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GENERAL ACCOUNTING OFFICE WASHINGTON DC COMMUNITY AN--ETC F/6 5/1
ANALYSIS OF CERTAIN OPERATIONS OF THE FEDERAL CROP INSURANCE CO--ETC(U)
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BY THE U.S. GENERAL ACCOUNTING OFFICE
Report To The Honorable Roger W. Jepsen
United States Senate

① LEVEL II

⑥ Analysis of Certain Operations of The
Federal Crop Insurance Corporation.

The law authorizing the Federal Crop Insurance Corporation was amended in 1980 to encourage greater involvement by the private insurance industry in the Federal program to protect agricultural producers from losses caused by unavoidable natural hazards. GAO's review found that:

- Premiums for crop year 1981 will be about \$327 million, compared to \$157 million in 1980. The number of acres insured increased from about 26.3 million to 47.7 million.
- The Corporation has not yet increased its premium rates to reflect 1980 crop losses.
- The Corporation conducted a nationwide campaign to inform producers about the crop insurance program, including coverage against hail and fire.

Some insurance companies are hesitant to participate in the program because they believe they would be considered Federal contractors and thus subject to Federal equal employment opportunity regulations. A decision by the Department of Labor is pending.

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UNITED STATES GENERAL ACCOUNTING OFFICE

WASHINGTON, D.C. 20548

July 30, 1981

COMMUNITY AND ECONOMIC
DEVELOPMENT DIVISION

B-204183

The Honorable Roger W. Jepsen
United States Senate

Dear Senator Jepsen:

Based on your June 5, 1981, request and subsequent discussions with your office, we reviewed certain operations of the Federal Crop Insurance Corporation (FCIC). In addition to responding to your specific questions, this report provides background information on the insurance program administered by FCIC.

In summary, we found that:

- Because of FCIC's normal lag in adjusting premium rates and its decision to concentrate its staff resources on expanding program coverage, FCIC has not made extensive changes in its premium rates since the passage of the 1980 amendment. As a result, the significant losses which occurred in crop year 1980 have not yet been reflected in FCIC's premium rates. These losses are to be reflected in the premium rates beginning in crop year 1983.
- FCIC's methodology in assembling and updating data for establishing an actuarial basis for insurance has not changed since the passage of the 1980 amendment. However, FCIC has established a committee to review the methodology.
- Whereas 30 private insurance companies initially indicated an interest, 19 entered into reinsurance agreements for crop year 1981, with 17 companies writing policies resulting in about \$13 million worth of premiums (about 4 percent of the total); the other two did not issue any policies for crop year 1981. Six other companies entered into an Agency Sales and Service Agreement (non-risk bearing) and wrote policies amounting to about \$900,000 in premiums. The primary reasons for those companies initially indicating an interest but not participating were the lack of time to implement the program for 1981 and the concern over whether companies that write FCIC insurance would be considered Federal contractors, and thus be subject to Executive Order 11246 which deals with equal employment opportunity. The Department of Agriculture has

asked for a legal opinion from the Department of Labor as to whether reinsured companies have to comply with the requirement of the Executive order, but a decision is still pending.

--FCIC conducted a promotional campaign to inform producers across the country about the Federal crop insurance program, including the availability of private hail and fire insurance and the credit permitted when hail and fire coverage is excluded from FCIC coverage. Preliminary data shows that, of 497,336 policies, the producers have applied to exclude hail and fire from FCIC coverage on only 3,125. However, because the producer has until harvest time to make an election, these statistics could change substantially.

--FCIC estimates that total costs for fiscal year 1981 will amount to \$333 million. This amount includes the estimated net deficit (indemnities less premium) of \$203 million for crop year 1980.

--Preliminary data shows that premiums for crop year 1981 will be about \$326.5 million as compared with \$157.2 million for 1980, or about a 108-percent increase. Similarly, the number of acres insured increased from about 26.3 million to 47.7 million, or about 81 percent.

These matters are discussed in more detail in appendix I.

We made our review primarily at FCIC's Actuarial Division, National Service Office, and other FCIC offices in Kansas City, Missouri. Various information was also obtained at the corporate headquarters in Washington, D.C. We reviewed laws, regulations, documents, and data pertaining to the crop insurance program and interviewed Federal officials. Because of the short time for completing our review, we relied extensively on the Corporation's records.

At your request we did not take the additional time to obtain agency comments on matters discussed in this report.

B-204183

As arranged with your office, unless you publicly announce its contents earlier, we plan no further distribution of this report until 2 days from its issue date. At that time, we will send copies to interested parties and make copies available to others upon request.

Sincerely yours,

Henry Eschwege

Henry Eschwege
Director

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ABBREVIATIONS

ASCS	Agricultural Stabilization and Conservation Service
CCC	Commodity Credit Corporation
FCIC	Federal Crop Insurance Corporation
GAO	General Accounting Office
USDA	U.S. Department of Agriculture

ANALYSIS OF CERTAIN ASPECTS OFTHE FEDERAL CROP INSURANCE CORPORATIONADMINISTRATION OF THE CROP INSURANCE PROGRAM

FCIC is a wholly owned Government corporation created February 16, 1938 (7 U.S.C. 1501), as an agency of the U.S. Department of Agriculture (USDA). The act has been amended by Public Law 96-365, approved September 26, 1980, to provide for nationwide expansion of an all-risk crop insurance program. FCIC's purpose is to promote the national welfare by improving the economic stability of agriculture through a sound system of crop insurance.

The amendment provides for an actuarially sound cost-sharing insurance program for agricultural producers to protect their production investment against essentially all unavoidable risks. In fiscal year 1982 USDA appropriations hearings, FCIC stated this program is to become the primary Federal disaster protection for farmers and eventually "* * * replace the many overlapping and conflicting farm disaster programs now in existence." They said that "these programs are costly and do not provide a fair and equitable program that farmers can depend on when disaster strikes."

