Answering Critics who want to Cut or Eliminate Reinsured Crop Insurance

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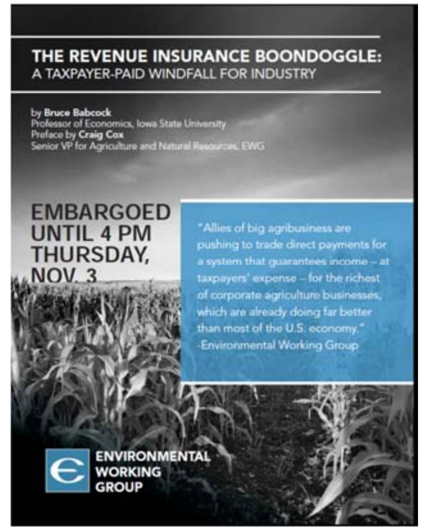
Crop Insurance Critics Continue to Target Crop Insurance with the Following Claims:



1. $3.5 Billion Crop Insurance Cut
2. Yield Exclusion (YE)
3. Trend Adjustment (TA)
4. Eliminate the Harvest Price?
5. Crop insurance provides windfall farmer profits?
6. Means testing?
7. Cut government paid premium share for "large" farmers?
8. "Excessive" company and agents profits?
9. "Free" disaster aid less expensive that is administered through FSA vs. private sector?

Insurance or a Government Subsidy Program

1. Is Crop Insurance a transfer (welfare) program or is it a cost share insurance program?
2. There is no cash subsidy transferred to farmers unless there is a claim.
3. There is no guarantee that farmers will net any of the cash subsidies or even recover their premiums. Cost share premium is a better description than subsidy.
4. Because farmers pay a share of the premium, most Great Plains farmers do not select the highest coverage available. If it were free, what level of coverage would farmers prefer?

Insurance or a Government Subsidy Program?

1. If insurance, then payment limits don't make sense.
2. If insurance, then means testing doesn't make sense.
3. If large farmers have a lower loss ratio than the industry, then forcing them out of the program could cause underwriting losses and increase premiums on the remaining farmers.
4. Loss of large farmers could increase the administrative cost for the remaining farmers.
5. If insurance, then there is no reason to eliminate the harvest price or eliminate the government's premium share on the harvest price.

CAP ON OVERALL RATE OF RETURN

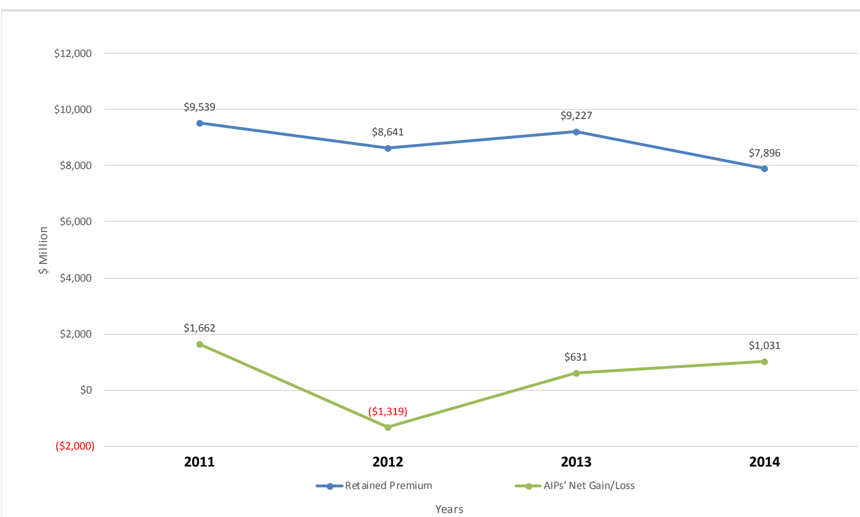
"(E) CAP ON OVERALL RATE OF RETURN.— Notwithstanding subparagraph (F), the Board shall ensure that the Standard Reinsurance Agreement renegotiated under subparagraph (A)(i) establishes a ***target rate of return*** *for the approved insurance providers, taken as a whole, that does not exceed 8.9 percent of retained premium for each of the 2017 through 2026 reinsurance years.".*

