

**HEARING TO REVIEW THE INTEGRITY
AND EFFICACY OF THE FEDERAL
CROP INSURANCE PROGRAM**

HEARING
BEFORE THE
SUBCOMMITTEE ON GENERAL FARM
COMMODITIES AND RISK MANAGEMENT
OF THE
COMMITTEE ON AGRICULTURE
HOUSE OF REPRESENTATIVES
ONE HUNDRED TENTH CONGRESS

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THURSDAY, JUNE 7, 2007

HOUSE OF REPRESENTATIVES,
SUBCOMMITTEE ON GENERAL FARM COMMODITIES
AND RISK MANAGEMENT
COMMITTEE ON AGRICULTURE
Washington, DC.

The Subcommittee met, pursuant to call, at 10:05 a.m., in Room 1300 of the Longworth House Office Building, Hon. Bob Etheridge [Chairman of the Subcommittee] presiding.

Members present: Representatives Etheridge, Marshall, Boyda, Herseth-Sandlin, Ellsworth, Space, Walz, Peterson (ex officio), Moran, Graves, Boustany, Conaway, Lucas, Neugebauer, and Goodlatte (ex officio).

Staff present: Tyler Jameson, Clark Ogilvie, John Riley, Sharon Rusnak, Bryan Dierlam, and Jamie Weyer.

**STATEMENT OF HON. BOB ETHERIDGE, A REPRESENTATIVE
IN CONGRESS FROM THE STATE OF NORTH CAROLINA.**

Mr. ETHERIDGE. This hearing of the subcommittee on General Farm Commodity and Risk Management to Review the Integrity and Efficiency of the Federal Crop Insurance will come to order. Let me say to our panelists and the ranking member, and I will be brief in my opening remarks, we have a pretty tight schedule today.

And for that reason, we are going to ask you, when we do ask you to open with comments, stick to the 5-minute summation as much as possible and try to keep your answers fairly concise because we have another committee on our heels coming in for mark-up. And we are time limited in this committee today in our time, as important to this committee is.

And I want to thank my colleagues for being here today, and you will see some move in and out because there is a lot going on. And I also want to welcome all of our witnesses, and in particular I will have more to say about Mr. Herring a little later on, one of our North Carolinians. It is good to have you with us today as well. We have several witnesses today, so I am going to keep my remarks short and to the point.

A little more than a month ago, another committee of the House of Representatives held a hearing to examine the Federal crop insurance. Certainly we on the ag committee do not have a monopoly

on oversight capability over crop insurance and their benefits, having fresh eyes take a look at what is happening in crop insurance in the industry.

With that being said, any oversight of crop insurance must recognize that this line of insurance operates very differently from other lines of property and casualty insurance. I have no doubt that those differences were made clearly evident in the May 3 hearing by the oversight committee. The purpose of this hearing is twofold. One, it is to extend the tradition of oversight over the crop insurance industry.

Since enactment of the Agricultural Risk Protection Act of 2000, this subcommittee, under the leadership of subcommittee chairman then Saxby Chambliss and his successor, my good friend to my left here, Jerry Moran, there have been 13 oversight hearings held on crop insurance. We have held hearings directly examining waste, fraud and abuse in the crop insurance program. We even held a hearing where a farmer from my district testified about problems with the pilot insurance program. His testimony led to changes which improved the programs integrity.

Our second purpose is education. Although part of property and casualty insurance, crop insurance is a very different animal. Terms that apply to one do not necessarily apply to another. They operate differently, and they are regulated differently. Before anyone makes broad generalizations or comparisons of the Federal crop insurance program and before someone accuses the program of being wasteful, they not only need to have the facts right, they need to make sure that they are accounting for the uniqueness of the crop insurance system.

And while some representations made of the crop insurance program remain questionable and hopefully will be correct at this hearing, one fact is undisputable. Premiums for crop insurance are increasing, and with them are projected administrative and operating costs for reimbursements. And as we are looking out for our farmers' interests, members are asking tough questions about these increases, questions I hope our witnesses today will be able to answer.

I look forward to hearing today's testimony from our witnesses, and I know turn to the gentleman from Kansas, Mr. Moran, for his opening statement.

**STATEMENT OF HON. JERRY MORAN, A REPRESENTATIVE IN
CONGRESS FROM THE STATE OF KANSAS**

Mr. MORAN. Mr. Chairman, thank you very much. I thank you for conducting this hearing. Thank you for your what I think is an insightful opening statement. Again with your request to be brief, I would only say that I worry that the crop insurance industry has become a target, simply because there is a perception that there is some money available within the crop insurance programs and therefore as we debate a farm bill and finalize a farm bill legislation, that crop insurance may become a target for those dollars. And I want to work to make certain that the crop insurance industry and the beneficiaries, the farmers in Kansas and across the country, do not suffer because of that mentality.

I also recognize that crop insurance must be profitable in order for us to have the benefits that accrue to farmers across the country, farmers and producers. We do have an opportunity, because tax dollars are involved, to make certain that the tax payers are protected in all of our crop insurance programs. And we need to make certain we find the right balance between profitability and the crop insurance industry and protecting those who pay their taxes on an annual basis.

Mr. Chairman, we just had a hearing, and I appreciate you coming to Kansas on Tuesday this week. We had a field hearing in Salina, Kansas. Interesting to me that the ag economist who testified from Kansas State University, based upon his survey of Kansas farmers, indicated that the number one priority for benefits that a farmer receives from Washington, D.C. is derived from crop insurance. That the highest priority of where money is most valuable comes from the crop insurance program. That is a reminder to me that the products that we have are valuable. They have increased in value over time. We need to make sure that continues into the future.

I look forward to hearing our witnesses as they answer the questions that you have described.

Mr. ETHERIDGE. Thank you, and I now yield to the gentleman from Virginia for an opening statement, Mr. Goodlatte, the ranking member of the full committee and former chairman.

Mr. GOODLATTE. Thank you, Mr. Chairman. I appreciate your holding this hearing on this very important subject, and I am anxious to hear the witnesses' testimony, so I will yield back.

Mr. ETHERIDGE. Thank you, sir. You almost caught me off guard here.

Mr. GOODLATTE. I do have a statement to submit for the record.

Mr. ETHERIDGE. Without objection.

Mr. ETHERIDGE. And the chair would respect this and request again that each of our members who are testifying stick as closely to 5 minutes as possible because of our timeframe. Your full statement will be included in the record. And for any member seated who would like to submit their statement for the record, we would do the same. We would like to welcome our first panelist to the table, Mr. Ron Brichler, president of Crop Insurance Division, Great American Insurance of Cincinnati, Ohio; Dr. Barnaby Jr., PhD professor, Department of Agro Economics at Kansas State University Research and Extension in Manhattan, Kansas; Mr. David Herring, branch manager of East Carolina Farm Credit in Kinston, North Carolina; Mr. Mike Mock, senior risk manager of the Anderson Incorporated in Maumee, Ohio; and Dr. Bert Little, associate vice-president for academic research, professor of computer science and mathematics, and executive director of the Center for Agribusiness Excellence at Tarleton State University in Stephenville, Texas; and finally Mr. Nick Ferens. Is that pronounced Ferens? Manager of U.S. Civil Market in Washington, D.C. Mr. Brichler, please begin when you are ready.

STATEMENT OF RON BRICHLER, PRESIDENT, CROP INSURANCE DIVISION, GREAT AMERICAN INSURANCE COMPANY

Mr. BRICHLER. Good morning, Chairman Etheridge and Ranking Member Moran. My name is Ron Brichler. I am a Senior Vice President of Great American Insurance Company and President of its crop division. I am also responsible for five other Great American divisions. Great American's property and casualty insurance group is ranked by AM Best as the 33rd largest property and casualty operation in the United States.

Great American is engaged in marketing and servicing a wide array of specialty property and casualty insurance products with crop insurance representing about 15 percent of our gross written premium. The crop division competes internally for capital with over 20 other Great American operating divisions.

My testimony today is presented on behalf of the crop insurance industry, not any one organization or group. We, the private sector partners in the crop insurance program, appreciate this opportunity to testify.

First, Mr. Chairman and members of the subcommittee, the crop insurance industry wants to clearly assert that the program is highly successful and has not failed at its primary purpose. The program is a risk management tool. Any statement claiming that the program has failed because Congress and the president have approved ad hoc disaster assistance laws is illogical. No program or law can deny a Congress and a president their constitutional rights and privileges.

Mr. Chairman, I started my career as a CPA, and that is why it hurts me to see this latest GAO report. Anyone understanding insurance industry accounting would know that they cannot compare crop insurance pure loss premium with fully expense loaded premium for other property casualty lines of coverage. This has led the GAO to state crop insurance companies have earned an average annual rate of return of 17.8 percent from 2002 through 2006, versus a property and casualty industry 6.4 percent. This improper comparison was further compounded by using different years in the analysis. These errors have caused inaccurate comparisons on both a premium basis and an analysis period basis.

Mr. Chairman, we have adjusted for these mistakes. After doing so, the appropriate property and casualty industry return is actually 17.4 percent versus the crop industry 17.8 percent. A mere rounding error, considering the inherent volatility of the crop insurance line of business. A difference of this magnitude is definitely not something worth a policy change.

Additionally, the GAO work used crop insurance underwriting gain as reported to RMA to measure the industry's profitability. The RMA reported underwriting gain cannot be equated to profit since it does not reflect all the industry's delivery cost.

Three separate profitability studies of crop insurance have been conducted over the last 10 years. One study concluded the return for crop insurance was reasonable. The other two concluded that the return for the crop insurance industry was actually below comparable property and casualty industry lines.

Next, I would like to address the issue of the administrative and operating expense payments to crop insurance companies on behalf

of the farmer. Although crop insurance companies are paid on average around 20 percent of the premium for selling and servicing expenses, the amount does not fully cover total delivery cost. The expense rate has been reduced by the government over time, and the proposals abound today including another by USDA to reduce this rate further.

In comparison, the Insurance Information Institute data for the years 2001 to 2006 showed that for the PNC industry, the expense-to-earn-premium ratio averaged around 40 percent. When adjusting the PNC industry premium data to make it comparable to crop insurance premium data, the expense-to-premium ratio for the same period averaged more than 60 percent. A 1997 GAO report that examined this issue recognized that delivery and servicing expenses were in excess of the A&O, concluding at that time that the true percentage was closer to 26.5 percent. While the program is significantly larger today, the percentages may be different, companies still expend more today than the average 20 percent rate.

In conclusion, I would like to make three points. First, the congressional vision of the crop insurance program was to provide an affordable risk management tool for agricultural producers. The public and private partnership we have today has made this a reality. To have the program become more inclusive, it has become more complex and expensive, but it is working. Now that we have built this risk management tool and over 1.1 million policyholders are using it, it is not the time to tamper with its funding.

Second, with the new energy initiative, more and more will be expected from production agriculture. Crop insurance will be required to support the growers, lenders, and production system if farm products are to help us become less energy dependent.

Third, commodity prices today are high; however, basing the 2007 Farm Bill on the assumption that this is a permanent change would not be wise. Commodity prices are variable, and they will fall. It has taken 25 years to bring the crop insurance program to where it is today. Please don't jeopardize it by looking to it for funding for other programs.

Thank you, and I will be happy to respond to questions at the appropriate time.

Mr. ETHERIDGE. Thank you. Dr. Barnaby.

STATEMENT OF DR. G.A. (ART) BARNABY, JR., PH.D., PROFESSOR, DEPARTMENT OF AGRICULTURAL ECONOMICS, KANSAS STATE UNIVERSITY RESEARCH AND EXTENSION

Dr. BARNABY. Thank you, Mr. Chairman. Good morning, Congressman Moran. Nice to see you again. Congressman Boyda from my state too, actually my district.

I started this quest, when I was asked about this, with the question are insurance companies paid too much? So that was my starting point with this question, and I was trying to think about how to approach and do the comparison so it is side-by-side and not subject to creative accounting that Enron and some other folks taught us how to do. And the way I looked at it if this were a private insurance contract. You would have a dollar coming in the front door, and out the back door, you would pay a certain percent-

age of that dollar in claims. And that number is a very hard number, and I didn't think any way you could really vary it.

So in order to get it on the same level, you will see in Table 1, that is exactly what I was up to. I took the A&O. I also included the company underwriting gain and loss, and I treated it as a cost. The insurance industry has taken a little issue with me doing that because it is sort of double accounting. But the way I was looking at it is if the government were to offer crop insurance through government employees and if they could operate at the same efficiency at the private sector, pretty big assumptions being made there, but if they could, then in theory, they would get to retain; although those underwriting gains would go back to the agency. So that is why I treated it as a cost rather than as embedded into the premium as paid itself.

And then I broke out the premium subsidy and the farmer paid premium, so those are all the dollars that come in the front door of the insurance company. And I end up with a total premium dollars there, in '06 for example, those wouldn't be final in '06 because those are still being updated, but about 6.2 billion in total dollars going in.

And then I looked at the number of indemnity payments that are paid, and again these are straight off of the RMA website. And then I looked at it by year, and what I am showing there, for example, in '93, for every dollar they took in, they paid out \$1.80. You really don't make any money with that year. But you can look at other years when they did very well. 1997, for example, every dollar went in. That year, they paid out 38.7 cents. And obviously profits would have been good that year.

Anyway, over that whole period of time, roughly they took in a dollar, and if I equally weight these, the other thing is you have got increasing sales volume, which means the 2000 Arper program worked as proposed. We increased participation. We increased coverages so it did what it was supposed to do, but in any case if you treat each year as equally probable, in other words, a 1993 could occur again, it roughly works out to where for every dollar that comes in, they pay out about 75 cents. That means there is roughly 25 cents left to cover the other operating expenses.

So how does that compare with property casualty? Table 2, I went through the same process. This is for premiums on auto insurance. Unfortunately, when they report their numbers, they include the lost adjustment expense in with the claims, so I had to separate that out, and that is why I gave a range of numbers. But roughly, they pay out about 65 cents for every dollar that comes in. 35 cents goes to pay commissions, operating expenses of the company, loss adjustment expense, turning on the power and lights at the company, et cetera.

Homeowners' policies on Table 3. Very similar numbers, about 35 cents left over. Private hail insurance is on Table 4. They retain about 30 cents out of every dollar. They pay out 70 cents. So a dollar is paid, and, of course, in the case of hail insurance, farmers pay the full dollar. So they don't expect to get back more than they pay in, or at least they shouldn't if they have looked at the actuarial numbers.

The other possibility is perhaps the expenses are greater in the other lines of insurance. To do a proxy for that, what I looked at was the percent of policy with claims. In the case of Federal crop insurance, I should say the risk management program—they paid out on average about 24 percent of all their policies had claims. Now, those were paid claims. What is not well understood there are also claims that are filed, but after the loss adjuster does the loss adjusting, they discover they do not exceed the deductible and therefore there is no claim due so the company has incurred the expense of working the claim but there is no actual payment made. And if there is no payment made, then that claim is not reported to RMA so it does not show up in the RMA numbers.

So when you look at the total ones, I come up with a number of about 30 to 40 percent of the policies actually have claims worked. The industry would argue that it is even higher than that. It is certainly higher than the 30 percent that is paid and we can document with an absolute hard number. Comparing that to other lines, you are looking at a percent of auto policies with claims about 4 percent, homeowners not quite 7 percent, and private hail is about 13 percent of their policies have claims.

So in closing, one final comment. I have done a lot of educational work of combining crop insurance with marketing tools. And the point is that come harvest time, farmers will either have dollars to replace loss inventories at current market values. By the way, those values have doubled over a year ago. Premiums in Chicago put options at doubled, so the market is telling me the risk on price especially is doubled from what it was a year ago, and so if you do have claims, if we do have a disaster, they will not be paying those corn claims at \$2 like we have in the past. It could be as much as \$6 and \$7 because of the tight supply. In fact, I have recommended people buy RA harvest price option for that very reason because there is no limit on the coverage.

So the point is a lot of farmers have made plans based on it being there for '08 and '09 sales—

Mr. ETHERIDGE. Thank you, sir.

Dr. BARNABY. —that is going to be in place. Thank you.

Mr. ETHERIDGE. Thank you. Mr. Herring.

**STATEMENT OF DAVID C. HERRING JR., BRANCH MANAGER,
EAST CAROLINA FARM CREDIT**

Mr. HERRING. Good morning, Chairman Etheridge and members of the subcommittee. My name is David Herring, and I work for East Carolina Farm Credit. I am a branch manager based in Kinston, North Carolina. East Carolina Farm Credit is a farmer-owned cooperative and a member of the farm credit system. In addition to my branch manager duties, I am a licensed property, casualty, life, and health insurance agent. I am here today to talk about the importance of crop insurance to our customer owners and to the safety and soundness of our financial institutions.

Farm Credit plays a unique role in the crop insurance industry. As a provider of crop insurance, we work to improve access to crop insurance products for our customers. As a financial institution, we rely on crop insurance as a backstop for many of the loans we make to farmers. As a farmer-owned cooperative, we work to pro-

vide the most efficient crop insurance delivery system for our farmer owners.

Farm Credit's net worth of nearly 100 customer-owned financial institutions provides crop insurance services to farmers throughout the nation. With approximately 10 percent market sharing crop insurance, Farm Credit institutions combine to sell more crop insurance to customers than any other single industry provider.

I would like to take this opportunity to give my personal testimony as to the Federal crop insurance program and its importance to the financing of the farmers of eastern North Carolina. In reflecting back to the summers of 1977 and 1985, both years were disastrous due to drought. At the time, crop insurance was carried only by a small percentage of farmers. As crop losses accumulated, many family farms were forced into bankruptcy or foreclosure. Without crop insurance as safety net, many farmers couldn't pay their debt.

For many of our formal borrowers, we require insurance coverage to be in place as a condition of providing a loan. The guarantees offered through crop insurance gives stability to an individual farmer's income and with assignments in place, a guaranteed source repayment to the lender. For many farmers and especially for young and beginning farmers, this is essential.

Serving the financial needs of the agricultural community involves taking risks. Prudent management of a loan portfolio is necessary to manage this risk. For our financial institutions, a requirement that some farmers carry crop insurance is an important tool that helps us manage that risk. For some farmers, credit would not be available without protection that crop insurance gives the lender. Changes to the crop insurance program that increases costs or reduces coverage to the farmers would significantly weaken the safety net of our farmers.

We encourage the subcommittee members, as you write this farm bill, to preserve the strength of the crop insurance program and ensure that farmers can continue to rely on it in years to come.

Thank you for inviting me to testify today. I would be happy to answer any questions.

Mr. ETHERIDGE. Thank you, Mr. Herring. Mr. Mock.

STATEMENT OF MIKE MOCK, SENIOR RISK MANAGER, THE ANDERSONS, INC.

Mr. MOCK. Thank you, Mr. Chairman, members. My name is Michael Mock. I am Senior Risk Manager at The Andersons, Incorporated. For more than 25 years, I have worked with producers assisting them with commodity-risk management. The majority of my clients are located in the eastern belt in our facilities, but we work with customers from Elgin, Nebraska to Lyle, Minnesota to Coldwater, Mississippi.

The firm I represent, The Andersons, is diversified with interests in the grain, ethanol, and plant nutrients sectors of U.S. agriculture. In addition, we are involved in rail car leasing and repair, turf products production, and general merchandise retailing. The company is currently celebrating its 60th year in operation, having been founded in Maumee, Ohio in 1947.

Last year, the company handled 170 million bushels of grain. We currently operate two ethanol plants with a third to come on board first quarter '08. When completed, they will produce a total of 275 millions gallons of ethanol annually. That equates to roughly 100 million bushels of corn consumption per year.

We are recognized as leaders in the ag industry as risk managers and grain originators. An integral part of our risk management strategy includes leveraging crop insurance. Our business structure includes a crop insurance agency, which will have premium sales approaching \$10 million for the '07 sale season. The Andersons actively promotes the use of crop insurance. We are unable to replicate the combination of price yield coverage it offers producers via other hedging vehicles such as exchange traded options. Echoing Mr. Moran's opening comments, the company believes strongly that a high quality, revenue-based crop insurance policy is the single most important step a producer can take to effectively minimize risk for his grain production.

The Andersons has demonstrated this stance to producers, bankers, insurance providers and others through our crop revenue profilers software program. Examples of the profiler are contained in our written statement, and they show the power of blending a crop insurance policy in combination with a good marketing plan. Producers who implement this risk mitigation approach have demonstrated consistent profitability. The financial strength of their businesses reflects the value of this methodology.

As a result, these producers rely less on government marketing loans. They have less need for counter cyclical payments or disaster payments. What they do need is access to quality insurance providers who can deliver high quality crop insurance alternatives at affordable prices.

With several grain and ethanol operations, The Andersons believe the use of revenue-based crop insurance provides a win-win both for our customers and for the company. Obviously crop insurance mitigates the client's risk of lack of production. But it also instills confidence for producers to forward contract early in the cycle at profitable prices. I can state very emphatically alleviating the fear of lack of production leads to more forward contracting by our customers, particularly over multiple-year periods. For The Andersons, this works to ensure a source of inputs for our ethanol plants as well as fulfill the needs of food and animal feed customers.

Another key point to consider in order to manage our own risk in doing business, The Andersons is a commodity input hedger. The cost of financing forward contracts is a significant expense and not without risk, especially in volatile market conditions. Our bankers know the company's ability to maintain contract integrity is directly correlated with the producer's ability to deliver on the contracts established with us.

Knowing this, The Andersons and others in the industry seek to contract with producers who have quality protection in the event lack of production becomes an issue. Crop insurance provides such protection for both parties. As a result, this contributes to the financial health and stability of both farmers and the grain industry alike.

This winter, producers were influenced by high commodity prices when making their crop mix decisions. The Andersons is convinced the unexpectedly large year-on-year increase in corn acres for '07 was due in large part to the crop insurance program. The ability to lock in excellent profitability provided both the farmer and his banker with the courage to invest significant dollars in additional high-cost corn acres.

As the U.S. moves forward in providing a stable food, feed, and fuel supply for its citizens, both The Andersons and its customers will become more reliant on affordable high quality crop insurance tools to manage ever-growing risk. We expect crop reduction costs to increase significantly in future crop cycles, especially for corn.

In addition, competition for crop land has resulted in sharply higher land rent cost. This will likely serve to pressure producer profit margins despite the relatively high value of grain prices. The ever-increasing costs of planting corn, especially corn after corn, may serve to encourage the farmer to explore other avenues with crops with less costly inputs.

Ensuring a steady supply of grain to consumers, especially corn for ethanol facilities, require producers to establish financial stability without necessary financial risk. To accomplish this, productions must continue to have access to affordable crop insurance.

In summary, our customers have embraced these products as their primary risk management tool. We strongly encourage clients to use these policies to assist us in managing our risk when writing forward contracts. The future promises high price opportunities but with an associated risk of a much higher cost structure. As we move forward, the need for an affordable, high-quality insurance program is greatly heightened both the producer as well as the grain and ethanol industries. Thank you.

Mr. ETHERIDGE. Thank you, Mr. Mock. Dr. Little.

STATEMENT OF DR. BERT LITTLE, PH.D., ASSOCIATE VICE PRESIDENT FOR ACADEMIC RESEARCH, PROFESSOR OF COMPUTER SCIENCE AND MATHEMATICS, EXECUTIVE DIRECTOR, CENTER FOR AGRIBUSINESS EXCELLENCE, TARLETON STATE UNIVERSITY

Dr. LITTLE. Chairman Etheridge, Ranking Member Moran, and members of the subcommittee, thank you for the opportunity to appear this morning before the subcommittee. I am Bert Little, associate vice-president for academic research and professor of computer science and mathematics at Tarleton State University, a member of the Texas A&M University system.

In this role, I also direct Tarleton's Center for Agribusiness Excellence, CAE, with implements USDA's mandate to use data mining and data warehousing to improve integrity in the Federal crop insurance program. Personally my own roots in agriculture run deep. My family obtained its first land grant in 1790 in southeastern North Carolina, and I worked on that same piece of land raising tobacco, corn, and soybeans, until I was almost 20 years old. I will use my testimony to give the subcommittee a fresh update on our program, Integrity Activities Involving Data Mining and Data Warehousing Approaches.

At the outset, let me emphasize we are pleased with the success CAE has had in this effort. USDA's risk management agency, in its annual program compliance and integrity reports to Congress, has conservatively estimated that over a period of 6 years, we have saved American taxpayers nearly a half a billion dollars by highlighting potential fraud and abuse in the program and as a result, helping RMA to avoid making improper payments.

In the course of our analytical work, we have found that the farmers who participate in the Federal crop insurance program by and large are honest people who follow the rules. Our spot-check program, described in more detail below, designed to identify suspicious patterns indicating possible program abuse has consistently found fewer than 1 percent of producers falling into this category. It is a strong indicator of program integrity and rates much better than comparable lines of insurance in the property and casualty field, as my friend Dr. Barnaby, has noted.

Each year with RMA staff, we use a database to identify multi-year patterns that signal suspicious or anomalous crop insurance claims. We use these results to produce what we call the spot-check list, an actual list of producers who will then become subject to increased compliance oversight. Most producers on the spot-check list react to the scrutiny by refraining from any contemplated abusive activities. The result is a visible, measurable reduction in indemnities paid. Simply put, growers change their behavior as a result of knowing they are being scrutinized. Over 6 years, 2001 to 2006, spot-check list initiative alone has produced measurable reductions in unneeded indemnities of approximately \$479 million.

The spot-check list that I have described is only one of more than 100 research products that we at CAE produce annually, aimed at improving program integrity. For instance, we have provided assistance to other Federal offices including the USDA office of the inspector general, the government accountability office, and various Federal prosecutors and the Federal Bureau of Investigation.

We believe the next logical extension would be to better include in the process the reinsured companies who deliver crop insurance to producers across the country, and we have begun this process with a good response so far. Most recently, CAE in collaboration with NASA Space Center Applied Sciences Division has begun integrating satellite data that measures the intensity of green light reflected by chlorophyll molecules in plants. And CAE has invested its own non-Federal resources to build a 42-terabyte data system to store satellite data for this use. Our preliminary results are exciting, indicating a better than 90 percent ability to evaluate crop production via satellite using this system.

In the future, CAE hopes to incorporate in our system the common land unit data held by USDA's farm service agency. We see many opportunities to improve our analyses with the inclusion of farm data reported to FSA, and we have been requesting FSA to provide this data to us for this purpose for a number of years.

I had a chance to look at the testimony of the man to my left here, and I underscore their point, that data mining involves more than just looking for isolate anomalies but involves a highly integrated advanced, analytic discipline. And I appreciate their support for the more far-reaching innovations we have incorporated.

Thank you again for this opportunity to address the subcommittee. Great strides have been made to improve the policing of the Federal crop insurance program since the adoption of ARPA in 2000, and we have been honored to be a part of the process. Thank you for your consideration this morning, and I would be happy to answer any questions you may have.

Mr. ETHERIDGE. Thank you, Dr. Little. Mr. Ferens.

**STATEMENT OF NICK FERENS, MANAGER, U.S. CIVIL MARKET,
DETICA DFI**

Mr. FERENS. Chairman Etheridge, Ranking Member Moran and members of the subcommittee, good morning. Thank you for the opportunity to appear before you today. My name is Nick Ferens, and I am the manager for the U.S. Civil Market for DeticaDFI. I am here today to talk to you about the importance of employing advanced data analytics to ensure the integrity and efficacy of the crop insurance program.

But before I do that for context, please allow me to tell you very briefly about myself. I have been a consultant for a number of years and have been working with various government agencies for over 8 years. My particular area of interest has been in helping clients tackle the issues of fraud, waste, and abuse. Prior to joining DeticaDFI, I worked with both CSC and Booz Allen. Across my career, I have had a particular interest in deploying advanced analytical capabilities to help our government solve difficult problems.

As I noted, I work for DeticaDFI. As a member of the Detica Group, DeticaDFI is a consulting organization that helps a wide range of public and private sector entities convert typically large volumes of data into actionable intelligence. We provide a broad spectrum of intelligence and analytic services with particular focus on the areas of fraud detection, risk management, security, and regulatory compliance.

Although we are well known in the financial services arena, we have a 30-year heritage of working with national security and civil government clients to find organized fraudsters, traffickers, criminals, and terrorists. Perhaps the easiest way of helping you understand what DeticaDFI does is to provide an example, but before I do that, I would like to tell you a little bit about how DeticaDFI came to be here in the U.S.

For several years, DeticaUK personnel were working with a Federal agency in the national security arena. At their request, we opened a U.S. office, incorporated in the U.S. and staffed entirely with U.S. personnel. Since then, we have leveraged our experience and now work with numerous U.S. agencies to help them deal with a variety of issues, including those related to fraud.

As an example of the type of work we do, the Insurance Fraud Bureau is a body established in 2006 to detect and investigate serious and organized fraud in the UK. The IFB was established because the insurance industry needs to tackle distributed claims fraud. The insured in this example would collude using a variety of techniques and make multiple fraudulent insurance claims across multiple insurers.

For example, individuals would insure a vehicle with multiple insurers using slightly modified information with each insurer. With

multiple policies in place, they would then stage accidents resulting in a damaged vehicle and soft tissue injury claims. Many would then continue to stage another wreck with the same car and make claims again another one of their policies. Detica applied a series of advanced new data analysis techniques to detect patterns of fraudulent behavior in large data sets.

The combined data is over 260 million records covering more than 32 million families. By combining multiple data sources to form the big picture, more accurate risk scores could be generated and delivered to investigators to maximize their capacity. This is in sharp contrast to traditional approaches which look for individual anomalies in data.

Once we have helped our clients understand and articulate the problems they want to resolve and formulate a strategy to resolve it, we can then offer a range of technological solutions as appropriate. These solutions do not just include data warehousing and data mining, but include the full range of predictive analytics.

Data quality assurance, web integration, enterprise content management, text mining, search and retrieval, and communications monitoring. In short, what we do through our solutions is use the data, however voluminous it might be, to identify whether there are linkages or connections between people and entities. Once the linkages are created, the customer, in this case RMA, can then begin to understand whether the linkages are meaningful in terms of suggesting potentially wrongful behavior and then further investigate those patterns and linkages.

The strength of the system is that it identifies networks, not just individuals. Equally important, it helps better direct taxpayer resources, not just investigate large populations but to focus investigators where there is a statistically high probability that bad behavior by multiple persons is occurring. Our vision for the RMA then is to employ a similar data-driven investigation approach to look holistically at data to find networks of suspicious activity.

The approach I have outlined requires more than data mining but leverages data mining. The use of advanced analytics in network detection capabilities will be added. Advanced analytics provides the ability to look forward rather than looking at data to see what has happened in the past. We let the data tell the story and then use statistics to validate the story. This approach will benefit RMA through earlier and accurate detection of emerging patterns, lower cumulative losses from earlier detection, better intelligence, more targeted investigations with fewer false positives which waste time, money, and investigative resources. And it will deter additional networks from emerging.

Furthermore, additional benefits beyond RMA will accrue to USDA, farmers, and the taxpayers. Some examples are that USDA will be able to maximize the use of data across departments and will achieve efficiencies in data applications. Farmers may enjoy the potential for lower premiums or at least stable premiums, and there may be an expansion of RMA's assistance to other due to cost savings. Farmers will also benefit from our proposed approach in that fewer of them will be compelled to respond to investigations initiated as a result of false positives. Insurance companies will benefit from better oversight and control. And finally taxpayers will

enjoy more efficient use and stewardship of resources. All of this, of course, requires adequate investment by Congress and the RMA.

With that, I conclude my statement. Thank you for the opportunity to speak today.

Mr. ETHERIDGE. Thank you, sir. Let me thank all the witnesses. And we have been doing—Mr. Cooper and without objection, they will be able to sit on the panel and listen in to the testimony. We welcome him. Now we will recognize members for 5 minutes, and the chair will recognize himself for the first 5 minutes.

Mr. BRICHLER, the argument has been made that companies are making money hand over fist, but as you pointed out in your testimony, if that were the case, why are we not seeing many new companies get in the business? Can you briefly give a history of the number of crop insurance companies that have been in operation over the course of the program's history and how that is growing, where we are?

Mr. BRICHLER. Yes, Mr. Chairman. The number of companies involved in delivering the MPCFI or the crop insurance program has varied over time, but it recently dropped by a few companies. And then within the last year, it has—

Mr. ETHERIDGE. What is that number?

Mr. BRICHLER. There are 17 insurance providers, I believe, 16 or 17. At one point, there were close to 50 companies initially in the 1980s. And as far as systemic issues that have caused the reduction in the number of companies involved, I think, one, it is a very specialized line of business. It requires a sophisticated information system. It requires a group of employees that need to be trained in a unique line of coverage and for the company to build a unique field adjustment staff to service this business.

In all the lines of coverage that I have been exposed to in the property and casualty industry, this is by far the most complex and the most paper intensive, and the most data transmitted to a regulator of any other line of coverage that I have been involved with. All those, I think, make a difference in how many people are willing to participate.

Mr. ETHERIDGE. A common complaint we hear, Mr. Brichler, from crop insurance companies is that the A&O reimbursements for delivery expenses does not cover the cost. With crop prices going up, price selections on policies have gone up, raising premiums and consequently raising the A&O reimbursement. Is the statement that A&O is not covering costs still true in this new environment?

Mr. BRICHLER. Well, without knowing where the final premium would end up this year, I couldn't answer that with any definite response. But I will say that as prices increase and as our policies reflect a combined yield and revenue exposure, as Dr. Barnaby pointed out in his testimony, the more the price component is an impact, the more claims that we end up having. The comparison between the amount of work on the claims side versus this line of business and other property and casualty lines is immense. And so we look at more claims. We process more paper due to that, and that all impacts the cost.

Mr. ETHERIDGE. Thank you. Mr. Herring, I believe I understood you to say that 100 percent of the farmers you deal with carry crop insurance. Is that correct?

Mr. HERRING. No, sir.

Mr. ETHERIDGE. Okay. Well, let me ask my question then in this way. What percent of the farm operating loans that you make carry crop insurance? And what are the characteristics of a farm in which your institution would require crop insurance? And finally, are there many such farmers? In other words, that you require to have it and you loan operating money to?

Mr. HERRING. Typically, I would say 75 percent or more. It is not 100 percent, but it well exceeds 75 percent of our operating loans are insured by crop insurance. And requiring crop insurance is not a yes/no answer. We have to look at everything from their repayment capacity to their equity position to other collateral we have. But typically on an operating loan, we do require it.

Mr. ETHERIDGE. But you also look at that balance sheet?

Mr. HERRING. Yes, sir.

Mr. ETHERIDGE. How much liquidity is in that balance sheet?

Mr. HERRING. Yes, sir, and that is with the young beginning small farmers, it is a major need because they are just beginning to grow their balance sheet. And they are starting off in a weaker position with low equity positions, and the insurance allows us to take risk and way to move the risk to the insurance companies and take it off of these young beginning farmers.

Mr. ETHERIDGE. Okay, thank you, sir.

Mr. MORAN. Mr. Chairman, thank you very much. Dr. Barnaby, I appreciate your testimony. I have always tried to find the outside expert who can analyze for me what it is that is happening as far as profitability or rate of return within the crop insurance industry. If I understand your testimony correctly, and I always struggle to understand your testimony, in this case, I think what you are telling us is straightforward, which is the operating margins, as compared to other sectors of the insurance industry, are in line, in fact, perhaps less, the operating margins are less than other areas of the insurance industry. And the expenses of delivery of the product are at least the same or more. Is that an accurate summarization of what you are saying?

Dr. BARNABY. It is a correct summarization. That is exactly what the data says.

Mr. MORAN. Is the operating margins, is that the appropriate criteria, the ingredient that needs to be judged? I sometimes think of this as like a monopoly in which it is a regulated industry and the commission in charge of regulating monopolies is desirous of finding a rate of return on assets that allows the industry to be profitable but not take advantage of the consumer.

I know this is not a monopoly. There are 17 participants in this program. There is competition within the crop insurance industry, but I have always looked for that similar kind of standard that would tell me that the rate of return is such-and-such, such that the industry is viable, profitable. And is there a difference between operating margins and rate of return on investment? Is this the right standard that we should be looking at?

Dr. BARNABY. It is the standard that is public, and I don't have access to the financial statements of many of the individuals companies that are involved because they are privately owned. The first place I looked actually was on my State Farm policy, which is a mutual, this is my personal policy. They actually give you an income statement, and they break all these items out: the amount that goes to loss adjustment, the amount that goes to paying claims, et cetera.

And as far as I can go with this data, it is basically to say exactly what you said. That the amount that is left over to operate the insurance company is not, in fact, smaller than it is with other property casualty lines. So I think basically you could argue that the crop insurance companies are at least as efficient as the auto insurance companies, the homeowners insurance companies, et cetera.

Mr. MORAN. And if you were looking to enter the insurance industry, according to operating margins, it would make a better investment by investing in property and casualty or other lines of insurance than crop insurance?

Dr. BARNABY. Well, apparently that was Fireman's Fund judgment. They withdrew from this industry, and there is a company that has a lot of assets. These, for the most part, are very small insurance companies. One of the things you might not pick up on those auto policies, we are talking about \$160 billion in premium versus \$4 to \$5 billion here to put those numbers in perspective. Great American is actually kind of an exception to that because they are a pretty good sized company too. But most of the crop insurance companies are not that large.

Mr. MORAN. Let me ask a question. This is somewhat a follow-up of the chairman's question. We have seen an increase in commodity prices for many commodities grown on American farms. The result of that is an increased premium paid by farmers. Is there a corresponding increase in administrative costs or risk associated with the increased price and premium?

Dr. BARNABY. There clearly is an increase in risk exposure. I did a presentation in front of an industry group where I looked at the supply demand numbers. This is back in February, and as tight as these stocks are, as I was pointing out to them, if we have a '93 excess moisture and '88 drought, I have no idea how high that price could go. And with these revenue products, the big risk is a short crop at high price. That is when you pay out the really big bucks. And it won't be just the insurance companies getting tapped. USDA is going to get tapped too if that occurs, I should say when it occurs. I don't think the weather has changed that we are through having disasters, so their exposure is substantially higher.

The A&O, yes, I mean that clearly went up as a result of higher prices. But the premium, what they are calling underwriting gain, that is not exactly a correct definition of underwriting gain. But what they call underwriting gain, we don't know where that comes out until we see what the loss experience is through the growing year. It is not going to be good in Kansas.

Mr. MORAN. Yes, sir. Mr. Chairman, thank you for the time. Dr. Barnaby, I have run out of time, but I would welcome your critique or review of the GAO report at our mutual convenience perhaps. Thank you.

Mr. ETHERIDGE. And if you would just submit that to the full committee in writing, that would be great.

Dr. BARNABY. Yes, sir.

Mr. ETHERIDGE. Thank you. The gentleman from Minnesota, the chairman of the full committee, Mr. Peterson.

Mr. PETERSON. I thank the chairman. I want to thank he and the ranking member for their leadership. I am sorry. I had to step out a minute that I might have missed something. But apparently, Mr. Brichler, RMA has requested, and GAO and the OIG have also said that they think that RMA needs the authority to renegotiate the SRAs. Do you agree with that? I would like to know what terms you think.

Mr. BRICHLER. My experience in the industry, I have gone through three renegotiation processes since 1994. While I think it is necessary that we always review what the contractual terms are, given the current set of affairs, one thing that is really difficult when you are a large company or a reinsurer of a large company or a small, privately owned company, not having an agreement that has multiple-year length makes it very difficult to manage any kind of operation. Why would you invest in a business for the future if next year they could change all the rules on you and it would be no longer worthwhile for you to stay in business?

So I think if we are going to renegotiate the SRA, it needs to be for a duration long enough that there is a set time period where companies can react to whatever the terms are, reinsurers can be, you know, approached and explained what the differences in risk or return have been made in the agreement, and it is set and not every December, you know, the way the SRA works currently, there is no negotiation because by legislation, it is locked down.

In the past, it could be cancelled at any December 31, so we always kind of sat on pins and needles until January 1 to know if the deal was going to change on us. So in response, I think it is appropriate to renegotiate it at some time, but not every year and certainly not every 3 years.

