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Strategic Issues for Insurance Industry Executives

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Election 2020: impact on the insurance industry

Introduction

Conning is providing a special election edition of its monthly *Conning Commentary*. The purpose is to highlight key issues we believe will affect the insurance industry resulting from the election outcomes.

As of this writing, there is not an official winner of the presidential election. While many have declared or projected Biden the winner, the Trump administration is proceeding with legal challenges. Georgia will conduct runoff elections for the state's two Senate seats on January 5, and other recounts may emerge, so an official outcome may not be available for some time.

For our primary discussion in this article, we assume a likely final outcome of the contested 2020 election will be a Democratic presidential victory and the Senate remaining Republican-controlled, with the House staying Democrat-controlled but with a smaller majority. An alternative scenario of the Senate flipping would have material differences in our commentary, mainly regarding taxation, health insurance, and Green New Deal-like initiatives.

We begin our article with a macro view of the economy and capital markets from Conning's Global Chief Investment Strategist Rich Sega, as a backdrop to more specific analysis of the impact to the insurance industry as follows:

- economic and capital markets outlook
- pandemic response and fiscal stimulus
- regulation
- health insurance and the ACA (Affordable Care Act)
- approach to immigration

While discussion of a potential vaccine is not a specific result of the election, the announcements by Pfizer on November 8, 2020, and by Moderna on November 16, 2020, could materially alter our analysis in several areas. The timing, rollout, and effectiveness of a vaccine will be key determinants of the direction and magnitude of any pandemic response and fiscal stimulus.

Market reaction

The graph on the next page illustrates stock price performance immediately before and after the election, comparing the insurance sectors (health, life-annuity, and property-casualty) to the overall market and against the backdrop of the ten-year Treasury yield. The overall market and the insurance sectors reacted positively since the election, suggesting a favorable view by the market of a divided government gridlock scenario. Health insurers were a clear winner, as prospects for significant disruption and a single-payer system seem unlikely. The life-annuity and property-casualty sectors each underperformed the market. Conning's expectation for life-annuity is additional regulation and the reality of continued very low interest rates. Our view is the property-casualty sector will see a net negative election impact, although there are many nuances based on specific lines and classes of business.

Election results supportive of capital markets

Special guest author—Rich Sega, Conning Global Chief Investment Strategist

The base scenario of Democrats holding the White House and House of Representatives and a Republican-controlled Senate is a fairly benign outcome, so we believe 2021 should be a good year for several reasons:

- Divided government tends to be favorable for economic activity as the most extreme vagaries of either party are tamped down and policy reverts to the center.
- Policy in place now, responsible for underpinning the surprisingly strong recovery from the lockdown-induced depression of early 2020, will not be rolled back quickly.
- Any significant policy drag on growth and earnings (specifically, tax increases and added regulatory burdens on employers) will be negotiated during 2021 to take effect in 2022, causing some economic activity to be advanced into 2021 to avoid penalties.
- The most challenging implications for growth in the Democrats' platform have been avoided, *viz.*, "packing" the Supreme Court by expanding its members; eliminating the Senate cloture rule, a.k.a., the filibuster; the more extreme features of the so-called Green New Deal. Similarly, we expect a more measured approach to a health care public option than "Medicare for All."

Examining the four major policy drivers of growth—monetary, fiscal, trade, and regulatory—we find no radical change that would derail the recovery or shock markets.

- **Monetary policy**. By targeting very low rates for at least the next couple of years (a very long time as these sorts of things go; imagine how a plan set just a year ago would look now), the Federal Reserve has ballooned bank reserves and increased the M2 money supply by double digits, nearly 25% year-over-year as of November 16. While Chair Powell has disavowed both Modern Monetary Theory and Negative Interest Rates by name, he's also committed

to do whatever is necessary to keep the economy going strong.

