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The Honorable Adrian Smith
Financial Services Working Group
U.S. House of Representatives
Washington, DC 20515

The Honorable John Larson
Financial Services Working Group
U.S. House of Representatives
Washington, DC 20515

The Honorable Aaron Schock
Financial Services Working Group
U.S. House of Representatives
Washington, DC 20515

RE: ACE Group Comments to House of Representatives Committee on Ways and Means Financial Services Tax Reform Working Group

Dear Congressman Smith, Congressman Schock, and Congressman Larson:

On behalf of the ACE Group of Companies ("ACE"), please let me express my appreciation for the opportunity to comment to the Tax Reform Working Group on Financial Services. ACE supports pro-growth, comprehensive tax reform which reduces complexity and makes the United States more competitive globally. Headed by its publicly-held Swiss parent, ACE is a global insurer writing over $21 billion in premium from companies located in over fifty countries. ACE employs almost 10,000 people in the U.S. with offices in 42 states. Its U.S. companies generated approximately $11 billion in premiums in 2012.

ACE's U.S. operations are primarily the result of the acquisition of distressed, unprofitable U.S. companies. Over the past fourteen years, ACE has grown the U.S. operations of these acquired companies, increased the number of U.S.-based employees, and become a profitable, very substantial taxpayer to the U.S. Treasury.

For well over a decade there have been proposals to limit or effectively prohibit the tax deduction for the purchase of affiliate reinsurance by foreign-owned U.S. insurers. That would raise the cost of doing business significantly for foreign-owned U.S. insurers and their U.S. customers. Although affiliate reinsurance is an effective risk and capital management tool universally used by U.S. insurers, these proposals would apply only to the use of affiliate reinsurance by foreign-owned U.S. insurers and not by U.S.-owned insurers. In prior Congresses, such legislation has been introduced in both the House and Senate. In addition, the President's budgets in 2010, 2011, 2012 and 2013 have contained similar provisions subjecting foreign-owned U.S. insurers to a more onerous taxation regime than that to which U.S.-owned insurers are subject.

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In these comments ACE will set forth background information regarding risk management and the importance of affiliate reinsurance to efficiently manage risk and capital, our concerns regarding the affiliate reinsurance proposals introduced to date, the implications of such proposals to global insurance markets, and why these proposals violate both U.S. international trade legal obligations and tax treaties.

1. **Affiliate Reinsurance is a Universally Used Risk and Capital Management Tool That Lowers the Cost of Insurance and Strengthens Financial Security.**

As the largest economy in the world with the most assets – and therefore the most property at risk – it is no surprise that the U.S. is also the largest insurance market in the world. As such, it requires substantial risk-taking capacity from foreign insurance and reinsurance markets. The foreign insurance industry absorbs a substantial portion of the economic losses when insured catastrophic events occur in the U.S. For instance, international reinsurers paid 64% of the losses arising out of the September 11th tragedy, 47% of the losses arising out of Hurricanes Katrina and Rita in 2005, and are on track to pay over 50% of the claims arising out of Super Storm Sandy. This global support of the catastrophe market is critical because it means that when there are massive losses, which for foreign insurers are not tax deductible in the U.S., those losses are spread around the world rather than concentrated in the U.S.

Pooling capital and using reinsurance allows efficient capital management and risk-spreading, leading to greater insurance capacity at lower costs.

Affiliate reinsurance allows insurance groups to centralize capital in one place, where it can be used to quickly meet the capital needs of expanding business opportunities. It allows an insurer to write more business than it otherwise would or could, while still doing so in a prudential manner. In this way, reinsurance – a binding obligation supported by the centralized pool of capital to pay in the case of a loss – substitutes for part of an insurer's capital. Affiliate reinsurance therefore allows a group to manage more centrally a portfolio of risks that in the aggregate is more diverse than would be written by an individual insurer on its own. All insurance groups in the U.S. utilize affiliate reinsurance in this manner as a way to pool risks and manage capital more efficiently.