Some of the principal changes mandated by the new legislation provided that the Corporation's Board of Directors would:

- To the maximum extent possible, use the private sector to sell and service crop insurance.
- Use the resources, data, boards, and committees of the Soil Conservation Service, the Forest Service, the Agricultural Stabilization and Conservation Service (ASCS), and other Federal agencies in assembling and developing actuarial data.
- Provide different coverage levels up to 75 percent of protection against loss in yields and to offer various levels of price elections with one not being less than 90 percent of the projected market price for the commodity involved.
- Develop insurance premium rates that are actuarially sufficient to cover claims for losses and to establish a reasonable reserve against unforeseen losses.
- Allow the producer to delete hail and fire coverage from the Corporation's policy (with a corresponding reduction in the premium) when he/she obtains at least equal coverage from a private insurer.

- Encourage the broadest possible participation in the program by having the Corporation pay 30 percent of each producer's premium up to a maximum of 65 percent of the recorded or appraised average yield. However, producers of crops covered by the "low yield" disaster payment program ^{1/} for 1981 are not eligible for the 30 percent reduction, if they elect to participate in the disaster payment program.
- Provide for a test program of reinsurance (whereby part or all of the risk is transferred from one party to another), to the maximum extent possible, to begin not later than with the 1982 crops.
- Beginning in the 1981 crop year and ending after the 1985 crop year, conduct a pilot program of individual risk underwriting of crop insurance in not less than 25 counties. This program allows purchasers of FCIC insurance to obtain an increase in the coverage offered based on his/her actual yield history.

Major activities

The Federal Crop Insurance program comprises the following major activities: (1) underwriting, actuarial, and program development, involving the development of crop insurance programs and the establishment and maintenance of rates and coverages for crops in each county, (2) marketing and collections, covering all aspects of marketing, including the development of marketing policies and programs, and the collection of premiums, and (3) contract servicing and claims, which includes servicing the insurance contracts, inspecting crops, and adjusting losses.

Insurance coverage

The crop insurance FCIC offers to agricultural producers provides protection from losses caused by unavoidable natural hazards, such as insects, plant diseases, fire, hail, drought, excessive moisture, freeze, wind, and other weather conditions. It does not insure profit for the farmer nor cover avoidable losses resulting from negligence or failure to observe good farming practices.

The 1981 crop insurance program is operating in 1,928 counties. Insurance coverage is being provided on almonds, apples,

^{1/}This program provides payments to producers for six crops--wheat, grain sorghum, cotton, rice, barley, and corn--because of low yield due to unforeseen weather conditions. It expires at the end of crop year 1981.

barley, beans, citrus, corn, cotton, flax, forage production, forage seeding, grain sorghum, grapes, oats, peaches, peanuts, peas, potatoes, raisins, rice, rye, soybeans, sugar beets, sugarcane, sunflowers, sweet corn, tobacco, tomatoes, and wheat. As of June 1981, about 48 million acres were insured for crop year 1981.

General administration

The insurance programs for the various crops are planned, developed, and monitored by the FCIC headquarters offices in Washington, D.C., and Kansas City, Missouri. The program is administered in the field through 18 regional offices and 10 field underwriting offices. In the past, FCIC employees (mostly part-time), a limited number of FCIC field offices, and a limited number of commissioned agents have sold or serviced the insurance at the county level. Under new legislation effective with crop year 1981, ¹/ this will be done primarily by licensed private insurance agents, private insurance companies, and other existing USDA county offices. The adjustment of losses will continue to be done primarily by FCIC employees or by adjusters under contract to FCIC.

The National Service Office in Kansas City processes insurance documents; records the detailed accounting and statistical data; and prepares the required accounting, statistical, and management reports. This function is essentially automated. As of June 30, 1981, FCIC had about 1,680 paid employees with 649 being permanent full-time and virtually all of the others being "when actually employed" employees.

OBJECTIVES, SCOPE, AND METHODOLOGY

On the basis of Senator Jepsen's request dated June 5, 1981, and subsequent discussions with his office, we inquired into and obtained information on:

- The extent to which premiums were increased for crop year 1981 and FCIC's plans for evaluating the need for future adjustments in the rates.
- How FCIC assembles and updates data for the purpose of establishing a sound actuarial basis for the program and whether FCIC has made any principal changes in actuarial methodology since October 1, 1980.

¹/Generally crop year means the period within which the insured crop is normally planted and harvested. It is designated by reference to the calendar year of normal harvest.

- Efforts FCIC has undertaken to make insurance companies aware of the reinsurance program, the extent of efforts to encourage participation, and the reasons for non-participation.
- Efforts FCIC has undertaken to advise purchasers of Federal crop insurance of the availability of private hail and fire insurance and the credit permitted where hail coverage is excluded from FCIC coverage and the extent to which purchasers have elected to exclude hail and fire coverage from FCIC coverage.
- Total estimated costs (net of premium income) to the Federal Government for crop year 1980.
- Comparison of participation in FCIC program before and after the new legislation's effective date.

We made our review primarily at FCIC's Actuarial Division, National Service Office, and at other FCIC offices in Kansas City. We obtained data on FCIC's efforts to advise purchasers of the hail and fire exclusion provisions at FCIC headquarters in Washington, D.C.

Because of the time constraints, we relied heavily on agency records and interviews with knowledgeable officials at the Kansas City offices. We did not contact any agricultural producers, purchasers of FCIC insurance, or private insurance companies to obtain their views on the different program aspects.

NO EXTENSIVE EFFORT MADE TO
INCREASE PREMIUM RATES

FCIC has not undertaken any extensive effort to adjust its overall premium rates since the passage of the 1980 act, although it has continued to adjust county and individual rates on a case-by-case basis. With a 2-year processing period, the crop year 1980 loss experience would normally have been reflected in overall premium rates starting in crop year 1982. However, due to FCIC's decision to concentrate its staff resources on expanding program coverage to more counties and more crops, FCIC will not start incorporating, to any great extent, crop year 1980 loss experience into premium rates until crop year 1983. Also, because FCIC adjusts the rates on only about a third of the program crops each year, the adjustments of the crop year 1980 loss experience probably will not be completed until crop year 1985.