1. Is the 8.9% limit a hard cap or target?
2. What is the definition for "% rate of return on retained Premium"?

RMA Definitions

1. RMA defines underwriting gain as the difference between total premiums and total claims. This is effectively gross margin because it does not include expenses.
2. RMA justifies the gross margin as underwriting gain by assuming the A&O covers all costs.
3. The private P&C definition of underwriting gain is premium less claims, less all operating expenses.
4. Without a clear definition for % rate of return, I calculated the % return on retained premium before non-claim expenses. This is clearly not a rate of return because no cost have been deducted, but it is the same approach that RMA uses to define underwriting gain.
5. Loss Cost RMA data prior to 2011 was under a different SRA and the current SRA increases the AIPs share of the losses and cuts their share of the gains.

Industry Retained Premium and Net Gain/Loss Before Expenses



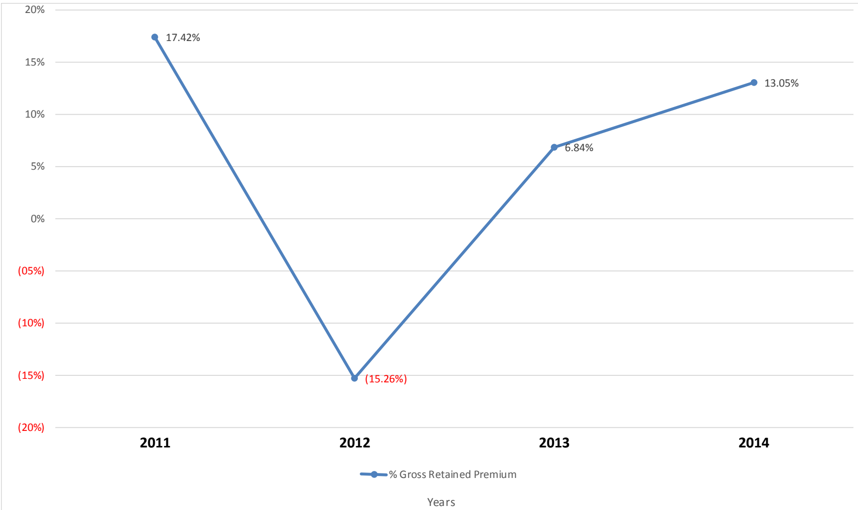
National Retained Premium - Retained Indemnity Overstates Gains and Understates Losses*

Year	Retained Premium	Retained Indemnity	Ret Prem - Ret Indemity	Net Gain/Loss	Over/under Real Gain/Loss
2014	7,895,668,332	5,881,050,807	2,014,617,525	1,030,731,466	**983,886,059**
2013	9,226,546,777	7,862,950,618	1,363,596,159	631,381,356	**732,214,803**
2012	8,640,864,294	9,001,226,587	(360,362,293)	(1,318,966,227)	**(958,603,934)**
2011	9,539,475,794	6,399,525,228	3,139,950,566	1,661,921,229	**1,478,029,336**