Further, affiliate reinsurance creates cost-effective risk taking and adds capacity, allowing more insurance to be sold at a better price. By aggregating risks from many insurers into one reinsurer, affiliate reinsurance reduces the amount of capital required to support those risks because aggregating risks provides a diversification benefit. For example, an insurance group knows that each of the property risks it writes will not all suffer a loss in the same year. Since the aggregated risks that are pooled together are more diversified than the risks of any one insurer, the volatility is lower for the pool than for any single insurer. That lowers the amount of capital an insurance group is required to hold to support the same level of risk and makes insuring that risk more affordable. In a July 14, 2010 congressional hearing, then-Deputy

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Assistant Treasury Secretary for International Tax Affairs Stephen E. Shay expressly recognized the legitimate business purposes of affiliate reinsurance when he testified that even though affiliate reinsurance does not reduce the overall risk for which the insurance group is liable, "it nevertheless remains an important tool among affiliates that can be used to efficiently allocate capital for regulatory and other business purposes, such as allowing insurers to lower overall costs by pooling capital from insurance written by various affiliates."[1]

This is the essence of insurance – charging premiums on individual risks, pooling those risks together, and relying on the diversification benefit to make a profit.

Like other service providers, manufacturers, and other businesses, reinsurance is a global industry.

Wherever capital is managed in this way, the risk is essentially moved to where the necessary capital is available. Very often, these transactions cross borders. When the insurer group is U.S.-owned, the pool is often domestic where the risk moves across state borders from one, usually smaller, affiliate to a larger "flagship" affiliate. Similarly, when the insurer group is foreign-owned, the pool is usually foreign and the risk moves between different countries, again often being centralized in one of the "flagship" affiliates. There is nothing sinister about this process. As explained above, it is done for well understood routine capital and risk management reasons. And because, like many other business sectors, reinsurance is a global industry, it is no surprise that reinsurance can and will be supplied to the U.S. from companies in other countries.

2. Discriminatory Taxation of Foreign Affiliate Reinsurance Violates U.S. Trade Obligations and Poses International Retaliation Risks.

The U.S. agreed to open its reinsurance market to foreign reinsurance providers and treat them just as it treats U.S. reinsurance providers.

The U.S. agreed in the World Trade Organization's ("WTO") General Agreement on Trade in Services ("GATS") to open its reinsurance market to foreign reinsurance providers fully, subject only to the 1% federal excise tax charged on premiums paid to foreign but not U.S. reinsurers. Proposals to subject foreign-owned U.S. insurers to additional tax burdens while exempting U.S.-owned insurers from those burdens clearly violate the GATS by treating foreign-owned U.S. insurers worse than similarly-situated U.S.-owned insurers. Former U.S. Trade Representatives Mickey Kantor and Susan Schwab have both come to this same unambiguous

[1] Statement of Stephen E. Shay, Deputy Assistant Secretary (International Tax Affairs), U.S. Department of the Treasury, U.S. House Committee on Ways and Means, Subcommittee on Select Revenue Measures, Hearing on Reinsurance, July 14, 2010, at 2. (Attachment 1).

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conclusion in two separate submissions for the record in congressional hearings on reinsurance issues.[2]

Their conclusion is inevitable. While GATS may allow measures designed narrowly to "safeguard a Member's tax base,"[3] it is abundantly clear that the proposals at issue have not been drafted to do so. In fact, they have been drafted specifically to discriminate against foreign-owned insurers for the purpose of providing a business advantage for U.S.-owned insurers, an outcome GATS was designed specifically to forbid. The proposals apply only to foreign-owned U.S. insurers, and they attach worse tax treatment to all reinsurance transactions with foreign affiliates. That increases taxes significantly on foreign-owned U.S. insurers for engaging in precisely the same important risk and capital management activity – and in the same amounts – in which U.S.-owned insurers engage as described in Section 1 above.

These proposals have not gone unnoticed by major U.S. trading partners. The European Union,[4] Germany,[5] the United Kingdom,[6] and Switzerland[7] – all of whom are home to significant global reinsurance companies – have all objected vigorously and emphasized the significant international trade and tax treaty violations that the proposals would incur. Enacting such proposals would make the U.S. vulnerable to WTO-authorized retailiation.