When FCIC updates its coverages and premium rates, the data used is about 2 years old. For example, the 1980 loss experience would normally have been evaluated during crop year 1981 for changes in 1982 rates. The Acting Director, Actuarial Division,

said that this 2-year lag is necessary to complete accumulating the data, evaluating the experience, and processing the needed changes.

Examples of the processing times needed to incorporate current yield and insurance experience are shown in appendix II. For winter wheat in Kansas, for example, the accumulation of crop year 1980 experience was not completed until about October 1980, whereas the ending sales date for crop year 1981 insurance was in August 1980. Thus, FCIC could not incorporate crop year 1980 experience into crop year 1981 premium rates.

Furthermore, because FCIC updates its premium rates on a rotational basis, adjustments for all crops normally take 3 years to complete. The Acting Director, Actuarial Division, said that management annually decides which crops need to have their rates updated; however, such revisions are on a rotational basis. This rotation results in the rates on each crop being updated about every third year. Accordingly, crop year 1980 experience, which will be incorporated into premium rates beginning essentially with crop year 1983, should be completed by crop year 1985.

Although major revisions have not been made in the overall premium rates, adjustments have been made in some county and individual premium rates. FCIC's field underwriting offices regularly review individual and county rate structures, especially those with extremely bad loss experience. In hearings on USDA's appropriation for fiscal year 1982, an FCIC official testified that these underwriters have in past years reviewed about 20 percent of the county programs each year. Each county program also receives a cursory annual review. Needed changes identified through these reviews are made.

Also, all FCIC policies have individual premium adjustment tables that provide for increases in premiums for poor insuring experience and premium discounts for favorable insuring experience. These automatic adjustments have continued to be made.

Determination of premium changes for crop year 1981

After being advised that no extensive changes were made in premium rates for crop year 1981, we made a cursory review of 16 county files for three crops--soybeans, grain sorghum, and corn. None of the 16 files had been updated, and thus no changes in premium rates were made between crop years 1980 and 1981, although many had a high loss ratio for crop year 1980.

Although FCIC did no major updating for crop year 1981, it had updated the rates for the sugar beet program in California, the tobacco flue cured-poundage quota program, and the wheat program in certain counties. The California sugar beet program was

updated because the program had not been updated since 1974. We reviewed files in 14 county sugar beet programs. In 13 counties the updating resulted in a decrease in premium rates; in the other county the premium rates did not change. For example the countywide rate for Monterey County was \$4.98 per acre for crop year 1980; after the updating, it decreased to \$4.61 per acre for crop year 1981. Monterey County's sugar beet program, started in 1978, had a cumulative loss ratio of zero through crop year 1980.

METHODOLOGY FOR ESTABLISHING ACTUARIAL BASIS REMAINS UNCHANGED

FCIC has not changed its basic actuarial methodology since the passage of the 1980 act nor are any changes in its basic methodology imminent. However, FCIC is using an alternative procedure to determine crop yields in some counties into which the program is being expanded. Also, it has established a rate evaluation committee to review the current actuarial methodology. This committee is composed of representatives from industry and academia as well as from FCIC's actuarial and marketing areas.

The 1980 act provided that FCIC establish a pilot program for individualizing its insurance program. To fulfill this mandate, FCIC is developing an "Individual Yield Coverage" program to be initiated for crop year 1982.

Actuarially sound program

The act provides that FCIC will

"* * * fix adequate premiums for insurance at such rates as the Board deems actuarially sufficient to cover claims for losses on such insurance and to establish as expeditiously as possible a reasonable reserve against unforeseen losses."

Prior legislation contained basically the same wording except the term "actuarially." Like the prior FCIC legislation, the 1980 act provides that the FCIC's administrative and operating expenses are to be provided by appropriated funds.

We did not analyze FCIC's program to determine whether it was actuarially sound. During House of Representatives appropriations hearings on USDA's 1982 budget, however, FCIC officials testified that, within the sense of the act, the program is sound. According to the officials, this meant that although private industry sets premium rates sufficient to cover administrative and operating costs, FCIC's premium rates do not cover its administrative and operating expenses, which are to be provided by appropriated funds.

Assembling and updating
actuarial data

FCIC's Actuarial Division is responsible for implementing an actuarially sound program. This includes program development, county coverage and rate determination, county and rate distribution, and a periodic updating of the program.

Program development

Based on interest by some party outside FCIC, the Actuarial Division begins investigating the possibility of developing the specific crop insurance program. This research includes determining the crop's economic importance, whether sufficient reliable historical yield and market data is available, which crop losses are avoidable and which are beyond the producers' control, and whether the program is marketable and could be effectively and economically administered.

Based upon its preliminary review, the Division recommends to FCIC's Board of Directors whether the crop insurance program is warranted and feasible. The Board's approval is dependent upon whether the crop can be precisely defined (navel oranges versus just oranges, nonpareil almonds versus peerless almonds, etc.), is of sufficient economic importance and interest, and has sufficient historical data available; whether the causes of losses are insurable; and whether the program is marketable and can be administered. If the Board approves the program, the Division continues its research in order to develop the specific provisions to be contained in the insurance policy.

The Actuarial Division then starts development of the provisions to be included in the insurance contract. This includes developing a precise definition of the crop, identifying farming practices which substantially affect yield, determining generally accepted management practices, and developing information on the insurable causes of losses. Provisions which affect the method of loss calculations are also further refined and contract language developed. Factors considered include the level of coverage and price elections to be offered, how quantity of crop yield will be measured and what standards the crop will be measured against, and whether coverage will be based on a quantity production guarantee or amount of insurance in dollar terms.

