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Special Election Commentary

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

As of November 14, the control of Congress was too close to call. There was not an official winner in several races, and some projected losers are contesting the results. The U.S. Senate will remain under Democratic control, even though the Georgia race will be determined by a runoff election on December 6. Control of the House remains undecided, though trending towards the Republican party.

Regardless of this outcome, with Biden remaining president, we expect Capitol Hill will remain gridlocked. Given that this was a mid-term election, most of the key elections occurred at the state level with many of the national issues being fought locally. For insurers, this will result in multi-state efforts to understand and respond to regulatory challenges.

Uncertainty around election outcomes and control extended to the state level. Arizona, shown in white in Figure 1, did not have a clear winner in its governor's race. Eighteen states, shown in blue, remained in Democratic control while Republicans, shown in red, retained control of 23 states. Eight states, shown in grey, remained divided, with one party controlling the governorship and the other party controlling both houses of the state legislature.

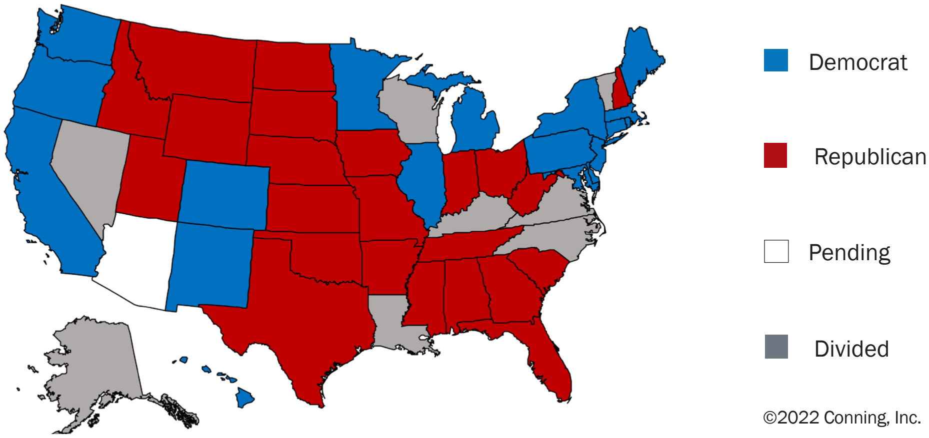
The Post Mid-Term Market Overview

If Republicans do gain control of the U.S House of Representatives, investors will likely celebrate the end of one-party rule as many of the most anti-growth measures being contemplated in Congress will fall by the wayside. But regardless, we believe 2023 could be a difficult year for markets, especially in the first half.

There are four major policy drivers of growth—monetary, fiscal, trade, and regulatory.

- Monetary policy - The Federal Reserve's (the Fed) Federal Open Market Committee (FOMC) is not likely to change course based on the election outcome. We expect the Fed to drive the economy into recession, one hopefully mild and short, to bring inflation down into its target range.
- Fiscal policy - As spending bills must start in the House per the U.S. Constitution, House party control is important. If Republicans gain control, as seems likely, it is unlikely that any new spending and, consequently, more inflation-spurring demand-side stimulus, will be forthcoming. New taxes are less likely as well. The lame-duck session will probably deal with funding the government (hopefully avoiding a shutdown threat) and the National Defense Authorization Act, as both will have some bipartisan support. If Democrats keep control, we would expect higher spending, such as a re-invigorated Build Back Better bill, and higher taxes.

Figure 1 Party of Governor and Controlling Party of both houses of State Legislature



“We expect earnings and equity markets to struggle, especially in the first couple of quarters next year, until the FOMC ends the tightening cycle.”

- Trade policy - Trade and foreign relations are largely purviews of the executive branch, so we expect little impact from the mid-term results. Further, there is not that much difference between the parties when it comes to dealing with China and Russia, the two biggest concerns right now.
- Regulatory policy - We can expect continuing aggressive regulatory initiatives from the current administration. However, as Congress holds the purse strings, whichever party gains House control will determine how easily the Biden team can achieve the appropriations to fund them.

So, we expect earnings and equity markets to struggle under these circumstances, especially in the first couple of quarters of next year, until the FOMC ends the tightening cycle. We believe the U.S. dollar trend will ease a bit but continue to be strong against economies still under stress, especially in the UK and Europe. In this environment, high grade USD bonds in the short to middle part of the yield curve should provide the best opportunity for income and stability. If we have a recession and it is short and mild, we will look for an earnings recovery in consumer sectors in the second half of next year, with opportunities in USD equities and longer-dated bonds.

Environmental, Social and Governance Progress or Pushback?

