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BY THE U.S. GENERAL ACCOUNTING OFFICE

Report To The Honorable Bill Alexander House Of Representatives

Information On The Federal Crop Insurance Corporation's 1983 Standard Reinsurance Agreement

The Federal crop insurance program is the primary disaster assistance program offered farmers by the Department of Agriculture. The program is available through the combined services of the private insurance industry and the Department's Federal Crop Insurance Corporation.

The Corporation, under a Standard Reinsurance Agreement, reinsures a private insurance company; that is, it protects a company from a part of the risk associated with insuring crops. The Agreement specifies how gains or losses are to be allocated between a company and the Corporation.

This report answers a series of questions asked by Congressman Alexander on changes made to the 1983 Standard Reinsurance Agreement.

GAO/RCED-83-114
MARCH 9, 1983

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UNITED STATES GENERAL ACCOUNTING OFFICE
WASHINGTON, D.C. 20548

RESOURCES, COMMUNITY, AND ECONOMIC DEVELOPMENT DIVISION

B-209866

The Honorable Bill Alexander
House of Representatives

Dear Mr. Alexander:

In your September 10, 1982, letter and in subsequent meetings with your office, you asked us to obtain information on the 1983 Standard Reinsurance Agreement approved by the Board of Directors of the Federal Crop Insurance Corporation (FCIC). FCIC is a Government-owned corporation within the Department of Agriculture. This report provides answers to the specific questions you raised. We did not attempt to draw overall conclusions nor make recommendations.

The Federal crop insurance program is the primary disaster assistance program offered farmers by the Department of Agriculture. The program is offered directly to farmers by private insurance companies who, under an agreement with FCIC, act as "direct" insurers for Federal crop insurance policies issued in the name of the company. These private companies are reinsured by FCIC; that is, they are protected from a part of the risk in insuring crops.

The reinsurance program offered by FCIC provides private companies an opportunity to share in any underwriting gains or losses associated with the crop insurance. The Standard Reinsurance Agreement entered in by a company and FCIC specifies the percent of premiums on policies sold that is allocated between the company and FCIC for their respective portion of risk sharing.

This letter highlights the information we obtained in response to your concerns. Appendix I describes the reinsurance program and the 1982 and 1983 reinsurance agreements. More detailed responses to your questions are provided in appendix II.

RISK AND PROFIT SHARING

The reinsurance program was established in 1980. In an attempt to get more private insurance companies involved and to encourage them to write insurance on all crops nationwide, FCIC has made revisions to the amount of premiums allocated between FCIC and the companies for their portion of risk sharing. 'Some of the changes incorporated in the 1983 Standard Reinsurance Agreement are as follows:

--The maximum gain or loss potential to a private company was increased from 8 to 11-1/3 percent of the premiums.

--A private company will not share in underwriting losses unless its loss ratio exceeds 1.28-1/3. For 1982 private companies shared in underwriting losses when the loss rates exceeded 1.00.

--Only when the loss ratio exceeds 2.00 would a company be placed in a less favorable risk-sharing position compared to the 1982 agreement.

In crop year 1981, 17 private companies sold crop insurance policies which accounted for only 3.4 percent of all Federal crop insurance premiums received that year. In crop year 1982, the number of companies participating increased to 35 and they sold policies which accounted for 23 percent of all Federal crop insurance premiums.

REIMBURSEMENTS FOR OPERATING AND ADMINISTRATIVE EXPENSE

At specified times throughout the year, FCIC reimburses companies for the costs associated with operating and administering the program. The amounts paid are based on percentages of premiums collected and net losses incurred and not on the private companies' actual costs. FCIC does not require private companies to report the actual cost of providing their services.

FCIC does not have audit procedures to determine if the reimbursement billings the private companies submit are valid. The Department of Agriculture's Office of the Inspector General recently issued a report on FCIC's reinsurance program which concluded that requirements to assure the accuracy of source documents were lacking and that this resulted in the use of erroneous data to determine administrative expense reimbursements. According to a special assistant to FCIC's Manager, FCIC will develop audit procedures, and the companies' reimbursement billings will be audited within 12 months.

PRIVATE COMPANIES' RESERVES

We were unable to determine from the financial statements available at FCIC whether the reinsured companies had enough reserves or assets to bear the risk undertaken. FCIC relies on State licensing and monitoring of the companies to assure itself of the companies' financial soundness.