County coverage and
rate determination

The Actuarial Division establishes countywide coverages and premium rates for each insured crop in each county. For the county coverage, it obtains and reviews yield data from processors and USDA's Economics, Statistics, and Cooperatives Service.

It validates this data as to its reasonableness, accuracy, and whether it is representative of local conditions and practices.

The Division determines average county rates by calculating the probability of loss at various levels of coverages through reviews of historical data showing frequency, severity, and amount of past losses. The expected amount of loss for quality adjustments and identification of major perils and expected loss from each is also determined. It compares rates in adjoining counties for comparability and the relationship of rates between crops with similar risk characteristics. The countywide coverage and rates are then provided to the responsible field underwriting offices who distribute them throughout each county.

Coverage and rate distribution

The distribution of coverages and rates within a county is based on an analysis of the basic productivity of the land as indicated by soil composition, topography, climate, and yield data; pattern and consistency of weather factors, such as rainfall, heat, cold, and hail; improvements made to the land; capital investments made by farmers in facilities and equipment; farming practices; farmers' skill and industry; variations between farming operations and various geographical areas in the county; available yield data; and any available FCIC insurance experience.

The field underwriting offices identify inequitable distribution, including overinsured producers, overinsured geographical areas in a county, and excessive risk situations. It prepares a county summary of the coverages, premium rates and prices, and county actuarial tables. The county actuarial tables are then finalized and posted in each county.

Updating insurance programs

The Actuarial Division updates crop insurance contracts as needed through a process similar to its procedures for program development. It makes annual reviews of its insurance experience and periodically updates the countywide coverages and rates. These periodic updates, which are performed approximately every 3 years, are dependent upon experience, yield trends, and policy changes with the rates being adjusted on the basis of the insurance experience.

The field underwriting offices also make detailed reworks (reviews) on approximately 20 percent of the insured counties annually. These reworks include a detailed analysis of the counties' insurance experience, a correlation of FCIC experience and yield data, and a review of the insurance policy and administrative procedures. Through this detailed rework, the office

recommends needed policy changes and makes appropriate adjustments to the counties' coverages and rates.

Program development
for expansion program

In crop year 1981, FCIC began a vast expansion program. The criterion FCIC uses in selecting expansion counties is whether the county has substantial plantings of disaster program crops. This program is to eventually encompass all commercial crops grown in the United States where actuarial data can be obtained in sufficient quantity to provide an insurance program.

Initial efforts are being made to expand the coverage on 18 major crops, including the six disaster crops involved in the current disaster program administered by ASCS. In crop year 1981, FCIC expanded its coverage by 1,340 additional county programs ^{1/} to 252 additional counties. As of July 14, 1981, FCIC had added 8,278 county programs and 1,050 counties for crop year 1982. See appendix III for actual and planned expansion for crop years 1979-82.

The basic criteria provided by FCIC in the 1982 appropriation hearings were:

1. The importance of the crop in terms of acreage, number of producers, and the crop's contribution to the county's total income from agriculture.
2. The interest exhibited by farmers, credit agencies, and others in insurance being made available in the county.
3. Whether sufficient and reliable actuarial data is available for establishing sound coverages and rates and measuring of the risk factors involved.
4. The time required to develop a sound actuarial structure for the county.
5. The county's location in relation to existing insurance counties and FCIC field offices.
6. The availability of funds for setting up and administering the program.

With the free low-yield disaster payment program expiring after crop year 1981, FCIC is expanding its program coverage to

^{1/}All insurable acres of a crop in a county represent one county program.

include those counties having substantial plantings of disaster program crops. The Acting Director, Actuarial Division, said that the 252 new counties added for crop year 1981 and the 1,050 new counties added for crop year 1982 all had plantings of disaster program crops. Although these counties were added because of the disaster program crops, FCIC has also added coverage for some nondisaster program crops in these counties. For example, for crop year 1982, FCIC is expanding its coverage to 8,778 new county crop programs in the 1,050 new counties. Of this total, 7,816 are being added for disaster program crops while 462 are being added for nondisaster program crops.

The Acting Director, Actuarial Division, stated that once coverage for the disaster program crops is obtained, the Corporation will revert to the established criteria for selecting expansion counties.

Alternative procedures used to determine yield data

Although FCIC has not made any changes in its basic methodology, it is making adjustments in its procedures due to a lack of available yield data. Some of the counties for which FCIC is adding coverage lack sufficient yield data for FCIC to utilize in determining premium rates. Instead of using yield data for these counties, FCIC is using an adjoining county's yield data or a districtwide average yield. After computing the countywide rate, FCIC underwriters analyze the yield data to ensure that it represents the expansion county.

Personalized crop insurance program

A pilot program of personalized crop insurance that FCIC began in crop year 1978 is being deemphasized and scheduled to be phased out by the end of 1981. With the 1980 act's mandate that FCIC pilot test an individualized program, FCIC is replacing the existing pilot program with the "Individual Yield Coverage" program.

In a December 1977 report ^{1/} to the Congress, we recommended that the Secretary of Agriculture and FCIC's Board of Directors develop a personalized crop insurance program with both production guarantees and premiums based on each producer's history of yields. In commenting on that report, FCIC's manager concurred in the principles of personalizing insurance premiums and guarantees. For crop year 1978, FCIC initiated a pilot program in 20

^{1/}"The Federal Crop Insurance Program Can Be Made More Effective" (FOD-77-7, Dec. 13, 1977).

counties. This was later expanded to 40 counties for crop year 1979.

This program was to test the capability of the ASCS county offices to sell insurance, provide more personalized coverage distribution, and administer the crop insurance program (excluding loss adjustments). According to the Executive Assistant to the Manager, FCIC, the ASCS county offices were providing a total insurance delivery program, with the county committee being used to index farmers into groups. Individual farmers' records were generally not validated.

The primary reasons for phasing out this pilot program were (1) FCIC's belief that the program would not get high participation, (2) the change in emphasis in the 1980 act from a public agency delivery to a private insurance delivery, and (3) a basic difference in the philosophies of ASCS, which usually provides emergency-type disaster coverage, and FCIC, which provides insurance coverage.

