RISK MANAGEMENT AGENCY
SERVICING OF CAT POLICIES
WASHINGTON, D.C.
AUDIT REPORT NO. 05099-6-KC

SEPTEMBER 1999

UNITED STATES DEPARTMENT OF AGRICULTURE
OFFICE OF INSPECTOR GENERAL - AUDIT
GREAT PLAINS REGION
P. O. BOX 293
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UNITED STATES DEPARTMENT OF AGRICULTURE

OFFICE OF INSPECTOR GENERAL

Washington D.C. 20250

DATE: September 30, 1999

REPLY TO
ATTN OF: 05099-6-KC

SUBJECT: Servicing of CAT Policies

TO: Kenneth D. Ackerman
Administrator
Risk Management Agency

ATTN: Garland Westmoreland
Deputy Administrator
for Compliance

This report presents the results of the subject audit. Your September 17, 1999, written comments on the draft report are included as exhibit E with excerpts and the Office of Inspector General's position incorporated into the relevant sections of the report. We appreciate your views regarding reasons for the high drop off rate of limited resource farmers in the crop insurance program. While your views as to the reasons why this occurred are somewhat different than ours, what is important is the recognition of the significant drop off rate, and moving forward with a plan of action to correct the problem. We also recognize that there are a number of factors that were instrumental in causing the significant drop off rate including the factors you cite in your response.

Regarding corrective action, you express disagreement with our Recommendation No. 1 which asked you to require reinsured companies to provide special servicing to limited resource producers who were flagged during the transfer of CAT policies. We are not sure for the reason for the disagreement since it is essentially what the Secretary required of the reinsured companies when he agreed that they would handle this portion of the crop insurance business and what the reinsured companies agreed to. Other parts of your response indicate some actions you plan to resolve the problem, but overall your response does not put forth a plan that will effectively deal with these issues. Therefore, we cannot reach management decisions on Recommendations Nos. 1, 2a, 2b, and 2c. For Recommendation No. 3a, your response seems to indicate that you have dealt with the problem, so we are not clear as to your reason for your non-concurrence. We need clarification on this issue. For Recommendation No. 3b, your response will be sufficient when you provide us with your plan and timetable for implementation of your action.

We recognize that you are working with Congress on a variety of ways to deal with some of the issues impacting limited resource farmers as noted in this report. We want to work with you to develop effective and achievable corrective actions for the issues described in this report, and request that you provide us with the results of your studies you refer to, and your more specific corrective action plans and timeframes to address each of the recommendations in this report.

In accordance with Departmental Regulation 1720-1, please furnish a reply within 60 days showing the corrective action taken or planned and the timeframes for completion of the recommendations. Please note that the regulation requires a management decision to be reached on all findings and recommendations within a maximum of 6 months from report issuance.

We appreciate the courtesies and cooperation extended to us during the audit.

JAMES R. EBBITT
Assistant Inspector General
for Audit

EXECUTIVE SUMMARY

RISK MANAGEMENT AGENCY SERVICING OF CAT POLICIES AUDIT NO. 05099-6-KC

PURPOSE

The audit was performed to assess the adequacy of servicing provided to policyholders who had Catastrophic Risk Protection (CAT) policies transferred in 1998 from Farm Service Agency (FSA) county offices (CO) to private reinsured companies. We initiated this review to evaluate the servicing of the CAT policies and follow up on conditions noted during a previous review.

CAT provides the most affordable kind of catastrophic crop coverage for producers. Producers with adequate resources can insure their crops for only $50 a crop, while producers with limited resources can receive the same protection for free.

RESULTS IN BRIEF

Our review of the final transfer of CAT policies showed that the program, as currently delivered, is allowing limited resource producers that had coverage in the past to slip away from the program and farm without crop protection. The participation of limited resource farmers declined about 78 percent in just 1 year, between 1997 and 1998, or the same period when reinsured companies assumed sole delivery of the CAT Program. Interviews with limited resource producers who dropped from the program revealed that over half of those who were still eligible for coverage had received inadequate servicing by the reinsured companies. We observed that the producers who remained in the program tended to be producers with larger acreages who could contribute more per policy to the reinsured companies' underwriting gains. From 1995 to 1998, the average farm size in the CAT program increased from 98 acres per policy to 155 acres per policy.

Generally, we question whether the CAT Program is a viable means of protection to farmers having catastrophic crop losses. Within our 8-State universe of 84,028 CAT Program policies, we estimate that only about 42,000 of the transferred policies were retained by the private reinsured companies.[1] Seventy-five of the producers surveyed said they cancelled their policies because they felt the servicing or coverage was inadequate. The shrinking enrollment,

[1] We are 95 percent confident that this estimate is within 12 percent of the true value.

however, appeared to have little effect on program delivery costs. From 1995 to 1998, reinsured companies received about $506 million for the delivery of CAT insurance while the producers they serviced only received about $250 million in CAT Program indemnities. In other words, even with the diminished enrollment, it cost over $2 to deliver the CAT Program for every $1 paid out to producers for crop losses.

We also found that RMA did not take an active role in monitoring the transfer and servicing of CAT Program policies. This concerns us because during the initial transfer of 1997 CAT policies, we had reported conditions similar to those we found again during this audit. RMA program officials had responded in 1998 that they planned a major evaluation of policyholder servicing during 1998 to help identify any servicing problems which needed to be addressed. However, our current audit showed that RMA did not conduct this evaluation and has not corrected the deficiencies we reported for the CAT Program.

On June 26, 1998, we also reported in a Management Alert that reinsured companies were not providing any special servicing to limited resource producers and that RMA had not provided any guidance to the companies on how to service the limited resource producers who were flagged during the transfer process. Again, RMA did not take any action to address the servicing of the limited resource producers.

Without improvements in the CAT Program, producer participation will likely continue to decline, and the effectiveness of the program as protection against catastrophic losses for producers, especially small and socially disadvantaged farmers, will diminish further.

KEY RECOMMENDATIONS

We recommend that RMA concentrate its efforts on improving the CAT Program policies, identifying ways of increasing producer participation, and evaluating reinsured company compensation in terms of program costs and effectiveness. Also, RMA needs to determine if an alternative CAT Program delivery system needs to be established, at least in areas without private agents and for producers who may not be serviced because of their small farming operations. As interim measures, RMA should require reinsured companies to provide special servicing to limited resource producers to ensure they are aware of the program benefits. In addition, we recommend that RMA follow up on policies cited in our review and, in the future, use audit recommendations and other management tools as a means to help ensure that assigned tasks, such as the transfer of the CAT policies, are accomplished effectively and in accordance with Secretarial directives.