The ability to "elect" to be treated as a U.S. taxpayer does not cure the trade violations associated with the proposals.

The proponents of denying deductions from U.S. income for reinsurance payments to foreign affiliates argue that any potential trade commitment or tax treaty issues presented by the discriminatory treatment can be cured by permitting the affected foreign reinsurer to "elect" to be treated as a U.S. taxpayer with respect to the reinsurance payment. Thus, they argue, foreign-owned insurance groups are always able to obtain the same treatment as a U.S. insurance group insuring U.S.-based risks. In reality, the election continues to result in numerous GATS violations through additional market access barriers and discriminatory treatment of foreign-owned insurance groups:

- Under the GATS market access provisions, the U.S. committed to accord foreign-based reinsurance service suppliers access to the U.S. market. In particular, those

[2] Letter from Ambassador Kantor to Chairman Richard E. Neal, July 13, 2010 (Attachment 2); Letter from Ambassador Kantor and Ambassador Schwab to Chairman Patrick J. Tiberi and Ranking Member Richard E. Neal, July 5, 2011 (Attachment 3).
[3] GATS Art. XIV, fn. 6.
[4] See Attachments 4 and 5.
[5] See Attachment 6.
[6] See Attachment 7.
[7] See Attachment 8.

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provisions state that "[i]n sectors where market-access commitments are undertaken, the measures which a Member shall not maintain or adopt, … [are] measures which restrict or require specific types of legal entity…through which a service supplier may supply a service."[8]

- It applies the branch profits tax ("BPT") of up to 30% to the after-tax earnings of an electing company, resulting in an effective U.S. tax rate up to 55% (compared to a top rate of 35% for similarly situated U.S. reinsurers at the corporate level). This is the case even where the reinsurer is located in a U.S. tax treaty partner country.[9]

- Even with the foreign tax credit, while the particular reinsurance lines of business which would be treated as U.S. income may be profitable, the overall business in the home country may not be, and thus U.S. tax may be due, with no foreign tax credit to offset, as the company would not have profits to tax.

- It subjects an electing corporation to U.S. tax but prevents it from consolidating its effectively connected results with those of U.S. affiliates as U.S.-owned companies are permitted to do.

Most importantly, these proposals can't possibly be made GATS compliant by using a non-compliant threat to force foreign companies that are not engaged in U.S. trade or business to fully subject themselves to U.S. tax jurisdiction. Indeed, the European Court of Justice reached the conclusion that "the choice offered . . . to non-resident taxable persons by means of the option to be treated as resident taxable persons does not serve to neutralize the discrimination[.]"[10]

3. Discriminatory Taxation of Foreign Affiliate Reinsurance Violates Tax Treaties and Invites International Retaliation.

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[8] GATS Art. XVI (2)(e).

[9] In its ordinary application, the branch profits tax does not discriminate, because it equalizes the U.S. tax treatment of foreign investors – who are actually operating within the U.S. - when they operate through U.S. branches (as opposed to formal subsidiaries), by attempting to approximate the additional shareholder-level dividend tax imposed within the U.S., and the related withholding tax applied to payments by subsidiaries to their foreign parents. Thus, ordinarily, the BPT taxes the payments when it leaves the U.S. branch destined for the foreign parent. However, here, it is being applied to a foreign-based reinsurer that is not a U.S. branch or subsidiary, it is not making a payment to a parent, and in most WTO member countries will also be subject to shareholder-level dividend taxes, thus double taxing these monies. Thus its application here discriminates at the corporate level (the relevant level for GATS purposes – *see* GATS definition of a juridical person, Art. XXVIII(l)).

[10] See Case C-440/08, Gielen of 18 March 2010, at ¶ 54, *available at* *http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=CELEX:62008J0440:EN:HTML*.

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U.S. tax treaties uniformly forbid discriminatory tax treatment of foreign service providers.