The 1980 act provided that FCIC establish a pilot program for individualizing its insurance program. To fulfill this mandate, FCIC is developing this program, to be initiated for crop year 1982, to provide a method by which an insured may obtain coverage based on individual yield data. The pilot program initially is to cover just the spring-planted disaster crops and soybeans.

According to FCIC, this program is to draw upon individual farmer records for yields, using the ASCS county offices to validate the individual's yields. Private insurance agents sell and service the insurance. This program also eliminates the ASCS county committees' grouping of individual farmers.

FEW COMPANIES PARTICIPATING IN THE REINSURANCE PROGRAM

In anticipation of the 1980 act, FCIC began holding meetings with the crop hail insurance industry in late 1979 and early 1980 about the potential role of private industry. These discussions covered many facets but focused primarily on developing a viable reinsurance program. 1/ As the legislation moved toward enactment, the discussions focused more on reinsurance agreements. FCIC and the industry made numerous analyses regarding potential terms. The 1980 act, as it was finally passed, mandates that FCIC provide reinsurance to writers of multiple-peril crop

1/Reinsurance is the term used to describe when the first insurer protects himself by transferring all or part of the risk to another insurer.

insurance to the maximum extent practicable, with a test program of reinsurance to be initiated not later than the 1982 crop year.

With the act's passage, a major effort was made by FCIC and various insurance associations to inform all companies about the potential for reinsurance for 1981. For example, during the period November 10-20, 1980, the National Crop Insurance Association, the Crop-Hail Insurance Actuarial Association, and FCIC co-sponsored eight 1-1/2-day meetings across the country to familiarize all interested companies' field personnel with the new comprehensive crop insurance program.

The new act, which became effective October 1, 1980, was passed too late for reinsurance of winter-planted 1981 crops, as the sales closing date for these crops had already passed. In addition, implementation of the 1980 act became more difficult when appropriations for expanding the program were not forthcoming. This budget problem was especially critical to decisions on reinsurance, as the reimbursement of the companies for their administrative and operating expenses depended on appropriations.

Following numerous discussions internally and with industry leaders, FCIC decided in late December 1980 to put in place a limited reinsurance program for the 1981 spring crops. This limited venture would give FCIC some experience in operating such a program and give the participating companies a year to learn the workings of the all-risk business before a more substantial expansion for 1982.

FCIC's plan was to commit up to \$8 million in funding toward reinsurance for crop year 1981. This funding level would support about \$30 million in premiums generated through reinsured companies. FCIC expected that only 10 to 15 companies would be interested in reinsurance for 1981 because of the limited time available to put an all-risk program in place following the late December 1980 decision and the estimated April 30, 1981, sales closing date for spring crops.

On January 5, 1981, FCIC's offer to provide reinsurance for writers of multiple-peril crop insurance was announced in the Federal Register. This announcement set out the method to be followed in submitting an application, the review process, entering into agreement, and the notice of the amount of book premium ^{1/} allocated to each accepted company. The deadline for submitting

^{1/}Book premium represents the portion paid by the producer and the 30 percent subsidy paid by FCIC for each eligible producer.

an application was set for January 20, 1981, and FCIC was to notify those companies accepted of their allocation of book premium by February 5, 1981. Both of these dates were extended, and most of the reinsurance agreements were not finalized until late February to mid-March 1981. Consequently, the reinsured companies had only about 6 to 8 weeks to put an all-risk program in place before the sales period for spring crops closed.

Once the decision to offer reinsurance for 1981 was announced, the mailing lists of the insurance and actuarial associations mentioned earlier were used to provide materials describing and announcing the terms of reinsurance to those listed. According to FCIC's Reinsurance Coordinator, one list included 355 names representing 99 companies, groups, or insurance management organizations and seven crop insurance trade organizations and associations. The other list included 155 names that this official believes to encompass companies writing about 99 percent of hail insurance premiums.

Extent of participation for 1981

A total of 30 private insurance companies submitted applications for the reinsurance program for crop year 1981. Of these, 19 signed reinsurance agreements with FCIC. Of the 19, 17 wrote policies resulting in about \$13 million worth of estimated book premiums, which represents about 4 percent of the total estimated premiums written for crop year 1981. The other two chose not to write any premiums.

According to the Reinsurance Coordinator and those companies submitting applications but withdrawing, the primary reasons for not participating were the lack of sufficient time to implement the program for 1981 and a concern about whether reinsured companies would be considered Federal contractors and thus be required to comply with the provisions of Executive Order 11246. ^{1/} In addition, several companies indicated that the amount of book premiums allocated to them was too low to make the program economically feasible. However, according to the Reinsurance Coordinator, the premium allocation to each company was negotiable and had been increased for some companies.

In addition to the companies entering into reinsurance agreements, another six companies--two of which had initially submitted applications for reinsurance--entered into Agency Sales and Service Agreements which are non-risk bearing. These companies wrote

^{1/}Executive Order 11246 entitled "Equal Employment Opportunity" provides for equal opportunity in Federal employment and requires that Federal contractors adhere to the provisions of the order.

policies amounting to an estimated \$900,000 in book premiums for crop year 1981.

Status of reinsurance program for 1982

For crop year 1982, FCIC made several revisions to the reinsurance program including (1) increasing the total book premium that reinsured companies can write from \$30 million to \$250 million, (2) increasing the maximum amount of annual profit (premiums less claims) from 5 to 8 percent, and (3) decreasing the maximum amount of loss that a company can bear from 8-1/2 percent to 8 percent. These amounts do not include additional distribution of any profit remaining at the end of a 5-year period.