AGENCY POSITION

In its written comments on the draft report (see exhibit E) RMA stated while instances of substandard service may have occurred, it believes that the quality of servicing of CAT policies by reinsured companies was not the primary reason why limited resource farmers moved away from CAT coverage but rather it was because of policyholders dissatisfaction with the product. RMA did generally agreed with our findings and recommendations or had taken some action to deal with the issues that were raised. However, RMA did not provide sufficient information for management decisions on the recommendations.

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INTRODUCTION

BACKGROUND

The Federal Crop Insurance Act, as amended by the Federal Crop Insurance Reform Act of 1994 (the Act), required the Federal Crop Insurance Corporation (FCIC) to implement a Catastrophic Risk Protection (CAT) Program for producers. The CAT Program provides the lowest level of coverage available to producers under the Act. The Federal Agriculture Improvement and Reform Act (FAIR) of 1996 created an independent office called the Risk Management Agency (RMA) with responsibility for the supervision of FCIC, and the administration and oversight of programs authorized under the Act.

For crop years 1995 through 1998, CAT provided coverage for a 50 percent loss in yield at 60 percent of the expected market price. For 1999 and subsequent years, producers will be offered coverage for a 50 percent loss in yield at 55 percent of the expected market price. Producers are charged $50 per crop in administrative fees for this protection. Producers with multiple crops pay no more than $200 per county and those farming in multiple counties never pay more than $600 for all crops. CAT coverage was initially offered through both reinsured companies and local Farm Service Agency (FSA) offices. Both delivery systems were authorized to waive the administrative fees for eligible limited resource producers.

The FAIR Act also provided for a change to a single delivery system. It authorized the Secretary to transfer CAT coverage from the FSA offices to private insurance companies, in a State or portion of a State, where there were sufficient numbers of these companies available to service the producers. For the 1997 crop year, the Secretary, in consultation with reinsured companies, approved 14 States for transfer to private insurance companies, including Arizona, Colorado, Illinois, Indiana, Iowa, Kansas, Minnesota, Montana, Nebraska, North Carolina, North Dakota, South Dakota, Washington, and Wyoming. RMA assigned 108,820 CAT policies to 15 reinsured companies in the 14 States.

In May 1997, the Secretary approved the transfer of CAT insurance in the remaining 36 States to private crop insurance agents, beginning with the 1998 crop year. The decision was made after reviewing the number of crop insurance agents in each State to ensure an adequate sales force was in place to provide all farmers with CAT coverage. Similar to the previous transfer, policies were randomly transferred to an insurance company, and producers could select another agent or company if they did so before the sales closing date. There were 126,512 CAT policies in 37 States transferred effective for the 1998 crop year, including 15 policies in Arizona that were not part of the first transfer.

OBJECTIVES

The primary objective of our review was to evaluate the adequacy of reinsured companies and agents' servicing of the CAT policies transferred in crop year 1998. Also, we assessed whether previous recommendations were addressed by RMA during the 1998 transfer process.

SCOPE

A random sample of 330 CAT policies that were transferred in 1998 to private insurance companies was statistically selected from an audit universe of 8 States with 84,028 transferred CAT policies, of which 8,144 policies were for producers who received an administrative fee waiver in 1997. The 330 policies were stratified equally between policies that were applicable to producers identified by FSA as either limited resource or nonlimited resource in each State. To achieve the audit objectives, we visited and/or contacted the RMA National Office; RMA Research and Development Division and Compliance Division Offices in Kansas City, Missouri; RMA Regional Service Offices in Jackson, Mississippi; Oklahoma City, Oklahoma; Topeka, Kansas; and Indianapolis, Indiana; and the Tennessee FSA State Office. We also visited five private reinsured companies in Overland Park, Kansas; Des Moines, Iowa; West Des Moines, Iowa; Council Bluffs, Iowa; and Anoka, Minnesota. In addition, we visited and/or contacted the customer service centers for one private insurance company in Bloomington, Illinois; Lexington, Kentucky; Amarillo, Texas; and Enfield, North Carolina. Personal or telephone contacts were made with 181 private insurance agents assigned to service the CAT policies. We also contacted 155 of the sampled policyholders by telephone, letter, or in person.

We also issued one management alert to advise RMA managers that reinsured companies were not providing any special servicing to limited resource producers, as agreed to in the decision memorandum approved by the Secretary on May 22, 1997. Although RMA had flagged the limited resource producers in the CAT policy files made available to the companies, it did not provide any guidance to the companies on the special servicing to be provided to the limited resource producers. As a result, little effort was made to address the needs of these producers.

The audit was conducted in accordance with <u>Government Auditing Standards</u>.

METHODOLOGY

We initially reviewed the servicing provided to CAT policyholders by interviewing RMA National and regional office personnel, and officials from five private reinsured companies. We then analyzed the distribution of the CAT policies applicable to the 36 States and decided to concentrate our audit efforts in areas with the largest concentration of CAT policies. Our analysis showed that eight States had over 60 percent of the transferred CAT policies and over 90 percent of the policies applicable to limited resource producers. Each State was stratified into two separate strata based on whether the policyholder was a limited resource or nonlimited resource producer.

The 330 sampled policies were statistically selected using a stratified simple random sampling scheme. The sample unit consisted of a CAT policy included in the 1998 transfer. The universe consisted of 84,028 CAT policies transferred in 8 States (see exhibit A). The universe was divided into 16 strata, and policies were selected in each stratum on a proportional basis according to the total policies in each stratum (see exhibit B).

We contacted 181 private insurance agents and personnel at 4 customer service centers to obtain a description of the policy assignment process, information on the level of servicing provided, and any comments or concerns they had regarding the servicing of CAT policies. In addition, we contacted 155 policyholders who had either cancelled their 1998 CAT coverage or were identified as a limited resource producer in 1997 who did not receive an administrative fee waiver in 1998. We obtained their reason(s) for cancelling their CAT coverage or not obtaining an administrative fee waiver, and we solicited comments on their satisfaction with policy servicing.

FINDINGS AND RECOMMENDATIONS

I. THE CAT PROGRAM IS NOT FUNCTIONING AS A SAFETY NET FOR THE NATION’S FARMERS

The CAT Program is not functioning as a safety net for the Nation’s farmers. Our analysis of RMA program participation statistics disclosed that the number of CAT Program policies and participating acres has declined dramatically since 1995, especially for limited resource producers. Although the reinsured companies received significant revenues to service this program, the companies did not adequately service the transfer and enrollment of limited resource producers from policies previously sold and administered through FSA county offices (CO). RMA itself did not take an active role in monitoring the transfer and servicing of CAT Program policies, and it did not instruct the reinsured companies to provide any special servicing to limited resource producers, even though the Secretary requested such servicing.