AGENCY COMMENTS AND OUR RESPONSE

FCIC took strong issue with the report. (See app. III.) It particularly objected to the use of what it called worst-case scenarios to examine the impact of the 1983 Standard Reinsurance Agreement. It made no attempt to comment on the facts presented in our report.

As pointed out above, our report is in response to specific questions raised by you concerning the 1983 Standard Reinsurance Agreement and should be viewed in that context. Because our review was limited, we did not draw overall conclusions nor make any recommendations. However, as a result of comments made by agency officials, we revised the report to more clearly reflect the limitations on the use of information presented in our report.

OBJECTIVES, SCOPE, AND METHODOLOGY

In response to your request, we obtained information on (1) underwriting risks shared by FCIC and the reinsured companies, (2) FCIC's reimbursement of reinsured companies' operating and administrative expenses, (3) FCIC's ability to establish a reserve under the 1983 Standard Reinsurance Agreement, (4) reinsurance activity during crop year 1982, (5) development of the 1983 agreement, and (6) procedures used to transfer business between reinsured companies and FCIC.

We did our work primarily at FCIC's Operations Office in Kansas City, Missouri, and also obtained information at the corporate headquarters in Washington, D.C. The Washington office provides general policy guidance and oversight while FCIC's Operations Office handles program operations. We reviewed historical premium and loss data on federally insured crops and financial statements and reports prepared by private reinsured companies. We also reviewed the 1982 and 1983 Standard Reinsurance Agreements, Board minutes, documents in correspondence files maintained in Kansas City, regulations and procedures used in reinsuring private companies and transferring policies, and the Department's internal audit reports.

We interviewed FCIC officials at FCIC headquarters and in Kansas City. In addition, we met with Office of the Inspector General representatives in Kansas City. We also met with officials of nine reinsured companies to obtain information on their operating and administrative costs and direct loss adjustment activities. And we interviewed representatives of the Crop Hail Insurance Actuarial Association which processes financial and statistical data on crop premiums and losses for private companies. We made the review in accordance with generally accepted government audit standards.

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As arranged with your office, unless you publicly announce its contents earlier, we plan no further distribution of this report until 30 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,

J. Dexter Peach
Director

Contents

ABBREVIATIONS

CHIAA	Crop Hail Insurance Actuarial Association
FCIC	Federal Crop Insurance Corporation
GAO	General Accounting Office
OIG	Office of the Inspector General

REINSURANCE PROGRAM AND AGREEMENTS

The Federal Crop Insurance Act of 1980 (Public Law 96-365) requires FCIC to offer a program of reinsurance to the private sector. The reinsurance program involves an agreement between private insurance companies and FCIC. Under the agreement, a company acting as a "direct" insurer for policies issued in its name is able to purchase reinsurance coverage from FCIC as protection against a part of the risk that could result from losses incurred in selling Federal crop insurance. This program provides private companies an opportunity to share in both the risk and any underwriting gains or losses associated with selling Federal crop insurance.

Before 1980, FCIC sold and serviced crop insurance policies using its own employees, employees of the Department's Agricultural Stabilization and Conservation Service, and a limited number of individual agents. In an attempt to shift the delivery system to the private sector, FCIC developed an Agency Sales and Service Agreement and a Standard Reinsurance Agreement to replace the Federal delivery system. Under an Agency Sales and Service Agreement, an insurance agency (commonly referred to as a master marketing agency) enters into an agreement to market and collect premiums on the insurance for FCIC. The agency is compensated on a commission basis. Under a Standard Reinsurance Agreement, an established insurance company enters into an agreement with FCIC to market crop insurance, collect premiums, and adjust the losses on the policies it sells. The company also shares in the gains and losses resulting from the Federal crop insurance it sells. In areas where an adequate private sales and service force is not available, the Agricultural Stabilization and Conservation Service will sell and service Federal crop insurance through its county offices.

The Standard Reinsurance Agreement specifies the percent of premiums that is to be allocated between the company and FCIC. Depending on the loss ratio, a company is credited or charged with a percent of premiums for its portion of risk sharing. FCIC has revised the allocation amount in the agreement each year to try to get more companies involved and to encourage them to write insurance on all crops nationwide.

