JANUARY 2017

Talking taxes

If we expected January 2017 to coax us gently into the new year, think again. The past few weeks have delivered mercurial conditions—including enough Bermuda rainfall to nearly tally a 60-year weather record. As a St Georgian whose winter commute virtually guarantees a sodden rainsuit, I am proof positive of January's meteorological guessing game.

Confounding politics is also shaping up as one of this season's few certainties. Unprecedented events unfolding in both Washington and Whitehall could wield significant social and economic repercussions for Bermuda. In Britain, the Supreme Court's decision against the government's Brexit agenda means Theresa May cannot trigger Article 50 alone. To Brexit, the UK parliament must give the go-ahead. Given the panoply of outcomes such a scenario could unleash, Brexit's timeline is shaky at best; with all the will in the world, Prime Minister May could find her March deadline for Britain's pullout from Europe impossible to achieve. Meanwhile, businesses' jurisdictional and investment decisions hang in the balance.

Things are no clearer to our west, where the transition of America's new President is upending political norms and keeping investors around the world on tenterhooks. Among the numerous promises Donald Trump's administration is championing, the possibility of a sweeping makeover of the US tax system poses the most ominous threat.

Tax reform, in and of itself, is not the issue, but elements of House Republicans' proposal could do extreme damage—and not only to international financial centres like Bermuda. A report just published by economists at global consulting firm The Brattle Group predicts a proposed "border adjustment tax" would have a highly punitive impact on American consumers.

The Brattle report examines the effects of the proposed consumption-based tax initiative that imposes tariffs on imports to the States, while lifting taxes on US exports.

The Paul Ryan blueprint on tax reform supports a popular notion—to reduce top tax rates to 20, or even 15, percent. Yet, the devil is in the details, for the matter is far more complicated. If financial services, specifically reinsurance, were to be bundled into the proposal along with manufactured goods, the Brattle study found, end users, particularly American homeowners, are the ones who actually end up footing the bill—to the tune of almost $30 billion.

"It would widen the protection gap between insured and uninsured losses, which would result in the excess risk falling on the government, particularly for natural catastrophes and other high-loss events," said the report's lead author Michael Cragg, who has extensive consulting, research and expert witness experience in corporate finance as The Brattle Group's chairman.

Commended by US-based Coalition for Competitive Insurance Rates (CCIR), the Brattle report noted that consumers and businesses in US regions vulnerable to catastrophes would be especially at risk. "Reinsurance is critical to risk management in the property and casualty (P&C) insurance industry, particularly for natural catastrophes and other infrequent but high-loss events," the study noted.

The findings should be a clarion call to US policymakers unfamiliar with the Bermuda market's exemplary track record in the wake of American catastrophes. It was our reinsurers who paid $22 billion to rebuild the Gulf and Florida coasts after devastating hurricane seasons in 2004–05; who covered nearly 30 percent of insured losses from Hurricanes Katrina, Rita and Wilma; who paid 16 percent of Hurricane Sandy's destruction in 2012, and close to a tenth of claims from 9/11.

The reason multi-national reinsurers, such as Bermuda's global carriers, are able to tackle such behemoth events efficiently is because they pool risk worldwide. They spread potential losses so capital can cover extreme catastrophes when they occur. This diversification benefits US insurance companies and ultimately consumers, who pay lower premiums.

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Bermuda's advantages as a reinsurance hub have been well documented, but they're worth underscoring to dispel misinformation and ensure US consumers are not inadvertently punished as collateral damage in any sweeping tax reform. As a well-regulated financial centre, with tax information exchange agreements with close to 100 countries worldwide, the Bermuda market is home to over a third of the top global reinsurance corporations. "Bermuda boasts a 45-year track record in its commercial claims-paying ability," noted Brad Kading in a Canadian Globe & Mail feature last year. "Notably, its property-catastrophe reinsurance market is now No. 1."

Reinsurance isn't about foreign entities taking advantage. Exporting risk and importing capacity and coverage is sensible economics for any country. Understanding this will help America's fiscal policymakers—and benefit those who can least afford to pay the heavy price of disaster.

ABOUT VIEWPOINT

A monthly blog by BDA CEO Ross Webber, with commentary on industries, issues and influencers affecting Bermuda as a global financial centre. Comments and feedback can be sent to ross@bda.bm

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