Neal-Warner Bill:
Bad for Consumers. Based on Myths.

REFUTING THE TOP TEN MYTHS ABOUT OVERSEAS REINSURERS

Coalition for Competitive Insurance Rates

IN THE 114TH CONGRESS, REP. RICHARD NEAL (D-MA) AND SEN. MARK WARNER (D-VA) INTRODUCED A BILL TO IMPOSE A SPECIAL PUNITIVE TAX ON FOREIGN-BASED COMPANIES PROVIDING REINSURANCE TO US AFFILIATES.

A tax increase on overseas reinsurers is the centerpiece of legislation (H.R.6270 and S.3424) supported by a small sector of the insurance industry – 12 companies led by William R. Berkley, chairman of the W.R. Berkley Corporation, that call themselves, "The Coalition for a Domestic Insurance Industry," also known as the "Berkley Coalition." Similar legislation was introduced three times prior by Rep. Richard Neal (D-MA). The bills mirror language that was included in former President Barack Obama's FY11 through FY17 budgets.

How this legislation is presented by its proponents, Rep. Neal and Sen. Mark Warner (D-VA) is thoroughly misleading. The legislation would impose an unnecessary and costly tariff on the companies that help spread insurance risks globally. In addition, it would unduly harm American consumers and businesses. Only a handful of large and profitable insurance companies stand to benefit from this bill, which serves to threaten competition and security within the insurance market.

However, opponents of H.R.6270 and S.3424 (The Coalition for Competitive Insurance Rates) represent a wide range of consumer, governmental and business organizations. A variety of independent experts, state government officials from both political parties, three state legislatures, business owners and associations have publicly expressed their opposition to this tax proposal. Additionally, studies published by The Brattle Group, the Laffer Foundation and the Tax Foundation have pointed out the potentially harmful economic consequences of this legislation.

In this fact sheet, we refute the myths that Rep. Neal, Sen. Warner and the Berkley Coalition use to justify a punitive tax on overseas reinsurers at the expense of American consumers and companies who benefit from a competitive, secure insurance market.

MYTH #1

"THIS LEGISLATION IS ESSENTIAL TO CLOSE A TAX LOOPHOLE"

Foreign-owned reinsurers don't enjoy any US tax loopholes. Currently, the US subsidiaries of these companies are subject to the same income tax laws as their US-based competitors. If foreign-owned companies obtain reinsurance from companies with which they're affiliated, they face the same tax consequences as if they reinsured with unaffiliated reinsurers that are based in the United States. **There is no differential or preferential treatment.**

In order to close this nonexistent "tax loophole," the Berkley Coalition wants Congress to deny foreign-owned insurers some or all of their deductions for the premiums they pay for reinsurance from foreign companies. The companies are also already subject to a one percent federal excise tax on the gross premiums on the policies for which they obtain reinsurance, unless waived by US bilateral treaties.

Furthermore, this denial of deductions for premiums would **not generate as much federal revenue as proponents claim.** A study by the Tax Foundation found that the dynamic federal revenue from this proposal, if enacted, would only be approximately $440 million – and it would come at a loss of $1.35 billion in GDP.

MYTH #2

TAX INCREASE IN H.R. 6270/S.3424 AND ON OVERSEAS REINSURERS "SHOULD NOT ADVERSELY AFFECT… PRICING IN THE INSURANCE MARKET."

Simply stating that raising taxes for some insurance companies won't affect the prices of their products doesn't make it true. On the contrary, economic analyses conducted by preeminent academic authorities on the global insurance industry have routinely found that prices are greatly affected. In 2010, Professor J. David Cummins of the Wharton School at the University of Pennsylvania, in conjunction with The Brattle Group, published a study on similar legislation previously introduced by Rep. Neal. This study was revisited and replicated in 2017 by Lars Powell, the director of the Alabama Center for Insurance Information and Research at the University of Alabama, and The Brattle Group. The 2017 study estimates that the proposed tax increase on overseas reinsurers would force American consumers to pay **$5 billion more** for their current insurance coverage. That is precisely why this tax increase has been publicly opposed by the stakeholders who are most concerned about the prices that homeowners, businesses and other consumers pay, including:

