



# BERMUDA SOLDIERS ON

Bermuda's pre-eminence as a (re)insurance centre is under attack from both rival centres and the US political agenda. But it is fighting back...

**B**ermuda has been watching as Paris Re, ACE, and then Flagstone Re moved their domiciles and headquarters to Switzerland. Others are said to have been weighing up their options.

It is also noteworthy that Beazley – the latest member of the fast dwindling UK-based Lloyd's peer group to redomicile – chose a structure that will see its holding company spurn Bermuda to be based in Jersey but registered in Dublin for tax purposes.

In stark contrast to fellow Lloyd's players, Catlin, Hiscox, Omega, Hardy and Kiln who redomiciled to Bermuda – Beazley cited Dublin's relative political stability and proximity to its London operational base as key factors promoting the Emerald Isle above the mid-Atlantic island.

But Bermuda is still one of

the main (re)insurance start-up jurisdictions – as recently as January, Maurice “Hank” Greenberg's company, CV Starr, used Bermuda as it joined forces with Bermudian start-up Ironshore to set up Iron-Starr Excess Agency Ltd.

Significant work has been undertaken by the Bermuda Monetary Authority to improve (re)insurance regulation on the island.

It has set out its intention to comply with Solvency II regulations and has been working hard on mutual recognition through the international regulators club, the IAIS.

The domicile has also implemented on-site visits and in 2008 brought in a risk-based solvency framework for Bermuda's largest commercial insurers.

Bermuda also got a good report card from the International Monetary Fund (IMF) in the same year.

“The authority is well advanced in its work on mutual recognition,” said Matthew Elderfield, the chief executive of the Bermuda Monetary Authority, who has the job of pushing through significant changes. “We started from a strong point of being highly compliant with international standards, as acknowledged by the IMF.

“In 2009 the authority will build upon the foundation established in 2008, in particular with enhancements to the regulatory framework for large commercial insurers and reinsurers.”

But let's not leave it to the regulator – *IQ* talked to senior market figures to canvass their views...

## What Bermuda thinks...



**David Brown**  
founder and  
CEO Flagstone  
Reinsurance Ltd  
– **DB**



**Marty Becker**  
chairman and  
CEO Max Capital  
Group – **MB**



**Greg Hendrick**  
president  
and chief  
underwriting  
officer, XL Re  
Ltd – **GH**



**Caroline Foulger**  
insurance  
partner PwC  
Bermuda – **CF**



*Are you worried about any potential damage mooted US tax changes and the incoming US Administration could cause Bermudian-domiciled (re)insurers?*

**DB** Possibly. How do I feel about it? Any measure taken by any government in a recession like this along the lines of protectionism and possibly reducing global free trade is a bad thing. Generally, if other countries start to do that, attacking imports or exports or otherwise disrupting free trade and if countries retaliate, then that is generally a bad thing for world trade. Specifically, with regard to Bermuda, who knows? Our business is done out of Switzerland, so we are somewhat removed from this at the moment. [Flagstone reorganised its operations last year and while it kept its holding company in Bermuda, the capital holding underwriting subsidiary is now in Switzerland].

**MB** What the changes will be remains to be seen, but it could be that many of them could be helpful, in that they will more clearly define what is appropriate offshore reinsurance and perhaps initiate more federal versus state regulation, which would simplify doing business. I think one issue that is very much misunderstood is the level of US tax that Bermuda companies are now paying. A recent survey of the four Bermuda insurance companies with the largest US operations indicated that, between 2004 and 2006, they paid, on average, between excise tax and income tax, approximately 28 percent US tax on the income generated by

their US affiliates – so it is not as though it is night and day.

**GH** Obviously we are aware of what is on the table. Worried? We are not worried, again, with an organisation like XL, with the structure we have we are able to be nimble and respond to changes that might occur. I think there is the possibility that some of the changes that are outlined can come to pass and Bermuda will still continue to be a very attractive domicile and continue to prosper. There are things you can worry about that you can control, and things that you can worry about that you can't control and this falls in the category of 'I can't control it'.