Mr. PETERSON. Apparently the studies, I guess that you cited on the profitably, cover pre-ARPA dates. Are they still reliable, given the climate we are in today where we put in more government subsidy and we have a very different price situation now than we had back then?

Mr. BRICHLER. I honestly couldn't tell you. I think it would be appropriate to look at that, but if you look at the data that, for instance, Dr. Barnaby has analyzed or what we have access to in the public domain, there is clearly a close relationship between the returns on the crop insurance sector and what is normal on property and casualty lines. I don't see a disparity there, and I think Dr. Barnaby's testimony leads me to believe that there are other major companies that have actually taken a different approach in saying this isn't a line of business that we want to be involved in because the volatility and the risk is too great for the amount of investment we need to make. He mentioned Fireman's Fund. Hartford got out. INA got out during my tenure. There are a lot of large companies that were in this business that are no longer in it.

Mr. PETERSON. For both you and Dr. Barnaby, I guess this A&O question, does it make sense to have a system where this is set by

a percentage. We have this situation now where my farmers are telling me that policies are twice as much as they were last year. And some of the agents that I have talked to say there is some extra work because of the price situation. It is more complicated now to try to figure out what you ought to do. Does this make sense, or is there some better way to do this than having a percentage in the law?

Mr. BRICHLER. I think it was two SRA negotiations ago, we kicked around, different ways of compensation for overseeing and managing this business. But we always came back to the industry in general works off of commission numbers off of a base premium. And that is where we always ended up. If there is another suggestion, as long as it is equitable for all parties, I think the industry would, you know, listen to that.

But again it has to be commensurate with what the returns are or the expense components are for other lines of business, or you will have people fall out of the program.

Mr. PETERSON. I think my time is up. Do you have anything to add, Dr. Barnaby? Have you looked at that?

Dr. BARNABY. Yes, I have a little bit. Obviously I don't think very many people were forecasting \$4 corn 6 months ago or 9 months ago. And so if you want to argue that was sort of a windfall on the A&O, you could certainly make that argument. Now, it is also true that if we had \$2 prices, then that A&O drops too. And so one of the things I thought about is one alternative, if you want something more stable, is to base it on a long run price rather than the current price as far as A&O. Now, that is totally different when you get over to the premium that your farmers are paying. The premium is substantially higher because the risk is just substantially higher, and that is measured by the Chicago Board of Trade.

Mr. PETERSON. I understand that. Could I ask one more question? This should just take a second. Okay, I think, Dr. Barnaby, I think Dr. Collins stated that they get a lower the loss ratio from the 1.075 to 1 without having much impact on premiums. Do you agree with that?

Dr. BARNABY. That they can lower the loss ratio?

Mr. PETERSON. Yeah, from 1.075 to 1.0. I think in the hearing we had here a while ago that was stated.

Dr. BARNABY. I have broken these out by state, and nationally the book, I would agree, is pretty close to the actuarially sound number. But it is certainly different by state, and the fact is my state is one of those that has a loss ratio that exceeds one. So that means there are some states that don't like Iowa and Illinois, and that is why it is a very competitive markets, why there are a lot of insurance companies there.

Mr. PETERSON. But nationally it is pretty close to—

Dr. BARNABY. Nationally, I won't argue over three points. I am not an accountant. I am an economist. You know, 3 or 4 percent doesn't mean anything to me, in the ballpark. It is close. I won't argue with him over three points.

Mr. ETHERIDGE. All right. I thank the gentleman.

Mr. PETERSON. Thank you very much, Mr. Chairman.

Mr. ETHERIDGE. Thank you. Mr. Boustany, 5 minutes.

Mr. BOUSTANY. Thank you, Mr. Chairman. Mr. Ferens, could you please explain further how what you are recommending is different from what RMA currently does to identify waste, fraud, and abuse?

Mr. FERENS. Certainly. Our approach is to take data mining and leverage it further. We use a systematic approach where we take in all available data, and we let that data tell us a story. We do that through the statistical methods that we have developed over time with a number of different clients, both in national security and civil market spaces.

But it really is a story that the data tells us. It is not looking for individual anomalies. It is not the human bias. It is not the hypothesis-driven approach. We try to understand what the linkages are between entities and individuals from that, and then using the statistically-based approach, measure those linkages in terms of strength. That gives us an ability to prioritize investigations.

If a network of individuals seems suspicious, we can pull in subject matter experts and say does this seem appropriate. We can then retrain the data and look for additional anomalies in large groups of individuals based on that subject matter expertise. Or if that anomaly turns out to be, well, what we would expect, we sort of set that aside, and we train the data a different way to ensure that those false positives don't continue to emerge.

But all in all, you get a prioritized profile of the bad behavior. You actually get a case built before you. All of the data is available at your fingertips. You don't have to go to each of the multiple disparate databases and pull in information. You know who the people are, how they are related, what the entities are, whether it is a cooperative, whether it is a group of farmers, whether it is a bad corporation. We can tell all that information quickly.

Mr. BOUSTANY. Thank you. Based on what you know at CAE at Tarleton, how would you rate their work? And are you suggesting that what they are doing is now one way to conduct oversight, but there are certainly other ways to go further with it?

Mr. FERENS. I am suggesting that what they do is quite good, and what we do is again to take that and leverage it. In some instances, the data mining results would be superior to what we might find. If the data sources are well mined, we would probably find no incremental benefit. However, when we pull together all of the data sources, we would look at probably seeing incremental benefit accruing across the board.

Mr. BOUSTANY. Thank you. And, Dr. Little, based on your professional experience and testimony that you have heard from Mr. Ferens, is it possible for you to use more of these analytical techniques as part of your work with RMA?

Dr. LITTLE. Congressman, the techniques that Mr. Ferens is talking about are things that have been published and have been around for a very long time. They are basically the foundations of matrix algebra and multi-varied analysis.

And, if I may, I would like to address what he was talking about in terms of linking entities together. My group won the best paper in economics in 2004 for doing exactly what he just described. It was published in "The American Journal of Applied Economics". So I don't see the difference here. What he described is exactly what we do. We try to integrate as much data as possible. I mean I just

told you that we are building a 42-terabyte system to hold all the satellite data from 2000 until now, to yesterday, for immediate use. And we are going to share that with the crop insurance companies also. I really don't see the difference. Thank you.

Mr. BOUSTANY. Thank you. Mr. Ferens, do you have anything else you want to add?

Mr. FERENS. I think that there are differences. I think that we can work together to illustrate those differences. Oftentimes what we as an organization do is perform proof concept, again working with subject matter expertise of the individuals. There is certainly opportunity for us to explore if what we have done is aggregate information across numerous agencies in the past. And without fail, we have found improvement across the board.

Mr. BOUSTANY. Thank you. Are you suggesting that you use different analytical techniques than what Dr. Little and his group are doing?

Mr. FERENS. I think we use a combination of techniques that may be innovative in the way we combine them.

Mr. BOUSTANY. Okay, thank you. That is all I have.

Mr. ETHERIDGE. I thank the gentleman. The gentlelady from Kansas, Ms. Boyda.

Ms. BOYDA. Thank you, Chairman. Dr. Barnaby, thank you for your testimony. It is actually the apples-to-apples comparison that is quite helpful for those of us who really don't understand the ins and outs of all of this. And I wanted to ask you a couple of questions. My guess is, like you, I am real happy to pay my taxes, but I am not interested in paying any more than we just have to. So with all the different options that are available to us, the current system being obviously the one on the table today, is this the way that you would use my tax dollars and yours? Anything that you would recommend to make the use of our tax dollars more efficient? Basically what I am asking is from your perspective, are the taxpayers getting a good value for this? Anything that you would change that would make it a good deal for our farmers and a better deal for our taxpayers, or is this the optimum?

Dr. BARNABY. Well, first of all, maybe you are not aware I created the crop revenue coverage contract. That revenue contract is mine.

Ms. BOYDA. See, I love this job. I love this job.

Dr. BARNABY. And obviously that started back in 1990. I have been at this for a while, and, no, I think that created a lot of marketing opportunities. We have some really good corn prices right now where farmers can take advantage of those. And it gives you the financial backing and the comfort level to make those decisions.

Having said that, there is one new theory that I have kicked around with Congressman Moran just yesterday, but I will gladly share it with you too. Looking at the idea that, on the government's spent dollars, is a general statement don't take over what can be insured. In other words, target the government dollars to the uninsured part of the revenue distribution rather than duplicate what can be insured. One reason for that is obviously it is still cheaper to do it under an insurance program regardless of who administers it if farmers are paying a share of the premium cost.

When we talk of things like loan deficiency payments and all the other kinds of payments that may come to farmers, those are essentially just variations of revenue insurance. But 100 percent of the premium is paid by the government. So if you are going to target those, target to the part that you can't insure. I haven't really fully pulled that document together yet, but I will gladly send it to you when I get it done.

Ms. BOYDA. I would appreciate that. The GAO report that Mr. Brichler was speaking about earlier, again I am not up to date on that. I know a little bit about it, but could you summarize what that said. And again basically what Mr. Moran was saying is what—just give me—we have got 2 minutes and 9 seconds now. Can you help me understand that report?

Dr. BARNABY. I am going to have to come back to you on that. I have not read the report. I saw it just a few minutes ago. I was comparing my numbers to make sure they agreed with theirs, and just doing some spot checks, I think I agree on the numbers. Now, we probably don't agree on the interpretation though, but I have not read the report. But I will send an email to your staff.

Ms. BOYDA. All right, I would certainly appreciate that. I had a question then for you, Mr. Brichler. This is the wonderful part of getting to learn about the whole process here. So I don't come to it with any preconceived idea. When we are talking about when we have lost so many of our companies, the big companies, when they get out of that business, do they sell that book of business to somebody else? Or is everybody just picking it up bits and pieces? How is the market accommodating from going from 50 down to 17?

Mr. BRICHLER. Congresswoman, the events, I guess, are unique to each one of those circumstances. Most of the time a company that currently is operating in the crop insurance sector will buy the renewal rights for the policies that the exiting company has. But we also have had issues in the past where some companies just have gone bankrupt, and their business has gone out and been absorbed by the direct competition among everybody in the industry. So it works best if there is a planned renewal rights purchase, but in the absence of that, if there is business on the table, the companies that are in this space will go after and compete for it.

Ms. BOYDA. All right. Thank you very much. I yield back.

Mr. ETHERIDGE. Thank the gentlelady. The gentleman from Texas, Mr. Neugebauer for 5 minutes.

Mr. NEUGEBAUER. Thank you, Mr. Chairman. Dr. Barnaby, I want to go to your chart, Table 1, I guess, and as you know, the USDA is proposing to increase the amount of underwriting gains retained by RMA in the farm bill proposal to kind of rebalance the risk sharing. And so in 1997, according to Table 1, that would have been a good deal.

Dr. BARNABY. For the government, yes.

Mr. NEUGEBAUER. Yeah.

Dr. BARNABY. Yeah, um-hum.

Mr. NEUGEBAUER. How would that deal have been in 1993?

Dr. BARNABY. Well, they would get a share of the underwriting loss.

Mr. NEUGEBAUER. Yeah, a pretty substantial share, as well as also in 2002, right?

Dr. BARNABY. As I understand that proposal, their proposal is to take 25 percent of the underwriting gain/loss, so whatever it is. Again I sort of cringe when we say underwriting gain or loss. It is really margin on the gross premium is what it really is, but yes, sir.

Mr. NEUGEBAUER. And so what, you know, and then maybe in the last few years, that could have been a good deal for the government. What happens to the industry though if the Federal government starts trying to pick those years or to anticipate going into those years and taking a greater participation in that. Does that — what happens to the companies long term? Do they begin to say since the government is getting into the interest business we are getting out?

Dr. BARNABY. Eventually that would be the case. I don't know where that point occurs. One thing I might point out to you just over the last 4 years, the government effectively had a billion dollar underwriting gain over that period.

Mr. NEUGEBAUER. Um-hum.

Dr. BARNABY. So they didn't pay in to those numbers. They are not listed here on this table. Now, in other years, the government effectively had an underwriting loss. So, you know, this is just the different sharing arrangements. So it kind of depends on what year happens. If this were to go into effect next year, and we get an '88 drought next year, why the government wouldn't only have underwriting losses, but then they would have a share of the company's. And they would probably be glad that you they have a share of it at that point.

Mr. NEUGEBAUER. Um-hum. Mr. Herring, one of the things that I think I am most concerned about, I am recently from the private sector. And some people think that profit is a 4-letter word. I always remind them that loss is a 4-letter word actually, and that to the degree we have healthy insurance companies, particularly in relation to crop insurance, that is vital to the agricultural industry. And quite honestly, in my part of the world, if you don't have crop insurance, you probably couldn't get a loan for your crop production.

Mr. HERRING. Yes, sir. That is the general rule, but sometimes there are other factors that we look at. But typically you have to have it.

Mr. NEUGEBAUER. Would you say that the current coverages available for some producers is adequate?

Mr. HERRING. Yes, sir, I would. I mean in eastern North Carolina, I feel like—

Mr. NEUGEBAUER. In your part of the world. In my part of the world, because of some of the production history, we have people who are not able to actually take out enough insurance to cover the cost of planting that commodity.

Mr. HERRING. Yes, sir.

Mr. NEUGEBAUER. So one of the things that I think makes more sense rather than trying to limit the amount of money that crop insurance companies make is working at making sure that we have a crop insurance program that covers the needs of the folks that are relying on it. Because as you know, and I am sure in your part of the world as mine, the small family farm is unfortunately becom-

ing extinct and that agriculture is really big business and that these producers are taking big risks. And to the extent we have a well-funded, healthy crop insurance market will really in a lot of ways determine what the future of agriculture is in this country. Would you agree with that?

Mr. HERRING. Yes, sir, operating expense is now at a higher ratio than they have ever been with the fuel prices and everything. And the margin is smaller, and that we can't handle any more risk.

Mr. NEUGEBAUER. And when you look at what we spent on ad hoc disaster programs, I notice someone alluded to that. But really when you look at what we spent on ad hoc disaster programs over the last few years in this country. The ability to enhance our crop insurance programs really would have been able to limit what we would have had to pay out had we had a better crop insurance program.

And just I know Ranking Member Moran would be disappointed if I didn't bring up the fact that I do have introduced some legislation that would actually increase the ability for producers to carry higher levels of coverage without really, even Dr. Collins who is going to testify later on, has scratched those numbers out.

And let me tell you when Dr. Collins scratches some numbers, he scratches them pretty hard. Is that really it is a very cost effective program, and so, I think, as we look at this issue of who gets what and how much money people get to make, I think what we need to do is make sure that we are looking after the interest of the producers in this country.

Mr. ETHERIDGE. We thank the gentleman for his comments, but he is getting long-winded.

Mr. NEUGEBAUER. I am sorry, Mr. Chairman. I apologize. I yield back the balance of time that I don't have.

Mr. ETHERIDGE. We thank the gentleman. The gentleman from Georgia, Mr. Marshall. We are running short of time. We got a vote.

Mr. MARSHALL. Thank you, Mr. Chairman.

Mr. ETHERIDGE. Just to let everyone know, we got a vote coming very shortly, and we are going to try to get everybody in before we have the vote.

Mr. MARSHALL. Mr. Chairman, in response to Mr. Moran and Ms. Boyda, Dr. Barnaby indicated that he is going to be willing to take a look at the GAO report and provide them both with his comments. Is it possible for the record remain open and let Dr. Barnaby take a look at the GAO report and submit something for our record in regard to that so we will all have it and it will be in the record permanently?

Dr. Barnaby, Ms. Boyda mentioned that it is nice to be able to look apples to apples, and taking a look at Table 1 and comparing the subsequent tables, there are two columns, I think, effectively two columns that don't appear. And one is this underwriting gains column, and the other is the premium subsidy column. Could you help me out in better understanding your analysis? The reason those two columns don't appear in your comparisons, obviously one column doesn't appear because there are no premium subsidies provided by the government with regard to that kind of insurance, but the underwriting gains?

Dr. BARNABY. Yes, well, that is the problem. Underwriting gains, I put it in quotes because what USDA is calling underwriting gains is not what is called underwriting gains in private property casualty. They start off in private property casualty with a dollar coming in and then from that, they subtract the marketing cost, which is primarily insurance agent commissions. They subtract off the loss adjustment expense. They subtract off the claims that are paid out to policyholders, and then the overhead of the company, you know, turn on the power and the lights, et cetera. And after you deduct all those from your gross premium, then you get something called underwriting gain, and then from that, they add investment income, which there really isn't any here

What I have done is simply take all those dollars and say if I am a private company, I have to get all my expenses plus pay my claims out of that \$1 that comes in. And that total dollar coming in is that combined A&O underwriting gain, and I am treating it as a cost rather than something that is at risk. I know it is at risk, but I am treating it as a cost, plus the premium subsidy, plus the farmer paid premium. That dollar comes into the insurance company, and then out of that dollar, over a period of years, you can pick out individual years, as Congressman Neugebauer did, and you would have paid, you know, 60 cents out of it. Other years, you would have paid a dollar out of it. But the long-run average you have got about 75 cents.

Mr. MARSHALL. Well, what—

Dr. BARNABY. And 30—

Mr. MARSHALL. —I wound up doing is taking the total number of years that you have here—

Dr. BARNABY. Um-hum.

Mr. MARSHALL. —and I deleted two outliers, which would be a fairly standard statistical technique, and I came up with 66 percent just as I was sitting here. But it is pretty close to the figures that you have as far as average is concerned, so I have no quibble with that. In your mind, does it make any difference in comparing—again it is this apples-to-apples analogy that was used earlier. Does it make any difference in comparing any returns to this industry with returns to the other industries, that 30 to 40 percent of the premiums—

Dr. BARNABY. Um-hum.

Mr. MARSHALL. —are pretty much guaranteed. They just come in the form of checks from the government.

Dr. BARNABY. Well, one of the things you need to look at, I would suggest to you, is how much variation there is in the annual payout out of that dollar. You say you deleted a couple of the outliers. Well, there are two other outliers that are not in here, 1988 and 1983, very long-run insurance. If you look at the property casualty, it doesn't vary that much annually.

Mr. MARSHALL. So that was going to be another one of my questions. You don't use very many years in statistical analysis normally. You take at least 19 samples, and you have got about 5 or 6 years for each of the others. And you did that simply because it is pretty standard. It is just with the others—

Dr. BARNABY. All the data that is available to me. If RMA wants to make the data public, I would be glad to work with it.

Mr. MARSHALL. No, I was referring actually to your comparison.

Dr. BARNABY. The—

Mr. MARSHALL. Your comparisons are pretty short on years.

Dr. BARNABY. On the auto policy for example? Yes, but again they don't change a lot from year to year.

Mr. MARSHALL. So basically your testimony is that we can go ahead and rely on that even though the sample number of years is pretty brief?

Dr. BARNABY. Yes, I don't think that is going to change very much. In fact, that is—

Mr. MARSHALL. I am going to have to interrupt you because I am running out of time. Real quick question. We mentioned this notion of changing the way the government participates in underwriting this risk and maybe the government getting more involved. If the government gets more involved. It is a bad year, then the government is going to experience some loss. If it is a bad year, don't we do disaster payments anyway? What would be a better deal, from the government's perspective, if we were able to restrain ourselves where disaster benefits are concerned and make crop insurance even more available? Net, how would the taxpayers come out?

Dr. BARNABY. Well, it is pretty much a hypothetical. I don't know exactly what this new program is going to look like. I have looked at the one that Congressman Neugebauer mentioned, primarily using a county yield number to design an insurance program that would tied to the individual that was based off of county yields. The only thing I would question on that, you need to make sure that those expected county yields are correct, and I would take issue that they are probably not. But in any case, I don't know the answer to that without doing more analysis that I have got at this point.

Mr. MARSHALL. Yield back what I don't have.

Mr. ETHERIDGE. Thank the gentleman. Gentleman from Texas, Mr. Conaway.

Mr. CONAWAY. Thank you, Mr. Chairman. Dr. Little, I know this is a crop insurance hearing, but would you give us a couple of thoughts on use of your data mining techniques and work being applied to other disbursement areas within USDA, such as the nutrition program used to apply what you do on looking for waste, fraud, and abuse in the nutrition program?

Dr. LITTLE. I think it has a wide application there, and we have discussed this with the FNS folks, and they feel that it has a great potential also. One of the data issues with FNS is that the vendors for the food stamp program are monitored by the Federal government, and the recipients are monitored by the states. That is a mistake, and those things need to be brought together so that you can do the kind of link analysis that has been mentioned here. And once you do that, I think that you will be able to recover quite a bit of maybe it is slop, maybe it is waste, fraud, abuse or all of it. But something that accounts for over half the USDA's budget certainly needs better oversight.

Mr. CONAWAY. Okay, give us a couple thoughts on how would you fix that disconnect between the state oversight and the Federal oversight? What would be your plan there?

Dr. LITTLE. I would consolidate the data. I would require the states to report the recipients. You have got California, for example, that won't report to USDA OIG on request who the recipients are. They give them aggregate county numbers, masking any possible abuse.

Mr. CONAWAY. Okay, so this field might be ripe for harvest, to use a phrase.

Dr. LITTLE. Sir, it is overripe.

Mr. CONAWAY. Okay, thank you. Mr. Barnaby—or Dr. Barnaby. I apologize. Or Mr. Brichler. Getting back to the differences between property and casualty insurance companies, they get the premiums up front in advance, and then they invest those premiums over some period of time in an attempt to make money, which as my good colleague from north of Texas said is not all bad, versus how the crop insurance. Would you flush that out a little bit?

Dr. BARNABY. Well, you don't pay for your crop insurance policy until after the growing season is over, not at the start over the coverage. Whereas with an auto policy, you pay for the premium up front before you have any—in fact, if you don't pay it right away, they will cancel your policy within—

Mr. CONAWAY. Right.

Dr. BARNABY. —30 days. So, yes. And if you look it is significant, again because State Farm is a mutual company, I get an income statement along with my premium notice. And you look down their income statement, the investment income is a significant part of their net returns to the company.

Mr. CONAWAY. If you had a similar approach under crop insurance, what would that do for the program itself? In other words, what is that impact of that? I mean I know the answer, but I want you to tell us what the impact would be if we had a similar circumstance in crop insurance.

Dr. BARNABY. If you paid the premium up front?

Mr. CONAWAY. Yes.

Dr. BARNABY. Yeah, well, you would add investment income to the industry.

Mr. CONAWAY. To the—

Dr. BARNABY. I might add that I have been involved in developing private insurance contracts, and that is two things I always do. Let us get the premium up front, and the expense load usually is 40 percent when it is done privately.

Mr. CONAWAY. All right, and again, this is for Mr. Brichler. Is this percent of premium the best way, the most reasonable way to determine the administrative subsidy pay on behalf of farmers to companies?

Dr. BARNABY. Congressman, as I said this earlier in response to Chairman Peterson's question, we have talked whether there are other ways to do that, but the entire industry always ends up focusing as a percent of premium. So while there may be better solutions, I don't know of one. It is certainly the industry standard. And if I could take one second to comment on your investment income, just to kind of put four corners around that, the estimated underwriting gain for the whole property and casualty industry in 2006 was \$15.7 billion. Now, the investment income for that same

period of time was \$54.6 billion. So, as Dr. Barnaby said, there is a gigantic difference between this line of coverage not having any investment income and only relying on underwriting gain.

Mr. CONAWAY. All right, thank you, sir. And, Mr. Chairman, I will yield back time that I have.

Mr. ETHERIDGE. I thank the gentleman very kindly. Let me thank each member of the panel for being with us today. It is a little unprecedented that our government witnesses are second rather than first, but I want to thank them for waiting and ask them if they would come to the table. Today we want to do it this way so they would have an opportunity to have their comments on what they heard from the first panel. We are going to try to get started with the second panel.

Please understand that we may have a vote called any time. We have been notified that any time from 11:30 on, we could have a vote. Maybe we can get through the testimony before we get started. I am asking Administrator Gould, if he would please, Administrator of the Risk Management Agency for the Department of Agriculture.

Okay, well, we will let you take a break, the vote is ongoing. I didn't get a buzz on it. How much time do we have? We have 11 minutes left on the vote, so we will have two votes. We should be back in about 20 minutes maybe if we can rush back, and I will try to come as soon as the second vote starts.

Administrator Gould would come to the table. He will be accompanied by Dr. Keith Collins, Ms. Tighe accompanied as a Deputy Inspector General of the Office of Inspector General, and Mr. Robert Robinson, Managing Director of Natural Resources.

And if you don't mind, we will stand in recess until we get back, and as soon as we get back, we will get started. We won't have to start with introductions at that point.

[Recess.]

Mr. ETHERIDGE. Mr. Gould, if you would please.

STATEMENT OF ADMINISTRATOR ELDON GOULD, RISK MANAGEMENT AGENCY, U.S. DEPARTMENT OF AGRICULTURE, ACCOMPANIED BY DR. KEITH COLLINS, CHIEF ECONOMIST, U.S. DEPARTMENT OF AGRICULTURE

Mr. GOULD. Mr. Chairman, I guess I can still say good morning, Mr. Chairman and I will cross out the portion here "members of the subcommittee". I am Eldon Gould, Administrator of the USDA Risk Management Agency. I am also a lifelong Illinois farmer who values crop insurance program that makes the best use of taxpayer dollars. I am fortunate to have with me today Dr. Keith Collins, Chairman of the Federal Crop Insurance Corporation Board.

The FCIC board and RMA have established overall program integrity as a high priority. RMA maintains program integrity within the Federal crop insurance program by the use of prevention, detection, and enforcement. The Federal Crop Insurance Program is meeting its mandated target loss ratio. That is not to say that more cannot be done, with regard to reducing program fraud, waste, and abuse.

We estimate that in 2007, we will reach \$68 billion in insurance protection for American agriculture. In a program of this mag-

nitude, we must be diligent in order to deliver a flexible, fair, and fraud-free program. RMA completed the second year of a structured random policy reviews in 2006. It is noteworthy that RMA's observed error rate from reviews on 600 randomly selected policies was 2.68 percent. We initially projected five percent on the first reports, so this number is lower than we expected.

Essential to the Federal crop insurance program are the 16 private insurance companies who actually deliver insurance to America's farmers and ranchers. There has been recent criticism of the profits that companies make by selling crop insurance. There is no question that in recent years insurance companies have benefited from this program. Moreover, we agree that rebalancing of the program should be a priority to allow a redistribution of the underwriting gains so that the Federal government would receive an increased share. In fact, this is one of the administration's Farm Bill proposals.

In addition, permitting RMA to renegotiate the terms of the standard reinsurance agreement every 3 years would give it the flexibility to routinely monitor program performance and maintain the proper risk sharing balance. That being said, the reimbursement of the company's A&O expenses and the underwriting gains made by the companies is a complex matter, and any analysis must include data specific to the crop insurance industry.

Recent underwriting gains by crop insurance companies have tended to be higher than other similar lines of insurance within the industry primarily because of an unusually good run of favorable weather over the past few years. It won't always be that way. If next year happened to be an extremely dry year, as 1988 was, at today's level of liability, the companies would lose \$980 million in underwriting. On the other hand, if next year happened to be a significantly wet year like 1993, companies would stand to lose an estimated \$440 million. It is not a matter of if but when similar kinds of weather events will occur in the future.

RMA has preempted millions of dollars worth of expected payments, and we continue to find ways to reduce program abuse. We continue to use data mining to identify anomalous producer, adjuster, and agent results, and with the assistance of FSA officers, conduct growing season spot checks of anomalous producers. Reduced indemnities on spot check policies over the past 5 years total approximately \$430 million.

I thank you for this support and cooperation provided by the committee to help improve the Federal crop insurance program, and I appreciate the opportunity to participate in this important hearing. And if we have time, at the appropriate time, I look forward to answering questions.

Mr. ETHERIDGE. Thank you, sir. Ms. Tighe.

STATEMENT OF KATHLEEN S. TIGHE, DEPUTY INSPECTOR GENERAL, OFFICE OF INSPECTOR GENERAL, U.S. DEPARTMENT OF AGRICULTURE

Ms. TIGHE. I think it is officially good afternoon, Chairman Etheridge, Ranking Member Moran, and Congressman Cooper. Thank you for inviting the Office of Inspector General to testify today concerning our views on the Federal crop insurance program.

The crop insurance program represents a significant investment by the Department of Agriculture and Congress to support and strengthen the Federal safety net for America's producers.

We at the Office of Inspector General have conducted substantial audit and investigative work pertaining to the crop insurance program and its participants. I am pleased to be able to share with you our findings and recommendations. My written statement contains my full testimony, so I will just briefly summarize a few highlights.

There is clearly a significant upward trend in Federal payments to approved insurance providers for their expenses in underwriting gains. From 2000 to 2006, total payments to insurance providers increased to record levels to over \$1.8 billion an increase of over 120 percent. The Federal reimbursement to insurance providers for administrative and operating expenses for each producer policy has increased to almost 100 percent during that period.

While Congress has successfully broadened the safety net for producers, we believe it is time to reassess what constitutes an acceptable cost to the government. To have an effective crop insurance program, we believe three elements are essential: proper assignment of risk between the insurance providers and the government, effective management controls including particularly a strong quality control system, and aggressive enforcement actions to address fraud.

In contrast to other insurance programs, the approved insurance providers that participate in this program face very low risks. Since RMA is underwriting most of the risk for the crop losses, the insurance providers have less incentive to vigorously administer Federal crop insurance policies in accordance with the best interest of the government and the taxpayers.

To ensure that Federal funds are used more responsibly and efficiently, the insurance providers need to consistently monitor policyholders, deny questionable claims, and address weaknesses in their own practices. We have reported on concerns such as conflicts of interest among sales agents, loss adjusters, and policyholders, and inadequate verification of losses by loss adjusters.

While RMA has taken positive steps to strengthen its quality control review system, more can be done to evaluate the private sector's delivery of the crop insurance program and prevent improper crop insurance payments. In addition, the full implementation of a common information system between RMA and FSA is critical, in our view, to improving integrity within the farm programs and reducing the risk of improper payments.

In the enforcement area, the Office of Inspector General works closely with RMA, FSA, and the Department of Justice to aggressively pursue fraudulent crop insurance schemes that undermine the program and burden taxpayers. Compared to fraud affecting other USDA farm programs, these cases are particularly complex in their details and time consuming to investigate. Since fiscal year '99, our investigations have resulted in 70 indictments, 53 convictions, and over \$54 million in money recoveries.

Some of the common schemes our investigations have revealed include losses claimed on crops that were never planted and collusion between program participants to fabricate or inflate crop

losses. While the great majority of participants and beneficiaries of this program are honest and faithfully comply with its requirements, there have been a few participants whose improper conduct has tarnished the program's reputation.

My full statement details our recommendations for steps that the department and Congress can consider to improve the program. Legislatively, we do support the crop insurance proposals contained in the department's 2007 Farm Bill proposal. Other actions that we believe are critical to providing effective management of the crop insurance program and to prevent fraud waste and abuse include, as I mentioned earlier, accelerating the full implementation of a comprehensive information system, finalizing conflicts of interests, policies, and procedures, and expanding RMA's data mining activities.

This concludes my testimony. I would be happy to answer questions at the appropriate time.

Mr. ETHERIDGE. Thank you, ma'am. Mr. Robinson.

**STATEMENT OF ROBERT A. ROBINSON, MANAGING DIRECTOR,
NATURAL RESOURCES AND ENVIRONMENT, GOVERNMENT
ACCOUNTABILITY OFFICE**

Mr. ROBINSON. Thank you and good afternoon.

As we in GAO have pointed out in many forums, the Nation's bleak financial condition should be a cause of great concern to all Americans. In this financial context, it is vital that every federal program be operated as effectively and as efficiently as possible, and that major spending leakages be plugged when they have been identified.

We have recently identified federal crop insurance as one such program in need of attention to better protect tax payer interests. Based on our most recent work, additional attention is needed in two areas. First, tightening procedures to reduce fraud waste and abuse in the payment of insurance claims, and second, adjusting excessive compensation insurance companies are paid to sell and service crop insurance policies.

Let me start with the fraud waste and abuse. On this front, RMA has taken a number of steps, as Administrator Gould has pointed out, to reduce previously identified problems. In particular, its use of data mining enabled it to identify producers with claim patterns consistent with fraud and abuse that warranted heightened inspection activity. Combined with other related actions taken by it and FSA, RMA has reported over \$300 million in avoided payments between 2001 and 2004. That is certainly good news.

Still, in our most recent work, we found that a number of important vulnerabilities open the system up to well over perhaps \$100 million a year in potentially fraudulent claims. Specifically, first, FSA was not conducting all the field inspections RMA requested to identify suspicious claims; second, RMA's data analysis of the largest farming operations was incomplete, reducing its ability to identify potential fraud. RMA and FSA started to do the information sharing to improve this analysis, but has now stopped because of privacy concerns.

Third, RMA was not effectively overseeing insurance company quality assurance programs, which are an important component of

the fraud detection system. And finally, RMA has infrequently used its full sanctioned authority to address identified program abuses. Likewise, we found out the basic program design components laid out in both regulation and statute contribute to increased chances for abuse. In particular, allowing farmers the option of insuring fields individually rather than as one unit enables farmers to switch production among fields either to make false insurance claims or to build up higher yield histories to increase eligibility for future insurance guarantees. Yield switching could be at the root of 10 to 12 percent of irregular claims.

Also, offering prevented planting coverage opens up a significant exposure to claims of loss whose legitimacy can be difficult to determine. RMA pays about \$300 million annually in such claims.

My second main point this morning, and obviously the one that drew the most attention in the earlier panel, is that compensation to insurance companies has been excessive. To this end, over 40 percent of the \$16 billion in Federal program costs over the last 5 years were payments to insurance companies, not benefits to farmers. In the last 3 years, this percentage is appreciably higher. Any system frankly that requires \$2 to deliver \$1 of net benefits would seem to have some efficiency problems.

In this regard, USDA pays the insurance companies participating in Federal crop insurance both underwriting gains and cost allowances. Underwriting gains total \$2.8 billion from 2002 through 2006. These gains represent an average annual return of about 17.8 percent. This rate is nearly 2-1/2 times the benchmark for other insurance lines, and I suppose that is what we are going to be discussing a lot more in the next few minutes.

USDA had a one-time authority to renegotiate the financial terms of its SRA with the companies which took effect in 2005. Nonetheless in 2005, insurance companies received a rate of return of 30 percent, and in 2006, the return was 24 percent. In addition to underwriting gains, USDA paid a cost allowance to the insurance companies of \$4 billion to cover administrative and operating expenses for program delivery from 2002 through 2006. USDA expects these expenses to increase by about 25 percent by 2008 because of higher crop prices.

Mr. Chairman, this means that the companies will receive a higher cost allowance without a corresponding increase in expenses for selling and servicing the policies, creating a windfall of sorts. Let me close by offering this observation. Congress has an opportunity in authorizing the farm bill to provide USDA with the authority to periodically renegotiate the financial terms of the SRA so that the company's cost of reimbursement is not overly generous, and its overall rate of return is more in line with private markets.

It also has the opportunity to address several statutory provisions that have proven to place the program at greater risk of fraud, waste, and abuse. We hope that Congress will take full advantage of this opportunity. Thank you very much for this opportunity to give our views.

Mr. ETHERIDGE. Thank you, sir. We now will turn to the members for their questioning. You each will have 5 minutes, and I will yield myself the first 5 minutes.

Administrator Gould, Deputy Inspector General Tighe states that you all believe that full implementation of a comprehensive information management system is not expected until 2012. What are the reasons for the delay, and is this just a question of resources, and what are the fundamental problems that are delaying the implementation? And finally had Congress not repeatedly cut the funds for it in the appropriations bill for the department in previous years, would we already have a CIMS system in place?

Mr. GOULD. Yes, thank you for the question. I would be happy to respond to that. Actually, the information about that not being fully implemented, the CIMS project, a comprehensive information management system, will be implemented long before 2012. That date has been used for full implementation, but in fact, there is some implementation already underway. And it is anticipated that, if we can get the system of records sorted out between RMA and FSA, that there will be much of the implementation done for the 2008 crop year. And then as time goes along, and we gain more experience, that CIMS project will come along nicely. And hopefully by 2012, it is fully functional.

Mr. ETHERIDGE. So 2008 to begin, but 2012 still for full implementation?

Mr. GOULD. That is right.

Mr. ETHERIDGE. Okay, so the statement is not that far off. Ms. Tighe, in your opinion, what is the level of fraud in crop insurance program in terms of percentage of policies or percentage of premiums? Is Dr. Little's measure of 0.02 percent of the claims that he has detected through data mining an accurate representation of fraud in the system in your opinion?

Ms. TIGHE. Mr. Chairman, we don't have a good basis for evaluating the total fraud in the program in terms of number of claims, and I can't speak specifically to Dr. Little's data. I can point out that RMA has itself has an error rate in improper payments of something just under 3 percent. Those are payments also that can give rise to fraud. We don't sort of track or evaluate that way. All we know is anecdotally, we have a lot of cases dealing with fraud in crop insurance. And we know, you know, the statistics I gave you in terms of dollars recovered and everything, but we really have no good way of evaluating the totality of the program.

Mr. ETHERIDGE. Okay, thank you. Mr. Robinson, has GAO conducted a profitability or rate of return analysis on crop insurance? And if not, are you aware of any studies that have?

Mr. ROBINSON. We certainly have looked at it as part of our work for the hearing in May. We certainly did a comparison of underwriting gain and profitability for this line of insurance and using the AM best averages for both 5 years and 10 years I might add. And that is where we came up with the, you know, roughly 2-1/2 times over that full 10-year period. That is where we came up with that number.

Mr. ETHERIDGE. Well, let me follow that up a bit. And as you use that over that 2-year period though, does it go far enough back to cover where you have those anomalies where you would have heavy drought and heavy losses as it relates to flood, et cetera geographically?

Mr. ROBINSON. Mr. Chairman, I think underwriting losses have been experienced under this program twice in the last 17 years, once in the last 10. So by having a 10-year analysis, we certainly cover one of those years. Yes, sir, and that is why we tried—obviously the most relevant comparison in looking at this program is since ARPA because so many rules changed. When you go way back, you are analyzing something that is not exactly the current situation. So that is why we started out with a 5-year period. But just to be on the safe side, we went ahead and did it over 10 years as well. And that 10-year period would have covered the 1 year where underwriting losses were.

Mr. ETHERIDGE. Where you had heavy losses. Thank you. I yield.

Mr. MORAN. Mr. Chairman, thank you very much. Part of the difficulty I have in trying to sort this out is the continued use of the phrase underwriting gain. Is that the correct standard by which we ought to be judging the profitability of the crop insurance industry? And does that allow for a satisfactory comparison to other insurance or other companies involved in trying to earn a profit? Is underwriting gain the standard by which we ought to be discussing these issues?

Mr. GOULD. Well, I am going to defer that question to Dr. Collins. My opinion is that it is a little bit like comparing apples to oranges because the crop insurance program is kind of a unique entity between the private sector and government. But I am sure Dr. Collins has got a good handle on that.

Mr. COLLINS. Thank you, Administrator Gould. Mr. Moran, I think underwriting gains is probably not the best way to be comparing returns from one business or one industry to another. There are lots of different measures that can be used. There are rates of return on equity, rates of return on assets, rates of return on sales. Those are typically the kinds of metrics that we use in comparing profitability across companies and industries.

The problem with crop insurance, as Dr. Barnaby noted, is there is problems with access to data. Crop insurance is a line of business sometimes in big companies. When you look at other lines of insurance, there are many different lines of insurance they have in those companies. So there are allocations of cost that have to be made.

There have been some studies on rates of return that have tried to move away from underwriting gains and look at a measure of profitability. The ones that have most often been quoted are the Price Waterhouse Cooper study, which covered data through 1995. There was the Milliman study, which we contracted for, to help us get prepared for the SRA negotiations. That had data through 2001. There was also the Deloidin 2 Study that NCIS contracted for that had data through 2002. So there are three studies right there that tried to move away from just the concept of underwriting gains and look at the concept of profitability. Now, all three of those studies, you could argue, are dated. They don't capture the post-SRA world, the low loss ratios of the last couple of years.