In crop year 1981, [1] the 17 companies in the reinsurance program sold crop insurance policies with total premiums of about $12.8 million. This was about 3.4 percent of all premiums

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[1] The crop year is the calendar year within which the crops insured are normally harvested or mature for harvest.

on Federal crop insurance that year. In crop year 1982, 35 companies participated in the reinsurance program. They sold policies on which premiums totaled about $75.7 million. This was about 23 percent of all premiums on Federal crop insurance during crop year 1982.

At specified times throughout the year, FCIC reimburses the reinsured company at specified rates for operating and administrative expenses. The insurance premiums a company collects are used to offset any amount due from FCIC and, in some cases, may result in a payment from the company to FCIC. An annual settlement is made between each company and FCIC based on the company's loss ratio (relationship of indemnities to premiums received) for the crop year.

OUR RESPONSES TO CONGRESSMAN ALEXANDER'S QUESTIONS

FCIC's LIABILITY IN REINSURING PRIVATE COMPANIES

Question 1

> Section III of the 1983 Standard Reinsurance Agreement defines the share of loss to be borne by private companies under different loss ratios. The loss not borne by private insurance companies is, of course, borne by the Corporation. Assuming the same loss ratio experienced by the Corporation from 1948 through 1981, what would the Corporation's liability have been or what would its gross underwriting profit have been in total for all of those years under the new Agreement and under the 1982 Standard Reinsurance Agreement?

GAO response

In 18 of the 34 years from 1948 through 1981, FCIC experienced an annual underwriting gain where the loss ratio (relationship of indemnities paid to premiums received) was less than 1.00. Nevertheless, FCIC incurred a net underwriting loss over the 34 years of a little over $180 million. Assuming that the risk-sharing provisions of the 1982 and 1983 reinsurance agreements had been in effect during the 34 years and all companies had experienced the same loss ratios as FCIC, FCIC's net underwriting loss would have been increased by about $73 million under the terms of the 1983 agreement compared with about $22 million under the 1982 agreement, or a difference of about $51 million.

Under both agreements, depending on the loss ratio, a company is credited or charged with a percent of the premiums for its portion of gains or losses experienced. The 1983 agreement, unlike the 1982 agreement, offers the companies a percent of the premiums even in certain cases where an underwriting loss may occur. Under the 1982 agreement, a company was to share in underwriting losses with FCIC in all cases where the company's loss ratio exceeded 1.00; but under the 1983 agreement, the company will not share in losses unless its loss ratio exceeds 1.28-1/3. Consequently, if the 1982 agreement had applied during the years 1948-81 and all companies had experienced the same loss ratios as FCIC, they would have received a share of the premiums only in the 18 years in which FCIC had gains.

Under the provisions of the 1983 agreement, however, the companies would have received a share of the premiums in 30 of the 34 years.

Because the distribution of gains to private companies is made from the premium surplus and/or FCIC's capital stock, any distribution of gains would reduce FCIC's share by that much. Therefore, the $22 million that would have been distributed to the private companies in 18 of the 34 years under the 1982 agreement would have increased FCIC's net loss to about $202 million. Under the 1983 agreement, the distribution of $73 million to the private companies in 30 of the 34 years would have increased FCIC's net loss to about $253 million. If these amounts had been distributed, the net gain to the private companies as a percent of total premiums would have been 1.3 percent under the 1982 agreement and 4.1 percent under the 1983 agreement, although FCIC's cumulative loss ratio was 1.10 over the 34 years.

PRIVATE COMPANIES' ABILITY TO SUSTAIN LOSSES

Question 2

Section III, paragraph A.4., of the 1983 agreement defines a private insurer's liability if the loss ratio exceeds 533-1/3 percent (that is, 5.33-1/3).

a. Since 1948, how many crops have suffered such a loss ratio? What were those crops? And what disasters caused the losses?

b. If the wheat crop suffered a 540-percent loss, what would be the liability of private insurance companies under this provision?

c. Do they have sufficient reserves or assets to bear that liability?

GAO response

Since 1948, five crops have suffered nationwide loss ratios of more than 5.33-1/3 in any 1 year. These crops and the primary disasters causing the losses are as follows:

Crop	Year	Disaster	FCIC's loss ratio
Citrus	1957	Freeze in California	7.25
	1962	Freeze and hail in Florida	9.25
Combined crop (note a)	1980	Drought in North Dakota	6.96
Forage seeding	1980	Drought in North Dakota	5.82
Peanut	1980	Drought in North Carolina, South Carolina, and Texas	8.23
Raisin	1976	Excess moisture in California	11.66
	1978	Excess moisture in California	12.13
	1982	Excess moisture in California	b/9.42

a/Consists of barley, flax, oats, rye, and wheat.

b/FCIC's estimate as of Nov. 24, 1982.