**CF** I think the present threat has more teeth than certain previous efforts by both administrations and groups of companies in the past. There is still considerable speculation as to what the changes might be, and the details are clearly yet to be articulated. I think it would not be prudent to show some level of concern for Bermuda given what has been discussed; but with the state of the US economy, the recession and the recovery plan, the US administration's agenda is likely to be jam-packed at least in the near term, and perhaps the focus on this will move out to some point in the future. I would make the point that most of the reinsurers here are Bermuda domiciled, and not all of them have significant US operations. Any potential changes that are speculated at the moment will vary depending on the circumstances and structures of each of those companies

on the island.

*Do you think that Florida will come back into the cat market in 2009?*

**DB** I think it is a possibility. I think that they should do it, given the exposure that they are taking. In the past they have thought that they could possibly finance post-loss through the debt markets – I don't believe that many people outside of Florida ever believed that to be the case. Now even some people in Florida are reaching the same conclusion, that it would be hard to finance post loss. That tells me they should be out in the private market. Whether they will or not is more of a political question, and frankly I find it easier to predict the weather than predict what politicians will do.

**MB** I think Florida will retain less of their own risk in 2009, so therefore there will be more transferred to the traditional market. Where those levels settle out remains to be seen. I think it is purely driven by the capital markets and Florida's recognition that raising the kind of money in a bond sale that would be required following a significant hurricane could be problematic at this point in time.

**GH** The feeling I am getting is of one where we are still watching the story. The Florida state legislature goes into session the first week of March. Normally I would say this is one of the top two topics but Florida is facing a pretty large budget deficit and the primary question **Continued on page 17**



## THE GREAT TAX DEBATE

As a senator, President Barack Obama sponsored anti-tax haven legislation, and with the Democrats now controlling both houses of Congress and the Executive, political pressure in the US is growing for action to nullify some of the tax advantages Bermuda-domiciled (re)insurers enjoy over domestic US rivals. *IQ* spoke to the two main protagonists in the great tax debate...

For	Against
<p><i>In the pro-legislation corner is Bill Berkley, chairman and CEO of US specialty (re)insurer WR Berkley. He is the outspoken founder of the pro-US domicile lobby group Coalition for a Domestic Insurance Industry, which counts Travelers, Hartford, Berkshire Hathaway and Chubb among its number. Berkley is vehement in his pursuit of what he sees as a level tax playing field:</i></p> <p>“We’re optimistic that the legislation will result in people having to pay tax in a similar manner as if they were a US business.</p> <p>“After Katrina, almost all the new capital, much of which was raised in the US, established companies in Bermuda and other places. I think the issue is that the capital emanates in the US yet people are using superficial structures to move the profits offshore. “</p> <p><i>But Bermuda pays out on large cat losses, for example after Katrina?</i></p> <p>“The reality is that paying out on losses is what you get paid premiums for. It’s not relevant to paying taxes. All we’re trying to suggest is that you need a level playing field.</p> <p>“We’re not suggesting that Bermudian companies should pay anything to do with their worldwide income; we are suggesting that if they write business in the US and they reinsure with an affiliate more than the average company reinsurers at an arm’s length basis, they do that for the purpose of minimising tax – therefore they have to pay tax on that amount. They are using a tax avoidance scheme.”</p> <p><i>What about US consumer groups expressing concern over the impact of the Neal Bill?</i></p> <p>“The answer is it has absolutely no impact on arm’s length reinsurance – WR Berkley buys reinsurance from people in Bermuda, right now, this will have no impact on that or on capacity in the reinsurance market. It only has an impact where Bermudian companies or offshore vehicles set up domestic subsidiaries and reinsure themselves.”</p> <p><i>Isn’t this protectionism?</i></p> <p>“You can’t fight economic reality – which is if you make somewhere between 6-10 percent better returns if you’re in a low tax environment, in the long run capital goes to where you can get the best returns. Offshore companies will be able to ultimately buy US vehicles because they will have a lower cost of capital because they’re paying no tax.”</p>	<p><i>In the other corner is Brad Kading, president of the Association of Bermuda Insurers and Reinsurers:</i></p> <p><i>Any worries about the new Obama Administration?</i></p> <p>“I don’t think anybody should say that President Obama is a critic of Bermuda, our challenge is with congress, people like Richard Neal and others who have been critical of the use of affiliated reinsurance.</p> <p>“It would be a mistake to characterise President Obama as having had a position on this issue – the rhetoric during the election was just a standard part of an American political campaign – Bermuda is a convenient target, as are the Cayman Islands and Switzerland takes its lumps too. Both Republicans and Democrats do it.</p> <p>“It’s important to recognise two themes in President Obama’s tax policy. An attack on 1 – US multinational corporations which shelter income and assets outside of the US. 2 – US tax code provisions that give incentives for job creation outside of the US. Those were the published themes on the campaign website. There was no endorsement of the Neal Bill in the president’s campaign.”</p> <p><i>What’s wrong with the Neal Bill?</i></p> <p>“It is a draconian measure which is isolationist and protectionist towards the US market. It is an attack on any international insurers’ US subsidiaries’ use of affiliated reinsurance – ceding premiums basically. It is simply a draconian tax which results in a 20-25 percent tax on the affected premiums over a certain threshold.</p> <p>“People who look back to the great depression see the Smoot-Hawley Tariff, which lead to a further exacerbation of the US economic crisis in the 1930s.</p> <p>“Certainly tariff-type measures – and I think the Neal Bill falls into that category – would be seen as examples of measures that are destructive to global commerce and capital formation.”</p> <p><i>And the Coalition for a Domestic Insurance Industry’s arguments?</i></p> <p>“What they are advocating is self-destructive; they fundamentally misunderstand tax treatment for Bermuda business coming out of the US. We will be able to demonstrate that on our US-generated business we pay an effective tax rate comparable to our US competitors. What I would say to them is that this issue will be decided based on what impact the Neal Bill will have on US consumers – that is the bottom line.”</p>