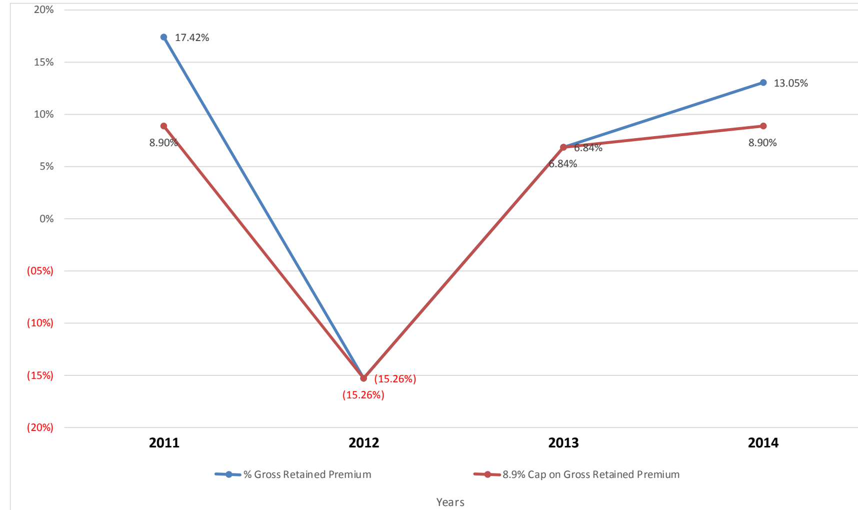
1. Retained Premium – Retained indemnity does not equal Net Gain/Loss. For example in 2012 premium $8.640 billion – indemnity $9.001B = $-0.360B. The AIP loss was $-1,319B and understates the loss by a $-0.959B. In 2013 the actual gain was $732 million less than the $1.364B difference in retained premium and retained indemnity.
2. The Net Gain is the result after the SRA splits the shares between AIPs and RMA. It is complicated by some AIPs having gains while others have losses in the same year because it is calculated at the state level. Once at the national level RMA takes a 6.5% quota share of an AIP's entire book.

*Source: RMA'S website, RMA Reinsurance Data

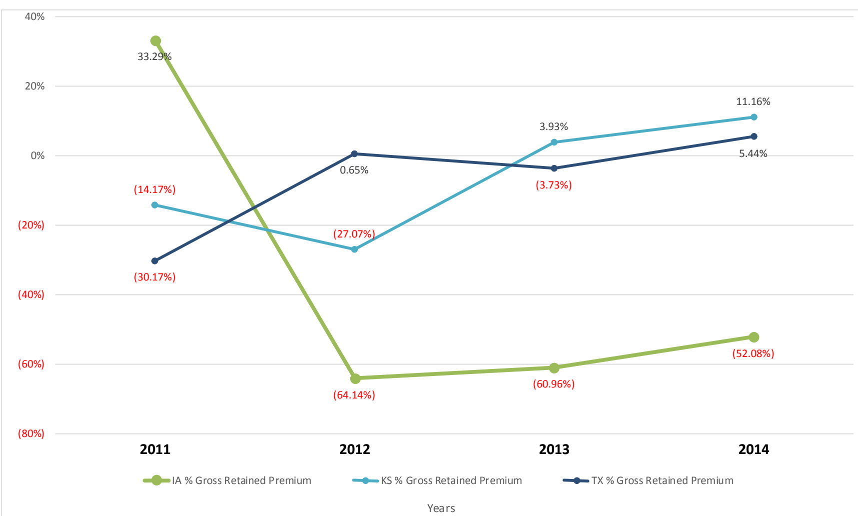
Industry Net Gain/Loss as % of Retained Premiums before Expenses



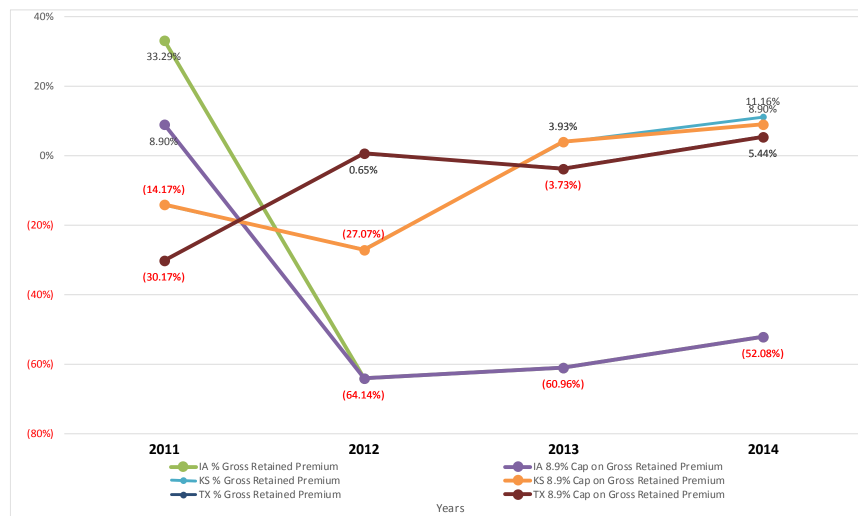
Industry Net Gain/Loss as % of Retained Premiums before Expenses with 8.9% CAP