Regardless of what happens in Congress, with the election further locking in single-party control at a state level, insurers will continue to face a patchwork of ESG disclosure and investment regulations. Our opinion is that this is likely to lead to higher compliance costs for insurers as the differences in ESG disclosure among the states increase. We also think the ability to reallocate investments will be hampered as some states continue to prohibit divesting from fossil fuels. From a public relations perspective, these differences among the states may make it more difficult to provide a clear and consistent message about ESG from insurers to their stakeholders.

Evidence of the gap between state views on ESG has been on display during 2022 and the mid-term elections have widened that gap. Red and red-leaning states have begun to push back against efforts to increase ESG disclosure and investment. Blue and blue-leaning states are likely to increase their oversight of ESG corporate initiatives.

Insurers are stuck between a rock and a hard place. On the one hand, stakeholder pressure to divest from fossil fuel investments and withdraw underwriting support for fossil fuel products is strong and growing, particularly in Europe where a string of insurers and reinsurers have adopted such measures in recent years. On the other hand, a number of Republican-controlled U.S. states – notably Louisiana, Florida and Texas – have pushed back on actions that they perceive as a violation of fiduciary duty and as damaging to local fossil fuel interests.

The state pushback against ESG has taken two forms: 1) No ESG investment and 2) Boycott. The states with “No ESG” laws do not allow state funds to be used for ESG or social investment. The boycott states bar local authorities from doing business with banks and investment management companies that have adopted ESG policies and divested from fossil fuel-based energy companies.[1]

Little Progress in Tort Reform

Tort reform typically has bipartisan support and this mid-term election saw little progress. No state had tort-law reform on the ballot, but Arkansas, California and Missouri were considering initiatives.

Although ballot initiatives were absent, Republican success in achieving or tightening control of state legislatures and governorships creates a more favorable business environment for future tort reform. Our eyes will remain on Florida, as it convenes a special legislative session in December[2] to address the challenges facing its home insurance market. Florida is by far the most expensive state in the nation for home insurance, with premiums in 2022 running at nearly three times the U.S. average,[2] so pressure for reform will continue to be strong.

Industry Pushback on the PRO Act

When it comes to insurance distribution and advice, many state and federal regulators have focused on suitability. However, proposed changes to U.S. labor laws have been a growing concern among advisors and their firms. The Protecting the Right to Organize (PRO) Act,[3] if passed, would impact U.S. labor law. The House passed the PRO Act in early 2021 and unions and other Democratic groups were pushing for the Senate to pass the PRO Act in 2022.[4] The PRO Act has stalled in the Senate as it would need at least 60 votes to avoid a filibuster and obtaining those votes may continue to prove difficult given the continuation of the Senate’s near balance of Republican and Democrats.

The PRO Act offers broad reform and multiple insurance and financial advisory trade groups have pushed back against the act[5] because it would reclassify many independent agents and advisors as employees. To determine the independent contractor status of an employee, the PRO Act would use the “ABC” factor test employed in similar legislation in California, though the California rule included a carveout for financial advisors.[6]

Medicaid Expansion Slowly Continues

Healthcare continues to be a focus within every election cycle. While the topic of the Affordable Care Act (ACA) was muted compared to prior election cycles, in some states Medicaid expansion was a hot topic. Based on mid-term results, that expansion slowly continues.

For insurers, an increase in Medicaid-eligible individuals provides the industry with an increase in membership and premium growth. Only 12 states[7] have yet to adopt and implement the Medicaid expansion program per the ACA; of those 12, 10 had a gubernatorial election and one had a ballot initiative focused on Medicaid expansion.

Ballot initiatives have been popular and effective in expanding Medicaid. However, in the 12 remaining states, only Florida, South Dakota, and Wyoming[8] allow voter-driven ballot initiatives. The remaining nine states would require voters to elect a governor and local state representatives who would support an initiative.

Voters in South Dakota passed a ballot initiative to amend the state's constitution to expand Medicaid eligibility. Governor Kristi Noem (R), who won re-election, has stated that while she does not support Medicaid expansion, she will implement the amendment if it is passed.[9]

Private Equity Annuity Insurers Remain Focused on the States

One subject where control of the Senate is particularly important is the involvement of private equity firms in the annuity industry. In March 2022,[10] Sen. Sherrod Brown (D-OH), chair of the Senate Banking Committee, called on the NAIC and Federal Insurance Office to study private equity annuity insurers' impact on the retirement security of individuals. He was especially interested in the impact on retirees who transferred their defined benefit pensions to such insurers. That request was followed by Banking Committee hearings in September[11] in which Sen. Elizabeth Warren (D-MA) echoed Sen. Brown's concerns.[12]

We think with the Senate remaining close, there is a low likelihood of federal regulation affecting the ability of private-equity-backed annuity insurers to continue engaging in pension risk transfers.

