# Who Is Best-Suited To Provide Crop Insurance?

***A New Report Looks At Ways To Reduce Subsidies Paid To Crop Insurance Companies.***

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A new report is likely to reignite the debate over who should deliver crop insurance policies to farmers and how those service providers should be compensated. Some say the federal government should stop paying so much in crop insurance subsidies, letting farmers and the crop insurance companies pick up more of the tab.

At the request of Rep. Henry Waxman (D-CA) and two other Congressmen, the Government Accountability Office (GAO) issued a report that echoes what many industry officials have admitted: "Crop Insurance: Opportunities Exist to Reduce the Costs of Administering the Program." Problem is, there is little agreement on exactly how the industry should cut costs, while continuing to deliver quality service across all 50 states and stay profitable.

Lawmakers took a shot at reducing costs in the 2008 Farm Bill, by reducing the Administrative and Operating (A & O) allowance rate paid to companies by 2.3 percent in 2009. USDA's Risk Management Agency (RMA) pays insurance companies a percentage of the premiums on policies sold to cover the A&O expenses of selling and servicing these policies.

But the 2008 Farm Bill also repealed a controversial provision that would have allowed companies to cut A & O expenses even more by offering "premium reduction plans." Several firms, as well as state insurance regulators, had complained that this amounted to rebating – a practice generally prohibited in most states – and the provision was dropped.

**Mixed messages**

At various times, Congress seems to be sending mixed messages. On one hand, lawmakers encouraged crop insurance companies to sell more policies at a higher coverage levels. In 2000, companies provided about $36 billion in coverage on 211 million acres. By 2008, the crop insurance program provided about $90 billion in insurance coverage for 272 million acres," according to GAO.

Three things occurred as a result of this effort to provide more crop insurance coverage, explains Keith Collins, former USDA Chief Economist and former head of the Federal Crop Insurance Corporation, who now consults for the crop insurance industry.

"Companies and agents aggressively went after more business and now find it hard to sell much more. Substantially more farmers buy at the higher coverage level. And revenue-based policies that didn't really exist a decade ago, became increasingly popular."

**Higher crop prices impact fees**

While the 2008 Farm Bill reduced the A&O allowance rate, the total sum of the allowances increased last year because they are calculated as a percentage of insurance premiums, So when crop prices rise and the value of policies increase, so do the allowances.

In response to last year's rising crop prices, A&O allowances increased from about $960 million in 2006 to about $2 billion in 2008 .Insurance companies used a large share of this increase to compete for more business. As a result many of the companies paid higher commissions to the nation's 12,000 crop insurance agents.

Why are agents so important? GAO explained that, because RMA sets the premiums for crop insurance policies, companies cannot compete by reducing premiums. Nor do they often have the opportunity to insure new crop acres or sell more policies overall. Thus, one of the key ways for companies to increase their market share is to draw insurance agencies (and their books of business) away from competing companies by raising the agencies' commission rates

In addition, company officials told GAO that some insurance agencies have considerable leverage in negotiating with companies for sales commissions because these insurance agencies have long-standing relationships with farmers whose crop insurance policies have historically produced high underwriting gains.

"Thus, companies compete against one another, offering higher and higher commissions until the increase in A&O allowances is exhausted. Insurance agencies have benefited from the increases in A&O allowances without selling more policies," according to GAO's report.

In a letter to the House and Senate Agriculture Committee Chairmen on June 1, some of the nation's leading crop insurance companies responded to the GAO report.

"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."

**Search for solutions**

In previous reports, GAO recommended that Congress authorize RMA to renegotiate its agreement with the companies that sell and service crop insurance policies. That process is set to officially begin next year.

The 2008 Farm Bill also directed RMA to consider alternative methods for determining A&O payment rates, including paying companies a flat fee per policy and a lower percentage of the premium on the policy.

GAO also noted that USDA's Farm Service Agency had administered a type of crop insurance – catastrophic insurance (CAT) – at a lower cost to the government than did private insurance companies. Even though few farmers currently buy CAT coverage, some folks fear that the Obama Administration may try to revisit this concept and require the federal government to play a bigger role in risk management.

In the short term, the folks at RMA seemed to agree with some of the GAO recommendations, such as the need to evaluate potential alternatives for calculating the A & O to "appropriately reimburse firms for services performed" – regardless of wild crop price swings.

Despite the drop in agent commissions and commodity prices, this issue won't be going away soon. Given the huge federal deficit, lawmakers will be looking at every way possible to cut costs in farm programs.

"We can all agree that there should be ways to more efficiently deliver crop insurance," says one crop insurance industry insider. "But when you look at all of the current rules and regulations imposed by the federal government, and the economics involved, getting consensus among the providers is much more difficult. Just because there are a few concerns doesn't mean we should throw the baby out with the bathwater." Δ

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