I still personally look at underwriting gains, understanding that underwriting gains are a complicated concept. They have to cover a lot of things. They have to cover, as noted earlier in the other panel, excess costs over reimbursement. And we believe that the

costs of delivering a program do exceed the reimbursement for most companies.

You know our data for 2006 suggests that out of 14 companies for which we have data, 12 of them have delivery costs in excess of the reimbursement rate. So underwriting gains have to go to that. They have to cover the excess cost. They also have to go to cover a policyholder surplus. You have to have capacity to sell crop insurance.

We require companies to have 2 to 2-1/2 years worth of basically policyholders surplus to cover 2 to 2-1/2 years of 500 percent loss ratio years. We have to have policyholder surplus to cover that. So they have to build up that surplus. So there is a lot of things that underwriting gains are going for, as well as profit.

Having said all that, we still use the simple concept that GAO used of looking at underwriting gains as a percent of premium, and when we started the SRA negotiation in 2004, we had in mind a goal there of 12 to 13 percent would be a goal that we thought was a reasonable measure of underwriting gains relative to premium. And if you look at the crop insurance program from 1981 to 2006, that is 26 years, the average of underwriting gains to premium is 9.6 percent. So it was less than what was had as our goal going into the SRA.

Now, look at the last 3 years, 2004, 2005, 2006. That measure, underwriting gains to premium, is 26 percent. So it is way beyond what we had set as a goal for the SRA negotiation, and it is way beyond what the historical performance of the program is.

So the question becomes difficult. You know, what do you read into that? Are the companies making too much money, or is that just simply the reflection of 3 good years of really unusual weather. So there is an uncertainty here about how to draw the line when you have an industry that has potential for very big losses, systemic losses, system-wide losses should we get a natural disaster.

Mr. MORAN. Mr. Chairman, I should never anticipate being able to ask more than one question when Dr. Collins is answering the one question. My time has expired—

Mr. COLLINS. Sorry.

Mr. MORAN. —some time ago, and the list is still on the piece of paper. What I would like to follow up with you, Doctor, is does that measure, underwriting gain, correlate with rate of return on assets or rate of return on investments, which is something that is much more understandable, at least for me, as to what the measure is? And so when you say we are shooting for 12 to 13 percent, we are significantly higher than that, would that also say that if we are shooting for a certain rate of return, that same increase, that corresponding increase, would be true for rate of return? Or does underwriting gain mask the difference? And Chairman has got his finger on my light. So we can talk, sir.

Mr. COLLINS. My guess is that they correlate.

Mr. MORAN. Okay.

Mr. ETHERIDGE. Thank you. The gentleman from Georgia, Mr. Marshall.

Mr. MORAN. It is a disadvantage of no longer being the chairman.

Mr. MARSHALL. Mr. Robinson, thank you for your testimony, and I have not read your report. And I actually stumbled into this hearing unaware of this big dispute, and so I am learning a lot. And what would be helpful to me, I suspect the committee as well, is if you could comment on Dr. Barnaby's analysis. You heard his testimony. I suspect you have read it. I have his Table 1 in front of me. There is a stark difference of opinion, I think, between you and Dr. Barnaby about whether or not this industry is functioning appropriately. And if you could help us by commenting on his testimony.

Mr. ROBINSON. Yes, I hope you can appreciate I heard Dr. Barnaby's comments for the first time a few moments ago.

Mr. MARSHALL. Have you seen the written testimony?

Mr. ROBINSON. I have not.

Mr. MARSHALL. Okay.

Mr. ROBINSON. But what I was going to suggest doing is we would love to have the opportunity to give you something in writing to give some real kind of analysis rather than some off-the-cuff instant analysis that I could give here today.

Mr. MARSHALL. And, as a matter of fact, it certainly would be helpful to me, and I suspect the committee as well, if we have already asked Dr. Barnaby to comment on what you have prepared, and he is going to do so and supplement the record. And Chairman just nudged me. We would be very interested in your comments on his testimony and having those submitted for the record. But I think what would be most helpful is for the two of you to talk with one another so that you can narrow your differences of opinion. We are lay folks at least with regard to some of the more esoteric points that the two of you can make. And if you could agree that you are on the same page then we don't have to wade through understanding all of that. We can get to the nub of the conflict between the two of you.

Mr. ROBINSON. I think it is a good idea, and also to shed the maximum sunshine on something which is admittedly not like falling off a log in terms of difficulty. I think that is an excellent idea. I took some note of Dr. Barnaby's comment that I don't know that we disagree so much on the facts but on the interpretation of the facts. So hearing that comment, I think a good conversation between us would be good.

Mr. MARSHALL. I am not sure who to address this—well, actually one of the things I would like to do, Mr. Chairman, if I am permitted to do it, I see that Mr. Cooper is here, and I was going to yield time to Mr. Cooper. If that—it is not. So, Mr. Cooper, you will remain mute in this hearing. But I will have a second round here, so you can go ahead and whisper in my ear, and I will ask it. We will not? You have decided not to? Okay. Dr. Little, in his testimony, made reference to spot checks and then a spot-check list and improved behavior by the farmers on that spot-check list. And I am sure that is of real interest to RMA and to the department. To me it is a rather unusual way of going about things, and it would be quite telling to me, if the improvement in behavior by these folks who have been identified is pretty significant. I would wonder to what extent behavior could be improved throughout the entire sample. Are these folks that unique? And is Dr. Little's testimony that

there is about 1 percent fraud—I thought it was a little higher than what you mentioned. Mr. Chairman is that accurate? I am not quite sure who to address that to, but that spot-check list seemed pretty interesting to me.

Mr. GOULD. I will make a brief comment. Actually, I have had the opportunity to look at the data and the subsequent behavior of the people that were on the spot-check list, and it is really telling that people—I should mention that the people that are placed on the spot-check list get a notice from their local FSA office that they are on a list. They are not accusing them of anything, but just say that some of their losses or behavior is an anomaly and just the fact that they are being watched causes a dramatic difference in their behavior. And we have tracked that over time, and they kind of tend to have less losses over time. And also then we have also tracked when they go off the list, they tend to revert back to their original behavior.

Mr. MARSHALL. Too bad we can't put the entire country on a spot-check.

Mr. GOULD. Well, that is—

Mr. MARSHALL. Members of Congress included.

Mr. GOULD. And we frankly would like to enhance the spot-check list and do more of it, but that is kind of a compromise between what we have with our resources and FSA has with their resources at the moment.

Mr. MARSHALL. Thank you, Mr. Administrator. Thank you, Mr. Chairman.

Mr. ETHERIDGE. I thank the gentleman. Let me thank each of you for your patience. There is no need to, we will apologize but only for the fact that we couldn't continue straight through because you understand how this system works. If they ring a bell, we have got to go. And they expect us to be there and vote, but thank you very much for taking your time and being here for your testimony. Mr. Robinson, let me follow up on the gentleman from Georgia's question. I would ask that you submit to us, if you would please, in writing after you have had a chance to comment on his question. I think it would be helpful to have that for the record.

And before I adjourn, I would invite the ranking member for any comments he might have.

Mr. MORAN. No, sir.

Mr. ETHERIDGE. Under the rules of the committee, the record of today's hearing will remain open for 10 days to receive the additional material and supplemental written response from the witnesses to any questions posed by members of the panel. The ranking member has asked that we extend that for 30. We would like to tighten it as we can. Would that be too much of an imposition on you, Mr. Robinson, 10 days since we are going to be moving to do something? If not, we will make it 30.

Mr. ROBINSON. We work for you, sir. We will do what you ask us to do so—

Mr. ETHERIDGE. Let us stick to 10 days.

Mr. ROBINSON. Okay.

Mr. ETHERIDGE. Okay, because I think that will help us have the information we need. If you could, that would be very helpful. With that, let me again thank each of you and the previous panel for

being here. With that, the Federal hearing on the Subcommittee on General Farm Commodities and Risk Management stands adjourned.

[Whereupon, at 12:33 p.m., the Subcommittee was adjourned.]

Statement for the record for Congressman Walz

Mr. Chairman, Ranking Member Moran, I want to thank you for holding this hearing today.

Farming is an inherently risky business, and farmers need tools to help manage that risk. The crop insurance program is one of the most important tools they have to do that.

But, the program has problems, no one can deny that. Producers aren't completely happy with how their coverage works, taxpayers aren't happy with the idea of private companies making profits from a government-supported enterprise, and some Members of Congress aren't happy when crop insurance programs fail to eliminate the need for annual disaster programs.

I'm interested to hear the thoughts of our witnesses today about these problems. And as the debate over the farm bill continues, I'm going to look for ways to address these problems.

Again, Mr. Chairman and Ranking member Moran, I appreciate your attention to these issues and the opportunity to hear these witnesses today.

Rep. Collin C. Peterson
Opening Statement
Hearing to Review the integrity and efficacy
of the Federal Crop Insurance Program
Subcommittee on General Farm Commodities and Risk Management
June 7, 2007

Thank you Mr. Chairman.

For many outside the agriculture community, the Federal Crop Insurance Program is a favorite point of criticism. We here on the Committee however, understand the vital role that crop insurance and other risk management practices play in American agriculture.

Although there is always room for improvement, this program is a necessary part of the farm system that provides Americans with a safe and abundant supply of food and fiber.

Last month, the Committee on Oversight and Government Reform held a hearing to look at waste, fraud and abuse in the Federal Crop Insurance Program. Their witnesses raised several concerns that I am sure we will also hear about today. But what it all boiled down to was the question of how much government money was actually making it to the farmers and ranchers.

Given the current budget climate, we need to ensure that we are making the best use of taxpayer dollars by maximizing efficiency and securing the integrity of the Federal Crop Insurance Program.

One of my main priorities for the 2007 Farm Bill is to include a permanent disaster assistance program. A disaster program that is tied to crop insurance would eliminate the need for ad hoc bills and reduce wasteful spending, while ensuring that farmers get help when they need it.

I thank the Chairman for calling this hearing and look forward to the witnesses' testimony.

**House Committee on Agriculture
Crop Insurance Hearing
Rep. Bob Goodlatte
7 June 2007**

OPENING STATEMENT

I appreciate Subcommittee Chairman Etheridge calling this hearing to conduct additional oversight on the Crop Insurance program.

Today we will have a series of government, academic and industry witnesses who will discuss the various aspects of the program. I look forward to their testimony.

Specifically, I want to hear suggestions about how we can improve the program so that it is a highly effective risk management tool for producers; how we can combat waste, fraud and abuse using the most appropriate technology; and any reforms that should be made so that we maintain public confidence in this program by being responsible with taxpayer dollars.

We are also in the midst of writing the 2007 Farm Bill. Everyone is aware of the budgetary pressure this Committee is under. I have no doubt that the crop insurance program will be looked at as a source of additional revenue to fund other programs. Before we do so however, I want to understand in advance the impact that such actions could have on the program so that we do not make decisions that have severe unintended consequences. I will also give careful consideration to reforms that improve public support for the program,

Thank you again for calling this hearing and I look forward to the testimony of the witnesses and to their response to our questions.

(WORD COUNT: 240)

Crop Insurance Industry Testimony
By
Ron Brichler
To
General Farm Commodities and Risk Management Subcommittee
House Committee on Agriculture
1300 Longworth House Office Building
Thursday, June 7, 2007

RE: To review the integrity and efficacy of the Federal Crop Insurance Program

Good morning Chairman Etheridge, Ranking Member Moran and Members of the General Farm Commodities and Risk Management Subcommittee of the House Committee on Agriculture. My name is Ron Brichler. I am a Senior Vice President of Great American Insurance Company, and President of its Crop Insurance Division. I also have operational reporting responsibility for five other Great American divisions. Great American Insurance Company, headquartered in Cincinnati, Ohio, is a subsidiary of American Financial Insurance Group, Inc (AFG). AFG is a publicly owned company with its stock traded on the New York Stock Exchange.

Great American's Property and Casualty Insurance Group is ranked by A.M. Best as the thirty-third largest property and casualty operation in the United States. Great American is engaged in marketing and servicing a wide array of specialty property and casualty insurance products, of which crop insurance represents about 15 percent of our gross written premium. The Crop Division competes internally for capital with over twenty other Great American operating divisions.

My testimony today is presented on behalf of the crop insurance industry – not any one organization or group. I certainly appreciate the support of everyone in the industry who directly or indirectly contributed to the development of this testimony.

While the crop insurance industry is pleased to have this opportunity to appear before this Subcommittee today, we certainly regret the circumstances that made this hearing necessary by presenting a distorted and misleading view of the crop insurance program. We believe recent oversight hearings by this Subcommittee, including two in May of this year and several in the 109th Congress, had completed a thorough and current review of the crop insurance program. Furthermore, we believe USDA's testimony in the May 3, 2007, House Oversight and Government Reform Committee certified the program's integrity and efficacy. Thus, as disappointed as we are about the occurrence that precipitated the need for this hearing, the crop insurance industry is very pleased to have the opportunity to respond and help set the record straight about the integrity and efficacy of the modern, highly successful and well-managed federal crop insurance program.

This Year's Erratic Weather Demonstrates the Need for Crop Insurance

We think the erratic weather patterns we have thus far experienced in 2007 are a grim reminder of why a good crop insurance program is so important not only to farmers, but to consumers that they provide with a low-cost supply of food, fiber and energy. Already we have experienced two major freeze disasters in 2007 – the January freeze on the West Coast and the April freeze that caused extensive damage in several areas from the Southeast to the High Plains. Currently, Florida, Georgia and surrounding states are suffering from a severe drought that is preventing planting, while other parts of the country are being hampered by excessive moisture.

While it is too early in the year to guess the extent of this year's losses in agriculture, these events are a reminder that farming is a very risky business, and the business of insuring the risks of farming is high risk insurance. While we have been fortunate to have low loss ratios in the past few years, one catastrophic loss year could wipe out the underwriting gains the crop insurance industry has received in those good years.

Crop Insurance Plays a Key Role in Energy Independence

Moreover, the farm sector is under more pressure to produce at full capacity than ever before. No longer are we worried about surplus production. Now that agriculture is expected to produce not only an ample food supply but the feedstock for bio-fuels, every available acre is needed for production. President Bush has set a goal of 35 billion gallons of alternative fuels in 10 years. There is a consensus among ethanol executives that we can never produce enough corn to provide more than 14-15 billion gallons of ethanol from corn in a year. Therefore, additional production must come from cellulosic feedstock such as switch grass. Farmers are never going to grow these new crops in abundance if they can't mitigate their risks by buying a good crop insurance policy. Crop insurance forms the foundation that supports their decisions to grow and harvest the raw materials that ultimately will help create energy independence.

The State of the Crop Insurance Program is Excellent

We, the private sector partners in the crop insurance program, are here today to declare the federal crop insurance program's integrity and efficacy to be in excellent shape. In support of our declaration, I offer up the words of the Risk Management Agency Administrator Eldon Gould from the May 3, 2007, House Oversight Committee hearing in which he said, "The federal crop insurance program is working as it was intended and it is performing well ..."

We believe it is significant that these are the words chosen by the federal regulator of the crop insurance program in commenting on its integrity and efficacy. After all, RMA employees are the people who have the depth of experience with the program, breath of knowledge about the program and a comprehensive understanding of the program, especially including its history, purpose, challenge and opportunity, to render an accurate and intelligent judgment on the program's integrity and efficacy.

Additionally, I am very pleased to refer you to a May 23, 2007, National Crop Insurance Services press release, which contains the following information:

The leadership of the Risk Management Agency (RMA) and the crop insurance industry met in Kansas City this week in an effort to strengthen their oversight of the Federal Crop Insurance Program. One of the most telling things they heard came from Dr. Bert Little of the Center for Agribusiness Excellence (CAE).

“About 0.2 percent, or less than one percent, of the policies in the crop insurance industry shows up as anomalies in our data mining,” Dr. Little told the group. “That’s one heck of a lot better than property and casualty where 10-12 percent of the claims are fraudulent.”

CAE conducts the data mining of the crop insurance industry on behalf of the RMA.

House Oversight and Government Reform Committee Hearing Statements

To more fully understand and appreciate the need for today’s hearing, I want to recall for the Subcommittee several statements from the record of the House Oversight and Government Reform Committee Hearing in question. They are as follows:

“This hearing examines allegations of waste, fraud, and abuse in two key areas of the federal crop insurance program:

The first is that the program has failed at its primary purpose: preventing the need for annual disaster payment to farmers.

A second focus of allegations of taxpayer waste and abuse in the crop insurance program are the large underwriting gains and commissions garnered by the private crop insurers, and the resulting inefficiency of the program.

The taxpayers understand that it costs money to run the government. But they can’t accept rampant waste, fraud, and abuse that squanders their money on boondoggle programs.

Our committee will learn today that the federal crop insurance program is costing taxpayers billions of dollars in waste, fraud, and abuse.

From the taxpayer perspective, it’s hard to imagine a more costly and inefficient way of providing a safety net for farmers.

The federal crop insurance program has become a textbook example of waste, fraud, and abuse in federal spending.

Over the last six years, over \$8 billion in taxpayer funds have been squandered in excess payments to insurers and other middlemen. Somehow, about forty cents of every dollar that taxpayers have put into the crop insurance program has gone up in smoke.

GAO has found that the private crop insurance companies are obtaining underwriting profits that are almost three times as high as industry averages.

Nobody begrudges assistance to a farmer whose crop is destroyed in a natural disaster. But no one should tolerate insurance companies that skim billions from the Treasury to fatten their profits.”

House Oversight Committee Statements Illogical, Inaccurate, Unfair

First, Mr. Chairman and Members of the Subcommittee, the crop insurance industry wants to clearly and definitely assert that the program is highly successful and, therefore, has not “failed at its primary purpose.” The program is a risk management tool. Any statement claiming the program has failed because Congress and the President have approved *ad hoc* disaster assistance laws is totally illogical. No program or law can deny a congress and a president their constitutional rights and privileges. No congress can bind a future congress. New *ad hoc* disaster assistance laws have been and will continue to be approved for any reason when there is the political will to do so. Let me repeat – political will to do so is all that is required. Nothing else matters. Furthermore, the word “need” is a “value” term – meaning it has no fixed or universally accepted definition. Therefore, the existence of *ad hoc* disaster assistance laws is an illogical and meaningless test of the success or failure of the federal crop insurance program.

Secondly, Mr. Chairman and Members of the Subcommittee, the crop insurance industry wants to clearly and definitely assert that the program is not riddled by “rampant waste, fraud and abuse.” It does not “squander money on boondoggle” programs. It is not inefficient. It is not a “textbook example of waste, fraud and abuse.” It does not make “excess payments to insurers and other middlemen.” Forty cents of every dollar put into the program has certainly not “gone up in smoke.” Insurance companies certainly are not “obtaining underwriting profits that are almost three times as high as industry averages.” Insurance companies do not “skim” money from the program.

Mr. Chairman, as you and Members of the Subcommittee know, all monies paid to insurance companies are controlled by the Standard Reinsurance Agreement (SRA), which has been written by the government, managed by the government and enforced by the government. Interested companies are required to sign the SRA in order to become an Approved Insurance Provider (AIP). Companies can lose their AIP status by not complying with the terms and conditions of the SRA.

A key question for this hearing to examine is this: If underwriting gains are three times industry averages and there are golden opportunities for receiving other excess payments, why are there so few AIPs? Why have large national insurance companies left the program? The industry’s answer is clear and definite – the statement is simply inaccurate and unfair.

In fact, Mr. Chairman, **when comparing crop insurance returns to those for property and casualty insurance generally and taking care to use comparable data for the exact same years – 2002 to 2006 – the results are almost identical.** In their presentation, GAO appears to have used the 5 year time period 2001 to 2005 for the P&C analysis because data for 2006 was not yet available. However,

for their crop insurance analysis, GAO appears to have used the 5 year time period 2002 to 2006. Keep in mind that the P&C insurance industry underperformed other industries in these years, especially because of negative returns in 2001 due to the events of September 11 and 2004 and 2005 as a result of all of the hurricanes. However, just because the total P&C industry underperformed in a particular time period, that does not mean crop insurance will also under perform in that time period. Of course, the P&C industry had a record profit year in 2006. **Adding 2006, a big profit year, and dropping 2001, the year of 9-11 and a big loss year, significantly changes the data for comparison purposes.**

Equally important, **it does not appear that GAO made the necessary effort to use comparable premium data either.** As my testimony will show later, **the raw premium data for the two lines of insurance do not have the same base.** P&C insurance premiums are expense loaded. Crop insurance premiums are not expense loaded. When a percentage analysis is conducted using two difference bases, the results will, of course, be drastically different. Thus, when you update the GAO work to use the exact same five year period – 2002 to 2006 – for both lines of insurance and make the necessary adjustment in premiums to have a consistent base for the percentage analysis, the P&C return is 17.4 percent. Now we are left with the opportunity to compare the differences between 17.4 percent on the one hand to 17.8 percent on the other. Our data source is Best Aggregates and Averages: Property Casualty and A.M. Best Special Report: US Property/Casualty, 2006 12-Month Financial Review.

One other important point about the GAO work is that it used crop insurance underwriting gain as reported by RMA to measure the industry's profitability. **As my testimony discusses later, the RMA reported underwriting gain cannot be equated to profit since they do not reflect all of the industry's delivery cost.**

No doubt, Mr. Chairman, the crop insurance program is complex. The level of complexity together with highly variable but at best only average returns may explain why there are no more companies in the business. However, the program has grown in complexity because complexity is a requirement for better satisfying the congressional goal of providing a personalized risk management tool to all of the nation's farmers, ranchers and growers regardless of their size, location or risk profile. Complexity contributes greatly to the work load and compliance challenges for companies and agents in selling and servicing the federal crop insurance program. Moreover, this level of complexity requires the investment of millions of dollars annually by the private sector in technology. The complexity factor and other distinguishing characteristics must be taken into proper consideration in any comparison of the crop insurance program and related income statements to other property and casualty lines of insurance.

Crop Insurance: Comparison to Property and Casualty Profitability

Crop insurance companies write a particular class of property and casualty insurance. Because of this fact, the business of crop insurance is frequently compared to the business of other property and casualty (P&C) lines of insurance. This comparison is reasonable as long as the major differences are recognized and understood. Significant differences exist in profitability opportunities between private lines of P&C insurance and federal crop insurance.

Differences between P&C Insurance and Federal Crop Insurance

	P&C Insurance	Federal Crop Insurance
Premium	Expense loaded – meaning administrative costs are included in the premium charged.	Not expense loaded.
Premium Rates	Set by company, approved by State regulators. Rates will differ by company due to risk and administrative loads.	Set by RMA – the same rates apply to all companies.
Premium payment	Upfront at time of sale. Held by company to generate investment income.	At harvest with companies turning over to RMA within 30 days. No investment income. Credit risk to company of nonpayment by policyholders.
Underwriting	Some ability to not write risks via underwriting rules.	No ability to not write risks. Must take all eligible regardless of risk profile.
Reinsurance	Private	Mixture of private and federal.
Administrative Expenses	Set by company and approved by State regulators as part of the Premium	Set by statute and RMA – may or may not cover actual expenses

What do these differences mean in practical business terms?

- 1) Because expenses are “loaded” into premiums for private lines of P&C insurance, a direct comparison of “premium” between the P&C insurance and crop insurance is NOT POSSIBLE without adjustments to premium. A better comparison of the two lines of insurance is overall profitability.
- 2) Companies that write crop insurance do not set the rates. The RMA does. This fact means that crop insurance companies have no ability to adjust rates (higher or lower) regardless of the associated risk.
- 3) Farmers pay their premium at harvest and crop insurance companies remit the paid premium to RMA within 30 days. **THIS FACT IS A SIGNIFICANT BUSINESS DIFFERENCE.** Private P&C companies collect premium upfront and invest those premium dollars. Premium dollar investments are the major source of income for P&C companies, not underwriting gains. In fact many private P&C insurance companies use investment income to lower premium rates to customers. The opposite is true for crop insurance companies. Underwriting gains are the major source of income because there is no opportunity for investment income from premium dollars. In addition, there is a credit risk to crop insurance companies because they are required to pay the premium to RMA whether the amount is collected from policyholders or not. Annually, several million dollars in premium receivables are written off by crop insurance companies as a result of nonpayment by policyholders.

- 4) Crop insurance companies must write all federal crop insurance lines in a State if they decide to operate in that State. Crop insurance companies are not allowed to turn down customers or adjust rates based on normal insurance underwriting rules. This fact means crop insurance companies take risks that they otherwise would not take.
- 5) Because crop insurance companies are unable to underwrite policies, a key component of the crop insurance program is federal reinsurance. Federal reinsurance is used to cover losses on policies that are of "high" risk and would not otherwise be written. Normally, in these situations, if allowed, company rates for policies providing coverage in certain agriculture production enterprises would be raised to levels higher than the RMA established rates.
- 6) Private P&C insurance companies can make adjustments in administrative charges through annual rate adjustments. Crop insurance companies are "reimbursed" for expenses but they are not allowed to adjust administrative charges to farmers to reflect changing business environments.
- 7) For crop insurance, the underwriting gain numbers reported by the Risk Management Agency (RMA) are not company profits. RMA does not deduct all expenses before publishing the crop insurance underwriting gain numbers, which is a requirement to reference profits. All expenses have been deducted in computing underwriting gain numbers for other P&C lines of insurance. Thus, published underwriting gain data for crop insurance and other P&C lines of insurance are not directly comparable.

Profitability analysis is the correct comparison. Profitability or the rate of return on capital employed is the correct business statistic to use when making a comparison between the federal crop insurance line and other P&C lines of insurance. However, an analysis of this kind is data intensive and involves accumulating business sensitive data. To date, only three comprehensive studies have been conducted comparing profitability between the two lines of insurance. They are: Deloitte and Touch 2004, Price Waterhouse Coopers 1997 and updated in 1999 and Milliman and Roberts 2002, a study commissioned by RMA.

- 1) **The Deloitte and Touché study reported a 10 year profitability measure of 7.9 percent for the crop insurance program with a standard deviation of 12.9 percent while other lines of property and casualty insurance ran a 12.7 percent return with an 8.9 percent standard deviation (1992 – 2002).**
- 2) **The Price Waterhouse study concluded that the pre-tax rate of return on crop insurance was 11.7 percent over an 8 year period (1988 – 1995) and lower than that of the P&C industry at 14.1 percent over the same time period.**
- 3) **The Milliman report concluded the estimated earned return on equity to crop insurers averaged 15.8 percent over a 13 year period (1989 – 2001) versus an average reasonable rate of return over the same period of 14 percent. The Milliman report also said "we would caution against drawing any strong conclusions on the adequacy or excessiveness of the historical returns based on a sample of thirteen years of data, in light of the fact that only one of those years is a catastrophe year. Had there been a second catastrophe year in the sample similar in magnitude to 1993, the average return over the period would have been below 14 percent." Thus, if RMA had included the major drought year of 1988 in the base period, the crop insurance industry would have earned less than the target rate of return.**

Conclusion on Comparison. Comparisons between P&C lines of insurance and crop insurance are possible based on profitability when all sources of income and expenses are taken into consideration. A comparison based on underwriting performance only is specious because it does not take into consideration significant differences in the definition of “premium” and “underwriting gains” between federal crop insurance and other P&C lines of insurance. Moreover, it does not recognize a significant business distinction between the two types of companies. **P&C companies’ primary earnings are investment income, not underwriting gains. In fact, data from the Insurance Information Institute indicate that for the P&C insurance industry, underwriting activity for the years 2001-2006 experienced an average loss of almost \$10 billion annually, while investment income over the same time period averaged more than \$42 billion annually.**

Crop insurance companies have no opportunity to invest premium dollars to earn income and, therefore, underwriting gains are their primary source of income. Although, crop insurance companies are reimbursed an average of around 20 percent of premium for selling and servicing expenses, the amount does not fully cover total delivery costs. Moreover, even though the average expense reimbursement rate has been reduced by the government from an average of slightly more than 30 percent, proposals abound today, including again by the government, to reduce the rate further. **In comparison, the Insurance Information Institute data for the years 2001-2006 show that for the P&C industry the “expense-to-earned premium” ratio averaged around 40 percent. When adjusting the P&C industry premium data for being normally expense loaded, making the data comparable to crop insurance premium data, the “expense-to-premium” ratio for the same time period averaged more than 60 percent.**

Crop Insurance: Multiple Farmer Benefit Program

Recent public statements have claimed that **40 percent or more of the crop insurance program benefits accrue to the private crop insurance industry.** This analysis is inaccurate on its face and misleading in the extreme. The analysis is based on “net indemnity” or “cost to the taxpayer,” which may be useful analysis for single-purpose federal transfer programs but **grossly understates the benefits of the multifunctional, multi-benefits federal crop insurance program.**

Net indemnity analysis (indemnities minus farmer paid premium) for the crop insurance program is an incomplete measurement of the benefits that accrue to farmers from owning these policies. **First, net indemnity analysis ignores the fact that delivery expenses (administrative and operating (A&O) reimbursements) are paid on behalf of farmers by the federal government** and therefore must be incorporated as a direct transfer of income benefit to farmers. **Second, the benefit of an insurance program is greater than indemnities.** No one buys an auto or homeowner’s policy hoping to collect an indemnity payment. Like farmers, they buy to insure against a disaster that they cannot afford to be at risk for. Like other policyholders, farmers purchase crop insurance for a multitude of reasons. That is to say, the federal crop insurance program is multifunctional, providing multiple benefits.

Moreover, if the rent-seeking behavior described by the economic literature is correct, then farmers would be expected to buy crop insurance coverage where the subsidy and, therefore, expected net indemnities are greatest – at the 55 percent coverage level. However, the average program coverage level is 70 percent, which is significantly higher than net indemnity analysis suggests is optimum. Other benefits are necessary to explain this difference in coverage level.

In addition, net indemnity analysis does not explain why many farmers buy revenue insurance instead of the APH yield-only plan of insurance. Revenue insurance costs farmers on average 30 percent more out-of-pocket, yet the loss ratio for revenue plans of insurance over the past 5 years is no better than the yield-only plans of insurance. Again, other benefits are necessary to explain this difference.

Thus, it is not only reasonable but also logical and sensible to conclude there are more calculations involved in farmers' decisions about buying crop insurance than simply the assumption of a net indemnity. There must be additional benefits that accrue to farmers for owning a federal crop insurance policy. A 2004 National Corn Growers Survey elicited the following 5 factors as top reasons farmers buy crop insurance: 1) cash flow protection 2) price of insurance 3) protection against weather 4) lender requirements and 5) risk management. Benefits beyond net indemnity are identified and summarized by the following three factors:

Credit and the Banker Factor: Nearly every farmer borrows money on an annual basis to operate their farm. Bankers and farmers have come to rely on crop insurance to help mitigate the risk of their production loans.

Landlord Factor: The president of the American Sesame Growers Association, Steve Chapman, recently testified before Congress that Sesame growers needed an insurance policy not because of the risk of growing sesame but because landlords demanded it.

Forward Marketing Factor: One of the primary reasons farmers buy revenue insurance is to use the insurance policy as security when they forward market a portion of their crop. Both RA and CRC allow farmers to forward market with less risk.

Clearly, there are farmer benefits derived from owning federal crop insurance policies beyond the assumption of net indemnities. Furthermore, it is also clear these benefits are not recognized and are not measured by the single-dimension analysis of "net indemnity" analysis and calculations. Until the economic literature addresses the full spectrum of benefits that accrue to farmers as a result of owning multifunctional federal crop insurance policies, program inefficiency claims should be significantly, if not totally, discounted.

A far more realistic analysis of the "benefit transfer efficiency" of the federal crop insurance program from farmers' total welfare standpoint may be to compare total federal crop insurance outlays to total federal crop insurance liability. This ratio calculates the level of farmer crop insurance protection benefit received for each dollar of federal crop insurance outlays. According to Federal Crop Insurance Corporation (FCIC) data, for years 2001 through 2005, outlays totaled about \$14.9 billion and liability totaled about \$205.5 billion, for a benefit-to-cost ratio of approximately 14 to 1. While the liability analysis aggressively assesses the program's benefit transfer value, it certainly is far more relevant than any analysis that concludes the crop insurance program benefit transfer ratio is less than 1 to 1.

Crop Insurance: Flexible, Affordable, Available, Predictable

While crop insurance isn't new, it is more important than ever to thousands of farmers. The ability to tailor coverage to each individual operation, obtain coverage at a meaningful level and affordable price, secure the coverage from a local, trusted insurance professional, and know that the coverage is in place and the fact that it can be counted on for financial planning purposes all combine to make crop insurance the cornerstone of many farmers' financial and risk management plans. These benefits of crop insurance always have and will continue to account for the success and acceptance of the program.

Tailored Coverage: Farmers can tailor their coverage to fit the needs of their specific operation. They have a choice of coverage levels ranging from 50 percent up to 85 percent. Numerous coverage plans are available for a variety of crops, including MPCY yield guarantee protection, revenue products providing yield loss and price protection, and area coverage programs which provide broad based, simple yield or revenue protection on a county basis. This variety of coverage and product levels provides growers the opportunity to obtain the coverage that fits their specific farming operation and risk management needs.

Affordable Farmer Premiums: Growers are able to purchase crop insurance at more affordable prices because the government shares in the risk and administrative premium costs. This cost sharing makes it possible for many growers to secure better coverage than they could afford without the government cost share. This results in affordable protection for growers, while also creating manageable costs for taxpayers.

Coverage Level	50%	55%	60%	65%	70%	75%	80%	85%
Premium Assistance	67%	64%	64%	59%	59%	55%	48%	38%

Private Sector Delivery: Private sector delivery provides competitive, localized service for growers because they can buy from the local agent of their choice. Private industry competition ensures prompt service on claims. Choice and competition help protect and stabilize the rural economy and small town businesses.

Furthermore, a study released in September, 1989, by **Arthur Andersen & Company** concluded that **USDA experienced delivery costs twice the amount of the private sector participants, on average. Specifically, the study reported that for 1987 total delivery cost by private sector companies equaled 43.17 percent of premium while for master marketers the total was 85.30 percent.** This finding and other factors supported a move by Congress to transition to sole delivery of the federal crop insurance program by private sector insurance companies and agents.

Assures a Stable and Secure Food Supply • Unlike disaster payments, crop insurance is predictable. Farmers and their lenders know what their protection is before they plant their crop. Crop insurance assures a stable and secure food supply — an important component of homeland security. From the taxpayers' standpoint, crop insurance is more economical than disaster payments because the growers pay a significant portion of the cost of crop insurance. The public cost share of the program is a manageable budget item for government, while disaster payments are normally an ad hoc item subject to funding availability.

The bottom line is that the crop insurance program is successfully meeting the needs of thousands of farmers who are relying on the protection that their local agent helped them tailor to meet their specific risk management needs. This protection represents a good value for America's taxpayers when compared to any other alternatives for addressing shortfalls in agriculture production.

Resist the Call to Use the Crop Insurance Program as a Piggy Bank to Fund Special Interests

We realize the Committee is being subjected to extreme pressure to raid the funding of the crop insurance program to pay for the pet projects of one commodity group or another or for some new scheme of a farm organization. I hope you would resist these attempts. They are extremely shortsighted.

These attempts would be a serious blow to a program that has taken a quarter of a century to build. The budget baseline for crop insurance is growing because it is successful. More and more farmers are buying it to lock in not only their yield, but their price. As the prices of commodities have increased due to the demand for corn acreage for ethanol, the budget baseline for the price support programs of these commodities has declined.

However, the amount of risk in agriculture has also increased. While farmers no longer receive such a large share of their income from their government, their cost of production and, therefore, their risk has also increased dramatically. **Without a good crop insurance program farming will only be a viable occupation to those who are wealthy enough not to need to borrow money.**

Other Crop Insurance Program Reviews and Comments by Knowledgeable People

Mr. Chairman and Members of the Subcommittee, you have heard what the industry has to say regarding the integrity and efficacy of the program. I thought you might like to know what has been said about the crop insurance program by individuals outside of the industry. Below are a few of these comments:

Daniel Pitts Winegarden, [former first deputy commissioner, Iowa Insurance Division], Des Moines Register, May 15, 2007:

“The federally subsidized private crop-insurance industry is a real success story in farm policy. Combining private expertise in risk management with incentives to manage risk is far more proactive and fairer than paying for disasters on an ad hoc basis.”

Steven Chapman, American Sesame Growers Assn., House Agriculture Committee, May 14th, 2007:

“The bottom-line is this: landlords and lenders demand crop insurance. Since crop insurance is unavailable to sesame, land and loans are given only to other crops.”

David Gillen, National Corn Growers Association, House Agriculture Committee, May 14, 2007:

“On behalf of NCGA, our 32,000 plus members from 48 states and more than 300,000 producers who contribute to corn check off programs, I cannot overemphasize the importance of an effective and affordable federal crop insurance program to our member growers’ risk management planning. Assuming commodity markets remain above current farm price support levels over the next several years, crop insurance becomes even more critical for protecting producers’ farm revenue against significant yield losses.”

Gary Iverson, Great Northern Cooperative Assn., House Ag. Committee, May 14th, 2007:

“Farmers have trouble getting bankers to support loans for their crops without crop insurance.”

Keith Collins, Chief Economist, USDA, House Agriculture Committee, May 1, 2007:

“The combined increases in A&O and underwriting gains have helped improve the financial performance of the companies since 2002, when the largest company became insolvent. The improved financial picture has also encouraged new entrants into the program.”

Eldon Gould, Risk Management Agency, House Agriculture Committee, June 15, 2006:

“RMA is continually seeking new and creative ways to work with the other regulatory bodies, government agencies and the companies, agents and producers to ensure the integrity of the Federal crop insurance program. RMA compliance reviews continue to reveal that there are only a small number of producers who have been involved in fraud or illicit activity. While no level of criminal or abusive behavior is acceptable, RMA continues to believe the number of persons involved in criminal activity is relatively small.

Because they share in risk, the approved insurance providers (AIPs) have a vested interest in working with us to prevent fraud, waste and abuse. We have worked closely with the AIPs to strengthen program integrity, protect taxpayer dollars, and better assure that those who deliberately break the rules are caught and punished.

The vast majority of people in the Federal crop insurance program-farmers, insurance agents, loss adjustors, industry professionals and government employees-are honest, hard-working men and women acting with the highest integrity and competence.”

Conclusions

In conclusion, I would like to make three points:

First, the federal crop insurance program originated and has evolved with a keen sense of purpose in being of value and service to the nation's farmers, ranchers and growers in their risk management needs. In reaching to satisfy this public policy objective, the program has grown more complex. However, this characteristic, that of being complex, is the essential element for the program to be of value and service to the maximum number of the nation's agricultural producers. **Complexity, however, requires more resources – time and capital – to implement and manage, but it is the major factor accounting for the level of success the program enjoys among producers today.** While very successful, the program can continue evolving and improving. In striving to enhance its value and service to current policyholders and attracting even more policyholders, the program must continue to enjoy the level of congressional support, understanding and commitment that was necessary to bring it to the performance level of today.

Second, with the nation looking for even greater production from our agricultural industry, including a major contribution to the new energy independence initiative while maintaining an abundant supply of safe and reasonably priced food, now is not the time to begin withdrawing federal financial support for a public policy that has proven to add real value to the agricultural industry and, therefore, to the nation's economic welfare. Federal dollars going to the crop insurance industry are definitely being earned. They are buying real, tangible goods and services for the nation. It has taken a lot of hard work and resources to build the capability that is contained within the current crop insurance program. Let's work to avoid giving up these gains and thereby discounting more than a quarter of a century in time and effort building the current program. **The crop insurance program should not be viewed as a source of funds for other initiatives.** "Robbing Peter to pay Paul" never works. Other worthwhile programs should be funded without harming the successful crop insurance program.