Our review also found that the CAT Program did not suit the needs of producers who were not in the limited resource category. Since 1996, producers have no longer been required to purchase CAT coverage in order to participate in other USDA programs. Consequently, many producers who could afford the $50 CAT administrative fee nevertheless dropped their policies when their operating plans did not include the need for the minimal coverage the CAT Program provides. Without improved RMA program management and adjustments in the CAT Program, participation will likely continue to decline, further reducing the catastrophic crop loss protection for farmers.

PARTICIPATION IN CAT BY LIMITED RESOURCE PRODUCERS HAS DECLINED GREATLY

FINDING NO. 1

Limited resource producers did not remain in the CAT Program even though it was available to them at no charge. Our review disclosed that reinsured companies did not inform limited resource producers of the waivers available to them for CAT Program administrative fees. In addition, RMA did not specifically require the reinsured companies to disseminate information on available waivers to limited resource producers. Of 165 limited resource producers we reviewed who participated in the 1997 CAT Program, 109 of the producers did not renew their CAT coverage for 1998. In our opinion, the participation of limited resource producers is likely to continue to decline if servicing does not improve. This conclusion is supported by RMA data which shows that the number of limited resource administrative fee waivers declined by 78 percent since 1997 from 9,499 to 2,069 waivers. This dropout rate is well above the 66 percent overall program drop-out rate over the last 4 years. We believe this condition significantly diminishes the effectiveness of the CAT Program as a risk management tool for small and limited resource producers.

On May 22, 1997, the Secretary approved a decision memorandum submitted by RMA for the "Delivery of Catastrophic (CAT) - Level Crop Insurance Policies For The 1998 Crop Year." The memorandum stated RMA would flag the policies of limited resource producers to enable companies to provide special attention to these insureds. Included in the memorandum were draft transfer procedures showing reinsured companies were responsible for ensuring that all agents were familiar with procedures for waiving administrative fees and that certification forms were available to agents. Also, reinsured companies were responsible for establishing procedures to ensure their agents contacted the limited resource producers and provided them with risk management advice.

In our June 26, 1998, Management Alert, we reported that reinsured companies did not provide special servicing to limited resource producers, as prescribed in the decision memorandum. When RMA issued the transfer procedures to the companies, program officials did not include the requirement that reinsured companies must contact limited resource producers or elaborate on the special servicing needs of these producers. Although RMA flagged the limited resource producers in the CAT Program files provided to the companies, it did not provide guidance for handling the special servicing needs of these producers. For their part, reinsured companies did not make personal contacts and did not even identify the limited resource producers to their agents, who were expected to service the policies.

We interviewed 181 insurance agents and found that only 12 of them (about 7 percent) provided some type of special servicing for limited resource producers. The other 169 agents acknowledged that they did not discuss the administrative fee waiver with producers unless the producer asked them about it. Except in rare instances, the agents were also not aware which producers were classified as limited resource producers in 1997.

During our review, we determined that 109 of the 165 limited resource producers in our sample did not renew their CAT Program coverage in 1998. We interviewed 90 of these producers and found the following servicing weaknesses (some producers listed more than one reason):

- 44 producers were not told about the administrative fee waiver;

- 25 producers did not understand the CAT Program;

- 22 producers either no longer had an insurable interest in the crop or did not plant insurable crops in 1998[2];

- 20 producers indicated the agent was located too far away;

- 14 producers were not contacted about CAT insurance; and

- 9 producers were no longer interested in CAT coverage because they thought the insurance coverage was inadequate.

The following table shows the estimated impact, based on our statistical analysis, of the above identified weaknesses on about 8,100 limited resource producers transferred to reinsured companies. (see exhibit C)

PROJECTED NUMBER OF CASES		
Description	Population Estimate	Precision[3]
Producers Not Told About Administrative Fee Waiver	2,429	20%
Producers Did Not Understand The CAT Program	1,381	29%
Producers Either No Longer Had Insurable Interest In The Crop OR Did Not Plant Insurable Crops In 1998	839	38%
Producers Indicated The Agent Was Located Too Far Away	1,139	31%
Producers Were Not Contacted About CAT Insurance	693	41%
Producers Were No Longer Interested In CAT Coverage Because They Thought The Insurance Coverage was Inadequate	446	53%

We also contacted 9 of the 56 limited resource producers in our sample who renewed their CAT Program coverage in 1998. We found that six of these were required to pay the $50 administrative fee. Four of the six producers stated the agents did not inform them of the potential for a waiver of these fees.

The high drop-out rate of limited resource producers has also changed the composition of producers participating in the CAT

[2] Some producers still have farms and could have insurable crops in the future.

[3] We are 95 percent confident that our population estimate is within the precision percent of the true value for each description noted.

program. The data shows that producers with larger farms are becoming the predominant holders of CAT policies. From 1995 to 1998, the average farm size in the CAT Program increased from 98 acres per policy to 155 acres per policy. Without greater oversight by RMA, this trend is apt to continue; larger producers increase the reinsured companies' underwriting gains and consequently give the companies an incentive to service these producers at the expense of limited resource producers.

We concluded that there is a direct correlation between the CAT drop-off rate of limited resource producers and the inadequate servicing those producers received from the reinsured companies. The administrative fee waiver should attract small and socially disadvantaged producers to the CAT safety net, but the waiver will have no effect if reinsured companies do not make an effort to inform the producers about it. Such an effort should include, as a minimum, personal contacts by agents to help ensure that the producers are offered an ample opportunity to participate in the CAT Program.

RECOMMENDATION NO. 1

Require reinsured companies to provide special servicing to limited resource producers who were flagged as such during the transfer of CAT policies. This should include personal contacts by agents to help ensure limited resource producers are made aware of the benefits of the CAT Program and encouraged to request waivers of administrative fees, as applicable.

RMA Response

In written comments on the draft report (see exhibit E), RMA did not concur with the recommendation. RMA stated while instances of substandard service may have occurred, it believes quality of servicing provided by reinsured companies was not the primary factor for the drop-off rate of limited resource farmers. RMA officials also stated, their review of OIG's workpapers raised questions regarding the support for OIG's position. Also, other USDA data shows that many limited resource farmers have consciously moved away from CAT coverage because of their dissatisfaction with the product as currently defined by statutes. RMA believes it is inappropriate to judge program performance based on sales of a policy that many farmers say they do not want.

RMA further commented that, in many cases, the information available to reinsured companies for contacting limited resource farmers was not correct, or nonexistent which may explain why some farmers stated that they were not contacted. In addition, the agency commented that the OIG auditors had difficulty reaching many of the transferred policyholders as evidenced in their workpapers.

RMA provided information on the actions taken by one reinsured company to reach and educate limited resource farmers. However, many of the limited resource farmers did not respond to the company's efforts to service them. According to RMA, some CAT policyholders expressed a dislike for crop insurance because they were required to participate during 1995 and 1996. RMA believes that the drop-off rate could be more directly related to the fact that producers were required to purchase the insurance in 1995 and it did not meet their specific needs. As a result, acting as cost-conscious consumers, many limited resource farmers simply chose not to continue with the product.