In addition to violating the GATS, the disallowance of the otherwise allowable deduction for reinsurance premiums paid to foreign affiliates is a clear breach of the non-discrimination provisions found in virtually every U.S. tax treaty. The U.S. Treasury technical explanation to the current model Tax Treaty provides:

> This article ensures that nationals . . . and residents of a Contracting State . . . will not be subject, directly or indirectly, to discriminatory taxation in the other Contracting State. Not all differences in tax treatment, either as between nationals of the two States, or between residents of the two States, are violations of the prohibition against discrimination. Rather, the non-discrimination obligations of this Article apply only if the nationals or residents of the two States are comparably situated. [This Article] prohibits discrimination in the allowance of deductions. When a resident or an enterprise of a Contracting State pays interest, royalties or other disbursements to a resident of the other Contracting State, the first-mentioned Contracting State must allow a deduction for those payments in computing the taxable profits of the resident or enterprise as if the payment had been made under the same conditions to a resident of the first-mentioned Contracting State.[11]

The disallowance of the deduction for reinsurance premiums paid by foreign-owned U.S. insurers to foreign affiliates clearly violates this prohibition. It is directed at foreign-owned U.S. insurers who purchase reinsurance from a foreign affiliate and not at U.S.-owned insurers who purchase reinsurance from a U.S. affiliate in the same amounts and for the same reasons. Thus, it is "discrimination in the allowance of deductions" between "comparably situated" U.S. insurers.

CEA, the European insurance trade association now known as Insurance Europe, has called the proposal to deny a tax deduction for purchases of reinsurance from a foreign affiliate a "punitive, discriminatory double 'tax' on the US insurance activities of foreign insurance and reinsurance groups, as they would only apply to affiliated reinsurance with *foreign* reinsurers."[12] CEA went on to state that the "[p]roposals deviate from the non-discrimination principle in the US Double Tax Treaties and are therefore inconsistent with decades of US tax and trade

[11] U.S. Model Technical Explanation Accompanying the U.S. Model Income Tax Convention of November 15, 2006, Art. 24 at 77, 80 (*available at* http://www.treasury.gov/press-center/press-releases/Documents/hp16802.pdf).

[12] "CEA's submission to Hearing on the deductibility of reinsurance premiums paid to affiliates," July 26, 2010, at 2 (Attachment 9) (emphasis in original).

policy[.]"[13] CEA concluded that "affected countries may retaliate with tax laws penalising US companies doing business abroad."[14]

The proposals depart from longstanding tax principles that related-party transactions must be taxed in accordance with the arms-length standard.

Not only do proposals to deny a deduction to foreign-owned U.S. insurers for reinsurance transactions with foreign affiliates run afoul of tax treaties, but they also depart from longstanding tax principles that taxation of related-party transactions must conform to the arms-length standard. The essence of this standard is that transactions between related parties should be treated no differently than transactions with third parties. This central principle of international taxation is widely accepted around the world, applies broadly to all industries, and provides the basis for accepted international taxation norms. In fact, the arms-length standard is linked in a significant way with U.S. international trade policy. For decades the U.S. has advocated both the expansion of free trade and the use of the arms-length standard as the appropriate basis for international taxation of cross-border trade. Proposals that deny an otherwise legitimate deduction to a U.S. affiliate based on the related-party nature of the transaction are a stark departure from the arms-length standard.

Equally important is the absence of any tax policy basis for the election. Normally, the U.S. does not assert jurisdiction to tax a foreign entity simply because a U.S. affiliate engages in a transaction with that foreign affiliate. Proposals discussed to date depart from the normal U.S. practice of respecting the sovereign rights of other countries to design their own tax systems. Instead, the approach implies that any foreign affiliate reinsurer is a legitimate target for the U.S. to impose punitive taxes regardless of what country it is located in and how much tax it pays there.

4. Deductions of Premiums Paid for Affiliated Reinsurance are neither a "Loophole" nor a Tax Expenditure.

Despite their purchase of reinsurance from affiliates for precisely the same capital and risk management purposes, and in similar amounts, several large U.S.-owned insurance groups have proposed denying foreign-owned U.S. insurers the deduction for purchasing reinsurance from their foreign affiliates. These proposals have taken various forms in legislation and in the administration's budget in recent years, but the underlying effect is the same – to deny the deduction, raising the cost for foreign-owned U.S. insurers and their U.S. customers. Such proposals do not simplify the tax code by closing a tax loophole or removing a tax expenditure. Rather, they complicate the tax code by trying to define certain types of affiliate reinsurance transactions – those involving foreign-owned U.S. insurers – and then denying them a deduction.