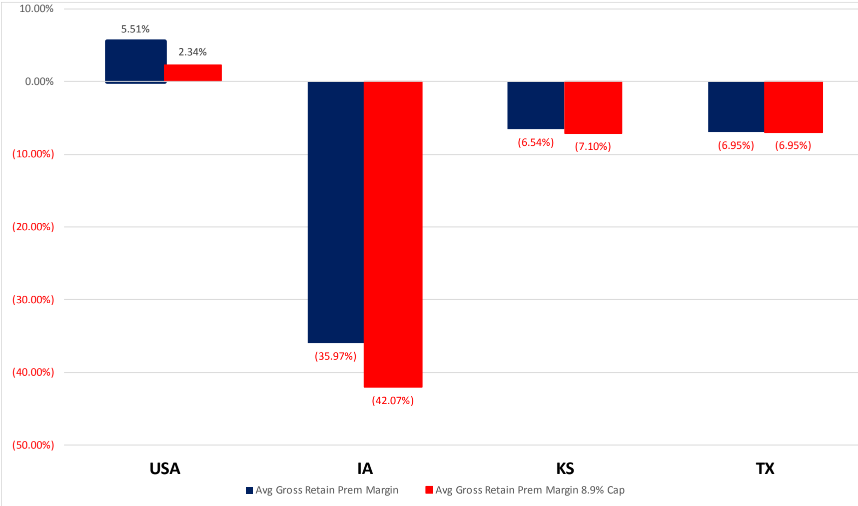
IA,KS,TX Net Gain/Loss as % of Retained Premiums before Expenses



IA,KS,TX Net Gain/Loss as % of Retained Premiums before Expenses with 8.9% Cap



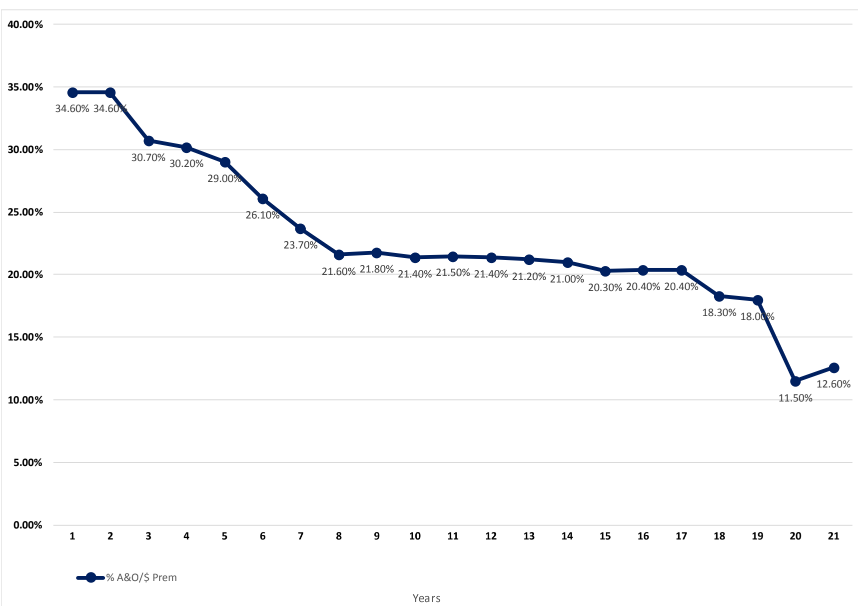
4-Yr Average Net Gain/Loss as % of Retained Premiums before Expenses, with & without 8.9% Cap