Under the 1983 agreement, the private insurance companies' liability is limited to 11-1/3 percent of the premiums on policies reinsured under the agreement. For example, if reinsured companies had sold all of the 1982 wheat insurance on which premiums totaled about $96,770,114 and had incurred a loss of 540 percent for the wheat crop, their loss would have been limited to $10,966,957 ($96,770,114 times 11-1/3 percent) or 2.1 percent of the total loss experienced. Under the 1982 agreement, the percentage loss to reinsured companies would have been less because their liability was limited to 8 percent of the premiums.

We were unable to determine from the financial statements available at FCIC whether the reinsured companies had enough reserves or assets to bear the risk undertaken. FCIC officials told us, however, that as a minimum, FCIC requires companies to submit financial statements and relies on State licensing and monitoring of the companies to assure itself of the companies' financial soundness. A special assistant to FCIC's Manager told us that no formal procedures or criteria have been used in evaluating the financial statements that have been submitted. He said, however, that FCIC proposed financial standards on September 10, 1982, that it will use in evaluating the private companies' ability to meet their obligations. The proposed standards would require an analysis of the companies' previous 3 years' financial ratios and assets. These ratios, which will facilitate FCIC's decision on whether to contract with a given company, relate to such things as (1) annual operations, (2) liabilities and liquid assets, (3) changes in surplus, (4) net premiums written and loss adjustment expense reserve, and (5) changes in the liability mix.

FCIC's HANDLING OF REIMBURSEMENT ALLOWANCES

Question 3

Section IV of the 1983 agreement defines the amount of operating and administrative expense to be reimbursed each reinsured company. It also states the time at which reimbursements shall be paid.

a. Does the Corporation have any audit procedure to determine whether the amount it is required by contract to reimburse to each company (i.e., a percent of book premium) represents the actual cost of each company's operating and administrative expenses?

b. Does the Corporation perform any audit or receive any assurance that by the time of payment the costs being reimbursed actually have been incurred?

c. Does section IV conflict or might it conflict with 31 U.S.C. 529? [2]

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[2] This section was repealed by Public Law 97-258, 96 Stat. 1084 (1982). References herein will be to the successor provision, 31 U.S.C. 3324.

GAO response

As of December 1982, FCIC did not have any audit procedures to determine whether billings by the reinsurance companies were valid. FCIC's Comptroller and the Chief, Reinsurance Branch, told us that billing statements the companies submit are not audited, although some checks are made to assure that payments agree with the statements filed. A recent report on FCIC's reinsurance program by the Department's Office of the Inspector General (OIG) concluded that requirements to assure the accuracy of source documents were lacking and that this resulted in the use of erroneous data to determine administrative expense reimbursements. According to a special assistant to FCIC's Manager, FCIC will develop audit procedures, and the companies' reimbursement billings will be audited within 12 months.

The amounts that FCIC is required to reimburse the companies for operating and administrative expenses do not necessarily represent the actual costs these companies incur. A company is reimbursed an amount equal to 27 percent of its premiums for new policies and an amount equal to 22 percent of carryover (renewal) insurance premiums. These percentages were based on FCIC's 1979 costs as a percent of 1979 crop year premiums. In addition, the companies are reimbursed for direct loss adjustment expenses. FCIC will reimburse a company 4 percent of its premiums and 3 percent of net losses for direct loss adjustment expenses. This allowance was based on FCIC's average direct costs for loss adjustment activities as a percent of premiums and indemnities for 1976 through 1979.

We believe that section IV's expense reimbursement provisions do not conflict with the prohibition on advance payment of public funds (31 U.S.C. 3324). Section 506 of the Federal Crop Insurance Act, as amended, [3] empowers the Corporation to

> "* * * determine the character and necessity for its expenditures under this * * * [act] and the manner in which they shall be incurred, allowed, and paid, without regard to the provisions of any other laws governing the expenditure of public funds and such determinations shall be final and conclusive upon all other officers of the Government * * *."

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[3] 7 U.S.C. 1506.

In view of the above, we believe the expense reimbursement provisions do not conflict with the prohibition on advance payment of public funds.