Third, commodity prices have a long and uninterrupted history of moving both up and down. Agricultural commodities share the same price history. The 2007 Farm Bill should not be written on the assumption or theory that there has been a change of some nature – ethanol included – that will produce a different future for commodity prices. **The old adage – what goes up will come down – most definitely applies to the commodity world, especially including agriculture.**

Thank you for the opportunity to appear before you today and offer a testimony on the federal crop insurance program on behalf of the private-sector crop insurance delivery industry. I will be happy to respond to questions at the appropriate time.

**Testimony of G.A. (Art) Barnaby, Jr.¹
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Before the Subcommittee on General Farm Commodities and Risk Management
U.S. House of Representatives
June 7, 2007**

Mr. Chairman Etheridge, Ranking Member Moran and Members of the General Farm Commodities and Risk Management Subcommittee of the House Committee on Agriculture; I appreciate the opportunity to appear before this hearing on an overview of the Federal Crop Insurance System. My name is Art Barnaby, with Research and Extension, Kansas State University.

Crop insurance has become an integral part of many farmers risk management plans. In the mid-1980's, Dr. Bill Tierney and myself developed a series of workshops to teach farmers how to combine crop insurance with marketing tools to manage revenue risk. In the process, it became apparent the standard multi-peril crop insurance contract offered through the Risk Management Agency (RMA) did not meet the real need of farmers who were preharvest pricing grain because multi-peril crop insurance replaced bushels not at current market value but at a forecasted price. For example, the 1988 drought caused both crop losses and an increase in market prices that far exceeded the price forecasted by RMA. A similar result occurred with the 2006 corn and grain sorghum harvest price increase above RMA's forecasted price. APH insured corn farmers were paid \$2 while Revenue Assurance with the Harvest Price Option (RA-HPO) insured farmers were paid \$3.56 per lost bushel. Any farmer who forward contracted corn but was not able to make delivery were required to purchase those lost bushels at current market value of \$3.56 plus basis to meet the requirements of their forward contract.

After the large price increase combined with a short crop in 1988, working with a private company we developed a multi-peril insurance contract that increased coverage when grain prices increased and replaced any loss production at current market value, not at a forecasted price at planting time. This was a private endorsement on the multi-peril crop insurance contract titled Market Value Protection (MVP). The MVP endorsement converted the multi-peril crop insurance contract from a bushel payment trigger contract to a replacement guarantee. Initially, that was done to offset the loss of deficiency payments that occurred when markets prices were higher and farmers had no yield to sell due to drought or other weather perils but after the 1996 Farm Bill, it was used primarily as a method to guarantee performance on forward contracts or hedges.

The MVP replacement contract was the first crop insurance contract to include price risk and was released in 1990. This concept of inventory replacement at current market value is not a

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and premium subsidy has increased from \$759 million to \$4.6 billion over this period of time. During this period of time, there have been many reforms of the crop insurance program that primarily focused on increasing participation and encouraging farmers to purchase higher coverage levels. Clearly, an increased number of farmers did purchase insurance in 2006 versus farmers in 1992. Apparently, Congress has recognized this too in the most recently passed disaster bill that does not provide benefits on insurable crops to uninsured farmers on that particular crop. In the past, farmers growing insurable crops were also allowed to collect disaster payments but that will not be the case for the most recently passed law.

There are two special cases where crop insurance may not provide the level of protection farmers' desire. The first case is shallow losses. As any insured farmers will tell you, crop insurance works extremely well if one has a total loss but if a farmer raises half of a crop that leaves one with all of the harvest expenses and greatly reduces production to sell. Because of the "large" deductibles in the crop insurance contracts a half of a crop leaves insured farmers with a much greater financial loss than if they had a total crop failure. The other issue is the case of multiple year losses where the APH declines and premium rates increase exponentially. For some growers with a declining APH the new Group Risk Income Protection (GRIP) or the Group Risk Plan (GRP) contracts maybe the best alternative in selected counties under conditions of a multi-year loss. However, those issues will be left for future discussions.

If crop insurance has worked as intended by Congress; then why are we having the current debate? One current argument being made is the crop insurance program has worked but it is "extremely" expensive. As one can see in table 1, as participation increases, the cost of premium subsidies also increases proportionally, therefore the more farmers that are insured, the higher the cost is for USDA. If we were still dealing with 1992 participation the government cost would be lower but Congress wanted higher participation and that is exactly what happened. Therefore, if Congress wants to reduce the USDA cost of the program then simply reduce participation, which may have unintended consequences.

The other fundamental question being raised; crop insurance is "too expensive" but compared to what? In order to try to answer that question, the USDA data in table 1 was converted to a format similar to private property/casualty insurance. First step in the analysis was to calculate the total premium costs that includes the A&O, the underwriting gains/losses by the insurance companies, the premium subsidy and the farmer paid premium to reach a total premium cost. One point that is often overlooked is "underwriting gain" as defined by the government is not underwriting gain as defined by property/casualty insurance. Because RMA uses an incorrect term, many analysts have made an error in their arguments by assuming underwriting gain has the same definition as it does in the private sector. Under private property/casualty insurance all of the company expenses and indemnity payments are paid before there is an underwriting gain/loss. Clearly some of those dollars USDA is reporting as "underwriting gains" to the companies are being used to cover some of the companies' operating expenses.

If multi-peril was a private insurance contract the companies source of revenue is the unsubsidized premium paid by the consumer for their auto policy, homeowner's policy, or crop hail policy. Out of each dollar of premium collected insurance companies must pay their claims,

loss adjustment expenses, insurance agent commissions, operating expenses of the company, etc. However, because of GAP accounting procedures for the insurance industry it becomes quite complex to compare federally subsidized crop insurance with other common lines of private property/casualty insurance. In addition most private property/casualty insurance companies, investment income is a significant source of revenue simply because premiums are paid at the start of coverage unlike crop insurance where companies are actually paying losses before they collect premiums. Crop insurance premiums are collected at harvest time, not at the start of the coverage period.

Once total premiums were calculated, which is all dollars paid in; the analysis then lists the total dollars paid in indemnity payments. The analysis then calculated the percent of the total premium that was paid in indemnity payments.

Percent of premium paid is a hard number that is not subject to accounting gimmicks or other manipulation and therefore, the one number that is the most relevant for comparison. Over this 15 year period, the weighted average percent of premium paid in claims was 66 percent. That means out of every dollar received in total premiums, 66 cents was paid out in claims and the remaining dollars would be used to cover agent commissions, loss adjustment expenses, legal litigation and all of the other operating costs of the insurance company.

The 66 percent of premium paid in indemnity payment is overly optimistic and a simple average of the percentage paid, that weights the risk of loss equal in each year, is probably closer to the long-run average, which was 74.1 percent of each dollar paid in premiums to cover claims. The reason is the most recent 5 years of experience has been exceptionally good in the crop insurance industry and because the sales volumes are significantly higher in the most recent 5 years that good experience overrides some of the earlier years that generated sizeable losses. Assuming RMA's premium rate is correct companies will have future large scale losses that will make the average closer to the 74.1 percent figure.

If one somehow believes weather has significantly changed so that companies will not have those severe future losses then RMA has set the premium rates too high and they should be cut. Most observers are willing to concede the past loss ratio experience is basically actuarially sound at the national level and the recent run of good luck is likely to be offset in future years bringing the loss experience back in to line. In fact, over the last 4 years effectively RMA has also generated about \$1 billion in "underwriting gain" that they retained. However, I don't expect that to continue either.

The other thing that is really striking is the amount of variability in the percent of premiums paid in claims ranging from a high of 181 percent to a low of 39 percent of premium paid in claims. While the average is closer to 70 to 75 percent, there is a lot of extreme variability annually. It is this annual variation in percent of premium paid in claims that makes crop insurance a particularly difficult risk to insure privately. Because these crop risks contain a significant amount of systemic risk is the reason the crop insurance loss ratios are either really high or really low. Unlike other lines of property/casualty insurance where losses are largely independent of each other, these losses are highly correlated. In other words, when a farmer has

a drought all farmers in the county/state have a drought and the result is a catastrophic risk that is difficult to insure privately.

As demonstrated the expected premium paid in claims over the long-run is likely to be in the 70 to 75 percent range, leaving 25 to 30 percent for operating the insurance companies. The remaining question; is that a reasonable margin? A comparison analysis was made of the performance of reinsured crop insurance versus other lines of common private property/casualty insurance. Table 2 contains historical losses for personal automobiles. Notice the dollar amounts are much larger than the \$5 to \$6 billion in reinsured crop insurance, approaching nearly \$160 billion dollars in premiums. A net premium was calculated that deducted dividends paid back to policy holders from premium dollars paid in by policy holders to allow for comparison with reinsured crop insurance.

The property/casualty industry statistics on claims unfortunately are not as clean as one would hope. In their reported losses property/casualty companies also include the Loss Adjustment Expense (LAE). By utilizing data published in AM Best, an annual report from State Farm automobile insurance company and the Insurance Information Institute, it was documented the percent of these total losses attributed to LAE range from a low of about 15 percent to a high of 18 percent of the combined LAE and auto claims. Therefore, the indemnity only payments were estimated as a range based on the estimated amount of dollars that would have been paid in LAE. Depending on how low or how high the LAE is the percentage of each dollar premium paid in claims ranges from about 62 percent to about 65 percent. The remaining amount of the premium dollar is then used to pay for all of the expenses of the insurance company and after the expenses are deducted the company generates an underwriting loss or gain. The private property/casualty companies then add their investment income to reach a bottom line.

A similar analysis was done for homeowner's policies where the expected payout ranged from about 60 percent to about 63 percent of the total premium paid in indemnity payments (table 3). Private crop hail insurance had an expected payout that ranged from about 63 percent to about 72 percent of the total premium paid in indemnity payments (table 4).

When comparing the percent of each premium dollar paid in claims between reinsured crop insurance versus auto insurance, homeowners insurance, etc, crop insurance is paying out anywhere from 5 to 10 percent more of each premium dollar in claims than are other private lines of insurance. That leaves crop insurance companies with a smaller margin to operate than the typical private property/casualty company. Any reasonable objective view would have to conclude the private crop insurance companies selling reinsured crop insurance are as at least as efficient as private sector property/ casualty insurance companies, which are market driven. In fact, there are few barriers to entry to the insurance industry other than the company must provide evidence they have the financial means to pay claims on the insurance coverage that they write. It is a very competitive market and one would have to conclude these margins are necessary for a viable private property/casualty insurance industry.

The data clearly suggests the crop insurance companies are operating with a smaller margin than the typical private property/casualty company. This would suggest there are limits

on how large Congress can cut the A&O or increase the retention of “underwriting gain” (quota share) by RMA and still have a viable private crop insurance industry to deliver reinsured crop insurance contracts. This data suggests crop insurance providers are already more efficient than the typical private property/casualty company so how much increased efficiency is possible is really an unknown. If Congress further reduces these margins, then these companies will have to find ways to be even more efficient or exit the industry. This data also does not answer the question, could USDA sell, service, and deliver crop insurance cheaper through government employees than through the private sector. There have been USDA studies completed several years ago that concluded sales through government employees would be more expensive, but there is no current data, only “common sense”.

As demonstrated the percent of premium that remains, after all claims are paid, to pay all of the operating expenses of the crop insurance company are less than for the typical private property/casualty company. Therefore, the other question is “are the costs lower for a crop insurance company versus a private property/casualty insurance company?” On the surface, one would certainly think the opposite would be true. For example, insuring an automobile is a fairly simple process and there are several major private property/casualty insurance companies who operate with only a web site and 800 numbers and don’t even employ agents. By contrast, crop insurance agents have a much larger paper volume than is required to write a crop insurance policy. This is primarily due to the extensive recordkeeping for proven yield purposes as those records must be maintained and updated by unit (often by crop field) over a period of years. Many insurance agents provide some of the recordkeeping help as a service to their clients.

Another source of cost to the insurance company beyond agent commissions is the Lost Adjustment Expense (LAE). It is difficult to find statistics that would allow for a direct comparison to give some indication of the LAE for crop insurance companies versus private property/casualty companies. As one thinks about the LAE for settling crop losses, particularly in the Great Plains, farms cover very large geographic areas that involve a significant amount of travel time as well as travel expense operating a vehicle for the loss adjuster to inspect the various fields for claim purposes.

As a proxy for the LAE cost, the percent of claims per policies (car or house) sold was compared with the percent of reinsured crop insurance policies with claims. The RMA web site reports the number of policies with premium and also reports the policies with indemnity payments. The percent of policies with paid claims’ 15 year average was 23.4 percent and was a little higher during the most recent 5 years at 29.34 percent.

In addition, there are a significant number of claims filed on crop insurance policies because farmers think they might have a loss. This requires the insurance company to pay loss adjusters to go through the process of settling the claim and checking to see if in fact there is an indemnity due. In a significant number of cases after working the claim the loss adjuster simply discovers the amount of loss does not exceed the deductible and therefore there is no indemnity payment due to the farmer. The policy is then released but the fact that this claim was processed and LAE incurred is never reported to RMA. Only claims that result in indemnity payments are reported to RMA and using only RMA data severely underreports the number of claims that are actually worked, all of which generate LAE costs for the insurance company.

Within the industry the percent of claims filed resulting in no indemnity payments has a very wide range, from 25 to 40 percent of the total claims filed. In the KSU estimate it was assumed 30 percent of claims filed resulted in no indemnity payment and therefore, was not reported to RMA. A 15 year average estimate for total claims processed is approximately 30 to 38 percent of the policies had claims worked that included both policies that had indemnity payments due as well as those that did not have losses exceeding deductible and were released without indemnity payments. When comparing the amount of claims that are worked under a crop insurance policy versus typical private property/casualty insurance policies such as auto, private crop hail, and homeowners, it is clearly significantly higher (table 5). With approximately 1/3 of the crop insurance policies having claims paid compared to less than 6 to 7 percent of the policies having claims on homeowners and a smaller percentage of auto policies with claims. The crop insurance claim rate per policy was more than double that of private crop hail.

Looking at the big difference in frequency of claims for crop insurance versus other lines of property/casualty would suggest the LAE would certainly be as expensive as auto, homeowners and private crop hail policies. However, the cost of loss adjusting expenses for homeowners and private auto insurance, in many cases, will exceed 10 percent of the gross premium. By this measure, one could only conclude the crop insurance companies have become very efficient at managing and settling their claims.

Summary. Based on this data, it is reasonable to conclude the operating margins in crop insurance are less than they are for a typical property/casualty insurance company and would certainly suggest the companies are at least as efficient at delivering crop insurance as other lines of insurance. Given the very "high" frequency of claim on a crop insurance policy, as well as the recordkeeping for selling a crop insurance policy there is no reason to believe the administrative burden is less for crop insurance than it is for other lines of insurance, in fact, the administrative burden is probably larger. Finally, the crop insurance program has performed basically at the level that Congress intended as participation during the past 15 years has increased from less than \$800 million premium volume to over \$4.5 billion. As more farmers continue to buy crop insurance and to buy higher levels of crop insurance coverage, the result has been higher aggregate premiums paid by both the government and farmers. If the government wants to reduce its contributions that will likely reduce participation in the crop insurance program.

Finally, one needs to remember many farmers have tied their marketing risk management plans to crop insurance not only for this year but in some cases they have already obligated themselves on 2008 and perhaps even 2009 crop sales. If major changes are made in the crop insurance program there may be some unintended consequences occur before farmers are able to unwind their forward marketing hedge position that is only a hedge as long as there are bushels or crop insurance dollars to offset that hedge.

Table 1. Compare Crop Insurance Delivery Cost with Private P/C Insurance; RMA Data Presented in Private Insurance Format

Year	A&O ¹ (\$ Millions)	Company "Under- writing Gains" ¹ (\$ Millions)	Premium Subsidy ² (\$ Millions)	Farmer Paid Premium ² (\$ Millions)	Farmer Paid Premium ³ (\$ Millions)	Total Premium = A&O + "Gain" + Premium Subsidy + Farmer Paid Premium ³ (\$ Millions)	Total Dollars Paid Out in Indem- nities ³ (\$ Millions)	Percent of "Total Premium" Paid Out in Indem- nities ³
1992	240	23	196.7	562.1	1,021.8	918.2	89.9%	
1993	243	-83	200.0	555.7	915.7	1,654.6	180.7%	
1994	282	104	254.9	694.5	1,335.4	601.1	45.0%	
1995	378	131	889.4	654.0	2,052.3	1,567.7	76.4%	
1996	468	246	982.1	856.5	2,552.6	1,492.7	58.5%	
1997	438	353	902.8	872.6	2,566.4	993.6	38.7%	
1998	443	280	946.3	929.6	2,598.9	1,677.5	64.5%	
1999	499	272	954.9	1,355.3	3,081.1	2,434.7	79.0%	
2000	552	285	951.2	1,589.0	3,377.2	2,594.8	76.8%	
2001	636	351	1,771.3	1,190.5	3,948.8	2,960.1	75.0%	
2002	626	-47	1,741.0	1,174.9	3,494.9	4,066.7	116.4%	
2003	734	388	2,041.7	1,389.7	4,553.4	3,260.8	71.6%	
2004	888	691	2,477.4	1,708.7	5,765.1	3,209.2	55.7%	
2005 ⁴	829	941	2,343.8	1,605.4	5,719.1	2,364.6	41.3%	
2006	961 ⁵	745 ⁵	2,680.3	1,896.1	6,282.8	2,680.3	42.7%	
Totals	7,256.0	3,935.0	19,333.7	17,034.5	49,265.6	32,476.7	65.9%	
Simple Average							74.1%	
5Year								
Total	3,077.0	1,973.0	11,284.2	7,774.8	25,815.4	15,581.6	60.4%	
5 Year Simple Average							65.5%	

¹Source: Joseph W. Glauber, Deputy Chief Economist, U.S. Department of Agriculture, Double Indemnity: Crop Insurance and the Failure of U.S. Agricultural Disaster Policy, paper prepared for American Enterprise Institute Project, Agricultural Policy for the 2007 Farm Bill and Beyond, directed by Bruce Gardner and Daniel A. Sumner.

²Source: Risk Management Agency, USDA, Washington, D.C., WEB Page: <http://www.rma.usda.gov/data/>, for years 1992 to 2006. The 2006 losses are not complete.

³"Total Premium" is defined as all farmer paid premium, subsidy, company "underwriting gain" and A&O.

⁴The underwriting gains for years prior to 2005 does not include the 5% quota share that companies started paying to RMA in 2005 that would have reduced the underwriting gains in prior years.

⁵KSU Estimates

Table 2. Personal Auto Insurance¹

Year	Premium (\$ millions)	Dividends (\$ millions)	Net Premium (\$ millions)	Losses & LAE (\$ millions)	Estimated Indemnity Payments Only ² (\$ millions)	% of Total Premium Paid Out in Indemnities
1999	118,515	1,002	117,513	91,835	75,305 - 78,060	64% - 66%
2000	119,402	1,603	117,799	99,651	81,714 - 84,703	69% - 72%
2001	128,133	641	127,492	105,554	86,554 - 89,721	68% - 70%
2002	139,452	634	138,818	109,200	89,544 - 92,820	65% - 67%
2003	151,676	805	150,871	110,950	90,979 - 94,308	60% - 63%
2004	157,709	749	156,960	109,726	89,975 - 93,267	57% - 59%
2005	159,517	748	158,769	113,125	92,763 - 96,156	58% - 61%
2006	159,990	1,908	158,082	112,669	92,389 - 95,769	58% - 61%
Totals	1,134,394	8,090	1,126,304	852,710	699,222 - 724,804	62% - 64%
Simple Average						63% - 65%
5 Year Total	768,344	4,844	763,500	555,670	455,649 - 472,320	60% - 62%
5 Year Simple Average						60% - 62%

¹Source: Conning Research & Consulting, Inc. 2007

²Published industry indemnity payments include loss adjustment expense (LAE). The published value was adjusted by the average percent loss adjustment expense rate for property/casualty insurance (18.17%) based on published values by Arthur Snyder; Publisher, President and Chairman, A.M. Best Co., Special Report, April 23, 2007. Edward B. Rust, Jr. Chairman and CEO, 2006 Annual Report to State Farm Mutual Policyholders, State Farm Mutual Automobile Insurance Company, Bloomington, IL.; stated the percent of premium paid in claims was 59.7% in 2005 and 74% in 2006. The percent of combined losses and LAE paid in loss adjustment expenses were 18.8% in 2005 and 15.4 percent in 2006. Insurance Information Institute estimated LAE for homeowners insurance at about 12% of the total combined claims and LAE. Therefore, to generate an estimate for indemnity payments only, a range of estimated indemnity payments was generated with a 12% to 15% of the combined losses estimated to be loss adjustment expenses for homeowners insurance and 15% to 18% for auto insurance.

Table 3. Home Owners Insurance¹

Year	Premium (\$ millions)	Dividends (\$ millions)	Net Premium (\$ millions)	Losses & LAE (\$ millions)	Estimated Indemnity Payments Only ² (\$ millions)	% of Total Premium Paid Out in Indemnities	
1999	30,649	1,002	29,647	23,024	19,570 - 20,261	66% - 68%	
2000	32,582	1,603	30,979	25,451	21,633 - 22,397	70% - 72%	
2001	35,436	641	34,795	31,039	26,383 - 27,314	76% - 79%	
2002	40,296	634	39,662	30,033	25,528 - 26,429	64% - 67%	
2003	45,989	805	45,184	30,081	25,569 - 26,471	57% - 59%	
2004	49,967	749	49,218	32,462	27,593 - 28,567	56% - 58%	
2005	52,992	748	52,244	39,274	33,383 - 34,561	64% - 66%	
2006	54,846	1,908	52,938	32,621	27,728 - 28,706	52% - 54%	
Totals	342,757	8,090	334,667	243,985	207,387	214,707	62% - 64%
Simple Average							63% - 65%
5 Year Total	244,090	4,844	239,246	164,471	139,800	144,734	58% - 60%
5 Year Simple Average							59% - 61%

¹Source: Conning Research & Consulting, Inc. 2007

²Published industry indemnity payments include loss adjustment expense (LAE). The published value was adjusted by the average percent loss adjustment expense rate for property/casualty insurance (18.17%) based on published values by Arthur Snyder; Publisher, President and Chairman, A.M. Best Co., Special Report, April 23, 2007. Edward B. Rust, Jr. Chairman and CEO, 2006 Annual Report to State Farm Mutual Policyholders, State Farm Mutual Automobile Insurance Company, Bloomington, IL.; stated the percent of premium paid in claims was 59.7% in 2005 and 74% in 2006. The percent of combined losses and LAE paid in loss adjustment expenses were 18.8% in 2005 and 15.4 percent in 2006. Insurance Information Institute estimated LAE for homeowners insurance at about 12% of the total combined claims and LAE. Therefore, to generate an estimate for indemnity payments only, a range of estimated indemnity payments was generated with a 12% to 15% of the combined losses estimated to be loss adjustment expenses for homeowners insurance and 15% to 18% for auto insurance.

Table 4. Private Crop Hail Insurance¹

Year	Premium (\$ Thousands)	Indemnity Payments (\$ Thousands)	% of Premium Paid Out in Indemnities	% of Premium Paid Out in Indemnities
1992	328.0	380.0	115.9%	
1993	396.0	326.5	82.4%	
1994	419.4	380.0	90.6%	
1995	416.6	265.9	63.8%	
1996	501.3	402.8	80.4%	
1997	561.1	331.7	59.1%	
1998	543.3	463.5	85.3%	
1999	485.5	381.8	78.6%	
2000	448.1	308.7	68.9%	
2001	414.0	293.9	71.0%	
2002	387.8	282.5	72.9%	13.9%
2003	403.4	227.1	56.3%	12.8%
2004	407.7	238.1	58.4%	14.0%
2005	415.5	185.6	44.7%	11.2%
2006	407.6	202.9	49.8%	11.7%
Totals	3,370	2,120	62.9%	12.7%
Simple Average			71.9%	
5 Year Total	2,022	1,136	56.2%	12.7%
5 Year Simple Average			56.4%	

¹Source: National Crop Insurance Services

Table 5. Compare Crop Insurance Percent of Policies with Claims vs. Percent of Property/Casualty Insured Policyholders with Claims

Crop Year	Policies with Premium ¹	Policies with Indemnity ¹	Percent of Policies with Paid Claims ¹	Estimated Total Claims Filed ²	Percent of Policy holders filing Claims	Percent of Claims per car, Bodily Injury ³	Percent of Claims per car, Property Damage ³	Percent of Home Owner Policies with Claims ³	Percent of Private Crop Hail Policies with Claims ⁴
1992	663,401	142,492	21.48%	185,240	27.92%				
1993	679,027	255,765	37.67%	332,495	48.97%				
1994	800,858	114,127	14.25%	148,365	18.53%				
1995	2,034,337	346,415	17.03%	450,340	22.14%				
1996	1,615,191	296,892	18.38%	385,960	23.90%	1.35%	4.17%		
1997	1,319,759	174,068	13.19%	226,288	17.15%	1.31%	4.03%		
1998	1,242,663	220,029	17.71%	286,038	23.02%	1.26%	3.97%		
1999	1,288,778	290,335	22.53%	377,436	29.29%	1.23%	4.00%		
2000	1,323,243	320,105	24.19%	416,137	31.45%	1.21%	3.99%		
2001	1,297,925	356,808	27.49%	463,850	35.74%	1.18%	3.99%	7.91%	13.95%
2002	1,259,484	449,439	35.68%	584,271	46.39%	1.18%	3.95%	6.89%	12.81%
2003	1,241,469	395,893	31.89%	514,661	41.46%	1.18%	3.89%	7.10%	14.02%
2004	1,228,811	334,162	27.19%	434,411	35.35%	1.16%	3.81%	6.72%	11.22%
2005	1,190,579	282,600	23.74%	367,380	30.86%	1.11%	3.69%	5.81%	11.73%
2006	1,147,358	318,241	27.74%	413,713	36.06%				
Total	18,332,883	4,297,371	23.44%	5,586,582	30.47%	1.22%	3.95%	6.89%	12.74%
5 Year	6,067,701	1,780,335	29.34%	2,314,436	38.14%				

¹Source: Risk Management Agency, USDA, Washington, D.C., WEB Page: <http://www.rma.usda.gov/data/>, for years 1992 to 2006. The 2006 losses are not complete.

²There are a significant number of crop insurance claims that are filed and must be appraised by loss adjusters but are released with no indemnity payment because the loss did not exceed the deductible. The percentage of the total claims filed but generates no payment ranges from 25-40% of filed claims. Only when there is an indemnity payment does the insurance company report the claim to RMA. RMA does not collect data on the claims worked but were released without making an indemnity payment.

³Source: The Insurance Information Institute

⁴Source: National Crop Insurance Services

Testimony of

**David Herring
Branch Manager
East Carolina Farm Credit**

Before the

**Subcommittee on General Farm Commodities and
Risk Management
Committee on Agriculture
U.S. House of Representatives**

Washington, DC
June 7, 2007

Good morning Chairman Etheridge and members of the subcommittee. My name is David Herring and I work for East Carolina Farm Credit. I am a branch manager based in Kinston, North Carolina. East Carolina Farm Credit is a member of the Farm Credit System. Like all other Farm Credit institutions, East Carolina is owned and governed by the farmers and ranchers to whom we lend.

East Carolina Farm Credit based in Raleigh, has more than \$850 million in loans outstanding to farmers, ranchers, farm-related businesses, rural homebuyers, and others in rural North Carolina. Farm Credit has, through East Carolina and our sister organizations in North Carolina, more than \$2.7 billion outstanding in North Carolina through some 29,000 loans.

East Carolina's Kinston Branch, which I manage, provides about \$40,000,000 in loan volume in our local area. In addition to my branch manager duties, I am a licensed property and casualty and life and health insurance agent.

I am here today to talk about the importance of crop insurance to our customer/owners and to the safety and soundness of our financial institutions. Farm Credit plays a unique role in the crop insurance industry. As a provider of crop insurance, we work to improve access to crop insurance products for our customers. As a financial institution, we rely on crop insurance as a backstop for many of the loans we make to farmers. As a farmer-owned cooperative, we work to provide the most efficient crop insurance delivery system for our farmer-owners.

Farm Credit serves as an insurance agent in the crop insurance program – selling policies underwritten by insurance companies. Importantly, Farm Credit institutions do not underwrite coverage and bear no risk of loss on crop insurance policies.

Farm Credit's network of nearly 100 customer-owned financial institutions provides crop insurance services to farmers throughout the nation. With approximately 10% market share in crop insurance, Farm Credit institutions combined to sell more crop insurance to customers than any other single industry provider. For crop year 2007, Farm Credit collected some \$494 million in premiums. In crop year 2006, Farm Credit collected about \$464 million in premiums.

With more than \$72 million in crop insurance revenue in 2006, Farm Credit institutions collectively, ranked as the 31st largest insurance agency of any kind operating in the United States. Farm Credit sells policies underwritten by almost all of the major crop insurance companies. However, about 75% of the policies sold by Farm Credit are underwritten by RCIS and Rain & Hail.

By law, Farm Credit is required to offer farmers at least two choices for crop insurance coverage. Farm Credit is prohibited from requiring lending customers to obtain crop insurance from Farm Credit.

I would like to take this opportunity to give my personal testimony as to the Federal Crop Insurance Program and its importance to the financing of the farmers of Eastern North Carolina.

In reflecting back to the summers of 1977 and 1985, both years were disastrous due to drought. At the time, crop insurance was carried by only a small percentage of the farmers. As crop losses accumulated, many family farms were forced into bankruptcy or foreclosure. Without a crop insurance safety net, many farmers couldn't pay their debts. This kind of financial stress in farmers ripples through a financial institution, especially one like Farm Credit that lends almost exclusively to production agriculture.

Since 1987, when approximately 582,000 acres were insured by Federal crop insurance compared to in excess of 3.1 million acres in 2005, the farmers of Eastern North Carolina have been able to handle many disasters including drought, excess rains, and hurricanes all with the help of the Federal Crop Insurance Program. Crop insurance is now a critical component of a farmer's risk management strategy.

For many of our farmer/borrowers, we require crop insurance coverage to be in place as a condition of providing a loan. With the requirement of crop insurance we as lenders are able to have affordable controls in place to transfer the risk of loss of equity and repayment capacity from the individual farmer to the insurance company. The guarantees offered through crop insurance give stability to an individual farmer's income and with assignments in place a guaranteed source of repayment to the lender. For many farmers – and especially for young and beginning farmers – this is essential.

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Serving the financial needs of the agricultural community involves taking risk. Prudent management of a loan portfolio is necessary to manage that risk. For our financial institution, a requirement that some farmers carry crop insurance is an important tool that helps us manage that risk.

Before requiring a farmer to carry crop insurance as a condition of extending that farmer a loan, we make a logical and objective analysis of the facts. We evaluate the borrower's past performance, repayment terms, collateral, strength of capital and capacity and existing loan conditions relative to the loan risk. For some farmers, credit would not be available without the protection that crop insurance gives the lender.

In part due to the crop insurance programs in place foreclosures are at an all time low with credit quality at an all time high. In the United States over 245 million acres are insured today through Federal Crop Insurance compared to less than 49 million acres in 1985. Changes to the crop insurance program that increase cost or reduce coverage to farmers would significantly weaken the safety net for our farmers. We encourage subcommittee members, as you write this Farm Bill, to preserve the strength of the crop insurance program and ensure that farmers can continue to rely on it in the years to come.

Mr. Chairman, I also want to encourage the committee to ensure that farmer-owned cooperatives – like Farm Credit System institutions – are not unnecessarily inhibited in offering crop insurance policies to their customer/owners. Over the past few years, USDA's Risk Management Agency has repeatedly attempted to adopt procedures defining how cooperatives can participate in crop insurance. Each of these attempts would have resulted in fewer and less satisfactory options for farmers who want to purchase crop insurance

We understand that the agency is again moving forward in this effort. We encourage the committee to examine RMA's proposal and provide guidance to the agency so that cooperatives can continue to play an important role in providing their members with crop insurance coverage.

Thank you for inviting me to testify today. I would be happy to answer any questions.

The Andersons, Inc.
Testimony before the U.S. House of Representatives
Committee on Agriculture
June 7, 2007

Presented by Michael K. Mock, senior risk management consultant

About The Andersons, Inc.

The Andersons, Inc. is a diversified company with interests in the grain, ethanol and plant nutrient sectors of U.S. agriculture, as well as in railcar leasing and repair, turf products production, and general merchandise retailing. Founded in Maumee, Ohio, in 1947, the company now has more than 40 operations in seven U.S. states plus rail leasing interests in Canada and Mexico.

With a workforce of nearly 3,000, The Andersons' 2006 revenue was \$1.5 billion. Last year the company handled 170 million bushels of grain and produced 1.5 million tons of liquid and dry agriculture nutrients. During the past 10 months, the company has begun operations at two ethanol plants and is constructing another scheduled to open in the first quarter of 2008. When completed, the three plants combined will produce 275 million gallons of ethanol annually.

The company also originates corn for other ethanol facilities as well as food-suppliers such as Frito-Lay and Kroger's. We are recognized as leaders in the agriculture industry as commodity risk managers and grain originators. An integral part of our risk management strategy includes leveraging the value of crop insurance and thus our business structure also includes a crop insurance agency which will have nearly \$10 million in sales premium in 2007.

Outside of its agriculture operations, The Andersons operates a railcar leasing and repair business. With more than 21,000 railcars in its portfolio, The Andersons operates the sixth largest private fleet nationwide. It has general merchandising retail interests with six stores in Ohio and has recently opened a specialty food store in a suburb of Toledo. The company's turf and specialty operation is a major manufacturer and marketer of premium dispersible and non-dispersible granular products for turf management and landscape markets.

Rationale for Testifying

The Andersons actively promotes the use of crop insurance for its producers because the company strongly believes a high quality, revenue-based crop insurance policy is the single most important step a producer can take to effectively minimize risk for his grain production. The Andersons has demonstrated this stance to producers, bankers, insurance providers and others through the Crop Revenue Profiler® software program, a proprietary tool that provides estimated net pre-tax revenue scenarios for producers based on input costs, price per bushel and yield per acre. The company has found that producers who have implemented this risk mitigation approach over a period of years are often operating a more financially sound farming business. As a result, these producers have less of a need for marketing loans, counter-cyclical payments and disaster payments.

However, they do need access to insurance providers and often participate in insurance programs because of the affordability.

With several grain and ethanol operations, The Andersons believes the use of revenue-based crop insurance provides a win-win for both the producer and the company. Crop insurance helps mitigate the risk for lack of production and provides confidence for producers to forward contract at profitable prices. Alleviating the typical barriers of production and price often leads to more forward contracting, ensuring a source for inputs to ethanol plants and fulfilling the needs of and food and animal feed customers.

Equally as important, because The Andersons is as a commodity input hedger, the company's bankers know that the company's ability to maintain contract integrity is directly correlated with the ability of our producers to deliver on the contract they establish. The two are closely related. Knowing this, the company (and others like The Andersons) seeks to contract with producers with sound financial integrity or those who have protection in the event of lack of production. Crop insurance provides that protection, giving producers the courage to sell in advance of planting and production, thus contributing to the financial health of producers and the grain industry alike.

Benefits of Revenue-Based Crop Insurance to the Producer

In simple terms, the amount of income a producer makes is:

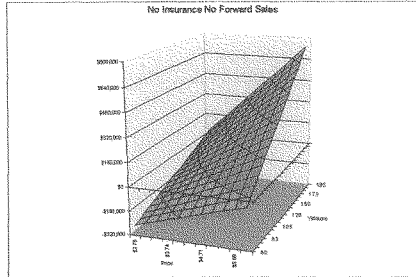
$$\begin{aligned} \text{Price} \times \text{Yield} &= \text{Total Revenue} \\ \text{Total Revenue} - \text{Total Cost} &= \text{Net Income} \end{aligned}$$

A strategic method to help protect the Price component in the above equation is forward contracting which establishes the price per bushel.

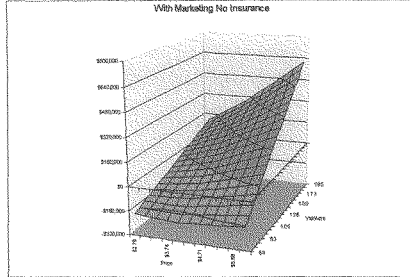
A strategic method to protect the Yield in the equation is to purchase crop insurance (preferably revenue-based). Should the yield not equal the forecast, the producer is protected from potential losses in revenue as well as potential penalties for not fulfilling contracts.

Combine these strategies with a sound marketing approach, and the producer has a much better opportunity for a consistent revenue stream from the crop. The risk management strategy of blending crop insurance and sound marketing enables the producer to eliminate the majority of his exposure to potential risks including crop failure, sharp drop in prices or a combination of the two.

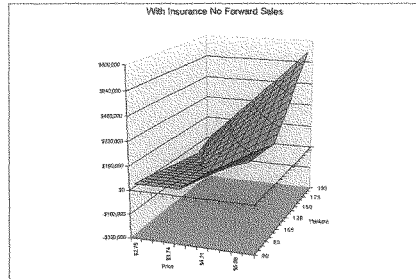
The following charts illustrate the progression of how risk (represented in red) is minimized with the implementation of each tool:



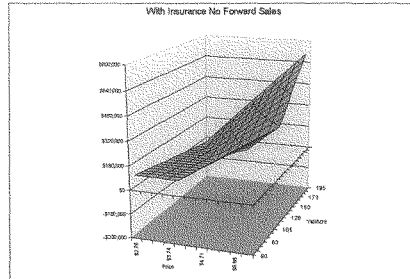
No Marketing, No Insurance



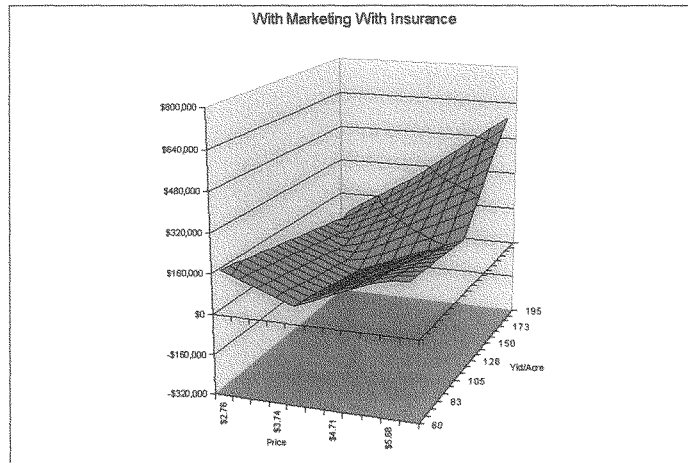
50% Priced, No Insurance



No Marketing, 75% RA-HPO Only



No Marketing, 85% RA-HPO Only



50% Priced with 85% RA-HPO

As is illustrated, with production planned and expenses estimated or locked-in, insurance provides producers the security to forward contract prior to planting when prices are often more profitable. In the event production does not meet expectation, revenue-based insurance offers protection to the producer in the form of a replacement cost alternative to production. The coverage of price protection that marketing offers, coupled with the production protection that crop insurance offers, helps secure financial stability for the farm operation regardless of size.

National Impact of Revenue-Based Crop Insurance

The development of revenue based crop insurance tools in the late 1990s had a huge impact for producers to manage the ever increasing risks associated with agriculture production. While producers were influenced by higher than typical commodity prices, The Andersons is convinced the significant increase in corn planted acres for 2007, as reported in the USDA's March estimates, was due in large part to the producers' ability to lock in profitability through attractive insurance guarantees. It was this guarantee that provided the farmer and his banker the courage to invest significant dollars in additional, high cost, corn acres.

As the U.S. moves forward in providing a stable food, feed and fuel supply for its citizens, as well as the people of other nations, both The Andersons and its customers will become even more reliant on affordable, high quality crop insurance tools to manage ever growing risk.

Growing risk will be magnified into future crop cycles. Much of the industry expects input costs such as seed and fertilizer to increase significantly during the next few years. In addition, competition for land has resulted in dramatically higher land rental costs.