In response to the insurance companies' concern, USDA's Office of General Counsel submitted a letter to the Department of Labor's Solicitor on June 4, 1981, requesting a determination as to whether a reinsured company would be considered a Federal contractor. FCIC believes that the reinsurance agreement is not a Government contract and therefore reinsured companies are not subject to the Executive order because the insurance does not involve the provision of goods and services to the Government. Because a number of insurers are apparently refraining from participating in the reinsurance program pending a determination, USDA asked that the matter be resolved as soon as possible. As of July 10, 1981, USDA had not received a response.

Although the initial cutoff for applications and amendments for reinsurance in crop year 1982 was June 26, 1981, this date was extended to mid-July. As of July 10, 1981, FCIC had received 23 applications from companies that did not participate in 1981. Of the 19 companies that had signed agreements for 1981, 10 had submitted the required amendment for 1982. According to the Reinsurance Coordinator, a total of about 40 companies will participate in 1982. He indicated that all companies participating in 1981 will continue for 1982 and that the delay in submitting amendments was due to the lack of a determination on the applicability of the Executive order.

In addition, FCIC had received 24 applications for Agency Sales and Service Agreements by July 10, 1981. Two of the 24 applicants had agreements for 1981. According to the Deputy Assistant to the Manager, FCIC expects to receive about 20 more such applications for 1982.

PROMOTIONAL CAMPAIGN ESTABLISHED TO ADVISE
PRODUCERS OF HAIL AND FIRE ELECTION
AND CREDIT ALLOWED

Since passage of the 1980 act, FCIC's efforts to inform producers of the new insurance program have included direct mailings to producers of disaster program crops and to FCIC policyholders;

national and local news releases; feature stories in national magazines; an advertising program in all major farm magazines, including most State publications, backed by a 14-week radio campaign; publication of several brochures; and formal training programs for independent agents, officials in reinsured companies, and FCIC employees. As discussed below, much of this material included reference to the hail and fire exclusion and the credit permitted when such coverage is excluded from FCIC coverage.

Although these efforts have been substantial, it is too early to determine the extent to which producers will elect to exclude hail and fire coverage from the FCIC coverage because producers will have until harvest time to make this election. Preliminary data shows that producers have submitted applications to exclude hail and fire coverage from FCIC coverage on only 3,125 of 497,336 policies.

The direct mailing to about 3.5 million producers of the six disaster program crops covered only the producers' options to either retain their full eligibility under the ASCS disaster provisions or to forfeit their eligibility and receive a 30-percent discount on FCIC's premium.

However, many of the other publications, including the direct mailing to about 200,000 FCIC policyholders, specifically pointed out the hail and fire exclusion and the credit permitted. For example, the letter to the FCIC policyholders said:

"The Federal Crop Insurance Act of 1980 includes a provision which allows, if you desire, to delete from any Federal Crop Insurance Corporation (FCIC) crop policy(ies) the protection against losses caused by hail and fire, and to obtain hail and fire insurance from a private insurer.

"In order to exclude coverage for hail and fire on any crop(s), substitute coverage must at least equal the dollar amount of protection provided by your FCIC policy for such crop(s). Your FCIC premium for such crop(s) will be reduced by not less than 15 percent nor more than 30 percent. The reduction in premiums shall not exceed the hail and fire premium for the substitute coverage. * * *

Some of the agricultural publications that included specific information on the hail and fire exclusion and the credit permitted are as follows.

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<u>Publication</u>	<u>Title of article</u>	<u>Date published</u>
Farm Industry News--South	"More Crop Insurance for Less Money"	1/81
Farm Industry News--Midwest	"More Crop Insurance for Less Money"	1/81
Agri-Finance	"Answers to Your Questions on the New Federal Crop Insurance"	1/81
Farm Money Management	"New Crop Insurance Plan Expands Coverage, Cuts Program"	1st Qtr 1981
Illinois Prairie Farmer	"Questions and Answers About the New Crop Insurance Program"	2/81
Indiana Prairie Farmer	"Questions and Answers About the New Crop Insurance Program"	2/81
Pennsylvania Farmer	"Federal Crop Insurance Goes Nationwide"	1/81

Many of the above publications included the following or similar comments relating to the hail insurance option.

"If hail is a concern in your area, you may want to take a close look at a fine print provision. It gives you the option of replacing the hail and fire loss coverage of your FCIC policy with an equal or larger amount of hail and fire insurance written by a private insurance company - in which case a part or all of the premium you pay for the private insurance is deducted from your FCIC premiums. Your FCIC representative can tell you the exact amount of the discount."

Of the various brochures FCIC published, one--FCIC Options for Hail and Fire Coverage--was specifically designed to cover questions and answers regarding this subject. One million copies were distributed to the ASCS county offices and another 1 million copies were reprinted for 1982. Another brochure--Crop Insurance Makes Good Sense (1 million copies)--also mentioned that producers could exclude hail and fire coverage from the all-risk policy, then purchase an equal amount from a private insurance carrier and obtain a reduction in their premium costs. FCIC also made numerous news releases and materials available at varying times to the news media. We did not attempt to determine the extent to which the hail and fire option was covered in this material.

To complement the above efforts, FCIC provided formal training to insurance agents selling FCIC insurance, officials in reinsured companies, and FCIC regional employees and provided manuals and procedures covering all aspects of the program including the hail and fire exclusion and the credit permitted.

Preliminary data provided to us by FCIC in June 1981 showed that of a total of 497,336 policies it had written, the producers had applied to exclude hail and fire coverage on 3,125 policies. Similar data on policies written by reinsured companies was not available. According to the Director, National Service Office, the data is only preliminary because the producer has until harvest time to make this election and these statistics could change substantially. The 3,125 applications included about 1,400 for corn, 1,000 for soybeans, and 500 for wheat. The remaining 225 were for various commodities.

COSTS OF THE PROGRAM FOR FISCAL YEAR 1981

FCIC's total estimated costs, net of premium income, for fiscal year 1981 are about \$333 million. This amount includes the estimated net deficit from program operations (indemnities less premiums) of \$203 million for crop year 1980. Because the crop year and fiscal year cover different periods, the total costs for fiscal year 1981 include some costs applicable to more than crop year 1980 and exclude other costs applicable to crop year 1980.