- The Insurance Commissioners of Florida, Georgia, Louisiana, Mississippi, Nevada, North Carolina, Pennsylvania, South Carolina and Utah;
- The Risk and Insurance Management Society, representing more than 3,500 industrial, service, nonprofit, charitable and government entities around the world;
- Consumer organization such as the California Consumers United, Consumer Federation of the Southeast and Florida Consumer Action Network, among others;
- The state legislatures of Florida, Texas and Louisiana in resolutions urging the US Congress to reject the proposed tax;
- Seven Florida members of the US House of Representatives: Reps. Dennis Ross, Bill Posey, Jeff Miller, Mario Diaz-Balart, Gus Bilirakis, Ander Crenshaw and Ileana Ros-Lehtinen;
- Industry organizations including the California Farm Bureau Foundation, Los Angeles Area Chamber of Commerce, Texas Grain and Feed Association, Texas Soybean Association, Louisiana Oil and Gas Association, Louisiana Home Builders Association, Florida Chamber of Commerce and others;
- Agricultural Commissioners from Florida, North Carolina and Tennessee;
- Georgia Lieutenant Governor Casey Cagle; and
- Florida Governor Rick Scott.

Moreover, the Berkley Coalition misleadingly claims that "the target of the bill – affiliate reinsurance – plays little if any role in providing catastrophic coverage." In fact, prices are particularly likely to increase in areas that are vulnerable to natural disasters – especially in states like California, Florida, Louisiana and Texas.

Here's why: Overseas reinsurance companies are the largest providers of US property catastrophe reinsurance. These companies also provide catastrophe-exposed insurance via US subsidiaries. If their affiliate reinsurance is taxed at a higher rate, these companies may substitute non-affiliate reinsurance to the extent possible. As the available supply of reinsurance shrinks, prices will rise.

In a state like Florida, The Brattle Group estimates that consumers could see their insurance bills increase by more than $649 million as a result of the proposed reinsurance tax. The price of Commercial Multi-Peril Insurance would soar by 6.7 percent to $367 million a year in added costs for Florida businesses, and the price of Homeowners Multi-Peril insurance would rise 1.9 percent, resulting in $282 million a year in added costs for Florida families. The Brattle report includes a 50 state, by line, premium increase analysis. Please see www.brattle.com for the full line-by-line analysis.

MYTH #3

"THE TAX INCREASE IN H.R.6270/S.3424 "SHOULD NOT ADVERSELY AFFECT CAPACITY…"

"Should not" is a wish, not an economic analysis. Based on analysis of financial data collected by the National Association of Insurance Commissioners on more than 700 large US property and casualty firms over a ten-year period, **The Brattle Group study concludes that the tax increase would reduce the supply of reinsurance in the US by $18.3 billion.**

MYTH #4

FOREIGN-BASED INSURERS CURRENTLY ENJOY "A SIGNIFICANT COMPETITIVE TAX ADVANTAGE."

The Berkley Coalition's proposal creates a punitive provision intended to compel foreign companies to pay US income tax on profits earned outside of the United States. A Laffer Foundation study notes that this proposal "involves trade protectionism implemented through the tax system, done at the behest of domestic insurers and reinsurers seeking protection from foreign competition." **This would be protectionism - not a level playing field.**

Foreign-based insurance companies shoulder a significant tax burden under the current structure, a burden which will increase drastically if the Berkley Coalition's proposal is enacted. As it stands, the tax burden is equitable – foreign insurers pay taxes on:

- **Their US subsidiaries**, which pay federal and state income taxes on taxable income;
- **Cross border transactions**, including the ceding commission paid to US insurers;
- **All gross receipts**, for which there is a one percent federal excise tax; and
- **Profits** in the jurisdiction where income is earned.

MYTH #5

"THE UNFAIR COMPETITIVE TAX ADVANTAGE…ALREADY HAS CAUSED A SIGNIFICANT PORTION OF THE CAPITAL BASE OF THE PROPERTY AND CASUALTY INDUSTRY TO MOVE OFFSHORE…"

On the contrary, the US property and casualty insurance industry is healthy and competitive – and it is not disappearing offshore. Yes, there is turmoil in the financial markets. It is affecting domestic and foreign companies. It extends beyond insurance and has nothing to do with supposed tax advantages for foreign companies.