Data Protection and AI Regulation, the Question is When not If

As technology firms expand their scope and opportunities grow for consumers to expose their personal information, data privacy is becoming an increasingly important issue. Insurers would like the freedom to use personal data for underwriting and pricing. Sensor-based technologies are rapidly developing uses in property insurance underwriting. Data-privacy legislation differs across jurisdictions but focuses on creating and regulating boundaries around the collection, use and disclosure of personal information by businesses.

Social media and genetic information are of interest to life and health insurers to help improve underwriting. All sectors are leveraging AI and machine learning to increase efficiency when underwriting and issuing policies. The potential for hidden biases in the algorithms driving those systems to discriminate is a concern among some regulators.

While there were no initiatives addressing data protection or AI on state ballots, control of governorships and state legislatures will determine the course of future regulation. Both political parties[14] have expressed interest in increasing data protection and privacy regulations.

According to the National Conference of State Legislatures,[15] in 2022 at least 35 states and the District of Columbia enacted or considered consumer privacy bills. Conning's view is these various state laws are creating a patchwork of rules insurers will need to follow.

"Most of the key elections were at the state level with many national issues being fought locally; insurers will need multi-state efforts to understand and respond to regulatory challenges."

At the federal level, the bipartisan American Data Privacy and Protection Act (ADPPA)[16] would create a comprehensive federal consumer privacy framework and generally preempt state laws. At this point, we believe it is unlikely that the bill will be considered in the full House or Senate before the conclusion of the 117th Congress on January 3, 2023, but ADPPA could become a priority issue for the new Congress.

The NAIC's[17] work on developing new model laws on the use of AI is likely to continue, despite the election outcomes.

State Insurance Commissioners

Insurance is regulated at the state level and a change in a state's insurance commissioner can impact the regulatory priorities of those states' insurance departments. In the 2022 mid-term elections, the states in which insurance commissioners were on the ballot - California, Georgia, Kansas, and Oklahoma - all kept their incumbents in office.

California: Commissioner Ricardo Lara (D) won reelection.

Georgia: John King (R), the incumbent appointed by Gov. Brian Kemp (R) to replace the former commissioner who resigned, won election to a full term.

Kansas: Incumbent Commissioner Vicki Schmidt (R) won re-election. Schmidt has been a national leader at the NAIC across health and property/casualty work.

Oklahoma: Commissioner Glen Mulready (R) ran unopposed for his second term.

In addition, in several states the governor appoints the insurance commissioner. A change in the state's executive branch could bring about a change in the office of the insurance commissioner, but we will need to wait and see which of those elections will result in a change of commissioner.

It Ain't Over 'Til It's Over

While this election has been bitterly fought and the outcome of many key races remains unknown, neither side can declare total victory in Washington. As a result, at the federal level, the likely election outcome is gridlock where little will be accomplished. This will lead to further rule by agency and executive regulations. However, the U.S. Supreme Court's ruling in West Virginia v. Environmental Protection Agency may have opened an avenue for lawsuits blocking some agency and executive regulations[18]. At the federal level then, the 2016 presidential election remains as it enabled the GOP to obtain a six-seat majority on the Supreme Court.

Where Republicans strengthened their control at the state level, we would not be surprised to see several outcomes favorable for insurers. There is likely to be less regulation, a more friendly tort environment, and higher barriers to ESG or DEI (diversity, equity, and inclusion) investment and reporting requirements. Health insurers may be relative losers due to more restrictions on Medicaid.

On the flip side, where Democrats enjoyed success at the state level, we think the outcome will be slightly negative for life-annuity insurers due to more regulation around underwriting. We also view it as negative for property-casualty companies, leading to a less friendly tort and business environment with added pressure to divest from fossil fuels. Health insurers appear to have emerged as the relative winners with no major adverse changes, at least for the near term.

One of Yogi Berra's most famous quotes was "It ain't over 'til it's over." With the U.S. elections, it's never over. With that in mind, in 2023, as executives manage their way through higher inflation, possible recession, and increased economic uncertainty, it can be tempting to put the 2022 midterms in the rear-view mirror. We think that proactive management teams, however, will remain engaged at all political levels to shape a more favorable regulatory landscape. After all, the next election is less than 725 days away!

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This article features significant contributions from Insurance Research industry analysts Julia Brinson, Mary Pat Campbell, Robin Davis, Alan Dobbins, Daniel Erickson, Manu Mazumdar and William Pitt.

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