Helicopter Money – How It May Save the Insurance Brokerage Business (and the Rest of the Economy)

Many clients have asked us our views about how the COVID-19 pandemic will affect the insurance brokerage industry broadly and the M&A and strategic market for brokers in particular. As much as we would like, we don't have a crystal ball and, of course, the answer to a great extent is "it depends." However, we believe at least part of that answer revolves around "Helicopter Money."

We know that many of our readers may not be familiar with the concept and may not understand its potential impact on our industry — so why do we think Helicopter Money may help save the insurance M&A industry and the U.S. economy as a whole?

The Insurance Business is a GDP Business – That is the Big Risk

What do we mean when we say that the insurance business is a GDP business? The total premium growth in the industry (and thus its revenue) is strongly correlated to the growth of gross domestic product ("GDP") in the United States. Hard and soft market forces act as the variables that move premium growth either higher or lower than GDP growth.

Some of the economic predictions regarding the economic impact of the coronavirus on the economy and GDP are quite dire. James Bullard, the President of the Federal Reserve Bank of St. Louis, predicts the U.S. unemployment rate may hit 30% in the second quarter, with an unprecedented 50% drop in GDP. Goldman Sachs and Morgan Stanley also forecast a substantial drop of 25-40% in Q1/Q2.

To give you some perspective on how draconian these numbers are, during the Great Recession of 2008/2009, GDP dropped by 4.3%; during the Great Depression, GDP dropped by about 30%.

While Bullard, Goldman Sachs, and Morgan Stanley all expect the economy to bounce back toward the end of the year, substantial economic damage will be done. In fact, without a strong policy response (which is already underway), the economic damage could take a decade to repair. While insurance premiums tend to be one of the last bills not to be paid, a 50% drop in GDP would surely have a massive impact on insurance premiums, brokerage revenues, and profit margins.

The Great Depression lasted for an entire decade. It took gearing up for World War II to ultimately end the economic dislocation. A sustained 20-50% drop in GDP would represent an economic tsunami that would be worse than the impact of the Great Depression, and in our opinion, would ultimately cause more death and destruction than the actual virus itself. So how do we stop the U.S. from entering a decade-long Depression?

Helicopter Money to the Rescue

We believe the response by the federal government will be massive doses of Helicopter Money.

As well explained by Investopia:

While 'Helicopter (Money) ' was first mentioned by noted economist Milton Friedman, it gained popularity after Ben Bernanke made a passing reference to it in a November 2002 speech, when he was a new Federal Reserve governor. That single reference earned Bernanke the sobriquet of 'Helicopter Ben', a nickname that stayed with him during much of his tenure as a Fed member and Fed chairman.

Bernanke's reference to 'helicopter drop' occurred in a speech that he made to the National Economists Club, about measures that could be used to combat deflation. In that speech, Bernanke defined deflation as a side effect of a collapse in aggregate demand, or such a severe curtailment in consumer spending that producers would have to cut prices on an ongoing basis to find buyers. He also said the effectiveness of anti-deflation policy could be enhanced by cooperation between monetary and fiscal authorities, and referred to a broad-based tax cut as "essentially equivalent to Milton Friedman's famous 'helicopter drop' of money."

Even though Bernanke's critics subsequently used this reference to disparage his economic policies, they were effectively silenced by his adroit handling of the U.S. economy during and after the Great Recession of 2008-09. Faced with the biggest recession since the 1930s, and with the U.S. economy on the brink of catastrophe, Bernanke used some of the very same methods outlined in his 2002 speech to combat the slowdown, such as expanding the scale and scope of the Fed's asset purchases.

While the notion of printing money as a means to avoid economic catastrophe may seem absurd for such an advanced economy as the U.S., that's exactly what we did from 2009-2014. At one point during that period, the Federal Reserve was printing up to $80 billion per month which was then used to buy U.S. Treasury bonds and mortgage-backed securities. While not perfect, the policy worked, saving us from another depression and ultimately leading to the longest economic expansion in history. Sadly, we can now bet that the economic expansion ended with an abrupt halt with the advent of the COVID-19 pandemic.

So How Will Helicopter Money Work This Time?

This time, Helicopter Money will be in a somewhat different form than in the Great Recession. Interest rates are already at or close to zero, so reducing rates is basically impossible and will not save the economy. What is happening and will continue is massive government spending to stop the free fall in the economy. The first part of this is already in progress with the newly passed $2+ trillion CARES Act stimulus bill. The plan is for the government to issue bonds at low-interest rates in order to borrow the trillions of dollars needed, which represents about 10% of total GDP and 50% of total government spending in 2019. This money will be pushed into the economy via various programs such as unemployment insurance, a small business payroll protection program, bailouts of large industries such as the airlines, tax relief, healthcare subsidies, etc. Our guess is that we will see another similarly sized relief package to follow this one.

This leads us to the following question - "Since the U.S. already has massive debts, who will lend the government this money by buying all of these bonds?" The answer is the Federal Reserve. The plan is for the Fed to create the money and buy up the U.S. Treasury bond issuance via a mechanism called quantitative easing "QE".

Another question you may have is - "Won't this spark massive inflation and destroy the value of the dollar?" Similar arguments were made in 2008 and 2009. The bottom line is that in those days inflation never got above 2% and the dollar never collapsed. The mechanics of why that was the case are complicated and better left to another article.

Can the Fed overdo it and print too much money creating out-of-control inflation or hyperinflation? The answer is "Yes, they can." However, in 2008 and 2009, it was able to print just the right amount during the financial crisis, and odds are they can do it again.

Right now, a deflationary spiral is a worse outcome than overdoing the stimulus. For the insurance distribution industry, limiting the damage to GDP is the number one priority. If the policy response can do that, insurance distribution will continue to be one of the best investment assets classes going forward.

The Bottom Line

We believe that Helicopter Money will work and get us through this phase of the economic catastrophe — but there are unknowns and risks.

For example, what if there is a second COVID-19 wave after the economy is restarted or later in the fall? It bears remembering that the Spanish Flu of 1918 came in three waves that lasted from the spring of 1918 to the summer of 1919. In fact, it was the second wave of the Spanish Flu in the fall of 1918 that accounted for most of the U.S. deaths from that pandemic. We are not out of the woods with COVID-19 once the initial death rate subsides.

So while there is room for optimism, many questions remain. Could we see more than one wave of fatalities with the coronavirus? Can we withstand two massive economic contractions in the same year? Only time will tell.

In these uncertain times, please reach out to us if you would like to have a discussion about your strategic options. We are here to help and would appreciate the opportunity to develop a dialogue and work as your strategic advisor to help you reposition your business for further growth and success.

About Sica | Fletcher

Among the brokerage community, Sica | Fletcher is well known as the leading strategic advisory firm in the U.S. that specializes in the insurance brokerage space and related industries that compliment it. In 2019, we led the country with 92 transactions completed for the insurance agents and brokers, and in 2018, we led the country with 79 closed transactions. We are also the leading advisor to the private equity firms that are most interested in investing in insurance brokerages and in the private equity sponsored agencies that have been created in recent years.

The firm was founded in 2014 by Michael Fletcher and Al Sica, two of the industry's leading insurance M&A advisors who have closed over $6 billion in insurance agency and brokerage transactions since 2014.