Before the financial crisis, US property and casualty insurers enjoyed record profits. They markedly expanded their capital base and premium volume. Between 2001 and 2015, the US property and casualty insurance companies' surplus (an insurance industry financial measure approximately equivalent to equity capital) grew by $391 billion – a 130 percent increase.

MYTH #6

"RELATED-PARTY REINSURANCE SERVES DIFFERENT PURPOSES THAN THIRD-PARTY REINSURANCE."

Affiliate reinsurance and third-party reinsurance both serve the same purpose: efficient management of risk. That is why US companies ceded more than $51 billion of premiums to affiliates in 2015. Indeed, 18 of the 24 companies in the W.R. Berkley US insurance group reinsure with affiliates, and most of the premiums they receive are from their customers.

MYTH #7

BECAUSE CROP INSURANCE RATES ARE SET BY THE FEDERAL GOVERNMENT, THE TAX INCREASE ON REINSURERS "SHOULD HAVE LITTLE OR NO IMPACT ON THE CROP INSURANCE MARKET."

While the federal government provides some support for the crop insurance program, crop insurance companies still remain exposed to substantial risks. This is why all Standard Reinsurance Agreement Holders in this sector cede a portion of their risks to commercial reinsurers. For instance, crop insurer Agro National's statement against the Neal bill concluded that "Increasing costs in this way would likely increase the general upward pressure on reinsurance rates." Members of Congress who are concerned about the declining number of companies providing crop insurance should be alarmed about the proposed tax increase. In the 1980s, more than 60 companies participated in the federal crop insurance program, but today there are only 17, and five of these companies write approximately three-quarters of the business.

MYTH #8

THE NEAL-WARNER BILL IS CONSISTENT WITH THE UNITED STATES' TREATY OBLIGATIONS.

These bills would violate US treaty obligations in several important ways. The Berkley Coalition claims the legislation does not "materially disadvantage" foreign groups relative to domestic insurers in writing coverage of US-based risks. In fact, the proposed disallowance of deductions would result in double taxation of reinsurance premiums ceded by a foreign-owned US insurer to a foreign affiliate in a high-tax country such as Germany. A study by renowned economist Arthur Laffer found that this proposal would constitute "stealth trade protectionism advanced by domestic US insurers and reinsurers seeking protection from foreign competition." This and other elements of the bills would violate the non-discrimination clauses in many tax treaties.

The desired impact of the legislation is to coerce foreign companies to elect to pay US tax as an alternative to the new punitive tax. How would US companies feel if foreign jurisdictions treated them the same way?

These are among the reasons why the European Union and many individual countries, including the United Kingdom, Germany and Switzerland, have warned that the proposed tax violates US tax treaties and commitments to the World Trade Organization.

MYTH #9

"THE LEGISLATION MERELY PREVENTS FOREIGN INSURERS FROM STRIPPING THE UNITED STATES' INCOME TO TAX HAVENS AND RESTORES A LEVEL, COMPETITIVE PLAYING FIELD."

The existing "earnings stripping" rules target the use of interest payments on related-party debt to "strip" operating profits out of the United States. The proposed tax increase on overseas reinsurers differs in three ways:

- First, it targets the overseas insurers' US subsidiaries.
- Second, reinsurance transfers risks and losses to related parties in transactions that clearly meet the definition of "true insurance."
- Third, the proposal fails to recognize that there is no guarantee that the transactions will generate a profit.

MYTH #10

"CLOSING THE AFFILIATE REINSURANCE LOOPHOLE IS IMPORTANT TO HELP MAINTAIN THE CURRENT MARKET FOR STATE AND LOCAL BONDS."

Offshore reinsurance poses no threat to the market for state and local bonds. The US property and casualty insurance industry's equity capital grew by $332 billion from 2003 to 2015, while offshore affiliate reinsurance increased by only $12.5 billion over the same period. The $45 billion of offshore affiliate reinsurance in 2015 pales in comparison to the nearly $3 trillion in state and local debt currently outstanding. Whatever difficulties state and local governments may have with bond issues have nothing to do with offshore affiliate reinsurance.

For more information, please visit: www.keepinsurancecompetitive.com.