- **Fiscal policy**. The battle to design the next round of spending continues into the lame duck session of Congress. Senate Majority Leader McConnell predicts a success by year's end. The impetus for a smaller package ($1 trillion or less) rather than a larger one (more than $2 trillion) might be helped by the great news of an effective COVID-19 vaccine in recent trials.
- **Trade policy**. A Biden administration promises to be less combative regarding tariffs and sanctions, particularly unilateral actions.
- **Regulatory policy**. It is here, especially in the energy arena, where as President, Mr. Biden could have a significant impact. As much current policy has been done through executive orders rather than Congressionally passed legislation, it can be altered via the same route.

So, we expect earnings and equity markets to perform well under these circumstances. We believe the U.S. dollar trend will be weaker so non-U.S. assets, especially those of emerging market economies, will be attractive. Sector biases, based on the new administration's policy preferences, include solar, wind, and clean energy ventures, consumer sectors, health care, and U.S. dollar-weakening trades such as gold and non-energy commodities.

Pandemic response and fiscal stimulus

A Biden administration is likely to be more aggressive and willing to encourage lockdowns or other strategies to "slow the spread." While a vaccine could make this a moot point, there is still a considerable chance for shutdowns depending on how quickly a vaccine can be deployed.

As "nonessential" businesses shuttered by government orders are slow to recover and significant confusion remains around business interruption coverage, the pandemic response shifts to a prospective one. The idea of pandemic cover funded by or in partnership with the federal government was discussed at the start of the pandemic, but has since largely been tabled. The House Financial Services Committee introduced H.R. 7011, the Pandemic Risk Insurance Act of 2020, in May to set up a federal solution to undiversifiable pandemic risks. The bill would require insurers to include pandemic coverage and create the Pandemic Risk Reinsurance Program to establish adequate capacity and act, similarly to terrorism insurance, as a federal backstop.

Currently, the bill has yet to see a vote on the House floor. The primary question on the timing of this bill is its prioritization among many other pandemic response bills introduced in Congress. One potential "fast track" would be in consolidation with other proposals in a future stimulus bill.

The prospects for another large stimulus package have decreased dramatically with the likelihood of a successful vaccine. With the need for a stimulus more remote, it may deflate growth expectations for insurers standing to benefit from a large infrastructure push—insurers with a significant portfolio tied to construction or construction-related coverages as well as surety specialists.

Anticipated changes in the regulatory environment

For insurers, state-level regulators exert more power than federal regulators. The states, especially the NAIC, are pursuing the implementation of regulatory changes developed in 2019 and 2020. As a result, the impact of a Biden presidency will likely be felt in the areas of distribution, consumer protection, and technology.

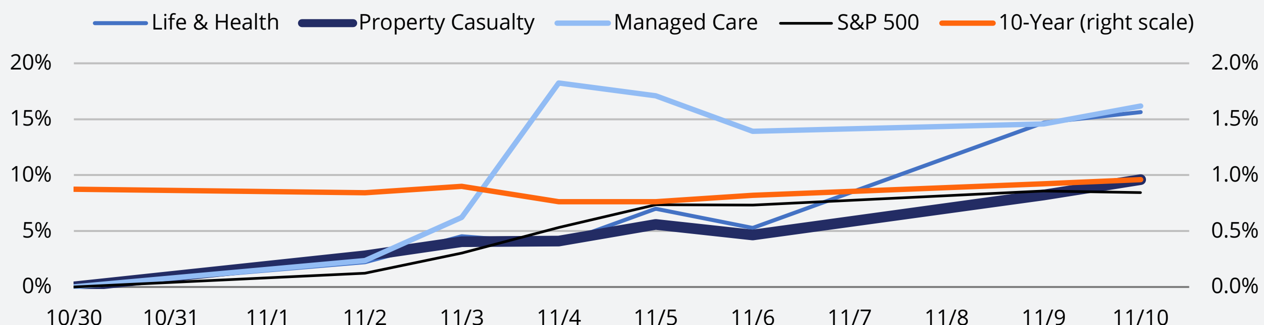
Stricter fiduciary and suitability rule enforcement

Under Trump, the shift toward protecting "Main Street" investors from unethical distributors was already underway, as evidenced by the DOL's fiduciary rule introduced in 2016 and the SEC's Regulation BI (Best Interest) introduced in 2019. Given Democratic concerns about consumer protection, the SEC under Biden could begin to take a more aggressive approach in using Regulation BI to enforce its view of fiduciary responsibility among all financial service distributors. This is an area where the NAIC and states such as New York are already implementing their version of these stricter rules. However, insurers will need to be alert for continued expansion of SEC authority into their market.