The ever increasing costs of planting corn, especially corn after corn, may work to discourage farmers from planting corn to lower cost crops. This is more likely with deferred soybean and wheat values well in excess of \$8.00 and \$5.00 per bushel respectively.

The Andersons believes strongly revenue-based crop insurance tools are of even more value today that when they were first introduced 10 years ago. The high level of producer participation in all regions of the country is a testimony to the value of the product.

Ensuring a steady supply of key commodities such as grain to consumers requires producers to have financial stability without unnecessary financial risks. To accomplish this, producers must have affordable access to crop insurance.

The Andersons, Inc.
Oration of Testimony before the U.S. House of Representatives
Committee on Agriculture
June 7, 2007

Oration or Written Testimony by:
Michael K. Mock, senior risk management consultant

Thank you Mr. Chairman, members of the committee for the opportunity to participate in this hearing.

For more than 25 years, I've been working with producer customers, assisting them with commodity risk management. The majority of my clients are located in the eastern Corn Belt, but I currently work with customers across the country from Elgin, NE to Mansfield, OH, from Lyle, MN to Coldwater, MS.

The company I represent, The Andersons, Inc is a diversified company with interests in the grain, ethanol and plant nutrient sectors of U.S. agriculture, as well as in railcar leasing and repair, turf products production, and general merchandise retailing. Founded in Maumee, Ohio, in 1947, the company now has more than 40 operations in seven U.S. states plus rail leasing interests in Canada and Mexico.

Last year the company handled 170 million bushels of grain and produced 1.5 million tons of liquid and dry agriculture nutrients. During the past 10 months, the company has begun operations at two ethanol plants and is constructing another scheduled to open in the first quarter of 2008. When completed, the three plants combined will produce 275 million gallons of ethanol annually.

We are recognized as leaders in the agriculture industry as commodity risk managers and grain originators. An integral part of our risk management strategy includes leveraging the value of crop insurance. Thus our business structure also includes a crop insurance agency, which will have nearly \$10 million in sales premium in 2007.

Rationale for Testifying

The Andersons actively promotes the use of crop insurance for its customers. We are unable to replicate the price/yield coverage it offers producers via other hedging vehicles such as exchange traded options. The company strongly believes a high quality, revenue-based crop insurance policy is the single most important step a producer can take to effectively minimize risk for his grain production. The Andersons has demonstrated this stance to producers, bankers, insurance providers and others through the Crop Revenue Profiler® software program. The Profiler is a proprietary tool that provides estimated net pre-tax revenue scenarios for producers based on input costs, price per bushel and yield per acre.

Producers who have implemented this risk mitigation approach over a period of years are often operating a more financially sound business. As a result, these producers have less need for marketing loans, counter-cyclical payments and disaster payments. However, they do need access to insurance providers and prefer to participate in insurance programs as long as they are affordable.

With several grain and ethanol operations, The Andersons believes the use of revenue-based crop insurance provides a win-win for both the producer and the company. Crop insurance helps mitigate the producer's risk of lack of production. It also instills confidence for producers to forward contract at profitable prices. Alleviating the fear of lack of production often leads to more forward contracting, ensuring a source of inputs for our ethanol plants as well as fulfilling the needs of food and animal feed customers.

To manage our company's risk in doing business, The Andersons is a commodity input hedger. The cost of financing forward contracts is a significant expense and not without risk. Our bankers know that the company's ability to maintain contract integrity is directly correlated with the ability of our producers to deliver on the contracts they establish with us. Knowing this, The Andersons, and others in the industry, seek to contract with producers with proven financial integrity and/or those who have protection in the event of lack of production. Crop insurance provides such protection, giving producers the courage to sell, often well in advance of planting, thus contributing to the financial health of producers and the grain industry alike.

National Impact of Revenue-Based Crop Insurance

Certainly producers were influenced by higher than typical commodity prices when making crop mix plans this winter. The Andersons is convinced the unexpected increase in corn planted acres for 2007, as reported in the USDA's March estimates, was due in large part to his ability to lock in profitability through attractive insurance guarantees. It was this guarantee that provided the farmer and his banker the courage to invest significant dollars in additional, high cost, corn acres.

As the U.S. moves forward in providing a stable food, feed and fuel supply for its citizens, as well as the people of other nations, both The Andersons and its customers will become even more reliant on affordable, high quality crop insurance tools to manage ever growing risk. We expect crop production costs to increase significantly in future crop cycles. Much of the industry concurs. In addition, competition for land has resulted in dramatically higher land rental costs. This may serve to pressure producer profit margins despite high grain prices.

The ever increasing costs of planting corn, especially corn after corn, may serve to encourage farmers to plant lower cost crops. This is more likely with deferred soybean and wheat values well in excess of \$8.00 and \$5.00 per bushel respectively.

The Andersons believes strongly revenue-based crop insurance tools are of even more value today than when they were first introduced 10 years ago. The high level of producer participation in all regions of the country is a testimony to the value of the product.

Ensuring a steady supply of key commodities such as grain to consumers requires producers to have financial stability without unnecessary financial risks. To accomplish this, producers must have affordable access to crop insurance.

To summarize:

- The Andersons is well versed in virtually all aspects relating to crop insurance.
- Our producer customers have embraced these products as their primary risk management tool.
- The future appears to promise an environment of high price opportunities combined with the risk of higher input costs.
- Accordingly, as we move forward, the need for an affordable, high quality crop insurance program is greatly heightened for both the producer and the grain and ethanol industries.

Thank you.

**Testimony of
Bert Little, Ph.D.
Associate Vice President for Academic Research
Professor of Computer Science and Mathematics
Executive Director, Center for Agribusiness Excellence
Tarleton State University
Texas A&M University System
Before the Subcommittee on General Farm Commodities and Risk Management
Thursday, June 7, 2007
10:00 AM**

Chairman Etheridge, Ranking Member Moran, and Members of the Subcommittee, thank you for the opportunity to appear this morning before the Subcommittee to discuss efforts to eliminate fraud, waste, and abuse in the Federal Crop Insurance program and, in particular, the data warehousing and data mining efforts currently undertaken by the Center for Agribusiness Excellence (CAE) with the Risk Management Agency (RMA).

I. Center for Agricultural Excellence (CAE)

I am Bert Little, Associate Vice President for Academic Research and Professor of Computer Science and Mathematics at Tarleton State University, which has been a member of the Texas A&M University System since 1917. In this role, I also direct the CAE, which was founded at Tarleton specifically to address the section of the Agriculture Risk Protection Act of 2000 (ARPA 2000) directing the Secretary of Agriculture to use data mining and data warehousing to improve integrity and compliance in Federal Crop Insurance. Personally, my own roots in agriculture run deep. My family obtained its first land grant in 1790 in southeastern North Carolina, and I worked on that same piece of land raising tobacco, corn, and soybeans until my late teens.

Recent press reports as well as testimony before this and other Committees of Congress have raised questions about the integrity and cost-efficiency of the Federal crop insurance program, and I appreciate the action of this Subcommittee in devoting this morning's hearing to this topic of great concern both to farm producers and to taxpayers in general. I will use my testimony to give the Subcommittee a fresh update on the program integrity activities conducted by USDA's Risk Management Agency (RMA) through its data mining and data warehousing initiatives housed at CAE. At the outset, I would emphasize that the data analyzed at CAE involves insurance policies and potential fraud and abuse of those policies. We do not analyze the financial data involving crop insurance companies who deliver the program to producers under the Standard Reinsurance Agreement with FCIC. As a result, my testimony will not address those issues.

II. DATA MINING AND WAREHOUSING OVERVIEW

We are pleased with the success CAE has had in applying data mining techniques to the crop insurance program. USDA's Risk Management Agency, in its annual Program Compliance and Integrity reports to Congress, has conservatively estimated that, over a period of six years, we have saved American taxpayers nearly half a billion dollars by highlighting potential fraud and abuse in the program and, as a result, helping RMA to avoid making improper payments. These savings are detailed in Appendix I. RMA and its staff are to be complimented for their effective and aggressive use of these powerful new compliance tools.

In the course of our analytical work, we have found that the farmers who participate in the Federal crop insurance program by and large are honest people who follow the rules. Our Spotcheck program, described in more detail below – designed to identify suspicious patterns indicating possible program abuse – has consistently found fewer than one percent of producers falling in this category. This is a strong indicator of program integrity and rates much better than comparable lines of insurance in the property and casualty field.

Crop Insurance is a data intense program with complex rules. Data mining works well in such an environment. The savings we have accomplished were achieved through a variety of coordinated activities aimed at exposing and preventing abuse. As a starting point, CAE has built a data warehouse comprised of all RMA policy information from 1990 to the present, as updated by RMA every two weeks. Data on weather, soils, and other agronomically relevant factors are integrated into the CAE data warehouse to complement policy data for analysis. All data maintained with the CAE data warehouse are subject to the same USDA privacy and security protections that apply to data maintained by USDA itself. The result today is a database containing more than two terabytes (terabyte = 1 trillion words (bites) of information, and we have linked this data across time to allow multiyear comparisons, a key analytical approach previously unattainable. With it, CAE produces more than 100 data mining research products each year in coordination with USDA.

III . ONE EXAMPLE: THE SPOTCHECK LIST

One example of how we use this foundation to identify and prevent abuse is the system that CAE has developed, along with RMA staff, to use its database each year to identify multi-year patterns that signal suspicious or anomalous crop insurance claims. The result is what we call the Spotcheck List, an actual list of producers who will then become subject to increased compliance oversight. Over the years, we have refined this process to the following five steps:

- (1) Based on such starting points as anecdotes from the field or experience of investigators, producers, agents, or adjusters about schemes to exploit the program, we design data mining algorithms to identify schemes that farmers might potentially use to obtain improper crop insurance indemnities;
- (2) These schemes are analyzed to determine whether they occur in the national data, where, and to what extent. RMA and CAE analysts review the data mining analyses

to determine whether or not the scheme is structured and results in personal benefit;

- (3) Schemes and specific producers are identified and placed on the Spotcheck List. The List is reviewed by RMA Compliance staffers, who may add additional persons of interest to the List;
- (4) The Spotcheck List is passed to USDA Farm Service Agency (FSA) State Executive Directors, who ask local county FSA offices to conduct inspections during the growing season on the identified fields;
- (5) FSA sends a letter to each producer on the Spotcheck List notifying them that an inspection will be performed on his or her crop. Additional pre-harvest visit(s) may be made.

Most producers on the Spotcheck List react to the FSA letter in step 5 by refraining from any contemplated abusive activities. The result is a visible, measurable reduction in indemnities paid. Simply put, growers change their behavior as a result of knowing that they are being scrutinized. Before they were on the Spotcheck List, this subgroup of producers had loss ratios that were several fold higher than their neighbors in their own counties. But after being informed they were on the list, their loss ratios fell to the county averages. Importantly, this effect of reduced indemnity lasts several years among more than two thirds of those on the Spotcheck List. In sum, over six years (2001 through 2006), the Spotcheck List initiative alone has produced measurable reductions in unneeded indemnities of approximately \$479 million.

As noted, the CAE Spotcheck List is only one of more than 100 research products produced annually by CAE at the request of RMA aimed at improving program integrity and contributing materially to cost savings. Other federal offices that have requested and received assistance from CAE in the form of data mining analyses have included the USDA Office of Inspector General (OIG), the Government Accountability Office (GAO), and various Federal prosecutors as well as investigators from the Federal Bureau of Investigation (FBI). When requested, CAE personnel have served as expert witnesses for Federal prosecutors in crop insurance fraud litigation.

IV. DATA SHARING; ONGOING RESEARCH AND FUTURE DEVELOPMENT

Our current analytical products can and should be more fully utilized, and we believe the next logical extension would be to better include in the process the reinsured companies who deliver crop insurance to producers across the country. At a meeting of the National Crop Insurance Services (NCIS) organization last month, RMA Administrator Eldon Gould announced that these insurance companies will now begin having access to the CAE Dashboard – our basic platform for accessing data at the county level -- and they will be able to submit work orders directly to CAE for research on specific problems. At the same meeting, I was given a green light to announce that the insurance companies would be provided a secure portal through which to report their growing season inspections on the RMA SharePoint system, the system they currently use to transmit policy information to RMA's Kansas City Data Center.

One analytical tool available on the CAE Dashboard that offers a particularly powerful resource is our searchable, stored archive of NEXRAD weather loops – essentially the same Doppler Radar images we see on our local television weather reports. To our knowledge, CAE maintains the only such active system of NEXRAD data maintained over a period of years. In one example, for instance, two farmers filed claims on hail damage that were denied because NOAA could not verify that a hail storm had occurred on the day in question. But by using our NEXRAD system, we were able to identify a very isolated, very heavy storm that produced the damage. As a result, the farmers' claims were verified, and they could be paid the indemnity they deserved.

Most recently, CAE, in collaboration with the Stennis NASA Space Center Applied Sciences, has completed much of the process of integrating into the data mining process satellite data that measures the intensity of the green light reflected by the chlorophyll molecules in plants – a measure of biomass present. CAE has invested its own non-Federal resources to build a 42 Terabyte data system to store or hold our satellite data for January 1, 2000 to the present. Our preliminary results are exciting, indicating a better than 90 percent ability to evaluate crop production via satellite using this system, and we are currently working to augment it with data from the Indian AWiS satellite.

In the future, CAE hopes to incorporate in our system the Common Land Unit (CLU) data held by USDA's Farm Service Agency. With CLU data, we will be able to assess biomass health (indicated by reflectance of chlorophyll green) at the field level using satellite data and quantify its direct relationship with crop production. We see many such opportunities to improve our analysis with the inclusion of farm data reported to FSA, and we have been requesting FSA to provide it to us for this purpose.

V. SUMMARY

Data mining as mandated under ARPA 2000 has been a striking success for Congress and USDA. For an investment of \$26.1 million, it has conservatively produced program savings of over \$479 million since December 2000 with the Spotcheck List alone. For the longer term, Congress may wish to consider continuing this program by providing a multi-year funding authority in the 2007 Farm Bill, similar to the multiyear approach used so effectively to fund the program in the original 2000 APRA legislation.

Thank you again for giving us this opportunity to summarize CAE's record of providing cost savings to the Federal Crop Insurance program under the ARPA 2000 data mining program. Congress and USDA deserve a great deal of credit for taking the bull by the horns and implementing this program in an effective way to the benefit of both farmers and taxpayers. Great strides have been made to improve the policing of the Federal crop insurance program since the adoption of ARPA in 2000, and we have been honored to be part of the process. Thank you for your consideration, and I would be happy to answer any questions you might have.

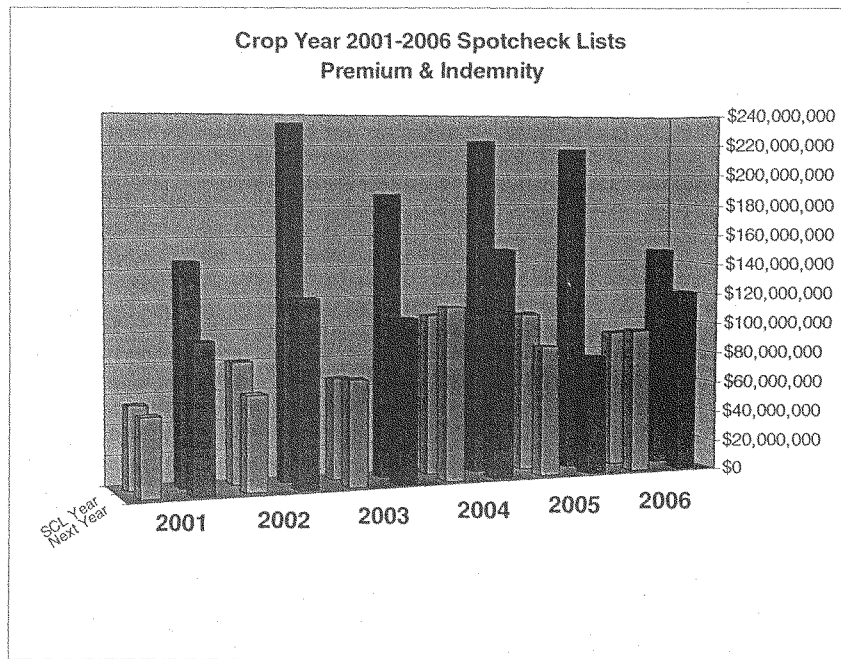


FIGURE: Indemnity Decreases for 2001-2006: \$479 Million.
 Taller bars (maroon, back row) reflect payments before producers were on the Spotcheck List, and the shorter bars (maroon, front row) are after they were on the Spotcheck List.

Statement by Nick Ferens
Manager, US Civil Market
DeticaDFI
Before the House Agriculture Subcommittee on
General Farm Commodities and Risk Management
June 7, 2007

Chairman Etheridge, Ranking Member Moran, and Members of the Panel, Good morning and thank you for the opportunity to appear before you today. My name is Nick Ferens, and I am the Manager for the US Civil Market for DeticaDFI ("Detica"). Before describing my company, qualifications, and recommendations, I would like to provide my aspirations for appearing here today.

I. Vision of the Future

The Risk Management Agency (RMA) has a difficult balancing job to do: promoting and regulating solutions to keep our agriculture sector stable and productive, while at the same time being good and effective stewards of taxpayer resources. The Agency has adapted useful tools to help it meet its mission, and it has partnered with well-regarded individuals, entities and programs to obtain some of the resources that it needs to do its job. But, in an age of changing technologies, rapidly expanding amounts of data, and behavior that quickly adapts to changed environments and circumstances, we need to think about RMA in a more holistic way, rather than approach the process of detecting fraud, waste and abuse in a linear but piecemeal fashion. We need to help RMA obtain more resources—human and technological-- to balance these needs and to be good, informed consumers to make better technology decisions for itself. Our view envisions an agency that has the technological infrastructure that can power the intellectual underpinnings of fraud detection, the internal workforce that can operate the infrastructure and understand the inputs and outputs of the system, and a collaborative process that builds and expands upon the successes that RMA has accomplished to date. Through this comprehensive approach, we believe the long term investment by RMA in fraud detection will be minimized, and the return on investment optimized through:

1. better oversight by and of the insurance agencies,
2. reduced management burdens on all participants,

3. better detection through efficiently targeted investigation and enforcement,
and
4. effective use of taxpayer resources.

II. Professional Qualifications

DeticaDFI is a consulting organization that works with a wide range of private and public sector organizations to convert data into actionable intelligence. We provide a wide spectrum of data intelligence and analytics services, with particular focus on the areas of fraud detection, risk management, security, and regulatory compliance.

Although we are well known in the financial services arena, our roots and domain expertise reside in the government/national security sector. Collectively, we have more than 30 years' experience working with various governmental entities.

Perhaps the easiest way of helping you understand what Detica does is to provide an example. The Insurance Fraud Bureau (IFB) is a body established in 2006 to detect and investigate serious and organized fraud in the UK. The IFB was established because the insurance industry needed to tackle distributed claims fraud. The insured in this example would collude using a variety of techniques and make multiple fraudulent insurance claims across multiple insurers. Detica applied a series of advanced new data analysis techniques to detect patterns of fraudulent behavior in large data sets. The combined data is over 26 million records covering more than 32 million families. By combining multiple data sources to form the "big picture", more accurate risk scores could be generated and delivered to investigators to maximize their capacity.

Once we have helped our clients understand and articulate the problems they want resolved and formulated a strategy to resolve it, we can then offer a range of technological solutions as appropriate. These solutions do not simply include data warehousing and data "mining", but include the full range of predictive analytics, data quality assurance, web integration, enterprise content management, text mining, search and retrieval, and communications monitoring.

We live in a world where vast amounts of data are being generated by the minute. It is beyond dispute that to detect fraud, one must be able to understand the data and use techniques that will winnow out the good actors from those that are bad. However, that is really only the beginning of the story. In this day and age, fraud, waste, and abuse (hereinafter “improper payments”) scenarios are increasingly sophisticated, being carried out less by individuals acting alone, but through organized networks of people. The trick then is to use the data to reveal these networks before the improper payment has occurred. In this respect, Detica has been a pioneer in the development and use of sophisticated software and techniques to detect these networks. I have attached a couple of power point slides that will help you to visualize how these networks appear. This is in sharp contrast to RMA’s current model, which is looking for individual anomalies.

In short, what we do, through our NetReveal solution, is use the data—however sparse or voluminous it might be-- to identify whether there are linkages or connections between people. Once the linkages are created, the customer, in this case, RMA, can then begin to understand whether the linkages are meaningful in terms of suggesting potentially wrongful behavior, and then further investigate those patterns and linkages. The strength of the system is that it identifies networks, not just individuals. Equally important, it helps better direct taxpayer resources, not just to investigate large populations, but to focus investigators where there is a statistically high probability that bad behavior (by multiple persons) is occurring.

Besides the ability to identify networks and connections between people, we help customers understand how their business processes may influence behavior leading to other types of improper payments that are beyond detection using traditional methodologies. Let me give an example. During this subcommittee’s hearing on the integrity of the crop insurance program last June, Administrator Gould was asked whether there was a cutoff as to which claims to pursue. Administrator Gould answered:

“Well, typically the \$100,000 limit is where we separate the big ones from the small ones. The \$100,000 ones and above get our undivided attention. Those under that get attention, but it comes down to a matter of resources and time as to how aggressively we pursue those.”

Because of that testimony, the Agency’s business rules are now a matter of public record. Individuals intent on defrauding the system know that the risk of detection and investigation is fairly low if they stay below this threshold. So what does the “smart” individual intent on bad behavior do? They bundle their behaviors differently—and work in concert with others-- to stay below the detection threshold. By having a system in place that detects these networks without false business rules, the RMA can begin to go after not only the low-hanging fruit, but the more complex cases with larger aggregate financial payoffs.

I also provide this insight to suggest another fundamental truth in detecting improper payments. And that is that people engaging in the type of improper payments change and adapt their behaviors. They develop new ways of operating to changed environments to stay below the radar. Consequently, systems must be adopted by RMA that can be refreshed to stay ahead of these changing behaviors. In short, we are suggesting that RMA needs a system that is:

- Agile;
- Unbiased;
- Moves away from “pay and chase” models that rely on deterrence and collections (which is hard to quantify), to one that is more “trust but verify” before payments are made;
- Based on real-time capabilities.

All of this is possible, with the right resources.

III. A Holistic Approach to Detecting Improper Payments

I provide this background as a means of setting context, both for my appearance as well as for the suggestions that Detica has to offer. We applaud Congress' foresight in the Agriculture Risk Protection Act of 2000 (ARPA) by acknowledging that information technologies are useful resources to help ensure program integrity. Indeed, ARPA itself has been instrumental in RMA's ability to augment its efforts to instill integrity to the crop insurance program. We also acknowledge the role data mining has played, and the assistance that CAE has provided to RMA to detect improper payments.

A. Data Mining: Is it just semantics?

At the outset, it is worth pointing out what we believe is a growing anachronism of ARPA. Clearly, the statute directs the Secretary to use "data mining" and "data warehousing" to ensure the program integrity of the crop insurance program. ARPA itself does not define what it means by data mining. Data mining can mean many things to many people. It can be used for beneficial purposes, and it can be misused, whether intentionally or otherwise. Much of the discussion that occurred during last summer's hearing had nothing to do with data mining, for example, but was exclusively concerned with RMA's ability to match data with FSA, which is not data mining at all. Moreover, as we have discussed, behavior and technologies change, and change rapidly. What might have been appropriate seven years ago may not be adequate now. While it may have made sense to direct RMA to use data mining and data warehousing, without updates to the statute, Congress may actually be locking the agency into technologies and techniques that are outdated. Consequently, we would offer that the statute should be revised to provide the Secretary with greater flexibility in choice of solution and approaches to stay current with modern day developments. Legislative suggestions are also attached.

B. The Importance of Infrastructure

As we have said attempts to find individual anomalies, without more, is not enough in this changing game of improper payments. As Administrator Gould noted,

A critical area in program integrity improvement is enhancing the capability of RMA's IT system. ARPA also instituted new data reconciliation, data mining and other anti-fraud, waste and abuse activities that require the data to be used in a variety of ways. The current IT system was not designed to handle these types of data operations. Consequently, the data must be stored in multiple databases, which increases data storage costs and processing times, and increases the risk of data errors. (May 3, 2007 testimony before the House Committee on Oversight and Government Reform).

These comments were, alarmingly, expanded in RMA's 2008 budget request:

As the existing information technology system reaches the end of its expected useful life, RMA has experienced increased program down-time due to computer outages and increased maintenance costs to keep the antiquated system operating. The current system requires RMA to maintain multiple databases of producer information magnifying the potential for data errors, increases the costs to companies that collect and report producer data, and limits the ability of RMA to provide participating companies with timely information regarding potential program abuse. Additionally, in the nearly 15 years since the current system was designed, the Federal Crop Insurance Program has increased tremendously in size and scope. New types of insurance are being offered which were not contemplated at that time, including revenue insurance, whole farm insurance ..., and products tied to rainfall and vegetative indexes (i.e. satellite imagery). While these programs offer great benefits to producers they also entail a level of complexity which is difficult to accommodate in an antiquated computer system. Consequently, RMA must use manual work-arounds and off-line processes, significantly increasing maintenance and processing costs.

Congress recognized the department's IT challenges during the debate surrounding ARPA, and indeed directed the Secretary to upgrade the information management systems of the Federal Crop Insurance Corporation. It also directed the Secretary to

make sure that these upgrades were compatible with other agencies within the Department of Agriculture.

Based on the Administrator's comments, we assume that the Agency has not been able to upgrade its internal technological infrastructure, as envisioned by ARPA. We understand that this is a difficult budgetary environment, but would submit that the Agency can only be as good as its weakest link. Right now, RMA's weakest link is that it does not have the internal infrastructure in place to do basic data matching, much less advanced analytics. If it does not have the internal information infrastructure in place to produce, aggregate, and cleanse data, even the most sophisticated data mining technologies will provide meaningless results. We would thus urge Congress to make sure that the authorized and appropriated funding level is adequate to allow RMA to upgrade its infrastructure and to exercise its oversight authority. By doing so, RMA will then be in full compliance with all provisions of ARPA, not simply those sections that permit the use of data mining. And, we urge that these steps are undertaken and completed before any further thought is given about expanding the use of analytical tools or information sharing. To do so would simply be a waste of taxpayer resources because the infrastructure that it needs to be effective is not in place.

C. RMA's Human Requirements

In our mind, part of that infrastructure has to include having the workforce internally that understands not only the technologies now and that might be developed to detect improper payments, but also how to interpret the results or the outputs from the those technologies. It is our understanding that all of the data mining expertise resides outside RMA. This arrangement begs a number of questions: how is it able to validate the results; how is it able to direct the queries; how can it assure that it is uncovering the most significant instances of improper payments, or even a high percentage of the waste; how can it possibly be a good overseer without its own expertise? Surely, Congress did not intend for RMA to relinquish its oversight role and authority by granting the Secretary the discretion to consult with outsiders in developing the technologies to protect crop insurance integrity.

During the summer of 2006, RMA circulated to the commercial sector a Request for Information (RFI) that explicitly acknowledges the need to build its internal capabilities by making training a central requirement of any contract that results. In pertinent part, the RFI states:

C.3.5 Training

- (a) Provide training to RMA personnel on how to utilize the software tools developed for the WEB User Interface in this contract.
- (b) Develop and implement a training plan to train RMA personnel on all aspects of developing, maintaining, and enhancing the data warehouse. The intent of the training is to provide RMA personnel with the capability to assume total operational control of the data warehouse at the conclusion of the project with the objective of achieving a smooth project transition to RMA.
- (c) Develop and implement a plan to train RMA personnel on all aspects of developing, maintaining, and conducting data mining research, data analysis, and pattern recognition using the tools of this project. The intent of the training is to provide RMA personnel all data mining research, data analysis, and pattern recognition operational capabilities at the conclusion of the project.

We strongly support the need to have the internal workforce and would urge Congress, in its consideration of the Farm Bill reauthorization to include workforce requirements.

D. Beyond Data Matching and Data Mining

Once RMA addresses its internal infrastructure issues, only then does it makes sense to discuss data mining and the use of other technologies to detect fraud. Our approach envisions creating a “think tank” or “center of excellence” within RMA. That center would be the principal center within RMA to oversee crop insurance program integrity. As such, it would have responsibility to oversee that the infrastructure is in place (including personnel), and the solutions at its disposal to do a complete job of oversight. In this regard, it would leverage the data mining that is and has been done by

CAE with more advanced capabilities. These capabilities include, without limitation, data integration and data cleansing, data driven investigation, advanced analytics, business process analysis and results management. To ensure access to current information and agriculture techniques, we would suggest a continuing consultative role with CAE, as well as other agricultural and technological experts from other institutions such as NC State, Virginia Tech, and the University of Minnesota, to name just a few

Once the center is created, we would suggest that RMA stop thinking about the analysis of transactions, accounts or even a single view of the customer, which is what is accomplished by looking for individual anomalies, but to instead think about what might represent a network of seemingly loosely related activities. It is only when operating at this level that the coincidences in the data start producing a bigger picture. It is this bigger picture that is then risk assessed and it becomes possible to identify fraud which consists of well spread and seemingly innocuous activity. It is precisely this current inability to detect connections that has raised questions by the General Accountability Office. (*See Statement of Lisa Shames, Acting Director, Natural Resources and Environment Division, GAO, May 3, 2007, before the House Committee on Oversight and Government Reform.*)

The key underlying principle is to allow the data to “drive” the investigation rather than the investigator “mine” the data. Through automated processing of the data, data-driven investigation uncovers potentially related rings of questionable behavior and presents these to the investigator as a complete picture. The clearer picture helps the investigator, and RMA, better prioritize limited resources. Because there is more evidence up front to suggest that identified behavior is questionable, there are fewer false positives—helping the Agency optimize its investigative resources, with a higher probability of success.

The key components of a data-driven approach are:

- Acquisition and Aggregation: a batch environment that collects and aggregates data in a meaningful way to reveal the “big picture”, and utilizing existing tools and sophisticated techniques to overcome issues of seemingly unrelated, poor

quality and often sparse data. This would include the addition of data from sources outside RMA, such as FSA and the insurance companies

- Analysis: Use of state-of-the-art techniques that to analyze and score cases for potentially bad behavior.
- Access: Apply web-based network visualization, search, and mapping tools to explore the detected high risk “big” picture. This would be a pre-populated environment allowing the investigator to immediately explore all the data and relationships without additional effort and preparation.
- Action: Identifying fraud is not where the effort should stop. To reduce fraud, waste, and abuse, the inventory of cases needs to be scored and prioritized for investigators to maximize the capacity in a manner that enables them to close cases.

What are the benefits to this type of think tank, holistic approach?

- More accurate detection. By using multiple data sources combined to form a big picture, it is possible to score far more accurately. This will result in fewer false positives and time wasted on unnecessary investigations. The identification of more serious and organized fraud by spanning across accounts, products and organizations makes it possible to build pictures of organized crime networks. This helps to overcome problems the RMA currently has integrating the information, particularly on large and disparate farming entities.
- More efficient investigation. Generally, there are more leads than investigators have time to pursue. Through an approach that includes pre-aggregating data, RMA investigators have a complete network diagram of all elements of the crime. This saves time in not having to collect intelligence and piece the picture together by hand—enabling the investigator to process more leads, and more worthwhile leads.
- Better intelligence. By centrally retaining data, fraud rings and investigations have enhanced access to intelligence, and intelligence that they can comprehend.

By understanding the modus operandi of those involved with improper payments, better measures can be implemented to prevent the crime in the first instance.

- More targeted investigations and use of responses. Data-driven investigations will reveal networks and connections, particularly useful to reveal new and emerging patterns much more rapidly than other types of tools. If behaviors are allowed to become entrenched, they become much harder to identify and address. More important, the cumulative losses are significant if detection is delayed until there is a critical mass of behaviors to uncover. Agile, easily refreshed approaches that use advanced analytics and network detection enable early detection and response, and fewer losses to the Agency.
- Prevention. With its ability to retain the outcomes of investigations, as well as more accurate detection, it is possible to link the “solution” directly into key stages in the business process. For example, by checking new applicants or significant transactions against the intelligence database, escalating crime can be halted. This will help RMA with its oversight of the insurance companies.

A holistic, linked approach is not simply good for RMA. The Department of Agriculture (USDA) benefits through maximizing the use of data across all departments—which is a central theme of ARPA. Besides efficiencies in data management, it will help USDA create efficiencies in the application of data. Farmers benefit if RMA has better information. Reducing dollars lost to fraud offers the potential for reduced insurance premiums and/or the expansion of programs to those truly in need. Insurance companies will experience more efficient oversight and control, reducing the management burden of the program. Finally, taxpayers benefit through having their resources effectively managed, and managed as intended.

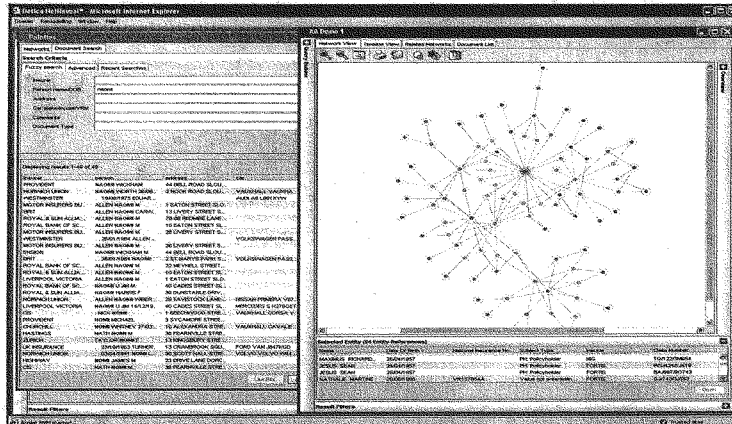
Again, I thank for this opportunity to appear before you today and am happy to answer any questions you may have.

LEGISLATIVE RECOMMENDATIONS:

1. Update ARPA to permit the Secretary greater flexibility in the technological choices employed. This could be accomplished by simply striking 7 U.S.C. 515(j)(2) and rewriting it to read as follows:

The Secretary shall use such information technology as he deems appropriate to administer the provisions of this title. Such technologies may include, without limitation, predictive analytics, modeling, pattern and network detection.
2. Require the Secretary to report back to Congress, within 45 days of enactment, as to the existing state of technologies that it now uses, what its requirements are, and the funding that it will take to fully modernize. Condition the expansion of information sharing to certain metrics related to upgrading the internal information technology infrastructure.
3. Set internal workforce requirements necessary to maintain and update the information systems and analytics necessary for a thorough, comprehensive risk management system.
4. Create an internal center within RMA tasked exclusively with fraud detection. This center should have responsibility to oversee the technology upgrades that must occur, vet and deploy technological solutions, attract, recruit and retain qualified internal personnel, and consult with outside consultants as necessary. Additionally, the range of outside consultants should be expanded to include not only CAE, but any other academic institution, including agricultural cooperatives, agricultural universities, and extension programs.

Network Visualization – Search and Overview



1

Defica Proprietary Information



Statement by Eldon Gould
Administrator
Risk Management Agency
United States Department of Agriculture
Before the House Agriculture Subcommittee on General Farm Commodities
and Risk Management
June 7, 2007

Mr. Chairman and members of the Subcommittee, I am Eldon Gould, Administrator of USDA's Risk Management Agency (RMA). I am also a life-long farmer in northern Illinois who values access to a crop insurance program that is administered to ensure program integrity and the best use of the taxpayer dollars. I am accompanied today by Dr. Keith Collins, Chairman of the Federal Crop Insurance Corporation.

I appreciate the opportunity to provide an update on the efforts of RMA to continue to improve the integrity and efficacy of the Federal crop insurance program. Any discussion of program integrity must include an update on our successes and challenges in implementing the Agricultural Risk Protection Act of 2000 (ARPA). In fulfillment of ARPA mandates and consistent with sound program management and oversight, the Federal Crop Insurance Corporation (FCIC) Board of Directors (Board) and RMA have established several priorities to focus development initiatives. These bring new and innovative insurance products to the agricultural community, monitor and improve our current insurance products, balance program initiatives with new Information Technology systems development, simplify and streamline products where appropriate, and work to combat and prevent fraud, waste and abuse through technology and strategic compliance initiatives. Clearly, the Board and RMA have established overall program integrity as a high priority.

The Federal crop insurance program has experienced extraordinary growth in the last quarter century. In crop year 2006, through the private sector delivery system, RMA provided \$49.9 billion of protection (insured liability) to farmers on approximately 370 commodities, covering nearly 80 percent of eligible acreage of major U.S. crops. This coverage was offered through 21 plans of insurance and approximately 1.1 million policies insuring about 242 million acres. In 2005, crop insurance provided approximately \$2.4 billion in indemnity payments to farmers and ranchers. For 2006, indemnity payments to farmers totaled approximately \$3.4 billion. In 2007, we will reach an estimated \$68 billion in insurance protection for American agriculture.

The Federal crop insurance program is working as intended and is meeting its targeted loss ratio. That is not to say that more cannot be done, especially with regard to reducing program fraud, waste and abuse. More can, should and must be done. RMA is responsible to the American taxpayer and works diligently to be a good steward of the tax dollar. America's farmers and taxpayers deserve a flexible, fair and fraud-free program. Program integrity is maintained through prevention, detection and enforcement.

Recent Criticism of the Crop Insurance Program

Before I speak to program integrity within the program, I would like to first address some of the recent criticism that this program has received.

Underwriting Gains

Underwriting gains and losses are terms used in the Standard Reinsurance Agreement (SRA) to tabulate results of the varying risk share arrangements applicable to the ceded premiums for the reinsurance year. It would be a mistake to consider them pure profit or absolute loss for the reinsured companies. Underwriting gains serve a number of functions – they cover partial delivery expenses for some companies, they are used to build reserves to meet the required policyholder surplus and they provide a return on equity. As part of RMA's financial integrity requirements, the insurance companies must maintain adequate policyholder surplus to pay losses resulting from two consecutive years of a 500 percent loss ratio, that is, years when indemnities paid would equal 500 percent of premiums.

FCIC policyholder surplus requirements generally exceed those of state regulators for general property and casualty lines of insurance. As total program premium increases, the necessary policyholder surplus increases correspondingly. To put this requirement in perspective, the highest loss ratio the program has experienced was 2.39 in 1988. The recent underwriting gains provide the surplus needed to cushion and plan for catastrophic weather events and years like 1988 and 1993. This is important as the companies today retain risk on almost 80 percent of the premium written, with much of the retained premium in the riskiest Commercial Fund.

Recent underwriting gains by crop insurance companies have tended to be higher than other similar lines of insurance that might be comparable within the insurance industry. While Congress and USDA have made many program improvements, much of these gains have been driven by an unusually good run of favorable weather over the past few years. From 1980 thru 1991, the program loss ratio was 1.55. However, from 1992 thru 2006, coinciding with the current SRA risk sharing arrangements, the program loss ratio was 0.99. In the past few years, some of the best major crop yields in history have resulted in even better program performance with correspondingly lower loss ratios and higher underwriting gains.

USDA takes prospective actions to assess potential increases in program risk associated with changes in weather and production agriculture. RMA continually analyzes available information to look for ways to improve its rating and program administration. The Board and RMA utilize parallel system reviews for uniform product development and routinely contract for program evaluations and studies to deliver more streamlined and actuarially sound insurance programs. As program improvements are made that result in better underlying program performance, this also translates to improved underwriting returns to the companies.

Currently, RMA tracks total program liability, a definitive measure of the total value at risk from natural causes of loss, and updates this information on a weekly basis available on our public website. RMA also estimates expected changes in liability up to 10 years ahead through RMA's

budgetary baseline projections. In addition, RMA can assess the current and long-term exposure of the crop insurance program to different potential catastrophic weather events, such as a recurrence of 1993 losses caused by flooding in the Midwest.

Today, if the program were to experience a major adverse weather event, companies would have significant underwriting losses. If an extremely dry year were to occur under today's program, with production shortfalls similar to those in 1988, the companies would incur an estimated \$980 million underwriting loss. Similarly, if a significantly wet year like 1993 were to occur again, companies would stand to lose an estimated \$440 million. It is not a matter of if, but when, similar kinds of weather events will occur in the future.

