February 9, 2021

2021: Beginning to Come Into View

To our friends and clients,

Despite the hope for material changes when the calendar flipped to 2021, we are a little over a month into 2021 and it feels a lot like 2020. COVID-19 still has a grip on the world and a material amount of uncertainty on the political and economic fronts remains. However, with the conclusion of the Georgia Senate runoffs on January 5, 2021, and the subsequent swearing-in of a new Congress and Presidential administration, the future is a little clearer, allowing us to make some predictions for 2021 and address the corresponding impacts to agents and brokers.

Tax Rates

It is certain that taxes will increase in the future. The questions are which taxes and when as the Biden tax plan is filled with multiple tax changes across areas. The two primary areas that would most affect agents and brokers are: 1) corporate tax rates and 2) capital gains tax rates. Under the Biden plan, corporate tax rates would increase from 21% to 28%, not only impacting agents and brokers that are C-corporations, but also clients of agents and brokers. On the capital gains front, the Biden plan calls for capital gains to be taxed at 39.6%, the proposed highest individual tax rate for individuals, as well as the elimination in the step-up bases for capital gains taxation.

majority in the Senate and COVID-19. COVID-19 makes economic stimulus and growth the number one priority and a slim majority in the Senate is not a mandate and there are several Democratic Senators that have a centrist voting record. While tax changes can be achieved with a simple majority of Congress, one vote can sway the argument and overreaching can result in negative consequences during the mid-term elections. As a result, capital gains rates will likely increase to 25% to 30%, a material change, but a far cry from the top individual tax rate. Corporate tax rates are likely to increase but unlikely to reach 28%, landing around 25%. Implementation of the full tax plan would be too much, too fast in a non-conducive environment.

When these changes will be effective is another question. Historically, tax law increases have not been retroactive and therefore we do not expect any changes to be effective until 2022. Mark Mazur, Treasury Deputy Assistant Secretary, recently stated, "You want to have a tax system where people -- taxpayers -- can react to the increases in the tax system so that they can change their behavior when you do retroactive tax increases that's not possible. That tends to be not the first choice."

Tax changes will impact agents and brokers. However, if the changes are not made retroactive, there is time to prepare for the changes. All that said, if we have learned anything in the past few years it is that the political world is filled with uncertainty.

Economy

The second round of economic stimulus is in progress and the short-term impact is likely positive. The Congressional Budget Office ("CBO") predicts real GDP growth of 4.6% in 2021 while the International Monetary Fund ("IMF") predicts 5.1% real GDP growth in 2021. The impacts of the macro-economy are realized by agents and brokers six to eight months after they happen so brokers should benefit from carryover economic momentum from 2020 and continued growth in 2021.

Given these projections, we believe economic optimism is warranted. If COVID-19 is effectively addressed in the first half of the year via vaccine, herd immunity, etc., late Q2, Q3 and Q4 could exceed expectations as consumers rush back to stores and book vacations, creating an even more favorable economic environment for agents and brokers. While other economic factors are in play (i.e., the national debt), we do not see those impacting 2021.

Changes to Healthcare

A recurring topic in the United States is healthcare. The Biden healthcare plan also had multiple components including adding a public option like Medicare, addressing drug prices, tax credits, and healthcare system regulations. A couple of important items to remember. One, COVID-19 and the related response will take priority over any other healthcare items. Two, Biden was a material contributor to the Affordable Care Act ("ACA") and the Act is part of his legacy as Vice President.

There will be changes to restrengthen ACA but we do not expect the changes to have a material impact on agents and brokers. Agents and brokers thrived when ACA was implemented and strengthening of ACA likely will also have positive impacts. We have impact agents and brokers in the near-term.

P&C Pricing

I once thought that the hard market was akin to Bigfoot, often discussed but never seen, but Q3 was the 12th consecutive hard quarter of P&C rates with an 11.7% increase on average. And they are happening across all lines and account sizes. As a result, and despite the challenges of 2020, organic growth for the industry in 2020 was 4.3%.

Based on COVID-19, natural disasters, civil unrest, and general uncertainty, we expect pricing to remain firm in 2021. And while pricing increases create pain in the sales process, it drives organic growth. Reagan Consulting Organic Growth and Profitability ("OGP") participants recently predicted 6.0% organic growth for 2021. Given the pricing environment and the potential for economic expansion that exceeds expectations, there is a real possibility that 2021 organic growth exceeds 6.0%.

COVID-19

COVID-19 dominated the headlines and our focus for much of 2020 and that will likely continue during the first part of 2021. As a result, most agents and brokers are operating in a remote environment. However, there is optimism that the COVID-19 restrictions will no longer be needed in the second half of the year. There have been numerous questions and theories around what agents and brokers look like on the other side of the pandemic. Specifically, a lot of the discussion has been around travel and entertainment expenses and occupancy expense.

Post pandemic travel and entertainment expense will be less than pre-pandemic levels, but not dramatically. Informational meetings will continue virtually; however, our industry thrives on relationships, propelling travel and entertainment to return to pre-pandemic levels, likely exceeding pre-pandemic levels in the early months due to pent-up demand. Occupancy will follow a similar pattern with some employees continuing to work remotely, while most other agents and brokers return to the office (at least part-time) as relationships, culture, and knowledge synergies are a critical component of success.

Another black swan event like COVID-19 or political upheaval could turn everything upside down or be more dramatic than anticipated. However, as witnessed in 2020, agents and brokers are resilient and have an amazing way of adapting. If things go as predicted, 2021 will allow agents and brokers to prepare for changes, enjoy a year of great returns, and return to an environment that more resembles the pre-pandemic environment.

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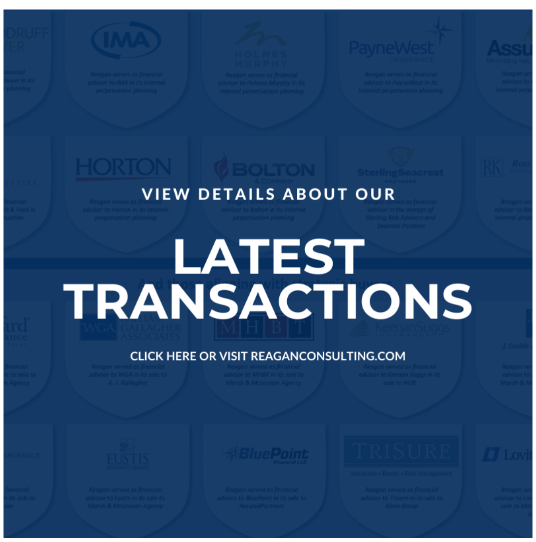

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