CFPB redux

With Biden in the White House, we believe the CFPB (Con-

Change in Conning Stock Price Indices since 10/30/2020 versus 10-Year Treasury Yield



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sumer Financial Protection Bureau) is likely to revert to a more aggressive, Obama-era version of itself. Helping develop and guide Biden's CFPB priorities will likely be former CFPB director Richard Cordray, as well as Sen. Elizabeth Warren (D-MA). Both Cordray and Warren view the CFPB as an aggressive watchdog whose role is to protect and inform consumers against a financial industry, including insurers, offering products that defraud them.

California Proposition 22

Beyond the presidential contest, there were indications of distaste for big government regulatory approaches, particularly at the state level. The ballot measure most relevant to the insurance industry was the passage of Proposition 22 in California, turning back an effort to classify independent contractors who work for gig-economy companies (Uber and Lyft) as full-time employees (Assembly Bill 5). Proposition 22 was not a complete overturn of AB5, but a compromise that will keep rideshare drivers as independent contractors and will not cause wholesale change in the business model of the rideshare platforms. Insurers have been developing commercial auto products to address this expanding market over the past several years, and Prop. 22 should allow continued expansion of the rideshare market. In addition, the classification of drivers as independent contractors rather than employees will have implications for the workers' compensation exposure base.

Environmental, Social, and Governance issues

ESG (environmental, social, and governance) issues are gaining prominence and starting to shape the business environment. For the U.S. insurance industry, these issues are only just beginning to be applied directly to the way the industry is run, and indirectly by influencing how the industry invests.

Biden has said his administration will require public companies to disclose climate risks and the greenhouse gas emissions in their operations and supply chains. Many companies already provide climate reports to the public voluntarily, and the number of insurers that have announced they are abandoning underwriting activities in fossil fuels is growing.

We believe the most likely way a Biden administration would implement this requirement is through the SEC. The SEC has already expanded its financial disclosure requirements by including human capital management practices and supply chain arrangements to the definition of "material information." According to the SEC's website, when this definitional change was made in August 2020, the SEC received more than 2,800 comments, including from the Sustainability Accounting Standards Board and the CFA Institute, requesting that climate change be added to the definition as well, but the SEC did not.

Disparate impact

With the Black Lives Matter movement and issues of race and racism featured prominently in election debate and commentary, there may be a renewed focus on disparate impact initiatives. In 2020, HUD (the Department of Housing and Urban Development) issued a final rule revising its 2013 Fair Housing Act disparate impact standards elevating the burden of proof for discrimination claims. While the focus of the Fair Housing Act is on discrimination in housing, it also applies to homeowners insurance. We expect the incoming Biden administration will seek to undo the recent changes and ease the standards for filing discrimination allegations.

Changes to tort environment

We expect the Biden administration to advance "regulation through litigation," a term introduced 20 years ago by former Labor Secretary Robert Reich. Examples of "regulation through litigation" include suing to hold gun manufacturers responsible for mass shootings and suing energy companies for contributing to environmental degradation. We expect the new administration to reverse the regulatory-lite posture that characterized the past four years. The Biden team has already announced its intention to strengthen regulation concerning worker safety and to reinvigorate the Consumer Financial Protection Bureau. Among the first acts of the Trump administration in 2017 was the scrapping of two business regulations for every new one introduced. We also expect there will be more resort to courts to address grievances where regulatory oversight proves unsatisfactory to plaintiffs. Areas and developments to watch in a more litigious climate include:

- reduction of pre-dispute arbitration agreements in favor of litigation
- heightened prosecution activity for unsafe work conditions and environmental damage
- removal of liability protections for businesses allegedly failing to provide adequate COVID protections to workers and third parties
- investigations and prosecutions of government-related misconduct
- strengthened whistleblower protections stimulating enforcement actions
- less shielding of gun manufacturers
- tax law changes regarding expert witness costs

The *National Law Journal* ("Big Law Chairmen and Prominent Trial Lawyers Help Drive Biden Fundraising," December 30, 2019) and other publications have published reports identifying large campaign contributions to the Biden campaign by trial lawyers. Syndicated columnist Ira Stoll suggested that a Biden presidency could be a "bonanza" for trial lawyers. Court activity is currently slow, and trials are largely stalled from COVID-19 restrictions. When normal conditions return to the courts, we believe the pendulum swing will be away from tort reform. Casualty lines, including general liability, products liability, EPLI, D&O, and E&O, will feel the impact and respond with continuation of rate hardening.

Impact to the ACA

The ACA was once again in front of the Supreme Court. This time, the issue is the constitutionality of the law's individual mandate. Under the Tax Cuts and Jobs Act of 2017, the individual mandate penalty, while not repealed, was to be reduced to

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$0 starting in January 2019. The case was first heard by a Texas federal judge in 2018 and the Fifth Circuit Court of Appeals in 2019, and the case was brought before the Supreme Court on November 10, 2020. The main questions being asked are whether the individual mandate is constitutional and, if not, is it severable from the rest of the ACA.

A verdict on the case is expected sometime in the spring of 2021. Based on the lines of questioning from the justices, Conning believes that, even if found unconstitutional, the justices may support severing the mandate and keep the majority of the ACA in place. Should the individual mandate provision be considered severable from the rest of the ACA, the main aspects of the ACA, such as Medicaid expansion and no denial for pre-existing conditions, would remain intact. With a Biden presidency and a divided Congress, it is unlikely that additions and updates to the ACA will happen through legislation.

Immigration

The Biden platform contained ambitious plans for changing the nation's approach to immigration. The Trump administration reduced legal immigration by 43% from 2016 to 2019, per the Census Bureau, and Conning believes the Biden administration will seek to reverse those changes, ease border restrictions, re-invigorate the flow of immigrants to the U.S., and provide "a roadmap to citizenship for nearly 11 million undocumented immigrants." (Quote from https://joebiden.com/immigration/#Modernize America's Immigration System) Assuming Republican control of the Senate, however, large-scale legislative changes are much less likely. Still, as previous presidents have shown, much can be accomplished via executive orders.

For a nation with slowing population growth, increased immigration could provide a boost to economic growth and to insurance exposure growth. In addition, enhanced international migrant flow will accelerate diversity trends in the consumer base and in the workforce, with implications for product and purchase preferences.

A Biden administration would likely begin its efforts by undoing the Trump era executive orders and proclamations on immigration. Reinstating the Obama-era Deferred Action for Childhood Arrivals (DACA) would be a quick focus for the new administration; it featured heavily in campaign promises. Amnesty for undocumented immigrants is certainly a high-profile goal of the new administration, but would likely require a legislative solution. Should such an immigration reform measure make its way forward, however, it could create a strain on state Medicaid systems.

Conclusion

A shift to Democratic control of the presidency is a massive one—the policy differences of the two parties are stark. However, with a continuation of divided government, the likely election outcome for much of the status quo remains, well, status quo.

The same largely holds true for the insurance industry. We view the election outcome as slightly negative for life-annuity insurers (more regulation) as well as for property-casualty companies (a less friendly tort and business environment). Health insurers emerged as the relative winners with no major adverse changes, at least for the near term.

We caution not to underestimate the detrimental effect to insurers of regulatory creep and executive orders. Those should feature prominently, at least over the next two years until the midterm elections. Meantime, insurers have much reason for optimism with strong balance sheets, prospects for a vaccine, and continued economic recovery.

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Guy Yeakley, Editor
Steven Webersen, Managing Editor

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