If one looks at the historical loss ratio performance of the Federal crop insurance program (attached to this testimony) and reverses the historical loss experience so that the experience of the 1980s and early 1990s was occurring with similar frequency today, there would likely be a different view and discussion of the crop insurance program regarding the issue of underwriting gains. While underwriting gains serve important purposes for the insurance companies and are closely related to weather experiences, gains must be monitored to ensure they reflect an appropriate balance in risk sharing between the public and private sectors.

Company Expenses

RMA first began collecting detailed program delivery expense data with the renegotiated SRA for 2005. For 2005, expenses of the companies averaged 23.8 percent of gross premium. In 2005, delivery costs were \$837 million to deliver \$44 billion of protection, on 1.2 million policies, covering 246 million acres. The major categories of costs were agent commissions, loss adjustment expenses, salaries of company employees, IT support, and overhead expenses.

As for how crop insurance expenses compare to other segments of the insurance industry, comparisons are difficult because crop insurance is unique and involves some costs not usually borne by other lines of insurance, such as loss adjustment training for a wide variety of crops ranging from nursery plants to clams to the more traditional row crops. While detailed historical data on costs is limited, the collection of detailed cost information that began in 2005 will be useful in making future comparisons.

For 2005, company aggregate program delivery expenses averaged 23.8 percent of gross premium, whereas administrative and operating (A&O) expense reimbursement averaged only 21.0 percent of gross premium. Consequently, there was a 2.8 percentage point aggregate cost deficiency as reported by the companies. However, some companies kept their expenses within the A&O expense reimbursement amount while others incurred greater expenses trying to expand their business, often by offering higher agent commissions to attract blocks of business. The largest and most variable cost category for most companies is agent compensation.

As a percentage of premiums, the A&O expense reimbursement has declined over the past ten years from 31 percent of the premium for 1995, to an effective rate of about 20.5 percent of the premium for 2006. However, as a dollar amount per policy during this same period, A&O has risen from \$367 to \$828. And with significantly higher crop prices for 2007, this number will be

higher yet. Given that the cost of servicing crop insurance policyholders varies more by the number of policies rather than by the amount of premium, companies today have far more dollars per policy to provide service than in past years.

RMA is working to reduce program delivery expenses by attempting to simplify the program and reduce the paperwork burden on companies. One key effort is to combine the actual production history and revenue plans of insurance. The effort will combine the Crop Revenue Coverage, Revenue Assurance, Income Protection and Indexed Income protection policies into the standard Basic Provisions and Crop Provisions, thereby reducing the amount of policies and actuarial documents that must be produced and sent to producers each year.

This effort should also reduce training costs because instead of five different policies with multiple pricing mechanisms, unit structure availability, rating structures, and options, there will only be one policy with one standardized rate structure and pricing mechanisms limited to only yield or one revenue coverage and options. After the completion of this rulemaking process, RMA will begin the process of combining other similar plans of insurance to reduce the burden on the program.

A&O Reimbursement

The General Accountability Office (GAO) has stated that from 1997 to 2006, more than 40 cents of every dollar the government spent on the Federal crop insurance program went to the companies that deliver the program, while less than 60 cents went to farmers.

GAO's numbers look at this only in terms of direct cash payments. However, this approach fails to recognize that the company cost allowance, or A&O expense reimbursement, is actually a benefit for farmers that is paid by the government to the companies.

In other lines of insurance, policyholders receive a billing statement, which indicates an amount of premium due. Included within this amount is a sum reflecting the expense of servicing the policy that the policyholder pays. Typically, this figure, which is not broken out as a separate line item, is referred to in the insurance industry as an "expense load."

When Congress set up the Federal crop insurance program, it established that the government would directly reimburse the companies for this "expense load" rather than having the farmer pay. In fact, the SRA requires that when a producer receives their billing notice, the amount of the A&O expense reimbursement or "expense load" being paid by the government must be shown on the statement so the producer is aware of this indirect Federal benefit. (See attached example of a farmer's crop insurance bill.)

If the Federal government did not reimburse for the administrative expenses, then these costs or expenses would be passed on to producers through increased insurance premiums.

Thus, there is a compelling reason to consider the company cost allowance to be a benefit to the producer. Using the figures provided by GAO, and taking out the company cost allowance payments (since this was paid by the government on behalf of producers), approximately 17

cents of every dollar the government spent on Federal crop insurance during 1997-2006 went to the companies to deliver the program, while the remainder of 83 cents, either directly or indirectly, went to farmers.

Farm Bill Proposals

There is no question that in recent years, the companies have benefited from this program, but crop insurance provides the key risk management tool to support sound business practices for producers. Crop insurance is the government's principal means of helping farmers survive a major crop loss. However, the benefits to farmers extend well beyond an indemnity payment. The farm lending industry depends heavily on crop insurance to collateralize loans, and insurance facilitates planning for the continuity of farm and ranch operations and the rural communities that depend on those operations.

Current law requires that to the maximum extent practicable, FCIC provide reinsurance to companies. While alternatives are conceivable, authorizing legislation is needed. The Administration's Farm Bill proposals would benefit taxpayers on several fronts. Currently, RMA does not have the authority to adjust the financial terms of the SRA. RMA recognizes that it needs more flexibility and authority to respond to changing conditions, and maintain a proper balance of risk sharing with the underlying program's performance.

Before the 2005 reinsurance year, the SRAs provided no net book quota share for FCIC and the companies retained all underwriting gains. RMA initiated a 5 percent net book quota share for the 2005 and subsequent reinsurance years. As reported by GAO, for the 10-year period 1997 through 2006, the companies received \$4.3 billion in underwriting gains from \$23.7 billion in retained premium, or an average annual rate of 17.8 percent. As a result, RMA has sought a redistribution of the underwriting gains so that the Federal government would receive an increased share, which is one of Administration's Farm Bill proposals. The Administration's Farm Bill proposal increases the net book quota share to 22 percent in exchange for a ceding commission of 2 percent, seeking better balance in the risk sharing arrangement.

This proposal would allow the Federal government to retain more of the underwriting gains in good years resulting in a better balance of risk sharing, and provide program savings. Further, permitting RMA to renegotiate the financial terms of the SRA at most every three years would give it the flexibility to routinely monitor program performance and maintain the proper risk sharing balance so that taxpayers can be assured the program is operating efficiently and effectively. Both of these program changes are contained in the Administration's Farm Bill proposals.

Emphasizing Prevention through Better Quality Control and Assurance

RMA's efforts to maintain program integrity within the Federal crop insurance program are comprised of numerous activities and initiatives: Internal Controls through Program Design and Standardized Data Collection, Quality Control and Assurance, Data Mining, Sanctions and Enforcement, IT System Improvements, Conflicts of Interest Guidelines and Program Simplification.

Prevention starts by effective program design and development utilizing internal controls such as effective policy deductibles, sound and consistent underwriting and loss adjustment standards, continual updating of actuarial rates and prices and finally with standardized rules and requirements for data submission. RMA's IT system is a critical line of defense in monitoring and assuring policy information is credible, consistent and within the rules and regulations of the program prior to disbursing funds. This adds to the integrity and analysis of the data for key program information and improvements, in addition to aiding in data mining efforts.

RMA is continually seeking new and more effective ways to work with the other regulatory bodies and government agencies as well as companies, agents and producers to ensure the integrity of the Federal crop insurance program. RMA compliance reviews continue to reveal that there are only a small number of producers who have been involved in fraud or illicit activity. While no level of criminal or abusive behavior is acceptable, RMA continues to strive to keep this number small.

Because they share in risk, the companies have a stake in working with us to prevent fraud, waste and abuse. We have worked closely with them to strengthen program integrity, protect taxpayer dollars, and better assure that those who deliberately break the rules are caught and punished. The vast majority of people in the Federal crop insurance program -- farmers, insurance agents, loss adjustors, industry professionals and government employees -- are hard-working men and women acting with the highest integrity and competence.

Program Integrity

RMA's Compliance function workload increased substantially due to the expansion of the Federal crop insurance program and the implementation of ARPA. In order to address the increases, RMA is emphasizing preemption through better quality control and assurance, while still aggressively pursuing program abuse by assisting USDA's Office of Inspector General (OIG) and the Department of Justice. Improvements in quality controls and investigations continue to be assisted by new and better technology, specifically the use of data mining, remote sensing, geospatial information technologies and other computer-based resources.

The renegotiation for the 2005 and subsequent SRAs resulted in changes in the way RMA ensures program compliance. The SRA directs companies to expend more resources on quality assurance and internal controls than ever before. The new SRA also recognizes that companies have improved internal control processes in response to requirements of the Sarbanes-Oxley Act. The SRA permits the insurance providers to document and receive credit for their efforts rather than complying with a separate set of assurance mandates.

In conjunction with the new quality control requirements, RMA Compliance has revised its work plans to reflect a more balanced approach between quality assurance and investigating program abuses. In a time of declining resources and increased responsibilities, effective internal controls provide a significant cost-benefit advantage compared to identifying and prosecuting program abuse alone. RMA is currently reviewing company operations and internal controls to determine if their efforts actually address crop insurance program vulnerabilities.

RMA Compliance personnel completed the second year of structured random policy reviews in 2006, and will soon begin the third round in the three-year cycle of reviewing participating insurance providers. Compliance completes random reviews in conjunction with an assessment of each insurance provider's operational compliance, and uses the information to establish a program error rate under the Improper Payments Information Act of 2002 (IPIA). It is noteworthy that RMA's observed error rate from reviews on 600 randomly selected policies was 2.68 percent. RMA initially projected 5.0 percent on the first IPIA reports, so this finding is less than expected. We would also note that the Administration requested funding for additional Compliance resources in each of the past three budget cycles, mainly for the purpose of fully staffing the work to determine the program error rate in accordance with the IPIA.

Compliance managers continue to concentrate on the mission-critical tasks of evaluating and improving new processes to prevent and deter fraud, waste and abuse in the crop insurance program. We have dedicated significant resources to building and adapting a reporting and tracking system to complement and integrate the oversight mandates established by ARPA and other statutory requirements.

While RMA, FSA and the companies have preempted tens of millions of dollars of improper payments through these and other measures, RMA is constantly identifying ways to balance competing needs to make our products fraud-proof while seeking to provide responsive, useful risk protection to farmers. While work remains and more improvements can be made, we are making good progress in our fight against program abuse.

Detection via Data Mining

RMA is making significant progress in preventing fraud, waste and abuse through the expanded use of data mining. As part of ARPA, data warehousing and data mining techniques were explicitly identified as tools to be used by RMA to strengthen the crop insurance program's oversight efforts. RMA contracts with the Center for Agribusiness Excellence (CAE) at Tarleton State University to develop these technologies. Since employing these technologies in 2001, RMA has achieved substantial program savings through proactive efforts to identify program vulnerabilities and abuse.

RMA continues to use data mining to identify anomalous producer, adjuster, and agent program results and, with the assistance of Farm Service Agency (FSA) offices, conducts growing-season spot checks to ensure that new claims for losses are legitimate. The annual spot check list combines the strengths of data mining technologies and the farm-level knowledge of FSA, to identify and monitor those producers whose crop insurance losses are not consistent with those of their neighbors. This effort alone has achieved reductions from prior year indemnities for the producers selected of more than \$430 million dollars since the 2002 crop year. Specifically, indemnities on spot-checked policies were reduced approximately \$112 million in 2002, \$82 million for 2003, \$71 million in 2004, \$138 million in 2005 and \$27 million in 2006.

More importantly, these reductions are achieved without RMA or FSA having to issue administrative sanctions or engage in lengthy and costly criminal investigations to curb program

abuse. These reductions represent more than a \$20 return for every dollar spent by RMA on data mining since its inception. Our analysis shows that this change in claims behavior for most producers persists for several years, resulting in overall program compliance benefits that are even higher over a longer-term period

Data mining findings also demonstrated that the considerable majority of producers participating in the crop insurance program used the risk management tools we offer exactly as they were intended. CAE, using an analysis technique known as a decision tree, classified the entire crop insurance book of business into a range of behavior, from those producers who almost never had losses to those who had frequent and severe losses. Through this method, CAE was able to demonstrate that most producers used the risk management tools as intended and only a small percentage, about 0.2 percent, of producers exhibited behavior that warranted future review.

In addition, CAE conducts internal data mining research for RMA to assist compliance and underwriting efforts and any other research deemed necessary by the agency to improve the effectiveness and efficiency of the crop insurance program. CAE currently produces approximately 160 such research products per year for RMA, including products such as crop simulation models, planting date studies and methods for correctly identifying high-risk land.

RMA also uses data mining to verify compliance with established rules and regulations. For example, data mining identified policies where a comparison of past claims and production data identified certain companies or their agents who had failed to use claim production data to establish future approved yields, as required by regulation. RMA provides this information to the companies to assist them in correcting producer data when such errors occur.

Outside audit bodies such as the USDA's OIG and the GAO have also recognized our success with the use of data warehousing and data mining technologies. OIG recommended that USDA employ data mining in other farm programs. Further, both OIG and GAO have been customers, using CAE on occasion to assist them with audits of farm programs.

The benefits from using data warehousing and data mining technologies have increased every year since its inception. RMA expects the benefits generated from using these technologies to continue and plans to expand its use of data mining technologies to other applicable areas of the program in the near future.

The President's Fiscal Year (FY) 2008 Budget includes a proposal that would expand the uses of mandatory ARPA research and development funding for data mining as well as for the Comprehensive Information Management System (CIMS). Specifically, the FY 2008 Budget would authorize the use of \$5.4 million for replacement of equipment and \$3.6 million to continue regular operations of data mining.

Enforcement

RMA continues to make progress in the Administrative Sanctions arena. In 2005, RMA imposed 24 sanctions, such as suspensions, debarments, and disqualifications on producers, agents and loss adjusters found to have violated approved policies and procedures. For 2006, RMA

imposed 41 sanctions and had 53 additional sanctions pending at the end of the year. RMA also routinely publishes the Department of Justice press releases regarding successful prosecutions of crop insurance program abuse on our website as a reminder to program participants that maintaining integrity is critical.

We are improving the timing and quality of our sanctions requests as well. RMA continues to work with USDA's Office of General Counsel (OGC) to limit the number of cases declined due to insufficient evidence. This improvement is attributable to Compliance personnel becoming more proficient at identifying evidence and establishing cases that will pass legal sufficiency requirements.

Finally, modifications to the Administrative Sanctions regulations that were identified by GAO as requiring publication are in clearance. These regulations will formalize all the sanctions authority Congress provided RMA in ARPA.

In 2005, GAO audited RMA's overall compliance activities, and recommended areas for improving our compliance efforts. GAO made several recommendations that RMA accepted and is working to implement. However, data mining remains central to our compliance efforts because it is cost efficient and cost effective.

Within current resources, compliance managers also continue to concentrate on the mission-critical tasks of evaluating and improving new processes to prevent and deter fraud, waste and abuse in the crop insurance program. We have dedicated significant resources to building and adapting a reporting and tracking system to complement and integrate the oversight mandates established by ARPA.

Information Technology (IT) System Improvements

A critical area in program integrity improvement is enhancing the capability of RMA's IT system. The number and types of crop insurance programs is ever expanding and growing more complex. ARPA also instituted new data reconciliation, data mining and other anti-fraud, waste and abuse activities that require the data to be used in a variety of new ways. The current IT system was not designed to handle these types of data operations. Consequently, the data must be stored in multiple databases, which increases data storage costs and processing times, and increases the risk of data errors.

The President's FY 2008 Budget includes two proposals that will facilitate funding of our IT needs.

The first is similar to last year's request, which required insurance providers to share in the cost to develop and maintain a new IT system. Insurance providers would be assessed a fee based on one-half cent per dollar of premium sold. The fee is estimated to generate an amount not to exceed \$15 million annually. After the new IT system has been developed, the assessment would be shifted to fund maintenance and would be expected to reduce the annual appropriation of the salaries and expenses account of RMA.

The second, as noted earlier, would expand the uses of mandatory ARPA research and development funding for data mining and data warehousing activities required by ARPA, and the testing and development of CIMS.

Conflict of Interest Supplementary Guidance

RMA recognizes that certain types of interactions between agents, loss adjusters and policyholders pose serious conflict of interest challenges to the integrity of the crop insurance program. RMA investigations and independent audits by OIG and GAO have identified instances where crop insurance claims have been influenced by such conflicts.

The 2005 SRA contained new and enhanced provisions that strengthened RMA's ability to prevent and detect those conflicts of interest that might adversely affect program integrity. Specifically, the SRA strengthened provisions that 1) prohibited certain conduct by agents during the loss adjustment process, and 2) required increased conflict of interest disclosure by agents, loss adjusters and insurance company employees.

To assist the companies in implementing new SRA provisions dealing with prohibited activities of agents during loss adjustment, RMA worked closely with companies and agents to develop a comprehensive guidance document that reflected tough but workable standards. RMA issued the resulting Manager's Bulletin in October 2005. The reaction of the crop insurance industry, agent associations and oversight bodies has generally been very positive to these standards.

After addressing this first area of concern, RMA has now turned to the problem of developing guidance on conflict of interest disclosure. The SRA requires that all company employees and affiliates disclose any potential conflicts of interest to the companies and, in turn, to RMA. Such disclosure is used to determine what conduct may be prohibited and what reviews must be done by the company. RMA has listened to the comments of the industry regarding conflict of interest disclosure to ensure that guidance will contain a workable standard that will be consistent across all companies and will provide important information for RMA's data mining efforts.

After seeking company input at the recent National Crop Insurance Service's Program Integrity Conference, RMA is now finalizing a Manager's Bulletin that contains further guidance to assist insurance providers in implementing changes to the SRA regarding conflict of interest disclosure. The Bulletin will establish standards for reporting conflicts of interest by insurance company employees, agents, and loss adjusters. This effort will promote program integrity and ensure adequate internal controls based on the identification of certain conflict of interest problems in past audits and investigations of fraud, waste, and abuse in the program.

Simplification of the Federal Crop Insurance Program

Simplification of the program is a priority of both RMA and the FCIC Board. As new programs have been added, more complexities have arisen.

As stated above, RMA is developing a combination policy, which combines the existing Actual Production History, Crop Revenue Coverage, Income Protection, Indexed Income Protection and

Revenue Assurance plans of insurance into one consolidated insurance plan (Combo). We have been working on this for some time now, and the draft final rule is being completed and is intended to be effective for the 2009 crop year, with publication slated for late 2007. We believe this change will provide producers a broader array of insurance options, in a more straightforward process, and improve product delivery and operations.

RMA is also working closely with FSA to simplify our joint reporting requirements. Where feasible, the two agencies are coordinating certain, similar program requirements seeking commonality and consistency to ease the reporting burden on the producer and on the agencies. Our objective is to vastly improve the reporting accuracy of producer information and share the data between the companies and FSA, ensuring greater program integrity for several different USDA farm programs.

RMA is actively working on the second phase of a project to implement section 10706 of the 2002 Farm Bill, known as CIMS, which will simplify and improve the programs administered by RMA and FSA. This project will provide an information system that allows RMA, FSA other USDA entities and companies to process, share and report on approved common information. The second phase of the project focuses on the sharing and analysis of existing RMA and FSA producer and acreage data. Recommendations have been provided to both RMA and FSA for subject matter experts to review elements for producers, land locations, crops and acreage reporting.

The common component of CIMS has been operational internally since July 2006. It is loaded weekly with over 141 million producer and acreage records from RMA and FSA for 2005, 2006 and 2007. This data is processed and is electronically available to approved RMA and FSA users to provide participation summary reports, information on individual producers and discrepancies in reported acreage. Once RMA's and FSA's System of Records have been updated for CIMS, the companies will have electronic access to their insured producers' information only. All data is secure and subject to controls to prevent unauthorized access.

In March 2006, a 'Notification Area' was added to the CIMS web interface to allow FSA County Offices and companies to communicate on data issues identified by CIMS.

Conclusion

Administration of the crop insurance program requires all interested parties working together to identify viable insurance products and solutions that meet the needs of the agricultural community. Moreover, if the program is to continue to be successful, the resources to provide the checks and balances necessary to guard against the risks of fraud, waste and abuse need more focus and priority.

RMA continues to improve and update the terms and conditions of existing crop insurance policies to enhance coverage and efficacy of the policies, as well as to clarify and define insurance protection and the duties and responsibilities of the policyholder and companies to improve the understanding, use and integrity of the program.

When I accepted this position, Secretary Johanns charged me with administering the crop insurance program in a timely, responsible, and farmer-friendly manner. I will continue to work with the insurance companies, agents' groups, producer groups and, of course, the Congress, to meet our common goals of providing effective insurance products, processing timely and accurate claims when losses occur and identifying and eliminating fraud, waste and abuse in the program to the greatest extent possible. Thank you all for the support provided by the Committee to help improve program integrity within the Federal crop insurance program. We have much to be proud of and much to look forward to in continuing to work together.

Again, thank you for the opportunity to participate in this important hearing. I look forward to responding to questions on these issues.



COUNTRY Mutual Insurance Company®
 P.O. Box 2100
 Bloomington, IL 61702-2100

**Statement of Account
 Crop Insurance**

Account Number	[REDACTED]
Reinsurance Year / State	2006 / IL
Statement Date	10/05/06
Pages	2 of 2

[REDACTED]

Agent Information:

[REDACTED]

Telephone: (815) 758-2913
 don.young@countryfinancial.com

Policy Number	Insured Name				Gross Premium	Subsidy/Endorsements	Adjusted Premium	Fees	Interest/Misc.	Statement Amount	Payments/Credits	Producer Balance
County Name	Plan of Ins.	Crop	Bill Date	Term Date								
[REDACTED]	KANE GRIP	CORN	10/01/06	3/15/07	12,321	6,777	5,544	30		5,574.00		
	KANE GRIP	SBEAN	10/01/06	3/15/07	973	535	438	30		468.00		
	DE KALB GRIP	CORN	10/01/06	3/15/07	0	0	0	0		.00		
	DE KALB GRIP	SBEAN	10/01/06	3/15/07	0	0	0	0		.00		
POLICY TOTAL					\$13,294	\$7,312	\$5,982	\$60	\$0.00	\$6,042.00	\$0.00	\$6,042.00
ADM/OP SUBSIDY \$2,579.03												
STATEMENT TOTAL					\$13,294	\$7,312	\$5,982	\$60	\$0.00	\$6,042.00	\$0.00	\$6,042.00

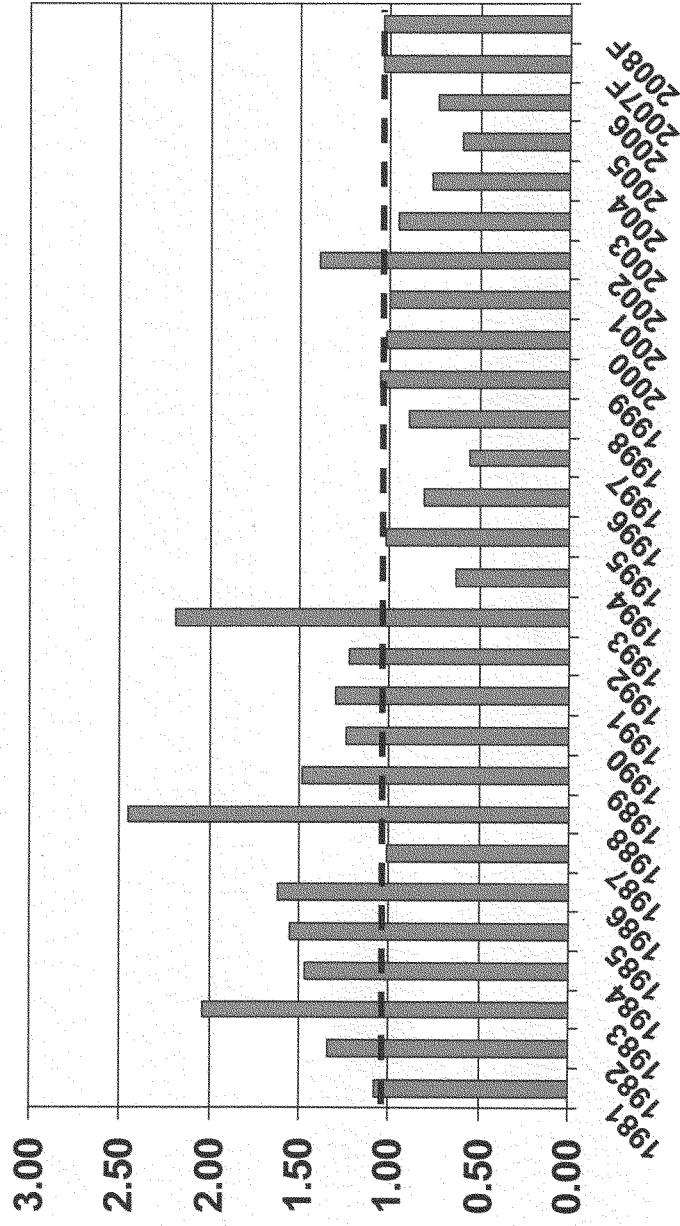
This is a Statement of All Crop Insurance Accounts. Please Refer to Your Remittance Stub of the Premium Billing.



00001000A000000A000000

Form: SOA Date: 04/14/06

Crop Insurance Loss Ratio



UNITED STATES DEPARTMENT OF AGRICULTURE
OFFICE OF INSPECTOR GENERAL

STATEMENT OF Ms. KATHLEEN S. TIGHE
DEPUTY INSPECTOR GENERAL

Before the
SUBCOMMITTEE ON GENERAL FARM COMMODITIES AND RISK
MANAGEMENT
COMMITTEE ON AGRICULTURE
U.S. HOUSE OF REPRESENTATIVES

June 7, 2007



Good morning, Chairman Etheridge, Ranking Member Moran, and Members of the Subcommittee. Thank you for inviting the Office of Inspector General to testify on the Federal Crop Insurance Program. The crop insurance program represents a significant investment by the Department of Agriculture (USDA) and Congress in the Federal safety net for America's producers. OIG has conducted substantial audit and investigative work on the crop insurance program and its participants. As requested by the Committee, I will address issues of integrity and efficacy of the crop insurance program. My testimony will also review some of our most significant findings and recommendations on the program's current costs, regulatory requirements, and areas of continuing concern.

I. Introduction

Congress established the Federal crop insurance program in the 1930s as a safety net for American agricultural producers as they strove to recover from the Great Depression and the Dust Bowl. Over the years the program has gone through significant changes. The 1996 Farm Bill¹ created the Risk Management Agency (RMA) to provide supervision to the Federal Crop Insurance Corporation (FCIC) and have oversight of its insurance programs. The FCIC is a wholly-owned Government corporation that publishes insurance regulations and manages the Federal crop insurance fund.

RMA administers the Federal crop insurance program through a joint effort with approved insurance providers (AIP) under the Standard Reinsurance Agreement (SRA), a cooperative financial assistance agreement allowing AIPs to sell and service Federal crop insurance program policies. Under the SRA, FCIC reinsures or subsidizes a portion of the losses and pays the AIPs an administrative fee—a predetermined percentage of premiums—to reimburse the AIPs for their administrative and operating expenses associated with selling, servicing, and adjusting crop insurance and subsequent claims.

¹ The Federal Agriculture Improvement and Reform Act of 1996, P.L. 104-127.

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¹ The Federal Agriculture Improvement and Reform Act of 1996, P.L. 104-127.

The Agricultural Risk Protection Act of 2000

In 2000, Congress passed the Agricultural Risk Protection Act (ARPA).² ARPA significantly expanded Federal crop insurance assistance for producers by increasing their access to more affordable insurance, enlarging the role of the private sector, and raising premium subsidies paid by the Government. Premium subsidies were expected to increase by \$8.2 billion over 5 years to encourage more producers to participate and also purchase higher coverage levels. The Act enlarged the role of the private sector in the program by prohibiting RMA from conducting research and development for any new policies for agricultural commodities. Rather, the Act required that new product development be accomplished through contracts with the private sector.

The impact of these ARPA provisions is demonstrated by two program statistics related to the period of 2000–2006: the number of acres insured increased from 206 million to 242 million—a 17 percent increase; and the total gross liability for all policies increased from \$34 billion to \$55 billion—a 62 percent increase.

II. The Increasing Federal Financial Responsibility

The year before ARPA was enacted, OIG issued a report to the Department, entitled *Report to the Secretary on Federal Crop Insurance Reform*,³ that brought together the major problems we identified in prior audits and investigations. We believe that many of the issues and concerns it presented remain timely and relevant to the program and today's hearing. In our report, OIG concluded that one of the underlying factors substantially contributing to the program losses and management problems we observed was RMA's policy of underwriting most of the risk for the crop losses. OIG believed—and we continue to believe—that by assigning low overall risk to the AIPs, the AIPs have less incentive to administer the insurance policies in accordance with the Government's and the taxpayers' best interest. That is to say, incentives are lacking for AIPs to

² The Agricultural Risk Protection Act of 2000, P.L. 106-224.

³ Report To The Secretary On Federal Crop Insurance Reform, Revised as of April 19, 1999. OIG Report No. 05801-2-At.

effectively monitor risky policyholders, deny claims of questionable losses, and address inadequacies in their own practices. We concluded that the structural framework of the program had increased the risk or vulnerability to fraud, waste, and abuse.

To demonstrate the impact of RMA's risk-sharing policies, we reported that more Federal dollars were going to AIPs than were paid to producers to cover insurable losses. From 1995 to 1998, producers received a total of \$5.4 billion in indemnities, but because only \$3.4 billion was covered by the producers' premium, the Government paid the remaining \$2 billion to AIPs to cover the claims. In contrast, the Government paid AIPs a total of \$2.8 billion for underwriting gains⁴ and administrative and operating (A&O) expenses.

The upward trend in payments (A&O expenses and underwriting gains) to AIPs that OIG observed in 1999 continues today. From 2000 to 2006, total payments to AIPs for underwriting gains and A&O expenses have increased to record levels—from \$834 million to \$1.852 billion, an increase of 122 percent. Although RMA renegotiated the SRA in 2004 and included provisions to reduce the A&O subsidy rate, total reimbursement for A&O expenses has increased from \$552 million to \$958 million during 2000 – 2006, an increase of 73 percent.

This has resulted in almost a 100 percent increase in the Federal Government's reimbursement to A&Os for each producer policy—from \$417 to \$829. This increase is due to ARPA increasing the percentage share that the Government pays for most coverage levels of insurance and the fact that more producers opted for higher levels of coverage. (Commodity price increases may have further impacted this increase.) Additionally, total premiums paid during this period (2000-2006) increased from \$2.5 billion to approximately \$4.7 billion; thereby increasing the Government's subsidy⁵ of

⁴ An underwriting gain (loss) is the profit (deficit) that remains after paying claims and expenses. Insurers generate profits from underwriting and from investment income. Their chief business is insuring against risks for a profit, and one measure of success is whether there is money left after paying claims and expenses. This amount, if any, is their underwriting gain.

⁵ The Government subsidizes a share of the producer's premium. ARPA increased the percentage share that the Government pays for most coverage levels of crop insurance, effective with the 2001 crop year. The Government's share significantly increases for all levels of coverage but declines as producers select

the premiums from \$951 million to \$2.680 billion—an increase of 182 percent. In 2000, the Government’s subsidized share of total premium amounted to 37 percent; in 2006, it was 59 percent of total premium.

While ARPA has been successful at significantly broadening the safety net for producers, we believe that policymakers and program managers should reassess what constitutes an acceptable cost to the Government.

In addition to our observations regarding the crop insurance program’s structure and assignment of risk to the AIPs, our report summarized a number of management control weaknesses we are still seeing today. These include conflicts of interest⁶ among sales agents, loss adjustors, and/or policyholders; inadequate verification of losses and errors by the loss adjustors (who verify the losses reported by producers and determine the indemnity amounts owed); and inadequate or non-existent quality control processes by AIPs and RMA. OIG continues to focus on these issues of concern in our crop insurance program audits.

III. Strengthening the Integrity of the Federal Crop Insurance Program

As the Federal crop insurance program evolved, Congress has recognized the need to strengthen the program’s integrity. While the passage of ARPA significantly expanded Federal crop insurance assistance to producers, Congress also included several mandates to improve program compliance and integrity. For example, ARPA requires annual reconciliation of all relevant producer information by RMA and the Farm Service Agency (FSA), authorizes the use of data mining as a new technology for targeting compliance reviews and investigations, and requires RMA to coordinate and work with FSA to monitor crop conditions throughout the growing season. RMA was also authorized to

higher levels of coverage. After ARPA, the Government’s share of the premium ranged from 67 percent at 50-percent coverage to 38 percent at 85-percent coverage.

⁶ Business or other (familial) relationships that could encourage or prejudice independent and accurate reporting of data such as yields, acreage, and payments.

renegotiate the SRA's terms and conditions once during the 2001 through 2005 reinsurance years.

The 2002 Farm Bill⁷ required the Secretary to develop a comprehensive information management system (CIMS) for RMA and FSA. Historically, RMA and FSA kept separate data about their program participants, even though the two agencies serve the same community of producers and some of their program data and payments are used to support producer eligibility for other program benefits. Congress recognized the value of reducing the waste associated with duplicative systems and simplifying the process for producers. Implementation of a common information system would help ensure consistency and accuracy of producer data and is, in our view, critical to improving integrity within farm programs and reducing risk of improper payments.

Preventing Improper Crop Insurance Payments

The identification and elimination of improper payments is a major Governmentwide initiative mandated by the Improper Payments Information Act of 2002 (IPIA).⁸ All Federal agencies, including RMA, are required to find out where they are most susceptible to making significant improper payments, estimate the size of the problem, identify the cause of improper payments, and take action to prevent them.

OIG has monitored RMA's actions and progress in complying with these important mandates. In September 2003, OIG issued an audit report assessing the Department's actions to implement significant portions of ARPA.⁹ We found that, to its credit, the Department had initiated reasonable actions to implement most of ARPA's significant provisions. However, the required annual reconciliation of all relevant RMA and FSA data was not accomplished. We recognized that there were significant barriers to implementing an effective reconciliation, including differences in RMA's and FSA's program definitions. For example, RMA allows the producer to subdivide his/her

⁷ The Farm Security and Rural Investment Act of 2002, P.L. 107-171.

⁸ The Improper Payments Information Act of 2002, P.L. 107-300.

⁹ USDA Implementation of the Agricultural Risk Protection Act of 2000. Audit No. 50099-12-KC.

farming operation into separate units and to opt whether to have insurance coverage on each unit; FSA defines a farm unit as a total operational unit within a county and it issues payment to that unit.

We recommended that RMA and FSA establish a task force to re-engineer its data reporting for each producer, landowner, and policyholder under a single integrated comprehensive information system. In response, RMA stated that it intends to fulfill ARPA's requirements through its (and FSA's) current CIMS efforts. However, the recent timetable provided to us by RMA indicates that full implementation of CIMS is not expected until 2012. As a result, the mandated reconciliation of RMA and FSA data will not occur until that year or later. In the interim, we would recommend that Congress work with RMA and FSA to determine whether implementation of CIMS can be expedited or whether some other action can reasonably be taken to fulfill ARPA's mandate in this regard.

We are currently reviewing RMA's implementation of the IPIA. With the concurrence of the Office of Management and Budget (OMB), RMA has instituted an alternative to the process required by the IPIA. Due to its limited resources, RMA has developed a National Operations Review program that will review a sample of loss claims from AIPs on a 3-year cycle to establish an error rate for improper payments. Although OMB has approved RMA's approach, we are discussing with RMA our concerns that a statistically valid sampling method will not be used to select claims. Whether this process will be effective in fulfilling the goals and requirements of the IPIA may not be known for some time.

The Standard Reinsurance Agreement: Preserving Federal Interests

OIG monitored RMA's renegotiation of the SRA and offered RMA a number of suggestions to improve program integrity. We suggested that RMA include specific authority in the SRA that would allow the agency to establish a standard quality control review system by regulation, strengthen its conflict of interest provisions, strengthen the

oversight and monitoring of large claims, and reduce administrative reimbursement rates. We acknowledged and concurred with RMA's attempts to reduce the Government's share of the risk, the A&O reimbursement rate, and the amount of the premium AIPs could retain (underwriting gains).

Although RMA had some success in strengthening SRA provisions, much of what was unfavorable to the AIPs was modified during negotiations with the AIPs. Our report, *Renegotiation of the Standard Reinsurance Agreement*,¹⁰ issued in January 2005, summarized our suggestions on ways RMA could strengthen program integrity, as well as some of the significant changes made to RMA's proposals after public comment. RMA was successful in strengthening program integrity by improving the conflict of interest provisions and oversight of adjusters; establishing its option to review large claims before payments are issued (loss claims in excess of \$500,000); obtaining authority to have companies review policies under a quality control environment driven largely by data mining; and identifying anomalous financial behavior.¹¹ In its renegotiation of the 2005 SRA, and as required by ARPA, RMA established an entirely new process that requires AIPs to review policies identified as anomalous by RMA data mining. OIG will continue working to monitor and evaluate the effectiveness of RMA's efforts in these areas.

IV. Weaknesses and Vulnerabilities Persist in the Federal Crop Insurance Program

OIG Investigations of Fraud in the Crop Insurance Program

The great majority of producers and private sector business entities that participate in the crop insurance program are, of course, honest and determined to properly comply with its requirements. The improper conduct of a minority of participants can tarnish perceptions of the program's value as part of the Federal safety net for producers. OIG continues to investigate fraud and other criminal activity in the crop insurance program across the

¹⁰ Audit No. 05099-109-KC.

¹¹ For example, producers who have very large approved yields relative to their peers and large, multi-year claims.

United States. Since fiscal year 1999, our investigations have resulted in 70 indictments, 53 convictions, and over \$54 million in monetary results.

Our investigative work has shown these cases to be—compared to fraud affecting other USDA farm programs—particularly complex in their details and correspondingly time-consuming to investigate. Crop insurance cases frequently involve multiple subjects such as producers, landowners, sales agents, and insurance adjusters. It is not uncommon for individual crop insurance fraud cases to involve comparatively large amounts of monetary losses to USDA, sometimes reaching into the millions of dollars per producer. We continue to work with USDA and the U.S. Department of Justice to aggressively pursue fraudulent crop insurance schemes that undermine the program and burden taxpayers.

Common Fraud Schemes

OIG's investigation into potential criminal activity in the Federal crop insurance program has revealed a series of schemes that are used by some producers and business associates to defraud the program and improperly obtain crop insurance payments. Among the primary schemes we have observed are the following:

- Claiming losses on crops that were never planted or that were intentionally made to fail. (e.g., *responsible farming practices are intentionally not used, and the cause of the crop loss is inconsistent with other area producers.*)
- Agents and adjusters collude to manufacture losses. (e.g., *they change an ineligible cause of loss to an eligible cause of loss.*)
- Creation of sham farming entities to illegally obtain crop insurance indemnity payments. (e.g., *setting up new entities or contracts to hide prior losses.*)

- Concealing actual production of insured crops to receive higher indemnity payments. (e.g., *claiming crop losses when none have occurred.*)
- Falsely reporting planting dates to receive crop insurance payments. (e.g., *backdating forms in order to ensure that the producer's planting dates are within the planting dates approved by RMA.*)
- Shifting crops to create loss units, wherein a producer sells crops from one section of insured land to either a non-insured parcel of land, or another non-loss unit.

Major Investigations

OIG crop insurance investigations have resulted in successful prosecutions and monetary recoveries from individuals engaged in each of the above schemes. I would like to present summary information to the Committee about several prominent and representative cases.