FCIC's ABILITY TO ESTABLISH A RESERVE UNDER THE 1983 STANDARD REINSURANCE AGREEMENT

Question 4

> The Federal Crop Insurance Act requires the Corporation "to establish as expeditiously as possible a reasonable reserve against unforeseen losses" and to provide reinsurance consistent with the establishment of such a reserve and with "sound reinsurance principles." If a shifting of risk and profit results from the changes between the 1982 and 1983 Standard Reinsurance Agreements, does that change affect the Corporation's ability to establish a reasonable reserve?

GAO response

The shifting of gains and losses resulting from changes between the 1982 and 1983 agreements will have an effect on FCIC's ability to establish a reserve. Under the 1982 agreement, the maximum gain or loss potential to a private company was 8 percent of its premiums. Under the 1983 agreement, the gain or loss potential has been increased to 11-1/3 percent of premiums. The changes to the private companies' share of premiums for 1983 place the companies in a more favorable position than in 1982 and guarantee them an annual gain in some cases where the underwriting experience may be unfavorable.

As shown in the following table, only in a crop year when the loss ratio exceeds 2.00 would a company experience a less favorable position under the 1983 agreement than under the 1982 agreement.

Loss ratio	Gain and (loss) distribution per agreement for crop year 1982 Company	1982 FCIC	1983 Company	1983 FCIC
	----------(percent of premium)--------			
.00	8	92	11-1/3	88-2/3
.40	8	52	11-1/3	48-2/3
.75	8	17	11-1/3	13-2/3
.90	3-1/3	6-2/3	6-2/3	3-1/3
.95	1-2/3	3-1/3	5	0
1.00	0	0	4-1/4	(4-1/4)
1.10	(1)	(9)	2-3/4	(12-3/4)
1.28-1/3	(2-5/6)	(25-1/2)	0	(28-1/3)
1.60	(6)	(54)	(4)	(56)
2.00	(8)	(92)	(8)	(92)
3.00	(8)	(192)	(9)	(191)
5.33-1/3	(8)	(425-1/3)	(11-1/3)	(422)

Under the 1983 agreement, the private companies would share in annual gains of 11-1/3 percent of premiums with a loss ratio of only 0.75. On the other hand, the loss ratio would have to reach 5.33-1/3 before the companies would share in an equal percentage of losses.

In accordance with legislative requirements, the premium rate for insurance coverage is to be based on expected indemnities and a factor to establish a reasonable reserve for unforeseen losses. Because the premium rate for insurance protection does not include a factor for expected distribution of gains to reinsured companies, the payment of any gains from the premium surplus and/or FCIC's capital stock will affect FCIC's ability to accumulate the necessary reserve. In addition, if the combined underwriting experience over a 5-year period is favorable, the companies will be entitled to a further distribution, which will be made from premium surplus. The Chief, Reinsurance Branch, said that payment of a higher gain to private companies under the 1983 agreement will not necessarily have an adverse effect on FCIC's ability to establish a reserve. He added that private companies have lower loss ratios than FCIC.

PRIVATE COMPANIES' UNDERWRITING RISKS

Question 5

Concerning underwriting risks:

a. Has the Corporation entered into any reinsurance treaties with private companies to reinsure risks additional to those reinsured by the present Standard Reinsurance Agreement?

b. Is it possible for the Corporation to reinsure all risks undertaken by private insurers and for such reinsurers thereby to escape all underwriting risks?

GAO response

FCIC has entered into treaties with some companies to provide surplus reinsurance for companies that seek a means to control their risk exposure by geographic area. Optional State and/or county treaties allow companies to maintain a balance in the amount of risk taken without shutting off sales in locations where their agents are most successful in their efforts.

Under a State treaty, if a company's underwriting business in a State exceeds an established amount, FCIC will assume a share of the net losses in consideration for 90 percent of the excess premium. An established amount reflects the approximate amount of premium upon which the company could reasonably assume risk. FCIC's share of the net losses for the State will be the same percentage of losses as the share of premiums surrendered (ceded) to FCIC. Premiums and losses not ceded to FCIC would remain subject to the standard agreement.

Under a combination county and State treaty, premiums ceded to FCIC would first be calculated on a county basis. If, after these cessions, too much liability remained with the company on a State basis, additional cessions would be made to FCIC.

For crop year 1982, FCIC entered into Standard Reinsurance Agreements with 35 companies. Of these, 17 had treaties with FCIC. For 1983, FCIC entered into treaties with 14 of 37 companies.