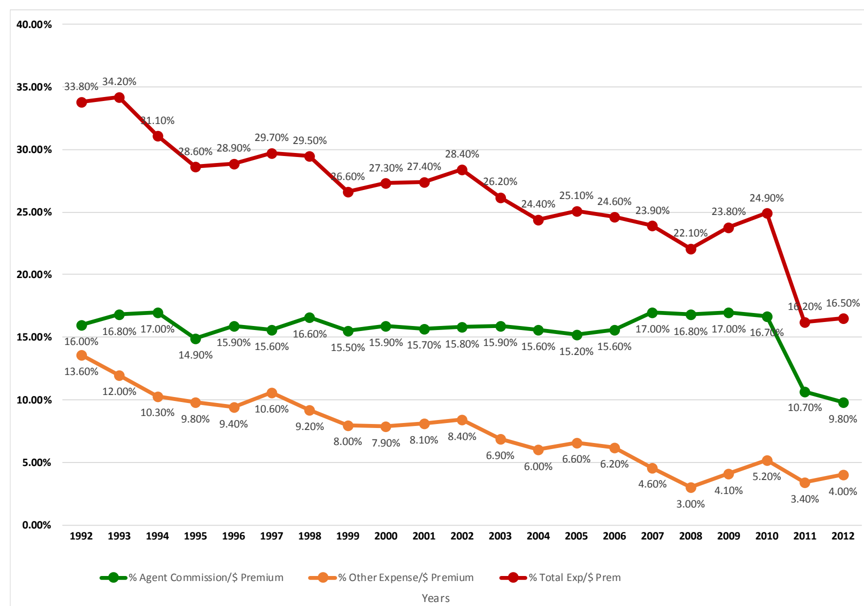
Cost Numbers are the Issue

1. Net/Gain loss must be positive to cover non-claim costs.
2. A&O is added to the AIPs income stream, but most of the A&O is used to pay agent commissions.
3. The most recent cost study was titled "Federal Crop Insurance Program Profitability and Effectiveness Analysis", prepared by Grant Thornton LLP, June 2014
4. The critics and RMA dispute the Industry's funded costs studies. However, government sponsored studies often have flaws in their numbers, but are never challenged and are treated as "fact". Worse, these studies are often cited by other authors.
5. Grant Thornton estimated cost as a % of gross premium. When measured as a % of retained premium, the % value is larger.

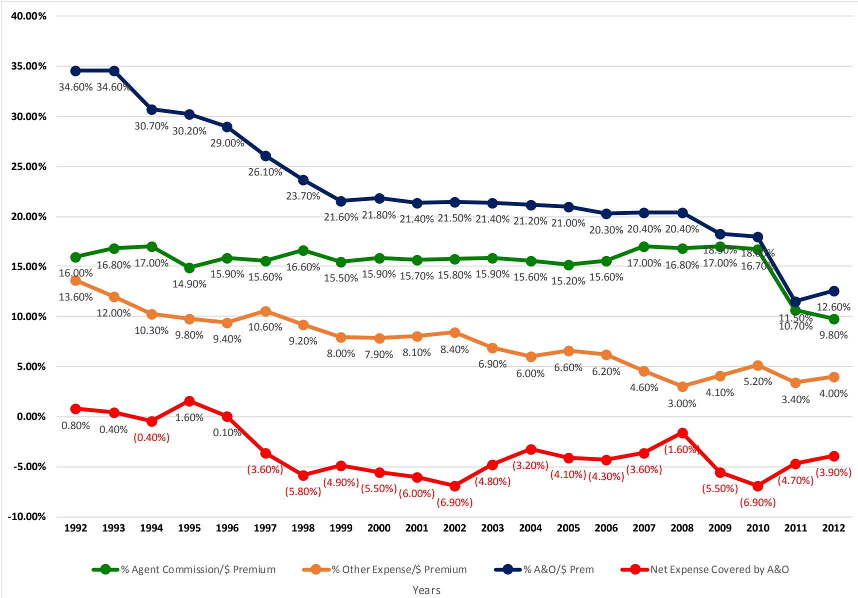
A&O as % of Gross Premium (Grant Thornton)