## What is the Neal Bill

Introduced by Congressman Richard Neal, a Democrat from Massachusetts, the bill aims to crack down on what the congressman sees as deliberate tax avoidance by disallowing “deductions for excess reinsurance premiums with respect to US risks paid to affiliated insurance companies that are not subject to US tax”

The bill aims to work by limiting the tax deductibility of any reinsurance premiums ceded offshore that exceed the industry average in any given line of business



### The stakes are high...

Effective Tax Rate Comparison (%)	Median	9/30/08	2007	2006	2005	2004
Bermuda Market Effective Tax Rate	9.9	8.7	10.7	10.0	(14.0)	9.9
US Market Effective Tax Rate	28.0	22.5	28.0	29.7	28.0	28.3
Bermuda Market Higher (Lower) than US	(18.2)	(13.7)	(17.4)	(19.6)	(41.9)	(18.5)

Source: Highline Data, Fitch Ratings

the state faces is how to address it. I have a feeling that insurance might drop down the priority list a little bit given everything else that is going on in Florida. But having said that, it is clear that the capacity of the FHCf to issue bonds does not exist to cover both the mandatory and the optional coverage that the cat fund supplies. So that would seem to imply that companies are going to be out in the marketplace looking for more protection.

*Do you think there is any chance of a class of 2009 forming – and would it choose Bermuda?*

**DB** I think it is very unlikely given how dry the capital markets are today. There seems to be little interest in new ventures, particularly illiquid start ups. There is a possibility that one or more might get off the ground, but in my opinion they are probably more likely to be focused on the insurance rather than reinsurance side given the problems with AIG.

It was clear when we formed Flagstone that Bermuda was the right place. But if you were doing that today, it would not be such an easy decision. Places like Switzerland, Singapore, Dublin, maybe Dubai, all look like attractive jurisdictions for forming companies. So

the days of Bermuda being the only logical place are now behind us.

**MB** The likelihood of that is low. The capital for that class right now, traditionally coming from hedge funds and private equity funds, is under significant stress. I think it would require much more price movement before people would be motivated. There are other domiciles that have increased their presence and infrastructure to the point where you do have choices, where previously Bermuda was the one place people thought about.

**GH** I think given the economic reality of today, it is not likely. However we have seen in the past a group of investors that prefer to hire a management team rather than buy something that exists. They could create their own vehicle and I wouldn't be shocked to see it happen, although I think it is unlikely given the current limited access to new capital and the current investment marketplace.

I'd be naïve if I didn't acknowledge that someone might look at Dublin or Switzerland as an alternative start-up location. But I still think Bermuda stands pretty far above the others.