Under the terms of the 1983 agreement and the surplus treaties, FCIC can virtually reinsure a private company's entire risk. For example, under the 1983 agreement, when a company's loss ratio exceeds 5.33-1/3 or more, its maximum liability is limited to 11-1/3 percent of its total premiums. This means that for every $1 in premium, the risk to the private company is at most 2.1 percent of the $5.33 loss, as the table below shows. However, the company's share of the loss gets smaller as the loss ratio exceeds 5.33-1/3. This results because the company's share is determined as a percentage of the premium and not of the underwriting loss.

A company never escapes all risk, but its share of the loss may be minimal. Under surplus treaties, a company's share of risk is further reduced for premiums written in excess of its established amount.

Liability of the Private Insurer

	Dollar amount	Percent
Premium	$1.00	100
Indemnity (losses paid)	5.33	533-1/3
Maximum risk to a private company per dollar of premium	.1133	11-1/3
Risk to a company per dollar premium based on total loss	.1133	2.1

PRIVATE COMPANIES' INPUT IN DEVELOPING THE 1983 AGREEMENT

Question 6

The 1983 Standard Reinsurance Agreement was long in creation.

a. Provide information on meetings between industry representatives and representatives of FCIC and the Department of Agriculture relating to the development of the new agreement, the negotiating positions taken by the participants, and the documents prepared by or supplied to FCIC and the Department relating to contract terms.

b. Can some companies profitably provide the same services for less reimbursement or assume more risk than presently provided for or required of all companies?

GAO response

We were unable to determine through discussions with FCIC personnel the extent to which private insurance officials may have negotiated with FCIC in changing the gain and loss formula to that in the 1983 Standard Reinsurance Agreement. We did not identify any formal proposals submitted by private officials in files at FCIC's Operations Office. Correspondence and informal notes in the files showed that private insurance officials frequently voiced concerns that the 1983 agreement should provide more potential for profit and added protection against losses than the 1982 agreement offered. However, FCIC Board minutes did not mention or make reference to any input that might have been offered by private companies.

The Chief, Reinsurance Branch, and the Director, FCIC Operations Office, were able to recall three specific meetings that one or both of these officials attended that may have concerned the 1983 Standard Reinsurance Agreement. These officials told us that they did not have any documented information on these meetings and that they could not recall the particulars of what was discussed.

The first meeting was held sometime in June 1982 at FCIC's Operations Office in Kansas City. The Chief, Reinsurance Branch, said that the meeting, held by the Director with representatives of the private insurance companies, was to get acquainted.

A second meeting was held in Chicago with a representative of one reinsured company and other insurance officials to study risk-sharing options. This meeting was held in June 1982 before adopting the revised agreement for 1983. The Chief, Reinsurance Branch, said that a proposal resulting from the meeting was considered by FCIC in arriving at the risk-sharing (gain and loss) aspect of the revised agreement for 1983. However, he was not able to locate a copy of the proposal document.

A third meeting was held in late July or early August, according to the Director. The Director said that he and the Chief, Reinsurance Branch, attended a meeting the reinsured companies held in Kalispell, Montana. The Director said that they simply presented the terms of the finalized 1983 agreement to industry officials. He recalled that although industry officials presented a proposal or two, they did not affect the 1983 agreement. The Director said that he did not recall what the specific proposals were, but that they were not even considered because the 1983 agreement had already been finalized (by FCIC's Board of Directors).

FCIC does not require the reinsured companies to report the actual cost of providing their services. Thus, we were unable to determine if any of the companies could profitably provide the same services for less reimbursement. As discussed previously (see p. 7), expense reimbursement allowances to the companies were based on an analysis of FCIC's 1979 costs and not the companies' costs. The expense reimbursement allowances have not changed since they were initially established for crop year 1981. However, the risk-sharing part (gain and loss formula) of the Standard Reinsurance Agreement has been revised for each crop year. As discussed previously (see pp. 8 and 11), the 1983 agreement places the companies in a more favorable position than they were in under the prior agreement. Under the 1982 agreement, the companies had less potential for gain and assumed greater risks.

