Assured Briefing Excerpt: Second-Order Effect of Tax Reform on Insurers

A bullish estimate of incremental P/C premiums could reach $215 billion over the next ten years

The recently passed *Tax Cuts and Jobs Act* is a massive document that will affect individual and corporate behavior for many years. In the February edition of our *Assured Briefing* we focused on how the modifications in tax laws can lead to renewed economic growth and business opportunities for P/C insurers.

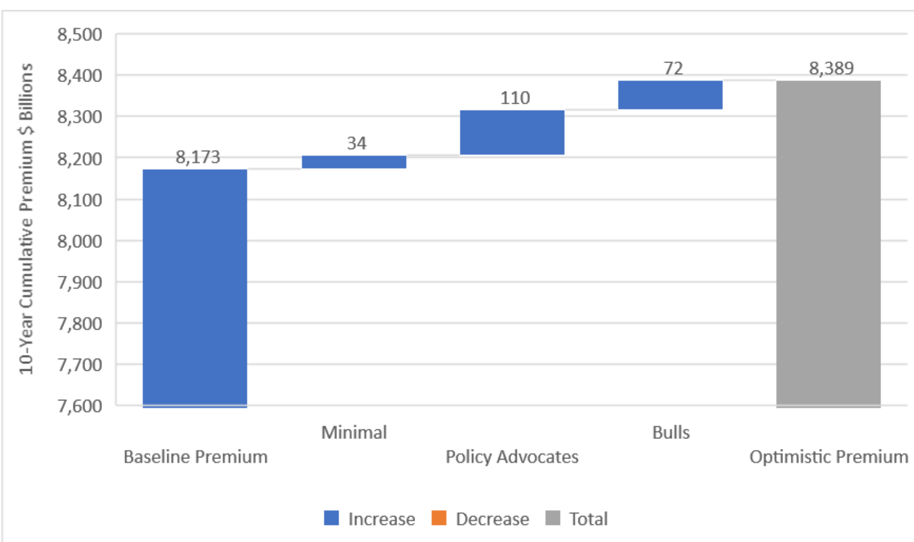
The Second Order Effects Matter…New Business Opportunities

How much incremental P/C industry premium will result from the tax reform act? No surprise – there are many different points of view ranging from some $215 billion of incremental direct premium stemming from bullish economic scenarios down to, well, zero.

Most analysts have focused on the direct impact of tax reform on publicly-traded P/C insurers. But that misses the greater opportunity – new sources of demand!

The most bullish forecasters call for a 4-5% impact on real GDP by year ten (or, 2027), and so our estimate of industry premiums by that year is 4.5% above the baseline.

Figure 1: Est. P/C Direct Premiums (2018-2027) Associated with Viewpoints on Tax Reform



Our baseline projection assumes 2.0% real GDP growth and 2.5% inflation, or 4.5% nominal GDP growth. We don't assume any change in premium concentrations by industry.

Source: Bureau of Economic Analysis, S&P Global, Various Policy Reports, Assured Research

Economists we have dubbed 'policy advocates' strike a slightly more cautious tone; they estimate real GDP will increase by 3% by the end of the ten-year measurement period. But the non-partisan government forecasters (like the Joint Committee on Taxation) only anticipate a modest 0.6-0.8% impact on real GDP (described as minimalists in Figure 1).

Tax reform won't affect the economy evenly

Any 30,000-foot view of the economy is bound to be too simplistic. **What's interesting to consider is how changes within the tax code may alter the behavior of consumers and businesses, in turn producing unintended second-order effects on industries such as P/C insurance**.

To gauge the sensitivity P/C premiums to changes in the GDP of each sector of our economy, we turned to data from our alliance partners at ISO MarketStance.

More details can be found in our unabridged *Assured Briefing*, but **suffice it to say that insurers will do well if construction booms and the professional sector accelerates. Manufacturing? The results may prove surprising.**

Specific behavioral changes in response to the new law

Also in our *Briefing*, we identify some specific behavior changes incentivized by tax reform. By no means do we think we have identified all the potential changes; our point is that **insurers should view the new law as an opportunity to seek out potential areas of growth**.

On the one hand, homeownership is being deemphasized – not good for home insurance. On the other, professionals will have incentives to form LLCs – good for small business and E&O sales.

Economic tailwinds may be gathering speed. We expect the exploration of business development topics will be a recurring theme in our 2018 research.