

June 1, 2009

The Honorable Tom Harkin, Chairman
Senate Committee on Agriculture
Nutrition and Forestry
328A Russell Senate Office Building
Washington, DC 20510

The Honorable Collin Peterson, Chairman
House Committee on Agriculture
1301 Longworth House Office Building
Washington, DC 20515

The Honorable Saxby Chambliss,
Ranking Member
Senate Committee on Agriculture
Nutrition and Forestry
328A Russell Senate Office Building
Washington, DC 20510

The Honorable Frank Lucas, Ranking Member
House Committee on Agriculture
1305 Longworth House Office Building
Washington, DC 20515

Dear Chairman Harkin, Chairman Peterson, Ranking Member Chambliss, Ranking Member Lucas:

We want to share our views on the state of the Federal crop insurance program in light of the impact on the agriculture and rural economies of the current global economic recession, and the relationship of these current economic events to the conclusions of the April 2009 Government Accountability Office (GAO) report—Crop Insurance: Opportunities Exist to Reduce the Costs of Administering the Program (# GAO-09-445)—and the May 13, 2009 congressional testimony of Secretary of Agriculture Tom Vilsack.

Although we have just received the GAO report and will have additional comments later, we note that a major concern of GAO—the amount of commissions paid to agents—has already been addressed. This GAO concern was first addressed by passage of the 2008 Farm Bill that included a 2.3 percentage point reduction in the A&O payment and 3 other factors which are used to pay agent commissions. The second development that addresses the GAO concern is the precipitous decline in commodity prices for 2009. Commodity prices were principally responsible for the 2008 increase in agent commissions. Regarding prices, the "base prices" for revenue polices are down 25 percent for corn (\$5.40 to \$4.04), down 34 percent for soybeans (\$13.36 to \$8.80), and down 44 percent for spring wheat (\$11.11 to \$6.20). These decreases will be reflected in agent commissions.

Crop insurance is successful, indispensable and working as Congress intended.

There is an unquestioned consensus in U.S. agriculture that crop insurance has evolved into a successful and indispensable program to protect farmers from market risks and natural disasters. Acres enrolled in the program have increased from 100 million in 1994 to 272 million in 2008, with the vast majority now protected at the higher levels of available coverage. The program simply would not have grown so successfully without the support of Congress and the private sector initiative and drive of the approved insurance companies and the tireless efforts of many thousands of dedicated crop insurance agents.

It is essential for a number of reasons, including consumer welfare, agricultural competitiveness, and national security, to keep the nation's crop insurance program strong, comprehensive, universally available, and effective so that it can continue to assist farmers and ranchers in dealing with risks and growing and remaining globally competitive. To achieve this objective, the industry is committed to working with the Federal government to address issues of risk management in order to ensure that American agriculture continues to have a successful and cost-efficient crop insurance program.

For American agriculture, the crop insurance program also helps farmers secure annual operating credit and execute effective marketing plans. Today, many farm banks are reporting lower earnings and significant erosion of loan quality, with non-performing assets up by more than 58 percent in the last year according to a May 2009 report by the American Bankers Association, and the U.S. Department of Agriculture (USDA) is reporting a significant decline in farmland values and an expected decline in farm income of 20 percent this year. With this in mind, there is as great a need as ever for an affordable, universally available crop insurance program like today's current Federal crop insurance program.

The last thing that should be done now is to penalize the crop insurance program at the suggestion of GAO, the Secretary of Agriculture or anyone else. Relative to many other sectors of the economy, the financial structure of American agriculture has remained strong during the current economic meltdown. It would be irresponsible to undercut the Federal crop insurance program at such a perilous economic time.

Crop insurance agents are especially vital, but they are only one part of a big, complex and successful program, and the agents' role varies from customer to company to region.

Agent commissions are just one component of today's successful crop insurance program. While agents are the face of crop insurance for farmers, crop insurance companies, reinsurance companies around the globe, loss adjusters, and federal employees work together every day to deliver unprecedented financial protection to U.S. agricultural producers. Over the past year, an estimated record-high \$8.6 billion have been paid to farmers to cover losses for the 2008/09 crop year.

Although the appropriate level of compensation of agents has been raised as a concern by GAO in its April 2009 report, historical data indicate that overall agent compensation has not been out of line with compensation paid in related insurance industries. The independent accounting firm Grant Thornton studied U.S. crop insurance program costs and concluded that the ratio of commission expenses to premiums in the crop insurance industry were below those in the overall property and casualty insurance industry in every year from 1992 through 2007 (the last year of available data).

In the insurance industry, it is a long-standing practice to pay agents—in crop insurance as well as other lines of insurance—based on the premium value of the policies they sell. This system is well known and accepted as a market-oriented means of determining agent commissions, which means some agents are paid more than others because they are more skillful in developing and servicing a client base for which companies are willing to bid more aggressively. This practice is no different in general effect than the practice any market oriented business adopts to best satisfy the most basic of all business goals—being successful in selling its product.

