is not the time to have a retreat in global U.S. leadership in the services sector. Whether it is in the context of "pay-fors" or as a part of a larger reform of the U.S. tax code, WTO obligations and the U.S. commitment to competition in the marketplace should be of paramount importance. We hope and trust you will keep these considerations in mind.

With best regards,

Mickey Kantor

Susan C. Schwab