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[13] *Id*. at 3.

[14] *Id*.

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Deducting the cost of purchasing reinsurance from a foreign affiliate is not a tax expenditure.

Tax expenditures are defined under the Congressional Budget and Impoundment Control Act of 1974 as "revenue losses attributable to provisions of the Federal tax laws which allow a special exclusion, exemption, or deduction from gross income or which provide a special credit, a preferential rate of tax, or a deferral of tax liability." The Joint Committee on Taxation Staff publishes a description of all tax expenditures annually, most recently on February 1, 2013.[15] Deducting the cost of purchasing reinsurance from a foreign affiliate is not, and never has been, included. Purchasing reinsurance is simply a cost of doing business for insurance companies, no different than purchasing office supplies or paying employee salaries.

Reinsurance premiums paid are fully deductible by the ceding insurer. The deduction for reinsurance premiums therefore cannot be considered a tax expenditure, and attempting to define in law certain reinsurance purchases that would be ineligible for a tax deduction adds unneeded and unwarranted complexity into the tax code.

The ability to deduct the cost of purchasing reinsurance from a foreign affiliate is not a tax loophole.

While the precise definition of a tax "loophole" is elusive, most generally understand a loophole to be a flaw in the tax code that allows businesses or individuals to avoid or lower their taxes by doing something the authors of the tax code never intended. For example, certain alternative fuel subsidies enable companies in non-energy businesses to realize large reductions in their taxes simply by making token investments in companies producing ethanol. This is commonly understood to be a loophole.

The deduction for reinsurance premiums, however, is not a loophole because it is neither unintended nor a flaw in the tax code. Reinsurance premiums are deductible whether paid to a U.S. or foreign company and whether the reinsurer is affiliated or not. This consistent treatment of reinsurance premium across the board can hardly be considered a flaw in the tax code. In fact, the tax code *specifically recognizes* these affiliate reinsurance transactions and requires that they be priced at arm's-length, have economic substance, and not have a significant tax avoidance effect. These proposals to restrict the deduction for reinsurance premiums paid to non-U.S. affiliates represent a significant departure from the internationally accepted arms-length

[15] Joint Committee on Taxation, Estimates of Federal Tax Expenditures for Fiscal Years 2012-2017 (JCS-1-13), February 1, 2013, *available at* http://www.tax.org/www/features.nsf/d1fdf849d972b14a8525751b000cb317/dd50987febd342ad85257b390046db2b/$FILE/ATTB2MB9/2013-2444-1.pdf.

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standard. Accordingly, these complex and controversial proposals do not constitute "loophole closers."

5. Affiliate Reinsurance Does Not Pose a Major Tax Avoidance Problem.

As discussed above, all insurers use affiliate reinsurance for important capital and risk management purposes. In fact, high levels of affiliate reinsurance are quite common within U.S.-owned insurance groups where there can be no tax reason for the use of affiliate reinsurance, since the whole U.S.-owned insurance group is subject to the same U.S. tax. Several of the U.S.-owned insurers promoting this discriminatory tax increase purchase affiliate reinsurance extensively for the very same capital and risk management reasons that motivate their foreign-owned competitors. This underscores the existence of an underlying business purpose for such transactions. For example, half the U.S.-owned insurers in the coalition of companies advocating to deny the deduction for purchases of affiliate reinsurance by foreign-owned U.S. insurers cede more than 70% of the premiums they write to an affiliate.[16]

Existing U.S. tax law should remedy any possible abuses in the purchase of reinsurance from affiliates.

The notion that inter-company transactions pose income-export risks is nothing new, and in the real world there is nothing extraordinary about arms-length affiliate reinsurance transactions in the insurance industry. Existing U.S. tax law, specifically §482 and the reinsurance-specific §845, *already give* the Internal Revenue Service powerful tools and great discretion in reallocating income to more clearly reflect the true economics of affiliate transactions.