REINSURANCE ACTIVITY DURING CROP YEAR 1982

Question 7

During the 1982 crop year:

a. What were the total sales, in premium amount, by all private reinsured companies? What was the amount of new sales? What was the amount of carryover business?

b. What dollar amount of premium business written directly by the Corporation was transferred to reinsured companies?

c. What was the dollar amount of premium business transferred from reinsured companies to the Corporation during the 1982 crop year? How does the Corporation report these transfers, as new business or as carryover business?

d. Under the categories of new sales, carryovers, and transfers, how many farmers carried their crop insurance with reinsured companies and how many acres were insured?

e. How many applications for crop insurance did all reinsured companies reject because of poor risk? How many of these rejected applications were eventually accepted by the Corporation?

GAO response

As of September 30, 1982, the premium amount on sales of Federal crop insurance by private companies for crop year 1982 was estimated at nearly $78 million. FCIC received this information, at its request, from the 35 reinsured companies. The information, however, did not identify what portion of the total was new sales or carryover business.

Previously, the Crop Hail Insurance Actuarial Association (CHIAA), the organization that processes financial and statistical data on crop premiums and losses for private companies, had provided the following estimates to FCIC on new sales and carryover business of the 35 companies as of June 30, 1982:

	Amount (millions)
1981 carryover	$ 7.8
Transfer business (FCIC to private companies)	50.0
Total carryover	57.8
New sales	26.1
Total new sales and carryover business	$83.9

CHIAA told FCIC that these figures were estimates because many companies could not readily provide a breakdown of new and carryover business. Neither FCIC nor CHIAA reports show the amount of business transferred from reinsured companies to FCIC during the 1982 crop year. Information on individual policies would have to be examined to determine whether transfers were reported as new business or as carryover business.

As of December 29, 1982, CHIAA reported a premium business for crop year 1982 of $75,741,000 for the 35 companies and total acres insured at 11,711,000. CHIAA's report did not show information on the total number of producers carrying Federal crop insurance with the companies under the categories of new sales, carryovers, or transfers. Although financial reports submitted by each company generally list this information, the information is not broken out nor summarized in each of the categories. The CHIAA report also does not provide information on the number of producers that may have been denied crop insurance by the companies because of poor risk.

FCIC requires reinsured companies to notify FCIC regional offices of the names and addresses of any individuals whose applications for crop insurance are rejected and the reasons for such rejection. FCIC's regional offices do not keep specific records on the number of producers that have been denied Federal crop insurance by private companies. However, at our request, FCIC's Director of Field Operations had 6 of 18 regional offices, which were geographically dispersed, contacted for this information. The following estimates were provided.

Regional office	Estimated number of rejected applications	Estimated number of rejected applicants who placed insurance with FCIC
Davis, California	0	0
Des Moines, Iowa	150	100
Manhattan, Kansas	a/300	a/225
Jackson, Mississippi	1	0
Columbia, Missouri	6	5
Columbia, South Carolina	160	125
Total	617	450

a/According to an FCIC crop insurance specialist, this estimate includes an unknown number of policyholders whose applications were not rejected but who, after transferring to a reinsured company, elected to go to an FCIC agent (an independent agent or an agent of a master marketing agency) instead.

PROCEDURES TO TRANSFER POLICIES BETWEEN PRIVATE COMPANIES AND FCIC

Question 8

Concerning transfers of policies:

a. What procedures has the Corporation adopted to regulate the transfer of business between insurers and master marketers and what policing mechanisms has it implemented to ensure that compliance is had with its procedures?

b. Have there been any instructions or is there any understanding, oral or written, by which all transfers to insurers are honored?

c. How does the Corporation prevent antedating of transfer requests to evade the last transfer date?

d. Do the last transfer dates used by the Corporation allow too much time for and thereby overly encourage sales efforts away from new sales and towards transfers?

GAO response

FCIC established transfer procedures on July 9, 1981, that were effective with crop year 1982. The procedures required that a notice of the transfer be sent to the new company and to the company previously servicing the policy or the applicable FCIC regional office. A copy was also to be sent to (1) the new agent, (2) the previous agent, and (3) the insured.

The procedures covered transfers of policies

--by an FCIC agent from FCIC to a private company reinsured by FCIC;

--between independent agents and those of master marketers or those of a private company, or vice versa;

--from a Government office to an agent of a private company; and

--between agents of a private company.

FCIC's monitoring of the private companies had been limited and generally consisted of visits to discuss company operations in general and to review loss adjustment activities. Consequently, FCIC did not know how effective the transfer procedures had been.