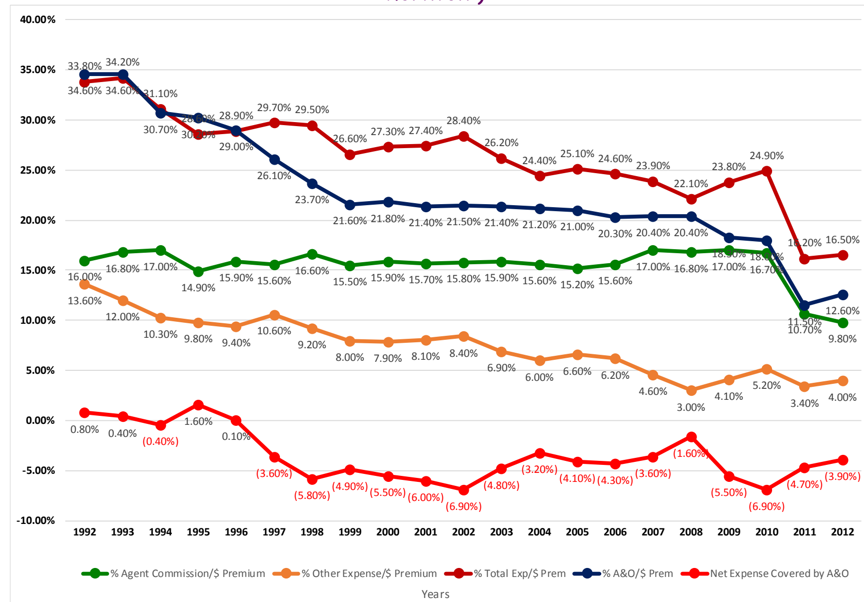
Non-Indemnity Expenses as % of Gross Premium (Grant Thornton)



Net A&O Non-Indemnity Expenses as % of Gross Premium (Grant Thornton)



Total Non-Claim Costs vs. Net A&O Expenses as % of Gross Premium (Grant Thornton)



New Proposed Crop Insurance Cuts

1. Sensenbrenner, (R-WI) and Kind (D-WI) have introduced a new Bill titled "Assisting Family Farmers through Insurance Reform (AFFIRM) Act". Similar legislation in the Senate is expected from Jeff Flake, (R-AZ)
2. Kind claims "These important reforms not only strike a better deal for taxpayers but will have no out-of-pocket expense to farmers". How?

AFFIRM's Crop Insurance Cuts

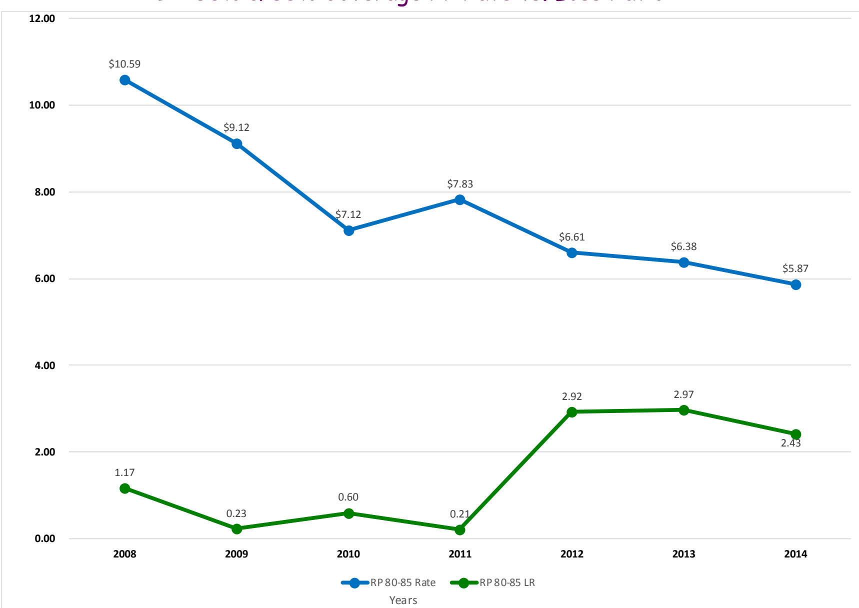
1. RMA's paid premium share would be limited to $40,000 and will shift a larger share of the premium to farmers. (DC calls it a subsidy)
2. Cap on RMA's paid premium share will have a larger impact in the Great Plains where premium rates are higher.
3. Eliminate the government's share of paid premiums for all farmers with an adjusted gross income (AGI) over $250,000.
4. Caps insurers' administrative and operating (A&O) at $900 million (Currently $1.3 B) a year likely causing another cut in agent commissions.
5. Eliminate the Harvest Price Option (HPO) will account for $19 billion of the $24 billion in cuts and applies to all farmers regardless of size.
6. Would retain the $3 billion cut to AIPs that is already signed into Law. It will have to be removed in the omnibus bill.