While it is theoretically possible that a company could purchase excessive amounts of reinsurance from affiliates for tax purposes, in other areas where income-export concerns have arisen, Congress and/or the U.S. Treasury Department have crafted solutions that are tailored to actually solving the problem, as opposed to effectively shutting out many foreign servicers. Generally, these laws and regulations place limits on the amount of earnings that may be exported while striking a balance between tax base erosion concerns and the legitimate non-tax reasons for the transactions. This being so, the solution for any affiliate reinsurance income-exporting problem – to the extent any additional solution is needed – is to place sensible parameters on the amount of affiliate reinsurance that allow for legitimate business uses, not to subject all purchases of reinsurance from foreign affiliates to discriminatory and punitive tax treatment.

[16] Based on tabulations of 2011 Annual Statement data from SNL Financial.

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Arguments that purchasing reinsurance from foreign affiliates is necessarily done for tax reasons ignores the fundamental point that reinsurance transfers risk as well as premium.

The blanket accusation that foreign-owned U.S. insurers are avoiding U.S. taxes by purchasing reinsurance from their affiliates ignores the fundamental point that a reinsurance transaction by definition transfers both premium and risk. A reinsurance payment to a foreign affiliate therefore is wholly unlike the issuance of debt and the guaranteed payment of interest, and unlike license payments for the use of intellectual property that were transferred to a foreign affiliate. Unlike these transactions, along with the premium and the potential for income, a reinsurance transaction also entails the transfer of risk and the potential for loss.

This is a crucial point. Those claiming that foreign affiliate reinsurance is a tax avoidance strategy ignore the fact that unlike interest or license payments, which will always result in expense for the U.S. company and income for the foreign affiliate, reinsurance always transfers risk and may result in a substantial loss for the foreign affiliate. And whether or not a particular reinsurance purchase will result in income or loss is unknown at the time it occurs. That is of course the fundamental nature of insurance.

As former Deputy Assistant Treasury Secretary Shay acknowledged in his testimony referenced previously, if the reinsurance transaction ultimately results in losses in excess of premiums, the U.S. Treasury benefits because the U.S. subsidiary who wrote the business receives no U.S. tax deduction for losses that have been ceded to the foreign reinsurer.[17] In addition, when the U.S. subsidiary reinsures to a foreign reinsurer, it receives a ceding commission of typically 20%-30% of the gross premium. The U.S. subsidiary pays U.S. tax on this ceding commission, whether or not there turns out to be any profit on the ceded business. Further, absent a tax treaty waiver, foreign reinsurance premiums are subject to a 1% federal excise tax on the gross amount of the premium a U.S. insurer sends to a foreign reinsurer (i.e., a 1% tax on *revenues*, not profits) – again regardless of whether the business is ultimately profitable or not. This federal excise tax is already intended to address any difference in tax rates between U.S. and foreign insurers – and the U.S. secured a specific exception from GATS obligations for it.

Reinsurance does not present the "intangibles" issue posed by the licensing of intellectual property by an affiliate in a lower-tax jurisdiction.

Some have likened the use of foreign affiliate reinsurance to the infamous "intangibles" transfer issue, whereby a U.S. patent holder transfers ownership of its patent to a foreign affiliate in a lower tax jurisdiction so that the U.S. company deducts license payments in the U.S. and the affiliate recognizes the license fees as income in the lower tax country. Again, however, these

[17] *Supra* note 1, at 3.

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arguments ignore the fundamental nature of reinsurance (i.e., that a reinsurance premium is always accompanied by the transfer of risk). At the time the reinsurance contract is negotiated, the parties do not know whether the risk will result in a profit or a loss.

Intellectual property transfers within U.S. multinational groups typically occur only as related party transactions and do not occur in the ordinary course of business. On the other hand, reinsurance is a core and essential capital and risk management transaction in the insurance industry and occurs in the ordinary course of business for all insurance groups.