OIG Position

We recognize that there are a number of factors that were instrumental in causing the significant drop-off rate for limited resource producers. However, our audit conclusions regarding the actions of reinsured companies to adequately service limited resource farmers is based on evidence complied during a lengthy review process that included record reviews, interviews of program managers, farmers and officials of reinsured companies. This evidence allows us to conclude that reinsured companies did not live up to the commitment they made to the Secretary in May 1997, when he authorized the reinsured companies to take over this portion of the crop insurance business from the Farm Service Agency.

We also continue to believe that personal contacts of limited resource producers are needed in order to adequately service limited resource producers. RMA comments that we were not able to contact many producers is not accurate, in that, we were able to contact, by telephone or in person, all but 10 of the 109 limited resource producers we attempted to contact. We also believe the reason limited resource producers were flagged was to facilitate the reinsured companies in providing additional servicing to limited resource producers.

In addition, we recognize that some producers may have a dislike for crop insurance because of the previous linkage requirement. However, our contacts of the limited resource producers did not identify any cases where a producer expressed dislike for the coverage because of the linkage requirement. In addition, the agency comment that limited resource producers, acting as cost-conscious consumers, chose not to continue coverage would appear unrealistic since the CAT coverage is free to them.

In order to reach management decision, we need to be informed of RMA's planned actions to ensure that limited resource producers are adequately serviced in the future. This decision should also include the timeframe for performing such actions.

CAT PROGRAM DID NOT MEET PRODUCER NEEDS

FINDING NO. 2

Producers have been rejecting CAT Program coverage over the past 4 years, but the cost to the Government of delivering the program has remained high. RMA statistical data shows there were about 1.2 million CAT Program policies in 1995 compared to only about 396,000 policies in 1998. This represents a loss of participation of about 66 percent. During the period 1995 to 1998, the reinsured companies received more than twice the amount paid to producers in crop indemnities. We concluded that the CAT Program is not cost effective in relation to the program benefits it provides to producers and that it is not acting as a viable means of protection to producers whose crops could be exposed to a disaster.

In our opinion, producers rejected CAT Program coverage because the insurance protection it provided was not sufficient to encourage them to participate. CAT will not pay indemnities until a producer has lost over half of his/her crop, and then it guarantees the loss at only slightly more than half of the market price. Consequently, a producer who has lost everything will recover only about a quarter of the value of the total crop, and producers believe this is not financially useful. Program changes have also affected producer choices; in 1996, Congress eliminated the requirement that producers purchase at least CAT Program coverage if they planned to participate in USDA programs.

We conducted a statistical analysis on enrollment data from eight selected States (Arkansas, Kentucky, Missouri, Ohio, Oklahoma, Tennessee, Texas, and Virginia). Based on our analysis, we estimate that about 33,500 of 75,884 nonlimited resource producers and about 4,900 of 8,144 limited resource producers in the States cancelled their CAT Program policies during the 1998 transfer from FSA CO's to private reinsured companies.[4] (see exhibit C)

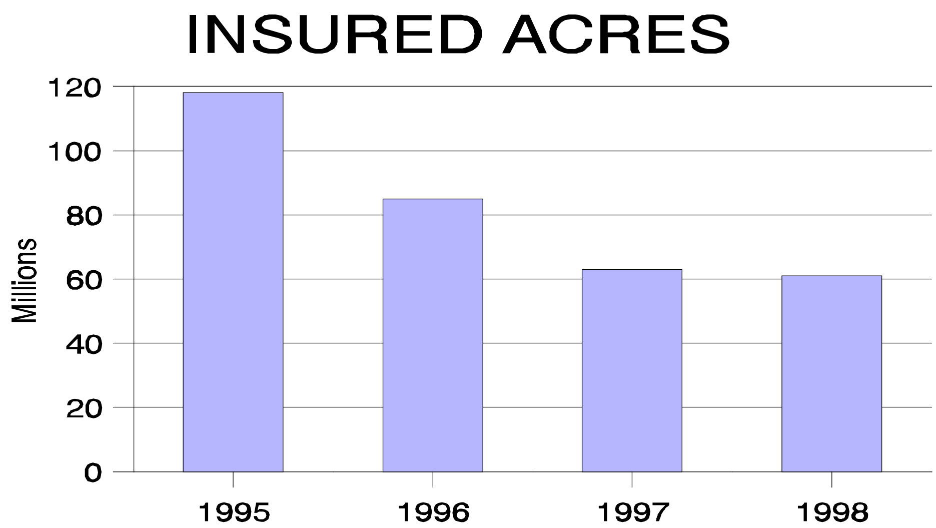
Our review disclosed that many producers who cancelled their CAT coverage in 1998 did not believe the CAT Program met their risk management needs. We contacted 155 producers (90 limited resource producers and 65 nonlimited resource producers) who held 1997 CAT Program policies and did not renew their CAT coverage in 1998. Based on their responses, we estimated that about 10,500 producers in the 8 States believed the CAT Program coverage was either too low or cost too much.[5] We also estimated about 8,300 other producers were simply not interested in obtaining the CAT coverage.[6]

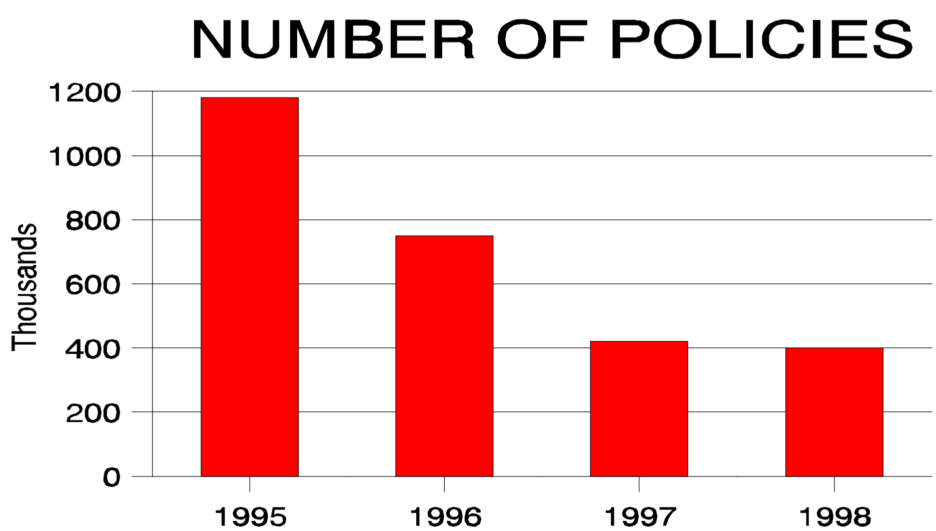
[4] We are 95 percent confident that our population estimate is within 15 percent of the true value for cancelled non-limited resource producers and within 10 percent of the true value for cancelled limited resource producers.