Eliminate the Harvest Price Option (HPO)

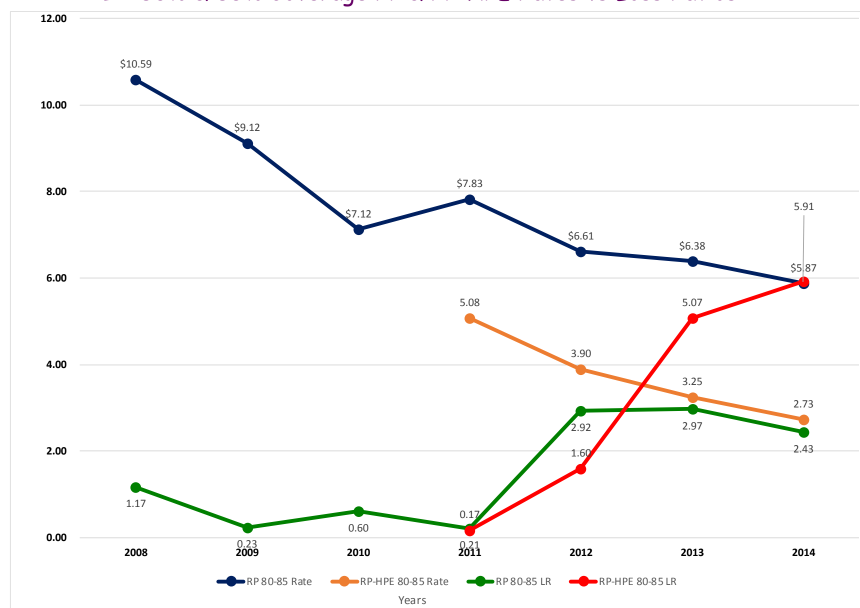
1. HPO started in 1990 following the 1989 wheat drought. Farmers lost their government payment and had little yield to sell at the higher prices. MPCI (renamed YP) did not cover the loss and the indemnity payment would be even smaller under today's RP-HPE than YP.
2. Farmers buy HPO to cover a hedge, a put hedge, fill forward contracts, loss of government payments due to higher prices, replace a lost feed supply at current market value, etc.
3. Eliminate HPO may cause underwriting losses. In Iowa, eliminating the harvest price will cut premiums by more than 40%, but historically it has not cut claims by a similar amount.
4. Estimating historical losses without the HPO is difficult using public data because RMA has only recently started to separate contracts without the HPO in their reported public data.

Iowa Corn Insured Acres under 80%-85% RP; 70%-75% RP; 80%-85% YP Coverage

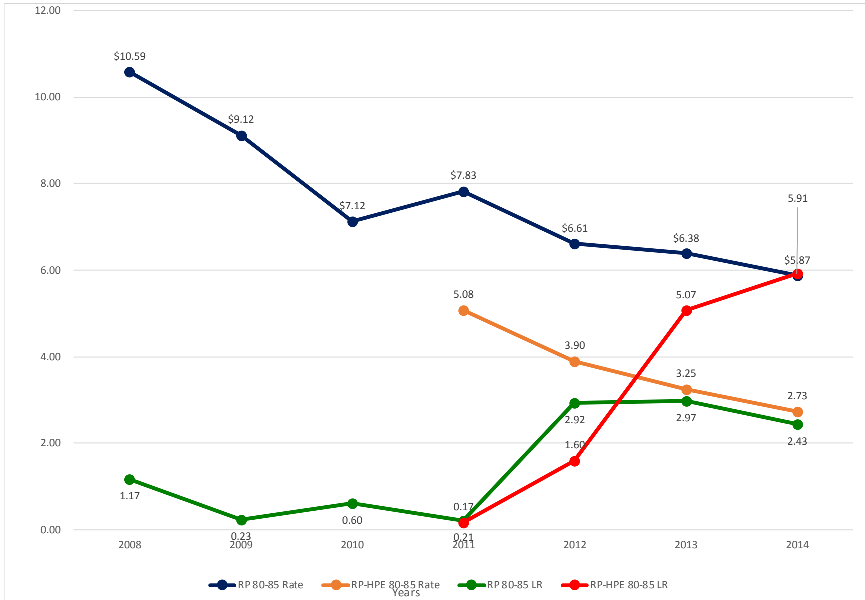
IA 80% & 85% Coverage RP Rate vs. Loss Ratio