6. **Denying the Deduction for Foreign-Owned U.S. Insurers – but not U.S.-Owned Insurers – For Purchases of Reinsurance from a Foreign Affiliate Severely Curtails their Ability to Use Affiliate Reinsurance, Resulting in Inefficient Capital and Risk Management and Increased Prices to U.S. Policyholders.**

It is a truism that any significant tax will affect market prices for the goods or services being taxed, and it applies to affiliate reinsurance just as it does to any other good or service. But the pricing implications of proposals to deny the deduction for purchasing reinsurance from a foreign affiliate are not simply a matter of passing on the cost of a tax increase to some degree as the market may bear it. While cost increases may not always get factored into pricing because of an inelasticity of supply or other market realities, burdening the use of a critical capital and risk management tool like affiliate reinsurance will necessarily impact both the availability and the price of insurance for U.S. consumers.

In a competitive market, pricing is mostly about supply and demand. Without the ability to utilize affiliate reinsurance, foreign-owned U.S. insurers would have to reduce the amount of business they write in order to meet their capital requirements. In the U.S. insurance market, where demand from policyholders stays fairly constant, this would mean less insurance capacity, decreased competition, and higher prices. And that is, of course, precisely the point for the supporters of this tax. The proponents of denying the tax deduction for purchases of affiliate reinsurance are not trying to "level the playing field." That purpose is already served by the 1% federal excise tax on foreign reinsurance premiums. They are trying to use tax policy to reduce competition so they can demand higher pricing from U.S. consumers.

The increased cost to U.S. consumers has in fact been addressed in a comprehensive analytical study conducted by the Wharton School's Professor David Cummins and the respected Cambridge-based economic consulting firm the Brattle Group. The study concluded that denying the normal tax deduction for purchases of reinsurance from foreign affiliates would impact availability and affordability of insurance by appreciably increasing costs for U.S. consumers.[18] Because they oppose this increase in insurance costs, a large, diverse group of

[18] Michael Cragg, J. David Cummins, and Bin Zhou, "The Impact on the U.S. Insurance Market of a Tax on Offshore Affiliate Reinsurance: An Economic Analysis," May 1, 2009, *available at* http://www.brattle.com/_documents/UploadLibrary/Upload758.pdf.

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stakeholders – including state governments, consumer groups, and institutional insurance buyers – all vigorously oppose proposals to deny the deduction for purchasing reinsurance from foreign affiliates.[19]

Insurers would seek to optimize their smaller capital base by trimming their portfolios and only writing business that provides the greatest risk-adjusted return. It will also have other follow-on consequences as other nations react to it. Encumbering the free flow of capital to efficiently support the writing of insurance where it is needed will affect global insurance markets in multiple, unpredictable ways, although it is fair to assume none of them are good from the standpoint of U.S. consumers. It is an experiment – an experiment in using the tax laws to affect competition by re-routing capital in a trillion dollar market. It is not worth the risk.

Conclusion

We commend the House Ways and Means Committee for taking on the important task of comprehensive corporate tax reform and for creating working groups to thoroughly consider various aspects of the current tax code and the implications of changes that have been proposed. The purchase of reinsurance by a U.S. subsidiary from a foreign affiliate is not about simply moving profit from one affiliate to another, as some would claim. Rather, affiliate reinsurance is used by U.S. and foreign insurance companies in comparable quantities for the efficient management of capital and risk. Where abuses occur, the Internal Revenue Service already has the tools under current law to remedy them.

Preventing foreign-owned U.S. insurers from utilizing affiliate reinsurance while preserving it for U.S.-owned insurers clearly violates U.S. international trade legal obligations and U.S. tax treaties and will invite international retaliation against U.S. companies. Yet this is the essential thrust of the proposals to date. Furthermore, this approach is not without real world consequences because the practical effect will be to decrease competition, raise the cost of capital for foreign-owned U.S. insurers, and increase insurance prices for U.S. consumers.

We look forward to working with the Committee and the Tax Reform Working Groups to achieve meaningful and sensible tax reform.

Very truly yours,

Richard Betzler
Senior Vice President & Global Tax Director

[19] *See* Attachment 10.