[5] We are 95 percent confident that our population is within 29 percent of the true value.

[6] We are 95 percent confident that this estimate is within 33 percent of the true value.

RMA enrollment data from crop years 1995 to 1998 also showed that participation in the CAT Program declined for both the number of policies and insured acres. This included CAT Program policies serviced by both FSA CO's and reinsured companies. The following graphs show the steady decline in both the total number of acres and the number of policies for each of the 4 years.[7]



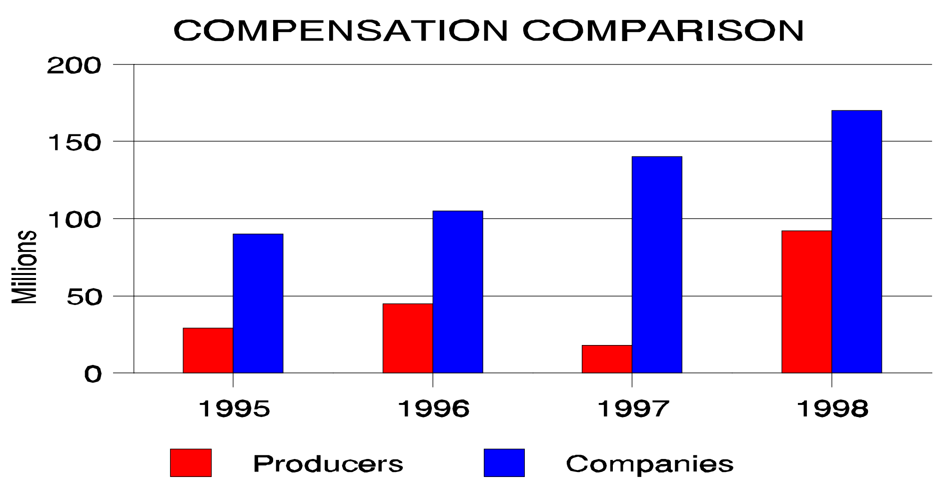


[7] In 1996, Congress eliminated the linkage requirement that producers purchase crop insurance in order to participate in USDA programs.

On October 21, 1998, the Secretary proposed an increase in CAT coverage for 1999 and future years as part of his "Strengthening the Farm Safety Net" proposal. The proposed change would cost about $372 million annually to increase coverage from 50 percent of yield at 55 percent of price, to 60 percent of yield at 70 percent of price. In our opinion, this proposed change would help maintain, and perhaps increase, participation in the CAT Program. In addition, the proposed risk management education efforts would provide an effective means of communicating the benefits of the CAT Program to producers.

Under the Secretary’s proposal, insurance providers would also receive an administrative and operating expense subsidy for CAT policies at the rate of up to $50 per policy. The subsidy, which would cost about $174 million annually, is designed to encourage reinsured companies to more actively promote CAT coverage among limited resource and other small-scale producers. We question whether additional subsidies to the reinsured companies are warranted for these activities.

Our analysis showed that reinsured companies are already receiving significant amounts for retained administrative fees, loss adjustment expenses, and underwriting gains for servicing CAT policies. For the years 1995 through 1998, reinsured companies received about $506 million in revenue from the CAT Program (see exhibit D). During the same period, producers with CAT Program coverage serviced by reinsured companies received indemnities for crop losses totaling only about $250 million. This means the reinsured companies received more than twice the amount paid to producers in crop indemnities during the same period. The following graph shows the disparity between the CAT Program funds received by reinsured companies and producers each year.



The Crop Loss Disaster Assistance Program for fiscal year 1999 (Public Law 105-277) requires producers to participate in USDA crop insurance programs, including the CAT program, for the following 2 years. However, unless the overall CAT Program insurance product is significantly improved, any increase in participation will only provide temporary relief for the affected producers. Also, the reappearance of a disaster aid program sends a signal to producers that ad hoc disaster programs may fulfill their risk protection needs without having to pay crop insurance premiums. This is especially true because the CAT Program was created to protect against extreme crop losses, thereby encouraging farmers to move away from dependence on crop disaster assistance.

We believe RMA needs to concentrate its efforts on improving the CAT Program insurance policy, rather than increasing subsidies to the reinsured companies. RMA should identify ways of increasing producer participation in the program, including steps to ensure coverage levels are sufficient to protect producers against catastrophic crop losses. In addition, RMA should evaluate the level of compensation being provided to the reinsured companies in comparison to the services provided and the declining producer participation. RMA should also explore other cost effective ways of delivering the CAT Program in areas not adequately serviced by insurance companies and their agents.

RECOMMENDATION NO. 2a

Focus efforts on improving the CAT Program to identify ways of increasing producer participation and increasing coverage levels to help ensure producers are protected against catastrophic crop losses.

RMA Response

In written comments on the draft report (see exhibit E), RMA concurred with this recommendation but commented that it does not have the authority to implement the recommendation. RMA is supportive of legislative efforts to increase the coverage level of CAT policies and has testified before Congress on its behalf. However, currently drafted legislation does not provide for any increase in CAT benefits.

OIG Position

We believe that RMA has non-legislative ways for encouraging and increasing producer participation, particularly for limited resource producers, in the CAT program. We concur with proposing legislation that addresses the deficiencies in the CAT program.

For management decision, we need to be informed of actions taken or planned to help increase producer participation and coverage levels to help ensure producers are protected against catastrophic crop losses.

RECOMMENDATION NO. 2b

Evaluate the compensation provided reinsured companies to service CAT Program policies, including underwriting gains, overall program costs, and benefits.

RMA Response

In written comments on the draft report (see exhibit E), RMA concurred with this recommendation. RMA will complete an evaluation within the next 60 days as part of an in-depth analysis that is currently being finalized.

OIG Position

In order to reach management decision, we need to be informed of the results of the evaluation and advised of any corrective action taken or planned. Such information should include the timeframes for performing any corrective action.

RECOMMENDATION NO. 2c

Explore other cost effective means of delivering the CAT program, including alternative delivery systems, in areas not adequately serviced by reinsured companies or their agents to ensure that all producers have an equal opportunity to participate in the CAT Program.

RMA Response

In written comments on the draft report (see exhibit E), RMA concurred with this recommendation. RMA is exploring alternative ways to deliver crop insurance programs to limited resource farmers. This included publishing a proposed rule "General Administrative Regulations: premium reductions, payment rebates, dividends, and patronage refunds; and payments to insured-owned and record-controlling entities" which RMA believes would allow cooperatives and other nonprofit organizations to offer crop insurance to certain groups with the intent to increase participation among community-based organizations such as minority and limited-resource farmers. In addition, RMA commented that the agency may offer a contract for proposals to deliver crop insurance to targeted group.