*Is the collateralised reinsurer model dead?*

**DB** I don't think so, no. It has made good returns for its investors in the last few years. I believe the problem right now is the typical investors in those vehicles have their own problems. I think that market is far from dead but we will likely see a hiatus this year.

**MB** I would say it is sleeping. I think it just depends on a lot of items unrelated to insurance; it really is more of a financial market question.

**GH** No. There are people who are currently in the marketplace who operate under that model, however it is smaller than it was as there is less capital in that area, but I don't think it is dead by any stretch of the imagination. It is challenged – cost of capital is up and the cost of collateral is up, probably even more, and there is an economic pressure point there.

Freelance Journalist Mairi Mallon conducted interviews for IQ

# Offshore on the agenda



The Obama administration is targeting offshore tax havens. Scott Nebergall looks at proposed legislation



**Scott Nebergall** is a tax lawyer at Edwards Angell Palmer & Dodge

**W**ith the current slowdown in the US economy, the credit market crisis, and other recessionary trends, pumping federal money back into the domestic economy will be a top agenda item of Congress and the new Obama Administration.

Usual targets for increasing federal tax revenues include addressing offshore business activity in low or no tax jurisdictions, such as Bermuda. On the campaign trail in September 2008, Obama featured Bermuda offshore business activity in campaign advertisements highlighting a McCain statement that he would oppose any measure that would upset the success of Bermuda's reinsurance industry. Another Obama advertisement charges that McCain "pledged to protect tax breaks for American corporations that hide their profits offshore". Financial data provided in September 2007 to the Senate Finance Committee shows a disproportionate growth in affiliated offshore reinsurance over the past few years.



**Obama:** Bermuda in his sights

This article summarises the arguments on both sides of the

offshore reinsurance issue and highlights potential federal tax changes affecting Bermuda that may be proposed by the incoming Obama administration.

Foreign-owned companies oppose change in the current tax policy. They argue that there are legitimate reasons for operating in Bermuda, such as its flexible regulatory framework and underwriting/IT expertise in reinsurance. They also argue that they are already subject to insurance excise tax on premiums paid for the reinsurance of US risks, which is levied regardless of whether the reinsurance results in a profit or loss. Any policy change that would increase tax could also increase insurance premiums to US businesses and consumers and reduce the availability of coverage for catastrophic events such as Hurricane Katrina.

Domestic insurance companies strongly support change in the current US tax policy regarding offshore reinsurance activity. These companies argue that they are at a competitive disadvantage to foreign-owned companies, despite the insurance excise tax, transfer pricing rules, and corporate expatriation rules for related-party reinsurance. They add that, regardless of a taxpayer's structure and legal entity, insuring US risks should generally be subject to US tax, which is currently not the case for companies operating in Bermuda.

## Proposed legislation

One major potential change could be revisiting the Dorgan Anti-Tax Haven Measure, introduced in January 2007, which proposed to treat certain controlled foreign corporations organised in low or no tax jurisdictions, such as Bermuda, as domestic corporations

for tax purposes. The proposed law would prevent companies from deferring foreign-source income tax if they operate in a country on the "tax-haven" list maintained by the Treasury Department. It was estimated by sponsors to raise federal tax revenue by \$14.7bn over 10 years.

Another piece of previously proposed legislation is the Stop Tax Haven Abuse Act. This legislation was first co-sponsored by, then Senator, Obama in February 2007, and would increase taxes, regulations, and penalties on companies in targeted low-tax jurisdictions. The Act would create a presumption that non-publicly traded offshore corporations are controlled by US taxpayers and impose tougher requirements on those operating in jurisdictions like Bermuda.

Another policy change could include increasing the tax burden on US companies reinsuring through offshore affiliates. The Reinsurance Tax Equity Act, proposed in 2000 and 2001, increases the federal excise tax on reinsurance ceded to a foreign reinsurer and imputes income based on reinsurance reserves back to ceding domestic companies. Along the similar lines, HR 6969, introduced in 2008, proposed limiting deductions for related-party reinsurance cesions to the average percentage of premium ceded to unrelated reinsurers.

At this point it is still too early to tell what, if any, legislative action will be taken by the new Congress and Administration with respect to US businesses connected with Bermuda. However, the rhetoric is certainly louder than in years past with respect to raising the bar on the ability of US businesses to take advantage of low or no tax jurisdictions such as Bermuda.