April 15, 2013

The Honorable Adrian Smith, Chair
Financial Services Tax Reform Working Group
Committee on Ways and Means
Washington, DC 20515

The Honorable John Larson, Vice Chair
Financial Services Tax Reform Working Group
Committee on Ways and Means
Washington, DC 20515

Dear Representatives Smith and Larson,

The Coalition for a Domestic Insurance Industry appreciates this opportunity to submit comments to the Working Groups on International Tax Reform and Financial Services Tax Reform. The Coalition consists of 13 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 to shift their U.S. reserves overseas, thereby avoiding U.S. tax on much of their underwriting and investment income. This 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.

Legislation has been filed in both Houses to close this loophole in order to level the playing field between U.S. and foreign-based companies. And both the House Ways and Means Committee and Senate Finance Committee have held hearings regarding this growing concern in the last few years. This past week, 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."

This proposed legislation has been developed by the tax experts at both the Treasury Department and the staff of the Joint Committee on Taxation to address concerns that have been raised with prior versions of the bill and to develop a balanced approach to address this loophole.

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. First, several U.S. insurance groups "inverted" into tax havens, moving their capital and tax base offshore. In addition, several new holding companies have been formed (and several U.K.-based companies have redomesticated) 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.

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]

We believe that the proposed legislation provides an appropriate, fair and effective remedy to the problems caused by offshore related party reinsurance.

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 does not violate tax treaties and is consistent with 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. However, these are just scare tactics meant to obfuscate the real issues. The proposal 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. It 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 the LECG group, a respected global expert services and consulting firm, this fact alone causes opponents' claims regarding potential adverse effects on capacity and pricing to be untrue.

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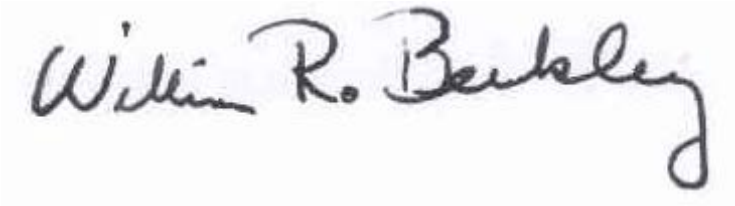
[1] Editorial, The Baltimore Sun, May 15, 2000.
[2] IBNR Weekly #7, Vol. XVII, Dowling & Partners, p. 1 (Feb. 26, 2010).
[3] See H. David Rosenbloom, "Practitioner Responds to Criticism of the Neal Bill," Tax Notes, pp. 703-4 (May 10, 2010); Memorandum from Covington & Burling, LLP (BNA TaxCore July 8, 2010).

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 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. Finally, contrary to rhetoric by offshore interests, affiliate reinsurance plays little, if any, role in providing catastrophe coverage in coastal markets and thus the rates for and availability of such insurance will remain unaffected by the proposal.

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 burgeoning deficits and 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 Congress and the Administration are currently exploring options to prevent base erosion aimed at U.S. companies. We believe it is important that we also address base erosion by foreign companies that are seeking to strip their domestic earnings out of the U.S. Thus, it is time to close this loophole to protect our tax base and place and U.S. and foreign-based insurers on a level-playing field.

Sincerely,



William R. Berkley
Chairman and CEO
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on behalf of the *Coalition for a Domestic Insurance Industry*