OIG Position

The agency comments do not address the recommendation. The cited regulations cover premium reductions under Section 508(e) in the Act in addition to premium rebates, patronage refunds and dividends. They do not address the use of alternative delivery systems to alleviate the lack of servicing in the CAT Program.

For management decision, we need to be informed of actions taken or planned to help ensure that all producers have access to and an opportunity to participate in the CAT Program. This decision should also include the timeframes for completing such actions.

AGENCY OVERSIGHT FUNCTION NEEDS STRENGTHENING

FINDING NO. 3

RMA did not ensure that the 1997 CAT policies transferred by FSA CO's to reinsured companies were properly serviced by these companies and their agents during the 1998 crop year. Also, RMA and FSA did not have adequate controls to ensure that all CAT policies were timely transferred to the applicable reinsured company. This occurred primarily because RMA officials did not take appropriate corrective action on prior audit recommendations or establish an effective monitoring system to ensure CAT Program servicing requirements were met in accordance with the Secretary's decision memorandum. As a result, we found many producers, particularly those of small and limited resource producers, were falling through the Department's farmer safety net (see Finding No. 1).

In March 1998, we issued Audit Report No. 05099-1-KC, Transfer of CAT Policies to Reinsured Companies, to inform RMA program managers of significant deficiencies in the servicing operations for transferred CAT Program policies. We recommended RMA monitor services provided by reinsured companies and their agents to CAT Program policyholders who were referred from FSA CO's. RMA officials responded to the report by stating that a customer service survey to evaluate producers' satisfaction with the agency's products and services would be included in the agency's Strategic Plan. The planned completion date for the survey was January 1999. However, this survey has not been conducted.

We pointed out that RMA should take a proactive role to evaluate the reinsured companies' servicing of transferred CAT Program policies and to obtain immediate feedback from the affected producers. We also noted RMA's customer survey would not be completed until well after 1998 sales closing dates for the policies. In our opinion, the agency's proposed action did not provide sufficient time to determine if the reinsured companies had offered transferred policyholders an opportunity to participate in the 1998 CAT Program.

The results of our recent audit illustrated the impact of the agency not taking appropriate corrective action on the lack of monitoring that we reported earlier in March 1998. We found that 2 FSA CO's in Tennessee (Claiborne and Union Counties) did not transfer a total of 187 CAT policies to reinsured companies. This represented 42 percent of the 443 CAT Program policies administered by the two county offices in 1997. We could not establish the reason(s) why county office employees did not make the required transfers; however, had either RMA or the Tennessee FSA State office initiated appropriate oversight functions and monitored the transfers, they might have ensured that the policies arrived at the reinsured companies.

Officials at the Tennessee FSA State Office acknowledged some policies had not been transferred. These State office officials stated they submitted a list of such policies to RMA's Regional Service Office (RSO) in Jackson, Mississippi. This list included the 187 policies from Claiborne and Union Counties. We made a followup inquiry on November 16, 1998, to RMA officials at the RSO, who acknowledged receipt of the list and stated the RSO assigned the policies to private insurance companies in November 1998. RSO employees asked the reinsured companies to provide a status report for the policies after the companies processed them. The companies had not yet submitted the requested reports to the RSO.

As indicated in Finding No. 1, the reinsured companies did not provide any information to limited resource producers on the administrative waivers available to them. Also, officials at three reinsured companies informed us that they did not have a record of all policies RMA listed as having been transferred to them. Each company noted at least one such policy and did not have records to show any insurance services were provided to these producers.

We believe if RMA program managers had implemented an effective monitoring system, many of the problems identified during this audit could have been corrected as they developed. Information on administrative fee waivers could have been made available to limited resource producers, and the completed transfer of all CAT policies could have been verified. Under the conditions noted by our audit, RMA did not have reasonable assurance that all policy transfers were completed in a timely manner, that the policies were serviced properly, and that limited resource farmers were offered an opportunity to participate in the CAT Program.

RECOMMENDATION NO. 3a

Follow up to determine if reinsured companies completed the transfers of the cited 187 policies and resolve any other cases where insurance company records do not show insureds that were transferred to them.

RMA Response

In written comments on the draft report (see exhibit E), RMA did not concur with the recommendation but the actions taken did address the issue. RMA forwarded the file of 215 policies missed in the transfer to the National Crop Insurance Services (NCIS) for distribution to the assigned companies. NCIS transmitted the file to the assigned reinsured companies with instructions to notify NCIS when they had completed their contacts with the policyholders. Also, the Jackson Regional Service Office issued letters in late July and early August 1998 to each of the policyholders that qualified for waivers in the past notifying them that they may continue to qualify for waivers upon being assigned to a reinsured company. Reinsured companies issued similar letters to their assigned policyholders. The reinsured companies later responded to NCIS that all producers were contacted.

OIG Position

We are unclear as to the reason for nonconcurrence because RMA’s response indicates that the corrective action has been taken. In order to reach management decision we need clarification as to why there is nonconcurrence with OIG’s recommendation.

RECOMMENDATION NO. 3b

As recommended in our prior audit, increase the monitoring of reinsured company operations to help ensure that assigned tasks, such as the servicing of the CAT policies, are accomplished effectively and in accordance with Secretarial directives.

RMA Response

In its written comments to the draft report (See exhibit E), RMA concurred with this recommendation. RMA plans to set up a process and timetable for monitoring the company’s servicing of CAT policies.

OIG Position

A management decision can be reached when we are informed of when and how RMA plans to monitor the reinsured company’s servicing of CAT policies.

EXHIBIT A - CAT TRANSFER UNIVERSE

STATE	NUMBER OF POLICIES	STATE	NUMBER OF POLICIES
ARKANSAS	5,652	OKLAHOMA	12,136
KENTUCKY	22,677	TENNESSEE	7,093
MISSOURI	9,594	TEXAS	15,212
OHIO	8,910	VIRGINIA	2,754
		TOTAL	84,028

EXHIBIT B - STATISTICAL SAMPLE DESIGN

STATISTICAL SAMPLE DESIGN

Farm Service Agency - Risk Management Agency

Catastrophic Policy Review for 1997

The general statistical sample design for this audit was a stratified random sample. The final constructed universe was composed of catastrophic (CAT) policies for 1997 applicable to limited and non-limited resource producers in the following 8 States:

Kentucky	Ohio
Texas	Arkansas
Oklahoma	Tennessee
Missouri	Virginia

There were 84,028 CAT policies for 1997 in this 8 State universe (i.e. 75,884 non-limited resource producers and 8,144 limited resource producers) which was acquired from the Risk Management Agency (RMA). Each individual State was considered to be a major strata. Within each State CAT policies applicable to non-limited resource producers were placed in a separate strata (POLTYPE=1) from CAT policies applicable to limited resource producers (POLTYPE=2). The stratification was as follows:

STRATA	BOUNDARY POLICY TYPE	NUMBER OF POLICIES	n=330
1	Non-limited	17,972	39
2	Limited	4,705	95
SUBTOTAL	MAJOR 1 (KY) STRATA 1-2	22,677	134
3	Non-limited	14,988	32
4	Limited	224	5
SUBTOTAL	MAJOR 2 (TX) STRATA 3-4	15,212	37
5	Non-limited	12,045	26
6	Limited	91	2
SUBTOTAL	MAJOR 3 (OK) STRATA 5-6	12,136	28

EXHIBIT B - STATISTICAL SAMPLE DESIGN

STRATA	BOUNDARY POLICY TYPE	NUMBER OF POLICIES	n=330
7	Non-limited	9,387	20
8	Limited	207	4
SUBTOTAL	MAJOR 4 (MO) STRATA 7-8	9,594	24
9	Non-limited	8,611	19
10	Limited	299	6
SUBTOTAL	MAJOR 5 (OH) STRATA 9-10	8,910	25
11	Non-limited	5,389	12
12	Limited	263	5
SUBTOTAL	MAJOR 6 (AR) STRATA 11-12	5,652	17
13	Non-limited	5,358	12
14	Limited	1,735	35
SUBTOTAL	MAJOR 7 (TN) STRATA 13-14	7,093	47
15	Non-limited	2,134	5
16	Limited	620	13
SUBTOTAL	MAJOR 8 (VA) STRATA 15-16	2,754	18
TOTAL		84,028	330

EXHIBIT B - STATISTICAL SAMPLE DESIGN

A sample size of 330 CAT policies (i.e. 165 non-limited resource CAT policies and 165 limited resource CAT policies) was selected. The allocation of the sample sizes of 165 non-limited resource and 165 limited resource to the individual State major strata was done proportional to the percentage of the number of policies, respectively, for MAJOR 1-8. The policies in STRATA 1-16 were selected with equal probability without replacement within each strata. The sample unit within each strata was a policy. The table above contains the details for this allocation and sample selection. A 95% one-sided lower confidence level was used for all the statistical estimates in this audit.

Statistical Analysis

All statistical estimation was accomplished on a DELL Pentium Personal Computer using SAS and SUDAAN. The statistical estimates used for projections along with their standard errors were produced using SUDAAN, a software system which analyzes sample survey data gathered from complex multistage sample designs. SUDAAN was written by B.V. Shah of Research Triangle Institute, Research Triangle Park, North Carolina. The sample design and sample selections used in this audit were generated using SAS.

The term sample precision (sp), as used in the report for estimating number of occurrences is defined as

$$sp = \frac{t * STDERR}{PTEST}$$

where

t - t factor for a 95% one-sided lower confidence level
PTEST - point estimate (estimate of the number of occurrences)
STDERR - standard error of the point estimate

The sample precision for estimating attribute percentage values is defined as

$$sp = t * STDERR$$

where

t - t factor for a 95% one-sided lower confidence level
STDERR - standard error of the point estimate (percentage value)

EXHIBIT C - STATISTICAL ESTIMATES

PROJECTED NUMBER OF CASES			
Description	Point Estimate	Lower Confidence Limit	Precision
CAT Policies That Were Retained By The Reinsured Companies	42,404	37,466	12%
Cancelled CAT Policy - Non-Limited Resource Producer	33,540	28,659	15%
Cancelled CAT Policy - Limited Resource Producer	4,898	4,389	10%
CAT Insurance Too Low or Too Costly	10,487	7,411	29%
Producers Claimed No Interest In Insurance	8,336	5,553	33%
Producers Thought CAT Insurance Was Inadequate	11,005	7,852	29%
Limited Resource Producers Not Told About Administrative Fee Waiver	2,429	1,953	20%
Limited Resource Producers Did Not Understand The CAT Program	1,381	986	29%
Limited Resource Producers Either No Longer Had Insurable Interest In The Crop OR Did Not Plant Insurable Crops in 1998	839	520	38%
Limited Resource Producers Indicated The Agent Was Located Too Far Away	1,139	787	31%
Limited Resource Producers Were Not Contacted About CAT Insurance	693	407	41%
Limited Resource Producers Were No Longer Interested In CAT Coverage Because They Thought The Insurance Coverage was Inadequate	446	210	53%

EXHIBIT D - ESTIMATED REVENUE RECEIVED BY REINSURED COMPANIES VERSUS INDEMNITIES PAID TO PRODUCERS

Year	Type of Reimbursement			Total	Indemnities Paid to Producers
	Administrative Fees	Loss Adjustment and Excess Lost Adjustment Expenses	Underwriting Gain 1/		
1995	$17,434,000	$25,925,333	$46,289,038	$89,648,371	$62,394,000
1996	13,659,500	29,463,973	62,548,430	105,671,903	59,730,000
1997	15,544,400	36,776,144	86,596,817	138,917,361	25,576,000
1998	16,103,600	49,747,268	105,748,895	171,599,763	101,950,000
Four Year Totals				$505,837,398	$249,650,000

1/ The underwriting gains for 1995, 1996, and 1997 were estimated based on a separate calculation for CAT and without any stop loss or other adjustment. The actual CAT underwriting gain for 1998 was as of February 13, 1999.

EXHIBIT E - RMA RESPONSE TO THE DRAFT REPORT

USDA

United States Department of Agriculture

Farm and Foreign Agricultural Services
Risk Management Agency

TO: James R. Ebbitt
Assistant Inspector General for Audit
Office of Inspector General

FROM: Kenneth D. Ackerman
Administrator

SEP 17 1999

SUBJECT: Office of Inspector General, Official Draft Audit Report No.05099-6-KC, Servicing of CAT Policies

Outlined below is the Risk Management Agency's (RMA) response to the recommendations in the subject audit report. RMA does not agree with the Office of Inspector General (OIG), as to the reasons cited in the report for the drop-off rate of limited resource farmers. The OIG argues that there is a direct correlation between the CAT drop-off rate for limited resource farmers, and the servicing those farmers received from the reinsured companies. RMA's review of OIG's work papers raised questions regarding the support for this position. Other USDA data shows that many limited resource farmers have consciously moved away from CAT coverage because of their dissatisfaction with the product as currently defined by statutes. While instances of substandard service may have occurred, the quality of servicing of CAT policies by reinsured companies was not the primary factor in the reduction of participation. RMA, thus, believes it is inappropriate to judge program performance based on sales of a policy that many farmers say they do not want. RMA will soon forward a detailed analysis of this issue to OIG.