The method of paying crop insurance agents has proven over time to be simple to administer and fair, and it has provided the right incentives for program expansion.

- In recent years, sales of policies that insure crop revenues have increased, and their premium value depends importantly on market prices. The sharp increase in market prices, particularly in 2008, led to higher premium value and agent commissions.
- However, this increase is turning around in 2009 because of lower market prices for crops, more widespread use of premium discounts on the use of biotech seeds, and new premium discounts for aggregating insurable units of land (so-called "enterprise units").
- In fact, despite the prospect of reducing their own commissions, many agents have been recommending that their clients shift to enterprise units, as appropriate for their clients' risk management needs.

· It is also important to understand that last year's unusual increase in premiums and commissions was not seen by all agents, as the increases occurred in specific regions. The higher commodity prices were mainly for corn, soybeans, and wheat, which are not grown in many areas of the nation.

While the issue of compensation has been raised, there is no question about the undeniable integrity of the crop insurance program and its participants. The program is highly and effectively regulated by the Risk Management Agency and the Federal Crop Insurance Corporation. In addition, independent studies, such as one by Tarleton State University, have concluded that fraud and abuse are minimal and far below the levels in property and casualty insurance generally.

The Federal crop insurance program is not simple, is not operating on automatic pilot and is not excessively profitable.

In explaining the administration's proposals to reduce premium subsidies for farmers and cut underwriting gains for crop insurance companies to the House Agriculture Appropriations Subcommittee on Wednesday, May 13, 2009, Secretary of Agriculture Tom Vilsack noted that it is not as difficult today as in the past to get farmers to sign up for crop insurance because of the requirement to participate in order to be eligible for disaster assistance and due to bankers' requirements. He went on to say that the result is that private companies have seen a huge increase in their market and are making "a tremendous amount of profit" and that there needs to be "a fairer deal for taxpayers."

In fact, the increased participation by producers in crop insurance is the result of many years of joint government, congressional and industry efforts. There is no one factor that explains the rise in producer participation. One grower survey indicated that the top reasons why farmers buy crop insurance include cash flow protection, protection against weather disasters, lender requirements, and risk management. The price of insurance was also identified as a key reason. Affordable insurance, combined with the sustained efforts of agents to educate producers and work with them to tailor insurance to their individual needs, have been essential factors in the long-term increase in program participation. Adequate private sector delivery infrastructure, including a large agent force, industry computer systems and trained loss adjusters, has been required to achieve today's level of participation, and is a result of a sustained public-private partnership investment over the course of several administrations. Producers now have a diverse portfolio of risk management tools available through the crop insurance program. Reduced funding to companies will cause erosion in support services and infrastructure necessary to adequately and appropriately maintain the highly successful, but extremely complex, program, which will lead to a loss of farmer participation.

The crop insurance industry agrees that a fair deal between the taxpayers and the companies that deliver crop insurance is necessary and it believes that actions of Congress, the administration and the industry over the last almost 30 years have continuously evolved that goal. Over this time, payments for industry delivery costs have been reduced substantially, most recently as part of a 10-year \$6.4 billion reduction in crop insurance funding under the 2008 Farm Bill.

Adequate underwriting gains will be required to offset these reductions and to provide a reasonable rate of return on the investment of private capital to keep it at work in the crop insurance program. In recent years, company underwriting gains have been higher than expected, mainly due to generally good weather that has caused indemnities to be less than premiums. In good years, companies must build up reserves for the bad years that are expected to follow. USDA sets premium rates so that, on average, premiums equal indemnities. Since that has not been the case in recent years, there is every expectation that there will be excessive losses in years to come. As a result, returns to companies should be judged over a long period of years, not in a short period of years.

An independent accounting firm, Grant Thornton, reviewed crop insurance over the period 1992-2007 and concluded that the net income of crop insurance companies was less than that of property and casualty companies generally. Consequently, there is a concern that further reductions in returns to companies, as the administration has proposed, would increase the risk borne by the taxpayer in crop insurance, reduce the incentive for private insurance and reinsurance companies to participate in the crop insurance program, inhibit the buildup of necessary reserves to pay future claims, and lead to a reduction in service for farmers and ranchers across the nation over time, especially in areas with limited premium volume and high loss ratios.

In conclusion, we believe that today's crop insurance program is performing the way Congress intended, and that it has become the preeminent program to strengthen the risk management capability of U.S. farmers and ranchers. We want to be sure that short-term political objectives do not lead to undermining this critical long-term asset for farmers and ranchers.

Sincerely,

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Independent Insurance Agents & Brokers of America
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