As of June 30, 1981, FCIC provided us with the following cost data for fiscal year 1981.

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	<u>Fiscal year 1981 estimated costs</u>		
	<u>Obligated</u>	<u>Estimated</u>	
	<u>through</u>	<u>for</u>	
	<u>May 31</u>	<u>June 1-Sept. 30</u>	<u>Total</u>
	----- (millions) -----		
Administrative costs	\$ 25.8	\$45.9	\$ 71.7
Interest on Commodity Credit Corporation (CCC) transfer	13.0	9.1	<u>a/22.1</u>
Agent commissions	12.2	14.6	26.8
Direct costs of loss adjusters	7.7	1.9	<u>b/9.6</u>
Indemnities (crop year 1980)	<u>352.0</u>	<u>8.0</u>	<u>360.0</u>
 Total	 <u>\$410.7</u>	 <u>\$79.5</u>	 <u>\$490.2</u>
Less: Premium income (crop year 1980)			<u>157.2</u>
 Total			 <u>\$333.0</u>

a/According to the Chief, Financial Branch, National Service Office, the interest on CCC funds is being accumulated but no payment is contemplated until a decision is made by headquarters officials as to how it will be funded. By excluding the interest charges, sufficient funds are available to fund the remaining estimated costs for fiscal year 1981.

b/Excludes about \$800,000 of costs estimated to be incurred by FCIC in making field inspections for ASCS relating to the disaster program. These costs are fully reimbursable.

According to the Chief, Financial Branch, the \$333 million cost will be funded as follows.

	<u>Amount</u>
	(millions)
Direct appropriations	\$ 57.8
Transfer from CCC	180.0
Net capital carryover from prior years	<u>87.1</u>
Total	324.9
Net deficit	a/ <u>8.1</u>
Total	<u>\$333.0</u>

a/See footnote a/ on page 18.

A crop year includes the period within which the insured crop is normally planted and harvested. It is designated by reference to the calendar year of normal harvest. For example, crop year 1980 would include the winter crops planted in the fall of 1979 but not harvested until the summer of 1980 and crops planted in the spring of 1980 and generally harvested in late fall of 1980. Because the Federal fiscal year begins after the winter crops are normally planted and ends before many of the spring crops are harvested, the crop year and fiscal year do not coincide.

Insurance operations for fiscal year 1981 relate principally to crop year 1980. Premium income received and indemnities paid before September 30, 1980, and applicable to crop year 1980, were deferred and recorded in fiscal year 1981. Other costs--agent commissions, loss adjustments, and other operating and administrative expenses--are not allocated by crop year but are recorded and accounted for in the fiscal year in which the expense was paid or incurred. Because all costs applicable to a specific crop year are not allocated on a crop year basis, certain costs applicable to a crop year would be recorded and accounted for in three different fiscal years.

PARTICIPATION IN THE PROGRAM INCREASING

As of June 1981, preliminary sales information shows that premium income for crop year 1981 will be about \$326.5 million as compared with \$157.2 million for crop year 1980, or an increase of about 108 percent. The number of acres insured increased from about 26.3 million in crop year 1980 to about 47.7 million in crop year 1981, or about 81 percent. Although the sales season for crop year 1981 is substantially complete, final participation figures will not be known until all acreage reports are received and processed.

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FCIC's Sales Position Report as of June 18, 1981, and a report of estimated premiums by reinsurance companies as of June 1, 1981, show the extent of increase in participation.

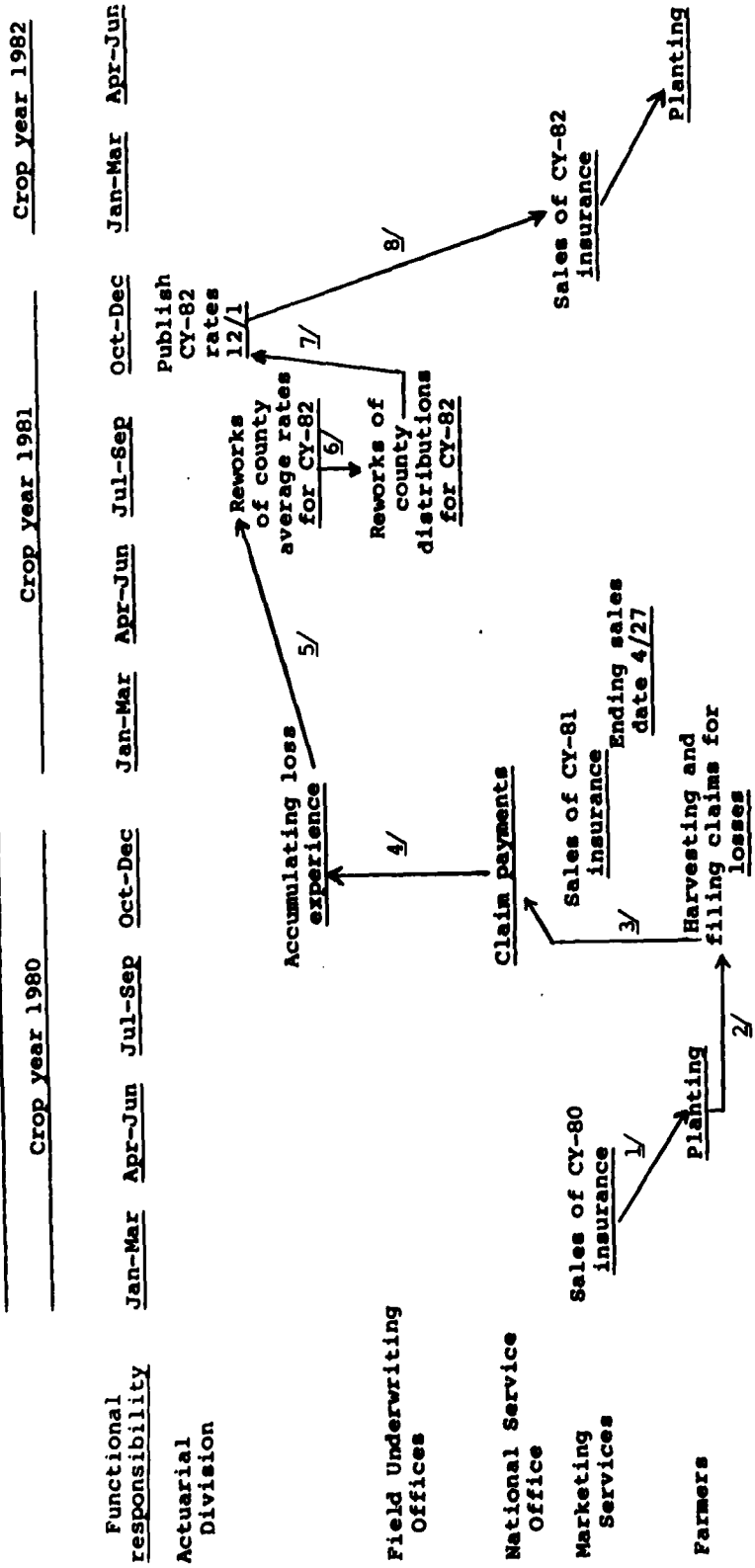
	<u>Amount of estimated premiums</u>	<u>No. of acres insured</u>
Total crop year 1980	<u>\$157,155,294</u>	<u>26,343,743</u>
Crop year 1981:		
Per sales position report	313,522,098	45,769,721
Per report of premiums by reinsured companies	<u>12,994,000</u>	<u>a/1,899,707</u>
Total for crop year 1981	<u>\$326,516,098</u>	<u>47,669,428</u>
Percent of increase	108	81