In terms of numbers of individuals involved, convictions gained, and court-ordered monetary recoveries, one of our most significant cases was a 3-year OIG investigation that revealed a complex conspiracy to defraud the FCIC and several private insurance companies. The owners of a North Carolina corporation received more than \$9.28 million in crop insurance payments and attempted to obtain an additional \$3.8 million via schemes involving hiding and shifting tomato production (to inflate losses) and submitting false reports and documents to insurance companies. The corporation overstated its total insured acreage in order to collect larger insurance payments. Its owners staged a “hailstorm”—complete with cocktail ice, bruised tomatoes, and a chemical spray in lieu of actual frost—and photographed the scene in order to document non-existent crop damages. Eight individuals ultimately pled guilty to charges such as conspiracy, money laundering, crop insurance fraud, perjury, and false statements. Sentences ranged from 8 to 76 months of imprisonment and forfeiture/restitution totaled \$7.3 million and \$9.15 million, respectively.

An OIG investigation involving a North Dakota farmer and insurance broker resulted in a \$5.9 million order of forfeiture to the Government after he and his farm business entities were found guilty of 19 criminal charges. The scheme involved the creation of seven sham farming entities made up of family members and insurance agents employed by the insurance broker. Crop insurance policies were written for each of these fraudulent operations. Insurance losses were fabricated by shifting production from one sham farm entity to another, thereby creating false loss units. Parties with no insurable interests thereby received Federal indemnity payments. In June 2003, the insurance agent was sentenced to serve 60 months in prison and both of the farming entities were placed on probation for 5 years.

A scheme involving collusion between a producer and a crop loss adjustor was uncovered during an investigation into a Texas crop insurance agency owner who was also a producer. He conspired with the adjustor in a scheme involving false statements about his wheat, cotton, and grain sorghum insurance policies and indemnity claims. Our investigation revealed that these individuals fraudulently obtained crop insurance benefits by having the crop loss adjustor prepare appraisal worksheets and production worksheets without conducting field inspections and appraisals. The producer also provided false and fictitious receipts on seed purchases. The producer was ultimately sentenced to 41 months in prison, 36 months of supervised release and was ordered to pay \$448,000 to RMA. He was also prohibited from engaging in the sale of crop insurance and was excluded from USDA programs. The crop loss adjustor was sentenced to 2 years' probation and a similar restitution.

The final investigative case that I would like to mention to the Subcommittee resulted in a \$240,000 restitution order in Federal court just over two weeks ago in the Eastern District of Virginia. After pleading guilty to conspiracy, the insurance adjustor involved was also sentenced to 24 months of probation for his misrepresentations about a producer's alleged tomato losses. The OIG investigation determined that the adjustor, working for an insurance company's supervisor, signed worksheets falsely stating that he

had visited a producer's fields to assess relevant crop losses. The supervisor recorded false production totals to ensure that the producer would realize a loss. The actions of the adjuster and supervisor resulted in a producer receiving a Federal crop insurance payment of over \$308,000 to which he was not entitled. The supervisor was sentenced earlier this year to 5 months' imprisonment and restitution of \$240,301.

OIG Audit Findings: The Need for Improved Federal and Private Sector Oversight

OIG has identified the need for strong, integrated management controls and effective interagency communication, coordination, and program integration as major management control weaknesses in our 2004, 2005, and 2006 Management Challenges reports to the Secretary.¹² Our prior audits and investigations have led us to conclude that RMA must adequately address these challenges if it is to mitigate the risks for fraud, waste, and abuse in crop insurance programs. While we recognize the positive efforts taken by RMA (such as during the SRA negotiation), we believe that effective interagency communication and program integration is essential for ARPA's successful implementation, in addition to enhancing the program integrity of the various farm programs that build upon the data, payments, and compliance activities of several USDA agencies.

In our 1999 report, we made a number of suggestions to strengthen the program's structural framework and improve its management controls; several remain directly relevant for current discussions about the program. Our primary suggestions included the need for RMA to take a more proactive role in monitoring and providing oversight of the AIPs and, most importantly, to strengthen the quality control (QC) review system.

We reiterated many of these same recommendations in our March 2002 report on RMA's QC review system.¹³ We found that, despite an 8-year effort in response to earlier OIG

¹² The "Reports Consolidation Act of 2000," P.L. 106-531, requires OIG to annually identify and report on the most serious management challenges facing USDA and its agencies.

¹³ Monitoring of RMA's Implementation of Manual 14 Reviews/Quality Control Review System, Audit No. 05099-14-KC.

and Government Accountability Office reports, RMA had not developed a reliable QC review system capable of evaluating the private sector's (AIP) delivery of the program. Basic policy questions remain, such as what constitutes an error, the amount of improper payments made, and at what level program delivery needed to be assessed (e.g., the AIP or crop insurance program as a whole). Since program delivery relies on private AIPs, they must be the first line of detection and prevention of program abuse and waste and improper payments. It is essential for RMA to strengthen its oversight of the AIPs' QC review systems and to validate that systemic causes for errors are identified and corrected. To date, RMA and OIG have still not reached agreement on the actions necessary to correct the concerns we have raised.

Our audits and investigations have consistently identified problems in the underwriting and loss adjustment review processes and with conflicts of interest, resulting in fraudulent and/or improper payments. We believe that an effective and independent QC review system, in tandem with effective monitoring and oversight by RMA, could have prevented or detected many improper payments. I would like to briefly discuss several OIG audits that illustrate situations wherein effective QC systems and improved RMA oversight could better serve the Government's interest in preventing excessive or improper crop insurance payments.

The Watermelon Insurance Pilot Program

In response to allegations of abuse in this program in Texas, we initiated three reviews. One focused on RMA's overall approval and review process and two focused on the eligibility of producers and the validity of their indemnity payments. OIG found that RMA, despite evidence that fall watermelons were not a suitable crop for South Texas and were not likely to produce a crop, approved this crop's inclusion in a pilot insurance program. RMA did not provide adequate oversight of the pilot program's development and approval process, particularly with respect to the actuarial risk associated with the crop. Our findings questioned \$21 million in indemnity payments to fall watermelon producers in the region. Prior to our audit, RMA promptly moved to suspend the pilot

program when it became aware of its impact on the market prices and allegations of abuses.

The two audits¹⁴ that focused on producer eligibility and the validity of their indemnity payments found that, because the risk associated with planting a fall crop had not been adequately determined, the pilot program created a “moral hazard,” whereby producers appeared to willfully neglect prudent management practices by planting an extremely large amount of acreage with a crop that had no more than a 10-percent chance of making it to harvest. Misrepresentation by the producer, inadequate loss adjustments, and a conflict of interest between the insurance agent (he leased acreage to the producer) and the producer caused over \$5.5 million in improper indemnities paid.

In response to OIG’s audits, RMA agreed to strengthen conflict of interest provisions to require disclosure of any business relationship between the insured parties and agents. RMA is in the process of implementing some of these provisions.¹⁵

The Adjusted Gross Revenue Program

OIG’s 2007 review of a second pilot program, the Adjusted Gross Revenue Program (AGR),¹⁶ substantiated our concerns about the AIPs’ review systems (including QCs). During insurance years 2002-2003, 9 insurance providers in 18 States paid AGR indemnities totaling over \$24 million. We reviewed 11 claims paid by 5 providers totaling \$6.9 million, and we questioned \$2.3 million of the \$6.9 million in indemnity payments issued. Four of the five insurance providers we reviewed had either issued policies to producers whose eligibility was unsupported or paid indemnities for unsupported loss claims. AIP reviews at multiple levels—the application, underwriting, loss adjustment, and QC reviews—did not ensure that policies and loss claims met RMA

¹⁴ Watermelon Claims in South Texas, Audit No. 05601-7-Te, August 2001; and Review of Large Insurance Claim for Watermelons in South Texas, Audit No. 05601-9-Te, September 2002.

¹⁵ Although the 2005 SRA strengthened the conflict of interest provisions, RMA issued notices in 2005 and 2006 to clarify the provisions. However, RMA’s conflict of interest disclosure form for AIPs and other parties is still in the clearance process.

¹⁶ The Adjusted Gross Revenue (AGR) Program is a non-traditional crop insurance pilot program where producers insure their farm revenue against losses caused by both natural disasters and market fluctuations. Adjusted Gross Revenue Program, Audit No. 50601-4-SF.

regulations. Furthermore, RMA was not aware of the problems and, therefore, could not correct the AIPs' noncompliance. RMA has since agreed to implement procedures requiring onsite file reviews during the implementation of selected pilot programs.

Current OIG Audit Efforts

We currently have a total of seven audits pertaining to crop insurance issues that are ongoing, and I would like to briefly describe for the Committee two of the more noteworthy audits. We have initiated an audit of RMA's compliance activities. We are focusing on (1) organizational structure (is the control environment adequate to support and sustain effective controls), (2) risk assessments (are internal and external risks and program vulnerabilities identified), and (3) policies and procedures (are controls over compliance activities in place and are they effective to identify and correct systemic weaknesses). We plan to report on this audit by the end of the year.

Another major effort we have underway is looking at RMA's management controls to ensure the timeliness and accuracy of indemnity payments for nursery crops resulting from Hurricanes Katrina and Wilma in Florida. As of January 2007, Federal crop insurance indemnity payments for losses of nursery crops in Florida due to hurricanes Katrina and Wilma totaled approximately \$264 million. We are evaluating the effectiveness of the AIPs' QC review system to detect improper payments and the effectiveness of RMA's oversight and monitoring of the AIPs on the indemnities paid.

V. Strengthening the Program Framework and Management Controls for the Crop Insurance Program: Administrative and Legislative Recommendations

Recommendations for USDA

If fully implemented, existing laws affecting the Federal crop insurance program (ARPA, 2002 Farm Bill, IPIA) would help strengthen the integrity of the crop insurance program.

However, we also believe that more emphasis on program design, management controls, compliance, and interagency communication would reduce improper crop insurance payments. As we have recommended in our annual *Management Challenges* reports to the Secretary, we believe the following actions are critical to provide effective management of the crop insurance program and other farm programs and to prevent fraud, waste and abuse.

- **Accelerate development and implementation of CIMS.** Uniform program data and integrated data systems need to be developed and shared by RMA and FSA. Such a system may negate the time consuming reconciliation of producer information between the two agencies. We believe that this project can serve as a model for further information sharing and coordination to ensure compliance and integrity in other farm-related agencies (e.g., Natural Resources Conservation Service) in USDA. Currently, full CIMS implementation is not anticipated until 2012.
- **Accelerate development and implementation of an effective QC review system.** A QC review system needs to incorporate elements that would provide an assessment of the delivery of the crop insurance program, whether at the AIP level or the program as a whole. While RMA requires AIPs to report discrepancies in policy data that may affect premiums, liabilities, and indemnities, individual AIPs apply inconsistent criteria for identifying and reporting errors. These inconsistent criteria provide unreliable and inconsistent results with respect to error rates and evaluating program delivery. We also believe the QC system should include incentives for good performance and disincentives for excessive error rates.
- **Finalize Implementation of ARPA.** In addition to annual reconciliation of RMA and FSA data, ARPA required RMA to identify and review claim anomalies that

can be identified to any sales agent or loss adjustor.¹⁷ Also, ARPA allowed RMA to impose civil fines and to disqualify producers, agents, loss adjustors, and AIPs for up to 5 years for willfully and intentionally providing false or inaccurate information or failing to comply with a crop insurance requirement. RMA has taken some actions to implement these provisions, but they have not been finalized.

- **Finalize Conflict of Interest Policies and Procedures.** RMA issued stronger conflict of interest provisions in the 2005 SRA, but the disclosure process has not been finalized. OIG provided feedback to RMA as it moved forward to issue guidance clarifying these SRA provisions. Recently, OIG provided comments to RMA on the draft of the conflict of interest disclosure form that is to be completed by AIP employees, agents, and loss adjustors.
- **Expand Data Mining.** RMA could improve program integrity and deter fraud, waste, and abuse by expanding data mining of program data for anomalous behavior or patterns by the producers, agents, and loss adjustors. The Department should also expand its data mining capabilities to other farm programs.

Recommendations for Congress: USDA's 2007 Farm Bill Proposal

USDA's 2007 Farm Bill proposals acknowledge that crop insurance fraud and abuse continues to be a serious concern and that an expansion of program compliance and data mining activities is needed to identify and sanction "bad actors" who are abusing the program. We agree.

¹⁷ ARPA required RMA to identify and review: (1) any agent where the loss claims associated with such sales by the agent are equal or greater than 150 percent of the mean for all loss claims associated with such sales by all other agents operating in the same area, and (2) any person performing loss adjustment services relative to coverage where such loss claims resulted in accepted or denied claims equal to or greater than 150 percent of the mean for accepted or denied claims for all other persons performing loss adjustments in the same area.

USDA's Farm Bill proposal summary states that "[C]ertain statutory requirements of the crop insurance program have put its future integrity and actuarial soundness into question." The changes proposed by the Secretary can, if passed, help meet the challenge of materially improving the compliance, integrity, and actuarial soundness of the program, yet continue to provide the safety net to the American producers. We support the Department's proposals to improve the program with statutory adjustments, including the allowed loss ratio, renegotiating the SRA, AIP risk sharing, premium subsidies, and compliance activities.

OIG, through our audit and investigative efforts, will continue to support the Department's goal of improving the effectiveness and integrity of the Federal crop insurance program, as well as protecting the safety net for American producers.

This concludes my testimony. I again want to thank the Subcommittee for the opportunity to discuss OIG's work and perspectives regarding the Federal crop insurance program. I will be pleased to address any questions you may have.

United States Government Accountability Office

GAO

Testimony
Before the Subcommittee on General
Farm Commodities and Risk Management,
Committee on Agriculture, House of
Representatives

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CROP INSURANCE

Continuing Efforts Are Needed to Improve Program Integrity and Ensure Program Costs Are Reasonable

Statement of Robert A. Robinson, Managing Director
Natural Resources and Environment



June 7, 2007

CROP INSURANCE

Continuing Efforts Are Needed to Improve Program Integrity and Ensure Program Costs Are Reasonable

What GAO Found

GAO reported that RMA did not use all available tools to reduce the crop insurance program's vulnerability to fraud, waste, and abuse. RMA has since taken some steps to improve its procedures. In particular:

- *USDA's Farm Service Agency (FSA) inspections during the growing season were not being used to maximum effect.* Between 2001 and 2004, FSA conducted only 64 percent of the inspections RMA requested. Without inspections, farmers may falsely claim crop losses. However, FSA said it could not conduct all requested inspections, as GAO recommended, because of insufficient resources. RMA now provides information more frequently so FSA can conduct timelier inspections.
- *RMA's data analysis of the largest farming operations was incomplete.* In 2003, about 21,000 of the largest farming operations did not report all of the individuals or entities with an ownership interest in these operations, as required. Therefore, RMA was unaware of ownership interests that could help it prevent potential program abuse. FSA and RMA started sharing information to identify such individuals or entities, but have stopped temporarily to resolve producer privacy issues. USDA should recover up to \$74 million in improper payments made during 2003.
- *RMA was not effectively overseeing insurance companies' efforts to control program abuse.* According to GAO's review of 120 cases, companies did not complete all the required quality assurance reviews of claims, and those that were conducted were largely paper exercises. RMA agreed to improve oversight of their reviews, but GAO has not followed up to examine its implementation.

RMA's regulations to implement the crop insurance program, as well as some statutory requirements, create design problems that hinder its efforts to reduce abuse. For example, the regulations allow farmers to insure fields individually rather than together. As such, farmers can "switch" reporting of yield among fields to make false claims or build up a higher yield history on a field to increase its eligibility for higher insurance guarantees. RMA did not agree with GAO's recommendation to address the problems associated with insuring individual fields. Statutorily high premium subsidies may also limit RMA's ability to control program abuse: the subsidies shield farmers from the full effect of paying higher premiums associated with frequent claims.

From 2002 through 2006, USDA paid the insurance companies underwriting gains of \$2.8 billion, which represents an average annual rate of return of 17.8 percent. In contrast, according to insurance industry statistics, the benchmark rate of return for companies selling property and casualty insurance was 6.4 percent. USDA renegotiated the financial terms of its standard reinsurance agreement with the companies in 2005, but their rate of return was 30.1 percent in 2005, and 24.3 percent in 2006. It also paid the companies a cost allowance of \$4 billion to cover administrative and operating costs for 2002 through 2006. USDA recommended that Congress provide RMA with authority to renegotiate the financial terms and conditions of its standard reinsurance agreement once every 3 years.

United States Government Accountability Office

GAO Accountability-Integrity-Reliability Highlights

Highlights of GAO-07-944T, a testimony before the Subcommittee on General Farm Commodities and Risk Management, Committee on Agriculture, House of Representatives

Why GAO Did This Study

The U.S. Dept. of Agriculture's (USDA) Risk Management Agency (RMA) administers the federal crop insurance program in partnership with private insurers. In 2006, the program cost \$3.5 billion, including millions in losses from fraud, waste, and abuse, according to USDA. The Agricultural Risk Protection Act of 2000 granted RMA authority to renegotiate the terms of RMA's standard reinsurance agreement with companies once over 5 years.

This testimony is based on GAO's 2005 report, *Crop Insurance: Actions Needed to Reduce Program's Vulnerability to Fraud, Waste, and Abuse*, and May 2007 testimony, *Crop Insurance: Continuing Efforts Are Needed to Improve Program Integrity and Ensure Program Costs Are Reasonable*. GAO discusses (1)

USDA's processes to address fraud, waste, and abuse; (2) extent the program's design makes it vulnerable to abuse; and (3) reasonableness of underwriting gains and other expenses. USDA agreed with most of GAO's 2005 recommendations to improve program integrity.

What GAO Recommends

Congress has an opportunity in the Farm Bill reauthorization to grant RMA authority to periodically renegotiate the financial terms of its agreement with companies to provide reasonable cost allowances and underwriting gains.

www.gao.gov/cgi-bin/getpt1?GAO-07-944T.

To view the full product, including the scope and methodology, click on the link above. For more information, contact Robert A. Robinson (202) 512-3841 or robinsonr@gao.gov.

Mr. Chairman and Members of the Subcommittee:

I am pleased to be here today to discuss our recent work on the federal crop insurance program administered by the U.S. Department of Agriculture (USDA). As you know, federal crop insurance is part of the overall safety net of programs for American farmers. It provides protection against financial losses caused by droughts, floods, or other natural disasters. USDA's Risk Management Agency (RMA) supervises the Federal Crop Insurance Corporation's (FCIC) operations and has overall responsibility for administering the crop insurance program, including controlling costs and protecting against fraud, waste, and abuse. RMA also partners with private insurance companies that sell and service the insurance policies and share a percentage of the risk of loss and opportunity for gain associated with each policy.

In November 2006, we identified the federal crop insurance program as a program in need of better oversight to ensure program funds are spent as economically, efficiently, and effectively as possible.¹ In 2006, the crop insurance program provided \$50 billion in insurance coverage for 242 million acres of farmland, at a cost of \$3.5 billion to the federal government, of which a total of \$1.8 billion was paid to insurance companies for their participation in the crop insurance program.² USDA reports that an estimated \$62 million in indemnity payments were made in 2006 as a result of waste, such as incorrect payments or payments based on incomplete or missing paperwork.³

To improve the integrity of the crop insurance program, among other things, Congress enacted the Agricultural Risk Protection Act of 2000 (known as ARPA). ARPA provided RMA and USDA's Farm Service Agency (FSA) with new tools for monitoring and controlling program abuses.⁴ ARPA required the Secretary of Agriculture to develop and implement a

¹GAO, *Suggested Areas for Oversight for the 110th Congress*, GAO-07-235R (Washington, D.C.: Nov. 17, 2006).

²Cost data in this testimony are reported on a fiscal year basis. Program data are reported on a crop year basis.

³See U.S. Department of Agriculture, *FY 2006 Performance and Accountability Report* (Washington, D.C.: Nov. 15, 2006). RMA officials indicated that they have not developed an estimate of losses attributable to fraud and abuse.

⁴FSA is generally responsible for helping producers enroll in agriculture support programs, overseeing these programs, and issuing program payments.

coordinated plan for FSA to assist RMA in the ongoing monitoring of the crop insurance program and to use information technologies, such as data mining—the analysis of data to establish relationships and identify patterns—to administer and enforce the program. Furthermore, ARPA provided USDA with the authority to renegotiate the financial terms of its contractual agreement—known as the standard reinsurance agreement (SRA)—with the private insurance companies once during 2001 through 2005. USDA renegotiated the terms of the SRA in 2004 and implemented the new agreement in 2005. In its recent Farm Bill proposal, USDA recommended that Congress provide the agency with authority to renegotiate the financial terms and conditions once every 3 years. RMA officials also told us they sought legislative remedies to address excessive underwriting gains in their budget proposals for fiscal years 2006 and 2007. The SRA between USDA and the insurance companies includes (1) a cost allowance that is tied to the value of the policy and that is intended to cover administrative and operating expenses incurred by the companies for program delivery, and (2) risk-sharing formulas that establish underwriting gains and losses.

GAO has issued reports on the federal crop insurance program that have raised a number of concerns. (See Related GAO Products.) Most recently, in May 2007, we reported that some farmers may have abused the crop insurance program by allowing crops to fail through neglect or deliberate actions in order to collect insurance; some insurance companies have not exercised due diligence in investigating losses and paying claims; and, the payments that USDA makes to companies for program delivery have been excessive.⁵ In addition, the effects of climate change, including rising temperatures and increasingly frequent and intense droughts, storms, and flooding, may be potentially significant in coming decades and affect the program's financial costs to the government. As we recently reported,⁶ major private and federal insurers are both exposed to the effects of climate change over the coming decades, but are responding differently. Many large private insurers are incorporating climate change into their

⁵GAO, *Crop Insurance: Continuing Efforts Are Needed to Improve Program Integrity and Ensure Program Costs Are Reasonable*, GAO-07-819T (Washington, D.C.: May 3, 2007). See also *Crop Insurance: More Needs to Be Done to Reduce Program's Vulnerability to Fraud, Waste, and Abuse*, GAO-06-878T (Washington, D.C.: June 15, 2006), and *Crop Insurance: Actions Needed to Reduce Program's Vulnerability to Fraud, Waste, and Abuse*, GAO-05-528 (Washington, D.C.: September 30, 2005).

⁶GAO, *Climate Change: Financial Risks to Federal and Private Insurers in Coming Decades Are Potentially Significant*, GAO-07-285 (Washington, D.C.: March 16, 2007).

annual risk management practices, and some are addressing it strategically by assessing its potential long-term, industrywide impacts. However, the major federal insurance programs, including the crop insurance program, have done little to develop comparable information.

My testimony today focuses on the (1) effectiveness of USDA's procedures to prevent and detect fraud, waste, and abuse in selling and servicing crop insurance policies; (2) extent to which program design issues may make the program more vulnerable to fraud, waste, and abuse; and (3) reasonableness of underwriting gains and administrative and operating expenses USDA pays to the companies for program delivery. My testimony is based on published GAO products. We performed our work in accordance with generally accepted government auditing standards.

In summary, since the enactment of ARPA, RMA has taken a number of steps to improve its procedures to prevent and detect fraud, waste, and abuse in the crop insurance program. Most notably, RMA reports that data mining analyses and subsequent communication to farmers resulted in a decline of at least \$300 million in questionable claims payments from 2001 to 2004. However, we found that, at the time our review, RMA was not effectively using all of the tools it had available and that some farmers and others continued to abuse the program. We identified weaknesses in four key areas: (1) field inspections, (2) data mining processes that exclude many large farming operations when farmers do not report their interest in them, (3) quality assurance reviews conducted by insurance companies, and (4) imposition of sanctions. Weaknesses in these areas left the program vulnerable to questionable claims, and the insurance companies and RMA could not always determine the validity of a claim to minimize fraud, waste, and abuse. RMA has taken steps on some of the recommendations we made. For example, RMA amended its crop insurance policy manual to provide information more frequently to FSA on suspect claims so that FSA is able to conduct timelier field inspections to detect potential abuse. In another case, we recommended that RMA promulgate regulations needed to fully utilize its expanded sanction authority provided under ARPA. In response, RMA developed draft regulations that, when final, will allow the agency to fully use this authority to sanction program violators.

We also found that the program's design, as laid out in RMA's regulations or as required by statute, can impede the efforts of RMA officials to prevent and detect fraud, waste, and abuse in a number of ways. In terms of RMA's regulations, farmers can insure their fields individually instead of insuring all fields combined, which makes it easier for them to switch

production among fields, either to make false insurance claims or to build up a higher yield history on a particular field in order to increase its eligibility for higher future insurance guarantees. RMA disagreed with our recommendation to reduce the insurance guarantee or eliminate optional unit coverage for producers who consistently have claims that are irregular in comparison with other producers growing the same crop in the same location. RMA stated that our recommendation represents a disproportionate response, considering the small number of producers who switch the yield on a field each year. Nevertheless, we continue to believe that RMA could tailor an underwriting rule to target those relatively few farmers who file anomalous claims related to yield switching. In terms of statutory requirements, RMA is obligated by law to offer farmers "prevented planting" coverage—coverage that allows for insurance claims if an insured crop is prevented from being planted because of weather conditions, but it is often difficult to determine whether farmers had the opportunity to plant a crop. In our 2006 testimony,⁷ we stated that Congress may wish to consider allowing RMA to reduce premium subsidies—and hence raise the insurance premiums—for farmers who consistently have claims, such as prevented planting claims, that are irregular in comparison with other farmers growing the same crop in the same location. To date, Congress has not granted RMA the authority to make such reductions.

Finally, USDA paid the insurance companies underwriting gains of \$2.8 billion, in total, from 2002 through 2006. The underwriting gains represent an average annual rate of return of 17.8 percent over this 5-year period.⁸ This rate of return is considerably higher than the insurance industry average. According to insurance industry statistics, the benchmark rate of return for U.S. insurance companies selling private property and casualty insurance was 6.4 percent during this period. RMA officials told us that this benchmark rate can be considered a starting point for measuring the appropriateness of the underwriting gains in the crop insurance program. As previously noted, USDA renegotiated the financial terms of its SRA with the companies beginning with the 2005 planting season. Nonetheless, in 2005, USDA still paid insurance companies underwriting gains of \$916 million—a rate of return of 30.1 percent. In 2006, USDA paid underwriting

⁷GAO, *Crop Insurance: More Needs to Be Done to Reduce Program's Vulnerability to Fraud, Waste, and Abuse*, GAO-06-878T (Washington, D.C.: June 15, 2006).

⁸In this testimony, we define rate of return as underwriting gains calculated as a percentage of premiums on the policies in which companies retain risk of loss.

gains of \$886 million—a rate of return of 24.3 percent. The companies received these underwriting gains despite drought conditions in parts of the country in 2005 and 2006 that would normally suggest they would earn lower profits. In addition to underwriting gains, USDA paid the insurance companies \$4 billion in cost allowances to cover administrative and operating expenses incurred for program delivery from 2002 through 2006. USDA expects the cost allowance paid per policy to increase by about 25 percent by 2008 because of higher crop prices, particularly for corn and soybeans. These higher crop prices increase the value of the policy. However, the companies and their affiliated sales agents will receive this substantially higher cost allowance without any corresponding increase in expenses for selling and servicing the policies. Congress has an opportunity in its reauthorization of the Farm Bill to provide USDA with the authority to periodically renegotiate the financial terms of the standard reinsurance agreement with the insurance companies so that the companies' rate of return is more in line with private insurance markets. USDA has requested the authority to renegotiate the SRA in its proposals for the Farm Bill.

Background

FCIC was established in 1938 to temper the economic impact of the Great Depression, and was significantly expanded in 1980 to protect farmers from the financial losses brought about by drought, flood, or other natural disasters. RMA administers the program in partnership with private insurance companies, which share a percentage of the risk of loss and the opportunity for gain associated with each insurance policy written. RMA acts as a reinsurer—reinsurance is sometimes referred to as insurance for the insurance companies—for a portion of all policies the federal crop insurance program covers. In addition, RMA pays companies a percentage of the premium on policies sold to cover the administrative costs of selling and servicing these policies. In turn, insurance companies use this money to pay commissions to their agents, who sell the policies, and fees to adjusters when claims are filed.

FCIC insures agricultural commodities on a crop-by-crop and county-by-county basis, considering farmer demand and the level of risk associated with the crop in a given region. Major crops, such as grains, are covered in almost every county where they are grown, while specialty crops such as fruit are covered in only some areas. Participating farmers can purchase different types of crop insurance and at different levels.

RMA establishes the terms and conditions that the private insurance companies selling and servicing crop insurance policies are to use through

the SRA. The SRA provides for the cost allowance intended to cover administrative and operating expenses the companies incur for the policies they write, among other things. The SRA also establishes the minimum training, quality control review procedures, and performance standards required of all insurance providers in delivering any policy insured or reinsured under the Federal Crop Insurance Act, as amended.

Under the crop insurance program, participating farmers are assigned (1) a "normal" crop yield based on their actual production history and (2) a price for their commodity based on estimated market conditions. Farmers can then select a percentage of their normal yield to be insured and a percentage of the price they wish to receive if crop losses exceed the selected loss threshold. In addition, under the crop insurance program's "prevented planting" provision, insurance companies pay farmers who were unable to plant the insured crop because of an insured cause of loss that was general to their surrounding area, such as weather conditions causing wet fields, and that had prevented other farmers in that area from planting fields with similar characteristics. These farmers are entitled to claims payments that generally range from 50 to 70 percent, and can reach as high as 85 percent, of the coverage they purchased, depending on the crop.

RMA is responsible for protecting against fraud, waste, and abuse in the federal crop insurance program. In this regard, RMA uses a broad range of tools, including RMA's compliance reviews of companies' procedures, companies' quality assurance reviews of claims, data mining, and FSA's inspections of farmers' fields. For example, insurance companies must conduct quality assurance reviews of claims that RMA has identified as anomalous or of those claims that are \$100,000 or more to determine whether the claims the companies paid comply with policy provisions.

Congress enacted ARPA, amending the Federal Crop Insurance Act, in part, to improve compliance with, and the integrity of, the crop insurance program. Among other things, ARPA provided RMA authority to impose sanctions against producers, agents, loss adjusters, and insurance companies that willfully and intentionally provide false or inaccurate information to FCIC or to an insurance company—previously, RMA had authority to impose sanctions only on individuals who willfully and intentionally provided false information. It also provided RMA with authority to impose sanctions against producers, agents, loss adjusters, and insurance companies for willfully and intentionally failing to comply with any other FCIC requirement. In addition, it increased the percentage share of the premium the government pays for most coverage levels of

crop insurance, beginning with the 2001 crop year. The percentage of the premium the government pays declines as farmers select higher levels of coverage. However, ARPA raised the percentage of federal subsidy for all levels of coverage, particularly for the highest levels of coverage. For example, the government now pays more than one-half of the premium for farmers who choose to insure their crop at 75-percent coverage.

RMA Has Strengthened Procedures for Preventing Questionable Claims, but the Program Remains Vulnerable to Potential Abuse

RMA has taken a number of steps to improve its procedures to prevent and detect fraud, waste, and abuse, such as data mining, expanded field inspections and quality assurance reviews. In particular, RMA now develops a list of farmers each year whose operations warrant an on-site inspection during the growing season because data mining uncovered patterns in their past claims that are consistent with the potential for fraud and abuse. The list includes, for example:

- farmers, agents, and adjusters linked in irregular behavior that suggests collusion;
- farmers who for several consecutive years received most of their crop insurance payments from prevented planting indemnity payments;
- farmers who appear to have claimed the production amounts for multiple fields as only one field's yield, thereby creating an artificial loss on their other field(s); and
- farmers who, in comparison with their peers, file unusually high claims for lost crops over many years.

Since RMA began performing this data mining in 2001, it has identified about 3,000 farmers annually who warrant an on-site inspection because of anomalous claims patterns. In addition, RMA annually performs about 100 special analyses to identify areas of potential vulnerability and trends in the program.

RMA also provides the names of farmers from its list of suspect claims for inspection to the appropriate FSA state office for distribution to FSA county offices, as well as to the insurance companies selling the policies to farmers. As a result of these inspections and other information, RMA reported total cost savings of \$312 million from 2001 to 2004, primarily in the form of estimated payments avoided. For example, according to RMA, claims payments to farmers identified for an inspection decreased nationwide from \$234 million in 2001 to \$122 million in 2002. According to RMA, some of the farmers on the list for filing suspect claims bought less

insurance and a few dropped crop insurance entirely, but most simply changed their behavior regarding loss claims.

However, as we testified in 2006, RMA was not effectively using all of the tools it had available and that some farmers and others continued to abuse the program, as the following discussion indicates.

Inspections during the growing season were not being used to maximum effect. FSA was not providing RMA with inspection assistance in accordance with USDA guidance. For example, between 2001 and 2004, farmers filed claims on about 380,000 policies annually, and RMA's data mining identified about 1 percent of these claims as questionable and needing FSA's inspection. Under USDA guidance, FSA should have conducted all of the 11,966 requested inspections, but instead conducted only 64 percent of them; FSA inspectors said that they did not conduct all requested inspections primarily because they did not have sufficient resources. Moreover, between 2001 and 2004, FSA offices in nine states did not conduct any of the field inspections RMA had requested in one or more of the years. Until we brought this matter to their attention in September 2004, FSA headquarters officials were unaware that the requested inspections in these nine states had not been conducted. Furthermore, FSA might not have been as effective as possible in conducting field inspections because RMA did not provide it with information on the nature of the suspected abusive behavior or the results of follow-up investigations. Finally, these inspections did not always occur in a timely fashion during the growing season. Because of these problems, the insurance companies and RMA could not always determine the validity of a claim.

USDA has implemented some of our recommendations to improve inspection practices. For example, we recommended that RMA more consistently inform FSA of the suspect claim patterns that it should investigate. RMA amended its crop insurance policy manual to provide information more frequently to FSA on suspect claims, as we recommended, so that FSA can conduct timelier field inspections to detect potential abuse. Specifically, RMA now provides a list twice a year—in the fall for crops such as wheat, and in the spring for crops such as corn and soybeans. However, FSA disagreed with our recommendation that it conduct all inspections called for under agency guidance, citing insufficient resources as the reason. Nevertheless, we believe that conducting these inspections would achieve potentially substantial savings for the crop insurance program by identifying cases of fraudulent claims.

RMA's data analysis of the largest farming operations was incomplete. RMA's data mining analysis excluded comparisons of the largest farming operations—including those organized as partnerships and joint ventures. These entities may include individuals who are also members of one or more other entities. Because it did not know the ownership interests in the largest farming operations, RMA could not readily identify potential fraud. For example, farmers who are members of more than one farming operation could move production from one operation to another to file unwarranted claims, without RMA's knowledge that these farmers participate in more than one farming operation. RMA could not make these comparisons because it had not been given access to similar data that FSA maintains. However, ARPA required the Secretary of Agriculture to develop and implement a coordinated plan for RMA and FSA to reconcile all relevant information received by either agency from a farmer who obtains crop insurance coverage.

Using FSA data, we examined the extent to which (1) farming operations report all members who have a substantial beneficial interest in the operation, (2) these farming operations file questionable crop insurance claims, and (3) agents or claims adjusters had financial interests in the claim.⁹ By comparing RMA's and FSA's databases, we found that 21,310 farming entities, or about 31 percent of all farming entities, did not report one or more members who held a beneficial interest of 10 percent or more in the farming operation holding the policy. RMA should be able to recover a portion of these payments because, according to RMA regulations, if the policyholder fails to disclose an ownership interest in the farming operation, the policyholder must repay the amount of the claims payment that is proportionate to the interest of the person who was not disclosed.¹⁰ According to our analysis, RMA should be able to recover up to \$74 million in claims payments for 2003. USDA has since implemented our recommendation that FSA and RMA share information on policyholders to better identify fraud, waste, and abuse. In addition, of the 21,310 entities failing to disclose ownership interest in 2003, we found 210 entities with suspicious insurance claims totaling \$11.1 million. Finally, we identified 24 crop insurance agents who sold policies to farming entities in which the

⁹The Center for Agribusiness Excellence conducted this analysis at our request. The Center, located at Tarleton State University in Stephenville, Texas, provides research, training, and resources for data warehousing and data mining of agribusiness and agriculture data. The Center provides data mining of crop insurance data for RMA.

¹⁰7 C.F.R. § 457.8.

agents held a substantial beneficial interest but failed to report their ownership interest to RMA as required. USDA initially implemented our recommendation, and FSA and RMA shared information on policyholders in 2006 to better identify fraud, waste, and abuse. However, since then, the agencies have stopped sharing this information while issues related to producer privacy are resolved.¹¹ Furthermore, RMA has not implemented our recommendation to recover claims payments to ineligible farmers or to entities that failed to fully disclose ownership interest.

RMA was not effectively overseeing insurance companies' quality assurance programs. RMA guidance requires insurance companies to provide oversight to properly underwrite the federal crop insurance program, including implementing a quality control program, conducting quality control reviews, and submitting an annual report to FCIC. However, RMA was not effectively overseeing insurance companies' quality assurance programs, and for the claims we reviewed, it did not appear that most companies were rigorously carrying out their quality assurance functions. For example, 80 of the 120 insurance files we reviewed claimed more than \$100,000 in crop losses or met some other significant criteria; RMA's guidance states that the insurance provider must conduct a quality assurance review for such claims. However, the insurance companies conducted reviews on only 59 of these claims, and the reviews were largely paper exercises, such as computational verifications, rather than comprehensive analysis of the claim. RMA did not ensure that companies conducted all reviews called for under its guidance and did not examine the quality of the companies' reviews. RMA agreed with our recommendation to improve oversight of companies' quality assurance programs, but we have not yet followed up with the agency to examine its implementation.

RMA has infrequently used its new sanction authority to address program abuses. RMA had only used its expanded sanction authority granted under ARPA on a limited basis. It had identified about 3,000 farmers with suspicious claims payments—notable policy irregularities compared with other farmers growing the same crop in the same county—each year since the enactment of ARPA. While not all of these policies with suspicious claims were necessarily sanctionable, RMA imposed only

¹¹According to an RMA official, FSA must provide a notice of routine use to producers that states that information they provide related to their participation in commodity programs may be shared with RMA. This is not one of the routine uses currently listed in the relevant regulation.

114 sanctions from 2001 through 2004. According to RMA officials, RMA requested and imposed few sanctions because it had not issued regulations to implement its expanded authority under ARPA. Without regulations, RMA had not established what constitutes an “FCIC requirement” and not explained how it would determine that a violation had occurred or what procedural process it would follow before imposing sanctions. RMA agreed with our recommendation that it promulgate regulations to implement its expanded authority, and issued proposed regulations on May 18, 2007 for public comment. Once final, these regulations will allow the agency to fully use this authority to sanction program violators.

RMA’s Regulations and Some Statutory Requirements Hinder Efforts to Reduce Abuse in the Crop Insurance Program

While RMA can improve its day-to-day oversight of the federal crop insurance program in a number of ways, the program’s design, as laid out in RMA’s regulations or as required by statute, hinders the agency’s efforts to administer certain program provisions in order to prevent fraud, waste, and abuse, as the following discussion indicates.

RMA’s regulations allow farmers the option of insuring their fields individually rather than combined as one unit. Farmers can insure production of a crop on an individual field (optional units) or all their fields as one unit. Farmers may want to insure fields separately out of concern that they could experience losses in a certain field because of local weather conditions, such as hail or flooding. If farmers instead insure their entire crop in a single basic insurance unit, the hail losses might not cause the production yield of all units combined to be below the level guaranteed by the insurance and, therefore, would not warrant an indemnity payment. Although insurance on individual fields provides farmers added protection against loss, this optional unit coverage increases the potential for fraud and abuse in the crop insurance program.

Insuring fields separately enables farmers to “switch” production among fields—reporting production of a crop from one field that is actually produced on another field—either to make false insurance claims based on low production or to build up a higher yield history on a particular field in order to increase that field’s eligibility for higher future insurance guarantees. We reported that of the 2,371 farmers identified as having irregular claims in 2003, 12 percent were suspected of switching production among their fields.

According to a 2002 RMA study, losses per unit (e.g., a field) increase as the number of separately insured optional units increases.¹² However, according to an RMA official, gathering the evidence to support a yield-switching fraud case requires considerable resources, especially for large farming operations. RMA disagreed with our recommendation to reduce the insurance guarantee or eliminate optional unit coverage for farmers who consistently have claims that are irregular in comparison with other farmers growing the same crop in the same location. It stated that our recommendation represents a disproportionate response, considering the small number of producers who engage in yield switching each year, and that the adoption of our recommendation would not be cost effective. Nevertheless, we continue to believe that RMA could tailor an underwriting rule so that it would target only a few producers each year and would entail few resources. Such a tool would provide RMA another means to discourage producers from abusing the program.