In a letter dated November 29, 1982, the Department's Inspector General told Congressman Alexander that the OIG was making a computer match for the 1982 crop year to identify cases in which FCIC had incurred improper expenses because transfer provisions were not followed. Because the OIG plans extensive work in this area to determine FCIC's ability to enforce transfer provisions for the 1983 crop year, we did not pursue this matter.

FCIC revised the transfer procedures effective December 20, 1982. The revised procedures make the assuming agent/company gaining the transfer solely responsible for completing the request for transfer and for furnishing a copy of the request to FCIC's Kansas City Office for FCIC approval. FCIC will then notify the policyholder, the assuming agent, and the losing agent of FCIC's decision on the transfer.

Before any transfer can become effective, it must be accepted by the assuming company and, under the revised procedures, by FCIC. The Standard Reinsurance Agreements have never required the private companies to accept all transfers. Information was not readily available showing the extent to which private companies had refused to accept transfers that were automatically made to them by FCIC. When FCIC closed its county offices in early 1982, it requested all producers to select an independent agent, an agent of a master marketer, or an agent of a reinsured company of their choice to service their crop policy in the future. If a producer did not select an agent, FCIC assigned one based on a system of random numbers, and the policies were automatically transferred to various agents. As we discussed earlier (see pp. 14 and 15), some policies that were tranferred to agents of a reinsured company were subsequently refused. However, there was no information readily available that showed the extent of such refusals.

The Chief, Reinsurance Branch, told us that no absolute way exists to prevent antedating transfer requests but that, if transfer procedures are followed, antedating should not occur. He added that, if antedating were a problem in the past, the new procedures should eliminate its possibility because, beginning in crop year 1984, the transfer date will be the same as the cancellation date. The cancellation date is the date by which producers must cancel their insurance coverage, or it is automatically renewed.

Currently, crop policy cancellation dates differ from sales/transfer closing dates. The cancellation dates as well as the sales/transfer closing dates vary by crop and by geographical area such as counties and States, as the examples in the following table show.

Crop	State	Policy cancellation date	Sales/transfer closing date
Barley	Alabama	June 30	October 15
	Arizona	June 30	November 15
	Kansas	April 30	September 30
Corn	Alabama	December 31	March 20
	Arizona	December 31	April 30
	Illinois	December 31	April 30
	Kansas	December 31	April 25

Because the cancellation dates were often several months before the crop insurance transfer closing dates, it is possible that this time span may have encouraged sales efforts away from new sales and toward transfers. However, the new procedures make the transfer and cancellation dates the same for crop year 1984 and succeeding years. If the sales closing dates used as the deadline for transfers have caused a problem in the past, the new procedures should correct the problem if properly followed and subsequently monitored by FCIC for compliance.

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AGENCY COMMENTS AND OUR RESPONSE

FCIC took strong issue with the report. (See app. III.) It particularly objected to the use of what it called worst-case scenarios to examine the impact of the 1983 Standard Reinsurance Agreement. It made no attempt to comment on the facts presented in our report.

As pointed out above, our report is in response to specific questions raised by you concerning the 1983 Standard Reinsurance Agreement and should be viewed in that context. Because our review was limited, we did not draw overall conclusions nor make any recommendations. However, as a result of comments made by agency officials, we revised the report to more clearly reflect the limitations on the use of information presented in our report.

United States Department of Agriculture | Federal Crop Insurance Corporation | Office of the Manager | Washington, D.C. 20250

MAR 02 1983

J. Dexter Peach
Director, Resources, Community and Economic Development
U.S. General Accounting Office.
441 G Street, N.W.
Washington, D.C. 20548

Dear Mr. Peach:

The Federal Crop Insurance Corporation takes strong issue with the GAO report on the 1983 Standard Reinsurance Agreement, prepared in response to a letter from Congressman Bill Alexander dated September 10, 1982. In the context of the requirements contained in the request, the Corporation disclaims the report's worst-case methodology and conclusions. The report, as structured by the request, makes broad historical generalizations which invalidate the scientific value of the conclusions.

The Corporation objects to the use of worst-case scenarios to examine the impact of the 1983 Standard Reinsurance Agreement. The issues would have been less flawed had they been examined in terms of conditions present in the real world.

In view of the above, the Corporation made no attempt to comment on the report's factual acceptability or possible omissions.

The resulting distorted picture of the Corporation and the Federal Crop Insurance Program leaves the Corporation no choice but to disclaim the report in its entirety.

Merritt W. Sprague

Merritt W. Sprague
Manager

(022862)

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