IA 80% & 85% Coverage RP & RP-HPE Rates vs Loss Ratios



IA 80% & 85% Coverage RP & RP-HPE Rate and Loss Ratio



EWG'S Replace Crop Insurance with "Free Disaster Aid"

1. Similar to ARC, based on county yields
2. EWG has not specified if the coverage will use NASS prices are futures prices to pay claims.
3. No Harvest Price Coverage.
4. Includes means testing and payment limits.
5. FSA would pay based on County Yield losses so there would be no need for individual loss adjusting.
6. Unclear if the EWG approach would cover non-program crops.

American Enterprise Institute (AEI)

1. Argues to eliminate the entire farmer safety net.
2. This would also include the commodity programs and conservation based programs.
3. They argue the private insurance market would offer coverage.
4. Drought, especially in the Great Plains, will likely be difficult to insure privately.
5. In order for a private market to have any chance of working it would require Farmers to have no expectation of an Ad Hoc Disaster program, and that would mean no USDA county offices that could provide delivery.

Methods to Eliminate Private Crop Insurance Delivery either by Law, Regulation, SRA, or Rating & Underwriting

1. Cut the Demand
   a) Eliminate the HPO
   b) Means testing
   c) Added environmental regulations
   d) Caps on RMA's paid share of the premiums
   e) Payment limits
2. Cut the Supply
   a) Cut the A&O and in turn agent commissions causing a reduction in service.
   b) Cut the AIPs returns.
   c) Under rate the coverage
   d) Increase the administrative cost (common land unit)

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Consequences of replacing crop insurance with a standing disaster program or eliminating the farmer safety net

1. Eliminates the private crop insurance infrastructure.
2. A future Congress could eliminate support for an agricultural safety net and there would unlikely be a private crop insurance market alternative.
3. Unlikely that Congress will layoff USDA county employees and eliminate the farmer safety net, i.e. a "free" market.

Groups with a "dog in the fight"

1. Farmers, both large and small
2. Non-program crop farmers
3. Crop insurance agents
4. AIPs
5. Ag Lenders
6. Commodity brokers, equipment dealers, and other farm service providers.
7. USDA employees and their union
8. Tax payers

Crop Insurance does Not Guarantee Profits

1. There are no profit or income guarantees for:
   a) Farmers
   b) Agents
   c) AIPs
   d) Exception, USDA employees unless the farmer safety net were eliminated.
2. There is almost no possibility for farmers to generate windfall profits from crop insurance. It would require the APH to equal expected yield, a zero basis, no margin losses, contract cancelation penalties, or replacement of a feed supply. It would then require a price increase in the 20% to 25% range, something that has happened only a few times in the last 40 Years.

Will Any of these Cuts become Policy?

1. There currently is a strong coalition of Republicans and Democrats from farm states and districts supporting crop insurance. Clearly the coalition will need to hold together.
2. More likely it will require a member of Congress to put these cut(s) in some non-related Bill that will pass. This is why there is a $3 Billion cut to crop insurance in the recently passed budget. It would only take a few words in a Bill to eliminate the Harvest Price Option.
3. Most farmers are clearly supportive of private delivery of crop insurance. If agents continue to look after the customer, then it is unlikely that crop insurance will be eliminated.

Thank You

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