Minimal risk sharing on some policies, as set by statute, may not provide insurance companies with a strong incentive to carry out their responsibilities under the program. In some cases, insurance companies have little incentive to rigorously challenge questionable claims. Insurance companies participating in the crop insurance program share a percentage of the risk of loss or opportunity for gain on each insurance policy they write, but the federal government ultimately bears a high share of the risk. Under the SRA, insurance companies are allowed to assign policies to one of three risk funds—assigned risk, developmental, or commercial. The SRA provides criteria for assigning policies to these funds. For the assigned risk fund, the companies cede up to 85 percent of the premium and associated liability for claims payments to the government and share a limited portion of the gains or losses on the policies they retain. For the developmental and commercial funds, the companies cede a smaller percent of the premium and associated liability for claims payments to the government.

Economic incentives to control program costs associated with fraud, waste, and abuse are commensurate with financial exposure. Therefore, for policies placed in the assigned risk fund, companies have far less financial incentive to investigate suspect claims. For example, in one claim file we reviewed, an insurance company official characterized the farmer

¹²Final Research Report For Multiple Year Coverage, Task Order # RMA-RED-01-06, Watts and Associates, Inc., June 27, 2002.

as filing frequent, questionable claims; however, the company paid a claim of over \$500,000. The official indicated that if the company had vigorously challenged the claim, the farmer would have defended his claim just as vigorously, and the company would have potentially incurred significant litigation expenses, which RMA does not specifically reimburse. With this cost and reimbursement structure, in the company's opinion, it was less costly to pay the claim.

RMA and insurance companies have difficulty determining potential abuse associated with statutory coverage for prevented planting. Under the Federal Crop Insurance Act, as amended, RMA must offer prevented planting coverage. RMA allows claims for prevented planting if farmers cannot plant owing to an insured cause of loss that is general in the surrounding area and that prevents other farmers from planting acreage with similar characteristics. Claims for prevented planting are paid at a reduced level, recognizing that farmers do not incur all production costs associated with planting and harvesting a crop. However, determining whether farmers can plant their crop may be difficult. Annually, RMA pays about \$300 million in claims for prevented planting.

Statutorily high premium subsidies may inhibit RMA's ability to control program abuse. ARPA increased premium subsidies—the share of the premium paid by the government—but this increase may hamper RMA's ability to control program fraud, waste, and abuse. Premium subsidies are calculated as a percentage of the total premium, and farmers pay only between 33 to 62 percent of the policy premium, depending on coverage level. High premium subsidies shield farmers from the full effect of paying higher premiums. Because premium rates are higher in riskier areas and for riskier crops, the subsidy structure transfers more federal dollars to those who farm in riskier areas or produce riskier crops.

In addition, by regulation, premium rates are higher for farmers who choose to insure their fields separately under optional units, rather than all fields combined, because the frequency of claims payments is higher on the separately insured units. Again, however, because of high premium subsidies, farmers pay only a fraction of the higher premium. Thus, the subsidy structure creates a disincentive for farmers to insure all fields combined. Over one-half (56 percent) of the crop insurance agents responding to the survey conducted for our 2005 report believed that charging higher premiums for farmers with a pattern of high or frequent claims would discourage fraud, waste, and abuse in the crop insurance program. In our 2006 testimony, we stated that Congress may wish to consider allowing RMA to reduce premium subsidies—and hence raise the

insurance premiums—for farmers who consistently have claims that are irregular in comparison with other farmers growing the same crop in the same location. To date, no action has been taken.

Compensation to Insurance Companies Has Been Excessive

From 1997 through 2006, USDA paid over \$10.9 billion to companies that participate in the federal crop insurance program in cost allowances and underwriting gains, as table 1 shows. The \$10.9 billion in total payments to the companies represents 42 percent of the government's cost of the crop insurance program—about \$26 billion—over this period. That is, more than 40 cents of every dollar the government spent on the federal crop insurance program went to the companies that deliver the program, while less than 60 cents went to farmers. While we provide 10 years of data to offer a broad perspective and to even out annual losses and gains, the most recent 5 years of data—2002 to 2006—show similar results.

Table 1: Cost Allowances and Underwriting Gains Paid to Insurance Companies, and Government Costs, 1997 through 2006

Dollars in millions

Year	Payments to insurance companies			Government cost for the crop insurance program ^a
	Company cost allowance	Company underwriting gain (loss)	Total payments to insurance companies	
1997	\$437.8	\$352.1	\$789.9	\$1,095.9
1998	443.3	279.2	722.5	1,373.8
1999	500.7	271.8	772.5	1,782.7
2000	552.1	267.8	819.9	2,175.1
2001	642.0	345.9	987.9	3,162.6
2002	625.9	(47.5)	578.4	3,465.6
2003	733.9	377.9	1,111.8	3,588.7
2004	890.0	691.9	1,581.9	3,125.7
2005	829.6	916.2	1,745.8	2,698.5
2006	949.8	885.9	1,835.7	3,462.0
Total—1997 to 2006	\$6,605.1	\$4,341.2	\$10,946.3	\$25,930.6
Total—2002 to 2006	\$4,029.2	\$2,824.4	\$6,853.6	\$16,340.5

Source: GAO's analysis of RMA's data.

Notes: (1) Cost data are reported on a fiscal year basis. (2) Payments to companies are reported on a crop year basis. (3) Totals may not add due to rounding.

^aGovernment costs also include total indemnities and other administrative and operating expenses, including certain costs for research, development, and other activities. This total is reduced by the premiums and administration fees that farmers pay.

As discussed earlier, USDA pays both underwriting gains and cost allowances, as negotiated in the SRA. Since the crop insurance program was revised under ARPA—that is, from 2002 through 2006—USDA has paid the insurance companies a total of \$2.8 billion in underwriting gains. In terms of profitability, these underwriting gains represent an average annual rate of return of 17.8 percent over this 5-year period.¹³ According to industry statistics, the benchmark rate of return for U.S. insurance companies selling private property and casualty insurance was 6.4 percent during this period.¹⁴ RMA officials told us that this benchmark rate can be considered a starting point for measuring the appropriateness of the underwriting gains in the crop insurance program. However, they stated that this program should have a somewhat higher rate of return because of the (1) high volatility of underwriting gains for this program compared with the relatively steady gains associated with the property and casualty insurance industry, and (2) lack of investment opportunities when participating in the program because premiums are paid to the companies at harvest, not when farmers purchase a policy. But these officials also said that current rates of return are excessive. USDA renegotiated the financial terms of its SRA with the companies beginning with the 2005 planting season. In 2005, USDA paid the insurance companies underwriting gains of \$916 million—a rate of return of 30.1 percent. In 2006, USDA paid them underwriting gains of \$886 million—a rate of return of 24.3 percent. The companies received these underwriting gains despite drought conditions in parts of the country in 2005 and 2006. Adverse weather conditions, such as drought, normally suggest that insurance companies would earn lower profits because of greater producer losses.

In addition to underwriting gains, RMA pays companies a cost allowance to cover program delivery expenses. The allowance is calculated as a percentage of total premiums on the insurance policies that they sell. Because the cost allowance is not tied to specific expenses, the companies can use the payments in any way they choose. From 2002 through 2006, USDA paid the insurance companies over \$4 billion in cost allowances.

¹³Similarly, over the 10-year period, from 1997 through 2006, USDA paid companies participating in the crop insurance program underwriting gains of \$4.3 billion, which represents an average annual rate of return of 17.8 percent.

¹⁴*Best's Aggregates and Averages: Property/Casualty, United States and Canada*. (Oldwick, New Jersey: 2006). According to this publication, the benchmark rate of return for property and casualty insurance for the 10-year period ending in 2005 (the most recent year data were available) was 6.9 percent. For calculating the rate of return, we used Best's ratio of pre-tax operating income to net premium earned.

Because the cost allowance is a percentage of the premiums, it also increases when the value of policies companies sell increases, as it does when crop prices rise. For example, USDA expects the value of policies, and thereby the cost allowances paid to companies, to increase by about 25 percent from 2006 through 2008. USDA expects these higher policy values, and ultimately higher cost allowances, because of external factors, including higher crop prices, particularly for corn and soybeans. Consequently, the companies and their affiliated sales agents will receive substantially higher cost allowances without any corresponding increase in expenses for selling and servicing the policies. Substantially higher cost allowances provide these companies and their agents with a kind of windfall. Greater insurance coverage results in higher premiums and ultimately higher cost allowances; yet, the purpose of this allowance is to reimburse program delivery expenses.

In this context, USDA has requested the authority to renegotiate the SRA in its proposals for the Farm Bill. Specifically, USDA recommends renegotiating the SRA financial terms and conditions once every 3 years. According to USDA, the crop insurance program's participation has grown significantly since the implementation of ARPA. Because higher participation rates have resulted in more stable program performance, the reinsured companies have enjoyed historically large underwriting gains in the last 2 years of the program. Granting USDA authority to renegotiate periodically would also permit USDA to renegotiate the SRA if the reinsured companies experience an unexpected adverse impact.

Conclusion

In conclusion, Mr. Chairman, federal crop insurance plays an invaluable role in protecting farmers from losses due to natural disasters, and the private insurance companies that participate in the program are integral to the program's success. Nonetheless, as we mentioned before, we identified crop insurance as an area for oversight to ensure that program funds are spent as economically, efficiently, and effectively as possible. Furthermore, a key reason that we identified crop insurance, as well as other farm programs, for oversight is that we cannot afford to continue business as usual, given the nation's current deficit and growing long-term fiscal challenges.

RMA has made progress in addressing fraud, waste, and abuse, but the weaknesses we identified in program management and design continue to leave the crop insurance program vulnerable to potential abuse. Furthermore, as our work on underwriting gains and losses has shown, RMA's effort to limit cost allowances and underwriting gains by

renegotiating the SRA has had minimal effect. In fact, it offers insurance companies and their agents a windfall. We believe that the crop insurance program should be delivered to farmers at a reasonable cost that does not over-compensate insurance companies participating in the program. A reduced cost allowance for administrative and operating expenses and a decreased opportunity for underwriting gains would potentially save hundreds of millions of dollars annually, yet still provide sufficient funds for the companies to continue delivering high-quality service while receiving a rate of return that is closer to the industry benchmark.

Congress has an opportunity in its reauthorization of the Farm Bill to provide USDA with the authority to periodically renegotiate the financial terms of the SRA with the insurance companies so that the companies' rate of return is more in line with private insurance markets. Such a step can help position the nation to meet its fiscal responsibilities.

Mr. Chairman, this concludes my prepared statement. I would be happy to respond to any questions that you or other Members of the Subcommittee may have.

Contact and Staff Acknowledgments

Contact points for our Offices of Congressional Relations and Public Affairs may be found on the last page of this testimony. For further information about this testimony, please contact Robert A. Robinson, Managing Director, Natural Resources and Environment, (202) 512-3841 or robinsonr@gao.gov, or Lisa Shames, Director, Natural Resources and Environment, (202) 512-3841 or shamesl@gao.gov. Key contributors to this testimony were James R. Jones, Jr., Assistant Director; Thomas M. Cook; and Carol Herrnstadt Shulman.

Related GAO Products

Crop Insurance: Continuing Efforts Are Needed to Improve Program Integrity and Ensure Program Costs Are Reasonable. GAO-07-819T. Washington, D.C.: May 3, 2007.

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United States Government Accountability Office
Washington, DC 20548

June 18, 2007

The Honorable Bob Etheridge
Chairman
The Honorable Jerry Moran
Ranking Member
Subcommittee on General Farm Commodities and Risk Management
Committee on Agriculture
House of Representatives

The Honorable Jim Marshall
House of Representatives

On June 7, 2007, we testified before your Subcommittee on the reasonableness of compensation paid to companies participating in the federal crop insurance program.¹ In our testimony we concluded that underwriting gains and cost allowances paid to these companies by the Federal Crop Insurance Corporation (FCIC) are excessive and should be reduced to more closely reflect returns earned by companies in the private property and casualty insurance industry. Another witness at the hearing, G.A. (Art) Barnaby, Jr., Ph.D. testified that the crop insurance program is delivered as efficiently as selected property and casualty lines of insurance and, as such, suggested underwriting gains in the program are not excessive. Because of these differing views, you asked us to critique the analysis presented and conclusions reached in Dr. Barnaby's testimony of June 7, 2007.

In our testimony, we measure reasonableness of underwriting gains in terms of return on retained premiums.² Retained premiums represent the premiums on which crop insurance and private property and casualty companies bear risk for paying claims. We believe this is the most appropriate measure for gauging the relative profitability of crop insurance compared with private lines of insurance, given available information. According to USDA's Chief Economist, FCIC uses a methodology similar to our analysis.

¹ GAO, *Crop Insurance: Continuing Efforts Are Needed to Improve Program Integrity and Ensure Program Costs Are Reasonable*, GAO-07-944T (Washington, D.C.: June 7, 2007).

² A key measure of profitability is return on equity (net income divided by shareholder equity) using financial statements prepared in accordance with generally accepted accounting principles. However, such information is not available because most companies participating in the federal crop insurance program are privately held or are subsidiaries of larger companies.

In contrast, to support his point of view, Dr. Barnaby did not directly measure the reasonableness of these gains. Instead, he presents two analyses—one on operating margins and a second on the frequency of claims—that we do not believe are as appropriate for this situation.³ With respect to the analysis of operating margins, these margins only partially explain rate of return and, hence, the reasonableness of underwriting gains. Operating margins show operational efficiency and not the amount of profit at the end of the crop year. We also believe Dr. Barnaby's analysis of operating margins contains several questionable assumptions. For example, he used the loss adjustment expenses of one insurance company to project the loss adjustment expenses of the all property and casualty insurance companies. Loss adjustment expenses are costs incurred by insurance companies to settle claims, such as fees for legal services and claims adjusters. Projecting loss adjustment expenses in this way assumes the company he examined is representative of the property and casualty insurance industry which is not necessarily the case. Nor does he explain how he selected the company as the basis for the projection.

Furthermore, Dr. Barnaby compares indemnity payments from automobile and homeowners insurance with those in crop insurance. In our view, this is a misleading comparison. Insurance regulators recognize that some lines of insurance, such as title insurance, have small indemnity payments but spend a greater portion of premium income on loss prevention. For these lines of insurance, a low percentage of the premium goes toward indemnity payments while a relatively high percentage of the premium goes toward loss adjustment and operating expenses. Conversely, other lines of insurance may pay more of the premium in indemnity payments but have lower loss adjustment and operating expenses. As such, a higher or lower percentage of the premium going toward indemnity payments does not necessarily mean that one line of insurance is more or less profitable than another. Nevertheless, Dr. Barnaby compares the percentage of premium going toward indemnity payments in the crop insurance program with auto and homeowner insurers without explaining why such a comparison is appropriate. Generally property and casualty insurance companies report losses and loss adjustment expenses together because they are closely related. We do not believe that separating them out as Dr. Barnaby has done is methodologically sound.

Finally, the analysis of operating margins does not consider the substantial role of government in supporting crop insurance companies. Not considering the extensive government role has the effect of overstating crop insurance expenses and, thus, understating operating margins. In contrast with other lines of insurance, the government incurs many expenses that do not have to be borne by the crop insurance companies, including setting premiums (rating) and developing loss adjustment procedures. Also, crop insurance companies do not pay premium taxes.⁴ The

³For purposes of this letter, we use the term "operating margin" as Dr. Barnaby does in his testimony, i.e., ratio of total dollars paid out in indemnities to total premium (i.e., sum of farmer paid premium, premium subsidy, company "underwriting gain," and administrative and operating reimbursement). However, in financial and business accounting, operating margin is the ratio of operating income to revenue.

⁴Many states levy several types of insurance premium taxes upon insurance companies. These taxes typically range from about 1 percent to 3 percent of total premiums on the policies a company writes.

fundamental differences between the operating margins of the crop insurance program compared with property and casualty lines of insurance, as shown in table 1, in our view make Dr. Barnaby's comparison misleading.

Table 1: Key Differences between Operating Margins of Companies that Provide Crop Insurance and Companies that Provide Property and Casualty Lines of Insurance

Federal crop insurance	Property and casualty insurance
Operating margins cited in the analysis include those of both FCIC and insurance companies	Operating margins include those of only private insurance companies
Operating margins, particularly underwriting gains to the companies, are calculated <u>after</u> reinsurance from FCIC	Operating margins are calculated <u>before</u> any type of reinsurance is recognized
FCIC incurs many program costs that are not incurred by companies, including setting premiums (rating) and developing loss adjustment procedures	All costs for property and casualty insurance are incurred by the insurance companies, including premiums (rating) and developing loss adjustment procedures
Companies do not pay premium taxes to states	Premium taxes to states are paid from operating margins by property and casualty insurance companies*
Companies do not experience cash out-flow for indemnity payments*	Companies experience cash out-flow for indemnity payments*

Source: GAO.

*Under the Standard Reinsurance Agreement, a company may ask FCIC to reimburse it for indemnity payments through an escrow account that causes the company to experience no cash out-flows.

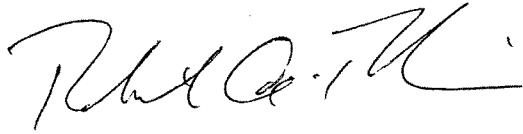
In his second analysis, Dr. Barnaby compares the frequency of claims on crop insurance policies with those in automobile, homeowners, and private crop-hail insurance and concludes that crop insurance has more claims than these other lines of insurance. For example, for crop insurance, the analysis uses the percent of policies with a claim, but for automobile insurance it uses the percent of cars with a claim. We do not believe this comparison is appropriate. Because many automobiles are insured under policies that cover more than one car, the analysis understates frequency of claims for automobile policies. In addition, he compares crop insurance, which protects farmers against losses caused by, among other things, drought, disease, or a decline in revenue, with private crop-hail insurance which protects farmers against losses caused by only hail and concludes the frequency of claims is higher for crop insurance than for crop-hail insurance. However, the analysis provides no support for why the frequency of claims for these lines of insurance should be comparable or how this analysis relates to reasonableness of underwriting gains in the crop insurance program.

We also testified that USDA expects the value of crop insurance policies, and thereby the cost allowances paid to companies, to increase by about 25 percent from 2006 through 2008 because of external factors, including higher crop prices, particularly for corn and soybeans. In subsequent discussions, Dr. Barnaby agreed with our conclusion that higher prices for some crops will result in substantially higher cost allowances paid to companies participating in the crop insurance program beginning in 2007. Dr. Barnaby also agrees that the companies and their affiliated sales agents will receive substantially higher cost allowances without any corresponding increase

in expenses for selling and servicing the policies. Because of substantially higher cost allowances, these companies and their agents, in effect, receive a windfall.

In conclusion, while there are numerous analyses that unfortunately can serve to cloud any evaluation of the crop insurance program, the fact remains that USDA paid about \$11 billion to crop insurance companies in underwriting gains and cost allowances from 1997 through 2006 which represent 42 percent of the government's cost of the crop insurance program. That is, more than 40 cents of every dollar the government spent on the federal crop insurance program went to the companies that deliver the program, while less than 60 cents went to farmers. In the most recent years this proportion is tilted even more heavily in favor of the crop insurance companies. Also, in part because of the excessive compensation paid to crop insurance companies, the program incurs nearly \$2 in administrative expenses to deliver \$1 dollar in net benefits to farmers—clearly a very inefficient way to deliver benefits. As the Congress considers options for future crop insurance program operations, we believe these fundamental facts need to be kept foremost in mind. We believe that the crop insurance program should be delivered to farmers at a reasonable cost that does not over-compensate companies participating in the program.

If I can be of further assistance to you or your staff, please contact me at (202) 512-3841.

A handwritten signature in black ink, appearing to read "Robert A. Robinson". The signature is fluid and cursive, with a large initial "R" and "A".

Robert A. Robinson
Managing Director, Natural Resources
and Environment



Independent Insurance Agents

Brokers of America, Inc.



**SUBMITTED TESTIMONY OF THE INDEPENDENT INSURANCE AGENTS &
BROKERS OF AMERICA BEFORE THE HOUSE AGRICULTURE
COMMITTEE, SUBCOMMITTEE ON GENERAL FARM COMMODITIES AND
RISK MANAGEMENT REGARDING THE
FEDERAL CROP INSURANCE PROGRAM
June 7, 2007**

The Independent Insurance Agents & Brokers of America, Inc. (IIABA) presents the following testimony to the United States House of Representatives Committee on Agriculture, Subcommittee on General Farm Commodities and Risk Management concerning the Federal Crop Insurance Program (FCIP). IIABA is the nation's oldest and largest national trade association of independent insurance agents, and represents a network of more than 300,000 agents and agency employees nationwide. IIABA members are small businesses that offer customers a choice of policies from a variety of insurance companies. Independent agents offer all lines of insurance – property, casualty, life, health, employee benefit plans and retirement products. We appreciate the opportunity to provide our perspective today on the importance independent agents play in the delivery of the Federal Crop Insurance Program (FCIP).

Private Delivery of the Federal Crop Insurance Program

From 1938 until 1981, the USDA was solely responsible for delivering the federal crop insurance program. Beginning in 1981 and continuing until the late 1980s, Congress began a transition period when the federal crop insurance program was delivered both by USDA, through a structure known as “master marketers,” as well as

private sector companies, through a structure known as the “standard reinsurance agreement” (SRA).

In mandating this transition, Congress recognized that “the sales talents and experience of the private sector commissioned agents . . . are essential to fulfilling the goal of nationwide, generally accepted all-risk insurance protection.” As a result of this demonstrated talent, Congress rested upon the agents' shoulders the “large burden of program delivery” and “providing full service to the client” including, but not limited to, sales.

Crop Insurance agents have proved instrumental in achieving the program’s goal of helping farmers make well-informed risk assessments and choices about the coverage that they purchase. These agents are knowledgeable about the technicalities of the crop insurance program and skilled at assisting farmers with concerns that directly impact their coverage, such as unit structures and yield guarantee weaknesses. They also have the training and experience necessary to encourage participation of small, limited resource and minority producers, as required under the Standard Reinsurance Agreement (SRA).

A study released in September, 1989, by Arthur Andersen & Company concluded that USDA experienced delivery costs twice the amount of the private sector participants, on average. Specifically, the study reported that for 1987 total delivery cost by private sector companies equaled 43.17 percent of premium while for master marketers the total was 85.30 percent. This finding and other factors supported a move by Congress to transition to sole delivery of the federal crop insurance program by private sector insurance companies and agents.

This move by Congress to the delivery of the FCIP through the private sector insurance companies and agents occurred as a result of legislation passed in 1994. Since then, the take-up rates and the insured acres increased dramatically, with total net acres insured having increased from about 83 million in 1993 to about 242 million in 2006. Crop insurance agents are proud to have been a partner in the successful expansion of this invaluable program for farmers.

Commodity Prices Are Cyclical

There has been much interest in the fact that agent's commissions are tied directly to the premiums paid for the crop insurance policies sold, and we understand given the current high prices of many commodities why that would be the case. However, it is important to remember that prices for agricultural commodities, and therefore the premiums that they are charged, are by nature cyclical. Agriculture commodities have a long and uninterrupted history of moving both up and down. While today's prices may be relatively high, that does not in turn mean that prices yesterday, tomorrow, or in 1 to 5 years were or will be the same amount. That argument holds true with premiums, and agent commissions, as well.

Further, as a policy goal, Congress has for years tried to encourage producers to self-insure at higher levels than they traditionally have. As the sales force of the Federal Crop Insurance Program, whom Congress and the USDA rely on to sell the product to sometimes reluctant producers, it makes policy, and economic, sense to have the agents rewarded on a commission basis. Farmers today certainly have the option this year of lowering their crop insurance coverage with prices high, agents should be rewarded for convincing the farmer to continue to insure at high levels.

Agent Workload

Unlike the property-casualty industry, a crop agent's responsibilities require a much more hands-on approach, which invariably increases the threshold for errors and omissions (E&O) exposure. On average, with advance meeting preparation, travel, and meeting time, an agent spends approximately 7 hours on a policy during the sales window alone. A transaction typically begins with the agent quoting the multitude of different plans of insurance available (as many as 247 in some states) and then explaining production reporting and supporting record requirements to the farmer. He or she explains different date requirements by crop and by coverage for application, the actual production history (APH), the acreage report, the farmer's options and claims. He completes APH-related forms for the farmer, calculates preliminary yields, reviews production early to determine if there is a revenue loss, reviews the APH form for completeness and accuracy, and forwards the signed form and any applicable worksheets to the company. The agent then must review approved APH from the company to ensure accuracy, explain approved APH yields to the farmer, and provide him with a copy.

Additionally, the agent is responsible for implementing procedures for Preventive Planting, Yield Adjustment, Unit Division changes, Power of Attorney requirements, or any of the other technical policy provisions. Everything listed above goes into writing the policy – and doesn't even factor in what transpires should the farmer experience a loss, which occurs more often than any other line of insurance.

Compared to the sale of life, homeowner's, or auto insurance, the sale of crop insurance is indeed extremely complex and tedious. Life, Auto, and Homeowner's each

only require one form (application) to file, and the claims made on those products are relatively rare.

For an example of just how much work goes into writing a crop insurance policy, consider the attachment labeled Appendix 1, which is a list of agent responsibilities, just for APH Reporting, taken directly from RMA's 2006 Crop Insurance Handbook.

Conclusion

The IIABA thanks the Committee for allowing us to present this written testimony at today's hearing, and we would be happy to work with this Committee at any time to further explain the vital role that crop insurance agents play in the Federal Crop Insurance Program (FCIP). We also note that the Chairman and Ranking Member of the House Oversight and Government Reform Committee have requested that the Government Accountability Office (GAO) examine the financial relationship between crop insurance companies, agents, and farmers, and we look forward to working with the GAO on this examination and providing them with our input on this issue.

As this Committee and Congress consider the 2007 Farm Bill, it is imperative that any and all proposals keep in mind the strength and security that the FCIP has brought to American farmers, and the role that independent insurance agents have in turn had in the success of the FCIP. In particular, we ask that the Committee take into account the increased efficiency of the private delivery of the FCIP over direct government sales, the cyclical nature of agriculture commodities, and the extraordinary workload crop insurance agents face as compared to other property and casualty insurance lines. The strength of the FCIP rests upon the partnership that exists between the Government,

insurance providers, agents, and farmers. We commend this Committee for continuing to examine ways to improve both these partnerships and the program, and we look forward to continuing to work with the Committee in this effort.

Appendix 1 (from RMA's 2006 Crop Insurance Handbook)

5A Agents/Representatives Are Responsible For:

A(1) **Explaining production reporting and supporting record requirements** to producers.

A(2) **Assisting producers in the completion of APH related forms.** When necessary, agents/representatives will assist producers in the completion of:

(2)(a) APH Forms. An APH form is required for each unit (by P/T/V when applicable) and crop year for which acceptable supporting records are available.

(2)(b) Producer's Pre-Acceptance Worksheets, when required for perennial crops and Underwriting Reports.

(2)(c) APH Block Production and Weighted Average T-Yield Worksheet (Category C only), when required for perennial crops. [See Sec. 7, Par. I (1), (2), (3).]

A(3) **Calculating Preliminary Yields.** For **NEW** insureds, for all APH crops agents/representatives **MUST** compute, quote, and enter preliminary yields on the APH form. Explain to insureds that:

(3)(a) For approved yields issued by AIPs, an insured may submit a written request to the AIP for reconsideration if the approved APH yield calculated by the verifier is less than 95 percent of the preliminary yield on ANY unit [See Sec. 11, for instructions]; or for cancellation of the entire crop policy (by county).

(3)(b) For approved APH yields issued by the RMA RO, if the approved APH yield is lower than the preliminary yield, the insured may request review of the approved APH yield through mediation, administrative review (formerly reconsideration) by RMA, or appeal to the National Appeals Division (NAD). [See Sec. 11, for additional information and Exhibit 12 for NAD Area Offices.]

A(4) **Informing insureds that mutual consent cancellations are not allowed** for a crop year subsequent to the crop year the application was accepted (carryover insureds) if approved APH yields are not acceptable. A participant may request mediation, or administrative review (formerly reconsideration) by RMA or appeal to the NAD.

A(5) **Explaining administrative review of approved APH yield or Mutual Consent Cancellation Requirements.** Agents/representatives must inform insureds that requests for administrative review or cancellation of crop policies (requested under A(3) above) must be made within 30 calendar days of the date the approved APH yield was mailed or otherwise made available to the insured. If the RMA RO makes an adverse decision, mediation, administrative review, mutual consent cancellation, agency appeal and/or NAD appeal rights are provided. If such a request is not made timely, it will be rejected and the approved APH yield(s) will be considered accepted by the insured for administrative review or mutual consent cancellations must be forwarded to the verifier no later than three calendar days after their receipt by the agent/representative as indicated below:

(5)(a) APH yields approved by the RMA RO. Administrative review requests must be referred to the RMA RO if the RMA RO approved the APH yield. Utilization of the agency's informal administrative review process will not prejudice the insured's right to subsequently request agency appeal, mediation, and/or NAD appeal. If during a administrative review an adverse decision is rendered (by the RMA RO), mutual consent cancellation (if applicable), mediation, agency, and/or NAD Appeal Rights must be provided.

(5)(b) Reconsiderations of APH yields approved by AIPs are made to the AIP. AIPs may correct errors in yield computation or in the application of RMA approved standards. Corrections will not be subject to additional reconsideration.

A(6) **Reviewing the APH form** for completeness and accuracy and obtaining the insured's signature and date.

A(7) **Obtaining Supporting Production Records.** For insureds establishing an APH yield history (database) who elect to provide records for verification rather than be subjected to an APH tolerance review, agents/representatives must forward copies of supporting records to the verifier. Insureds who provide records are subject to APH field reviews associated with program, conflict of interest, simplified claims, consecutive loss adjuster, and large claims reviews and during the investigation of suspected misrepresentation, fraud, waste and abuse. [See Appendix IV of the Standard Reinsurance Agreement for review information.]

A(8) **Forwarding the signed APH forms and any applicable worksheets** to the AIP within 10 calendar days of completion, but not later than 10 calendar days after the production reporting date. APH forms signed after the production reporting date are not timely filed and are not acceptable.

A(9) **Forwarding requests for inspections** for ALL Category C APH (perennial crops) to the applicable AIP's representative, no later than 10 calendar days after the PRD. [See Sec. 7 Par. G for the perennial crop pre-acceptance inspection form and instructions.]

A(10) **Explaining Approved APH Yields.** Upon receipt of the approved APH yield, the agent/representative must be able to:

(10)(a) Explain the approved APH yield(s) and determine production guarantees(s).

(10)(b) Explain premium provisions and, if applicable, premium discount and compute the premium.

(10)(c) Verify insurance units and explain appropriate provisions.

(10)(d) Administer and explain to the insured yield limitations, yield floors, yield adjustments, yield reductions (for actual yields that exceed RMA's maximum yield edits and inconsistent approved APH yields when acreage limitations are exceeded), record requirements, misreporting penalties and that assigned yield provisions will apply for subsequent APH crop years if production reports are not provided.

(10)(e) File and maintain copies of the APH form.

A(11) **Updating APH databases** when insureds do not supply acceptable production reports for APH purposes.

(11)(a) When necessary, determine the correct T-Yield(s) from the applicable County Actuarial Table to be used for APH yield calculation purposes.

(11)(b) Determine preliminary APH yields according to RMA approved standards. [See Sec. 6 for annual crops and Sec. 7 for perennial crops.]

(11)(c) Assign basic units according to those allowed in the policy. [See Sec. 4, D(3).]

(11)(d) Administer assigned yield provisions for carryover insureds (Category B and C crops).

(11)(e) Follow applicable New Producer procedures for insureds qualifying as "new producers."

A(12) **Determining the correct unit structure for added land.** If additional cropland is purchased or rented after the production reporting date, it may be added as a separate unit (provided it meets basic/optional unit requirements and production reporting requirements) or added as part of an existing unit, if applicable. [See Exhibit 36 for added land provisions for Category B crops.]

A(13) **Entering the prior crop year's approved APH yield** in the prior yield block on the APH form and identifying each yield in the database with the correct yield type descriptor [See Sec. 6 Par. D for annual crops and Sec. 7, Par. H(10) for perennial crops].

A(14) **Comparing current crop years' yield history on the APH form** received from the verifier to the yield history on the previous crop year's APH form. If the yield history does not agree, attach a copy of the previous crop year's APH form to the current crop year APH form and return it to the verifier for a corrected current crop year APH form.

A(15) **Retaining prior years' APH forms** for the insured in the insured's file folder.

A(16) **Incorporating corrections** resulting from APH reviews and/or corrected claims to APH databases and then transmitting corrected databases to the AIP for the applicable crop year.

A(17) **Referring requests for field visits for APH acreage and yield determinations** (appraisals, bin measurements, etc.) to the appropriate AIP's representative. [See Sec. 10, D for more information.]



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13 June 2007

Dear Chairman Etheridge and Ranking Member Moran,

I appreciated the opportunity to appear before you to provide insights about improving fraud detection that DeticaDFI has garnered through its professional engagements here and abroad. I was asked a question during the hearing about the difference between what data mining is and what DeticaDFI proposes. Although I answered the question, given that there appears to be continuing confusion in this area, I submit this letter for the record in an attempt to clarify.

Fraud is a rapidly changing, complex pattern of criminal behavior, which requires dynamic approaches to effectively detect and mitigate. This challenge is complicated further by the fact that not all unusual behavior or improper payments constitute actual fraud. Fraud detection also can surface honest errors or mistakes. Not only do these "false alarms" waste precious investigative resources, but they also place a burden on innocent victims that frequently are challenged to respond to these claims, which may require that these unintended targets secure legal defense resources at their own expense at a time when they also are dealing with a crop failure. Therefore, the balance required in an effective fraud detection program includes the need for analytical power, as well as fidelity to ensure that the number of false positive results is maintained within acceptable limits.

While methods and approaches for perpetrating fraud can be aggregated into certain categories based on general patterns of behavior or modus operandi (MO; e.g., identify theft), individual differences among those that perpetrate fraud also serve to impart sufficient complexity in the data to challenge even the most powerful programs of fraud detection. Moreover, as agencies work to ensure that they are serving the public's interest by reducing improper payments to the greatest degree possible, savvy individuals monitor these efforts and modify their behavior so as to avoid detection, thereby creating a "moving target" of improper or otherwise suspicious behavior. As a result, best practices in other insurance programs indicate that effective fraud detection programs must address the fact that the behavior of interest is complex and dynamic, and is complicated further by differing approach or MO, as well as by individual differences in method and approach.

Therefore, the short answer to the question that I was asked, is that anomaly detection is one form of statistical analysis or data mining that can be used to detect improper or fraudulent claims. Anomaly detection can be used to detect unusual patterns or relationships in data that fall outside of expected norms or behavior. Unfortunately, this type of analysis generally identifies events that have occurred already; after a sufficient amount of data have been collected to define "normal" patterns of behavior and transactions. In the case of RMA, these anomalies are added to a "spot check" list and the individuals involved receive a letter advising that they will be the subject of additional scrutiny. Unfortunately, per Administrator Gould's testimony, knowledge that an individual is being watched generally results in improved behavior while they are on the list, which begs the question whether the data mining is reducing

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13 June 2007
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fraud, of particular concern given that the Administrator also acknowledged that behavior changes again once the individual is notified that they are no longer being watched.

Of further concern is that some of the anomalies are in fact perfectly innocent behavior, but are nonetheless identified as requiring additional investigation. These instances are called "false positives", imposing burdens on the agency and the individual that might be better directed elsewhere. In general, with data mining, the investigator sets out with a specific hypothesis and looks for data points or patterns to verify that hypothesis and to explain what has already happened. The concern with using anomaly detection alone and in this manner is that it is retrospective. In terms of fraud, it only provides insight as to what has happened in the past, which essentially means dollars that have already gone out the door – the so-called, "pay and chase" model. In this case, the data mining is not even being used on a real time methodology. Traditional fraud detection methods also lose their value once the agency's business operations and processes become known, and cannot provide insights about who might be working in concert with others, or those who are intentionally altering their behaviors to stay within known and acceptable patterns of behavior; a problem that has been underscored both by the Inspector General's office and the General Accountability Office. For these reasons, anomaly detection and other data mining strategies, by themselves, are underinclusive in terms of the improper payments that they can and will detect.

In response to the complex and dynamic nature of fraud, DeticaDFI employs a comprehensive program to reduce improper payments that includes an array of complementary analytic strategies, which are based on best practices in other industries. One analytical strategy included in this approach is social network analysis. Increasingly, other industries are seeing growth in the number of highly sophisticated, organized rings or networks of individuals engaging in coordinated patterns of fraud. As a category of improper behavior, organized fraud rings distinguish themselves as being highly lucrative, with a relatively low risk of identification and associated consequences. Market sectors including the health care reimbursement domain have noted an increased prevalence of groups of individuals working together in highly organized networks, which employ increasingly sophisticated methods to perpetrate fraud, including the use of cooperating individuals, fictitious information, and/or aliases. These organized rings are able to evade detection by leveraging large, dispersed networks of individuals, relationships, information and claims. The loose relationships created by these very savvy individuals are extremely difficult to detect using traditional analytical methods and are used to mask large enterprises, which go well beyond the direct collusion models currently being monitored. Moreover, these organized fraud networks may intentionally keep claims below established detection thresholds (e.g., the 150% threshold for claim review established in ARPA); increasing the overall monetary yield of the fraud by adjusting the scale through multiple, ostensibly independent claims. Far from being simple "link analysis" tools, as they were referred to at the hearing, social network analysis models have been used very effectively in other insurance claim industries to surface the subtle and indirect relationships and patterns of behavior cultivated by these increasingly sophisticated and successful perpetrators of organized fraud, to identify suspicious or otherwise unusual relationships among loosely-related claims, and to discern patterns of behavior that are more likely to occur in the future with a high degree of statistical certainty and accuracy, prospectively and in real time.

This comprehensive approach brings at least three benefits: Increased fidelity of improper payment detection efforts and associated increase in ROI, increased efficacy and optimization of investigative resources, and reduced number of false positives. Again, fraud and other improper payments comprise a varied group of claims that range from simple errors in completing forms or filing claims to highly sophisticated patterns of fraud designed to slip past common, standard, or known methods of fraud detection. Differences in methods of fraud, as well as individual differences among those perpetrating fraud further add to the complexity of the fraud detection challenge, while patterns of fraud and improper payments as methods evolve and motivated criminals try to game the system. Therefore, leveraging an array of complementary strategies for improper payment detection increases the ability of an organization

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to detect the varied and diverse patterns; ultimately increasing the fidelity and depth of the overall program and its associated ROI.

DeticaDFI's comprehensive approach to reducing improper payments also generates results that can be used to optimize investigative resources and enhance investigative strategies; the different types of improper payments identified and patterns of fraud revealed may merit different or graded investigative responses. By optimizing resources, the personnel required for these investigations will be available when and where they are needed most, proactively investigating active, ongoing cases of organized fraud; rather than chasing improper payments already made. The increased information provided through a comprehensive program of improper payment detection can be used to guide the nature and level of response, further increasing the ROI by efficiently allocating resources.

False positives represent a waste of investigative resources and unnecessary burden to claimants that are already trying to address the loss associated with the claim. Thoughtful, comprehensive fraud detection programs include methods for the review, cross-validation, and analytical evolution necessary to significantly reduce the additional cost and burden of trying to defend a proper claim that has been flagged by overly aggressive, outdated or inaccurate decision rules. Moreover, reducing false positives through a comprehensive fraud detection program will reduce the likelihood that precious investigative resources will be misdirected from other, founded cases.

We hope that this provides greater clarity and are happy to provide any other information you would like.

Regards,

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DeticaDFI