a/This figure was not available but was estimated on the ratio of estimated premiums to acres insured per the Sales Position Report.

According to the Director, National Service Office, the above data is preliminary and will change upon receipt and processing of all acreage report information. However, the amount of change is not expected to be significant.

FCIC's PROCESSING CYCLE FOR ADJUSTING PREMIUMS
Example no. 1 of timeframes for FCIC operations

Iowa corn



NOTE: Footnotes are on page 23.

FCIC's PROCESSING CYCLE FOR ADJUSTING PREMIUMS
Example no. 2 of timeframes for FCIC operations

Kansas winter wheat

	<u>Crop year 1980</u>	<u>Crop year 1981</u>	<u>Crop year 1982</u>
<u>Functional responsibility</u>	<u>Jan-Mar</u>	<u>Apr-Jun</u>	<u>Jul-Sep</u>
<u>Actuarial Division</u>	<u>Jan-Mar</u>	<u>Apr-Jun</u>	<u>Jul-Sep</u>
<u>Field Underwriting Offices</u>	<u>Jan-Mar</u>	<u>Apr-Jun</u>	<u>Jul-Sep</u>
<u>National Service Office</u>	<u>Jan-Mar</u>	<u>Apr-Jun</u>	<u>Jul-Sep</u>
<u>Marketing services</u>	<u>Jan-Mar</u>	<u>Apr-Jun</u>	<u>Jul-Sep</u>
<u>Farmers</u>	<u>Jan-Mar</u>	<u>Apr-Jun</u>	<u>Jul-Sep</u>

Functional responsibility

Actuarial Division

Field Underwriting Offices

National Service Office

Marketing services

Farmers

Reworks of county average rates for crop year 82

Accumulating loss experience

Reworks of county distribution

Claim payments

Sales of CY-81 insurance - ending sales date 9/2-22

Harvesting and filing claims for losses

Publish CY-82 rates 4/1

Sales of CY-82 insurance - ending sales date 9/2-22

Planting

NOTE: Footnotes for this example are the same as Example No. 1 except that the dates are shown on this chart.

FOOTNOTES

1. The ending sales date of insurance for Iowa corn for crop year 1981 was April 27, 1981. This date would be approximately the same each year.
2. The planting dates for Iowa corn are late April to the first part of June. FCIC's last planting date for Iowa corn for crop year 1981 was June 5 to 10, with farmers required to report their planted acreage by June 30.
3. Farmers have up to 30 days to report losses after the loss occurs. Thus the filing of claims for losses normally would begin some time after the crop has started to grow and would continue until 30 days after the insurance ending date. The insurance ending date, which is basically the ending date of FCIC liability, for Iowa corn for 1981 is December 10, 1981. Thus, the last filing date, excluding unusual circumstances, would be January 10, 1982.
4. During the period claims are filed and paid, FCIC is accumulating the loss experience. This is essentially completed some time in March or April.
5. FCIC's management annually decides which crops are to be revised (called reworks) to update premium rates to incorporate, among other things, current experience. Reworks for corn are normally made during the summer to make changes in the next year's premium rates. The revised countywide rates are then provided to the responsible field underwriting offices for distribution.
6. The field underwriting offices distribute countywide premium rates in accordance with the procedures set out on page 8. The Actuarial Division estimates an actuarial table for each level of coverage.
7. The Actuarial Division publishes the actuarial tables for each county and makes these tables available to Marketing Services.
8. Marketing Services distribute the actuarial tables to the sales agents.

FCIC's ACTUAL AND PLANNEDEXPANSION FORCROP YEARS 1979-82

<u>Crop year</u>	<u>Expansion</u>		<u>Total</u>	
	<u>No. of counties</u>	<u>No. of programs</u>	<u>No. of counties</u>	<u>No. of programs</u>
1979	4	74	1,526	4,063
1980	150	566	1,676	4,629
1981	252	1,340	1,928	5,969
1982	<u>a/1,050</u>	<u>a/8,278</u>	2,978	14,247

a/Expansion as of July 14, 1981.