In many cases, the information available to reinsured companies for contacting limited resource farmers was not correct, or nonexistent. This may explain why some farmers stated that they were not contacted. The OIG auditors had difficulty reaching many of the transferred policyholders as evidenced in their work papers. Contacting these farmers has been a difficult task. USDA published a new Privacy Act System of Records for the sole purpose of identifying and listing minority owners and operators for the purpose of ... "locate [ing] minority farmers for the purpose of informing them of USDA and other programs that may benefit them ..."

Reinsured companies have attempted to reach these farmers. One large writer of multiple peril crop insurance that services a significant number of limited resource farmers conducted its own survey in the process of trying to reach these customers. The reinsured company took the

RMA

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EXHIBIT E - RMA RESPONSE TO THE DRAFT REPORT

following actions to reach and educate limited resource farmers:

1) Each field office was provided a list of 1997 FSA limited resource farmers.

2) Extensive efforts were made to contact a sample of the 1997 limited resource farmers who had been insured but dropped out of the program for 1998.

3) A letter was sent to all 1998 limited resource farmers that were insured, but had not yet filed their limited resource declaration.

4) A letter was sent to the organizations included on the USDA list of minority and limited resource farmer groups to invite interested parties to contact the company.

5) Agent training sessions included a training section on limited resource farmer qualifications, waivers, and forms.

6) Monetary incentives were provided to agents for writing policies to limited resource farmers. Additional monetary incentives were provided to agents in the States of Alabama, Arizona, Arkansas, California, Florida, Georgia, Kentucky, Louisiana, Mississippi, Montana, Tennessee, and Wyoming.

Unfortunately, many limited resource farmers did not respond to the company's efforts to service them. Some CAT policyholders expressed a dislike for crop insurance because they were required to participate during the 1995 and 1996 crop years in order to obtain other USDA benefits. This impacted their attitude about the program and continuing participation. Further, other factors which affected participation rates have not been considered, such as steps RMA took to consolidate multiple CAT policies for operators and owners of small tobacco farms.

The high CAT policyholder drop-off rate could be more directly related to the fact that, in 1995, these producers were required to participate in the crop insurance program, and the product did not meet their specific needs. As a result, acting as cost-conscious consumers, many limited resource farmers simply chose not to continue with the product. RMA has asked Congress for the authority to develop a program that might better meet their needs. Congress has not yet provided this authority.

RECOMMENDATION NO. 1:

> *Require reinsured companies to provide special servicing to limited resource producers who were flagged as such during the transfer of CAT policies. This should include personal contacts by agents to help ensure limited resource producers are made aware of the benefits of the CAT Program and encouraged to request waivers of administrative fees, as applicable.*

EXHIBIT E - RMA RESPONSE TO THE DRAFT REPORT

RMA Response

RMA does not concur. As pointed out above, efforts were made by reinsured companies to service these individuals. Also, RMA believes the actions to be taken to implement the other recommendations in this audit, such as conducting outreach programs and monitoring CAT servicing, address this recommendation as well.

RMA requests management decision be reached on recommendation 1.

RECOMMENDATION 2a:

> *Focus efforts on improving the CAT Program to identify ways of increasing producer participation and increasing coverage levels to help ensure producers are protected against catastrophic crop losses.*

RMA Response

RMA concurs with the goal of increasing coverage levels and in increasing use of some form of risk management tool by these producers. Limited resource farmers have told RMA that increased coverage would be of value to them. However, RMA does not have sufficient authority to implement this recommendation.

Section 508(b) of the Federal Crop Insurance Act defines and controls the benefits offered by CAT policies. Neither the Federal Crop Insurance Corporation nor RMA may provide enhanced coverage benefits without additional legislative authority.

For this purpose, RMA is supportive of legislative efforts to increase the coverage level of CAT policies. In addition, RMA has testified before Congress on its belief for needed improvements to CAT coverage. However, it should be noted that H.R. 2559 as currently drafted does not provide for any increase in CAT benefits, but rather focuses on improving the quality of buy-up coverages. USDA has expressed dissatisfaction with H.R. 2559 on this point.

RMA request management decision be reached on recommendation 2a.

RECOMMENDATION 2b:

> *Evaluate the compensation provided reinsured companies to service CAT Program policies, including underwriting gains, overall program costs, and benefits.*

RMA Response

RMA concurs. We will complete an evaluation within the next 60 days. It is part of the more in-depth analysis RMA is currently formalizing.

RMA requests management decision be reached on recommendation 2b.

RECOMMENDATION 2c:

> *Explore other cost effective means of delivering the CAT program, including alternative delivery systems, in areas not adequately serviced by reinsured companies or their agents to ensure that all producers have an equal opportunity to participate in the CAT Program.*

RMA Response

RMA concurs. RMA is exploring alternative ways to deliver crop insurance programs to limited resource farmers. On May 12, 1999, RMA published "General Administrative Regulations; premium reductions, payment of rebates, dividends, and patronage refunds; and payments to insured-owned and record-controlling entities" as a proposed rule for comment. This rule was published for the purposes of allowing cooperatives and other nonprofit organizations to offer crop insurance to certain groups. This rule was published with the intent to increase participation among community-based organizations such as minority and limited-resource farmers.

In addition, RMA may offer a Federal contract for "request for proposals" to deliver crop insurance programs to certain targeted groups. Requests for proposals may offer compensation and the full administrative and operating expense reimbursement rate of 24%.

RMA requests management decision be reached on recommendation 2c.

RECOMMENDATION 3a:

> *Follow up to determine if reinsured companies completed the transfers of the cited 187 policies and resolve any other cases where insurance company records do not show insureds that were transferred to them.*

RMA Response

RMA does not concur. RMA documents show a lotus file of 215 policies missed in the single delivery transfer were forwarded to the National Crop Insurance Services (NCIS) for distribution to the assigned companies on July 24, 1998. NCIS transmitted the file to the assigned reinsured companies on July 24, 1998. The companies were instructed to notify NCIS when they had completed activities to initiate contact with the policyholders. The Jackson Regional Service Office issued letters in late July and early August 1998 to each of the 215 policyholders. Those qualifying for waivers in the past were specifically notified of this, and it was also communicated

EXHIBIT E - RMA RESPONSE TO THE DRAFT REPORT

to them that they may continue to qualify for waivers upon being assigned to a reinsured company. Reinsured companies issued similar letters to their assigned policyholders. All companies assigned policies as a result of the transfer request issued on July 24, 1998, responded to NCIS that all producers had been contacted.

RMA request management decision be reached on recommendation 3a.

RECOMMENDATION 3b:

> *As recommended in our prior audit, increase the monitoring of reinsured company operations to help ensure that assigned tasks, such as the servicing of the CAT policies, are accomplished effectively and in accordance with Secretarial directives.*

RMA Response

RMA concurs. RMA will set up a process and timetable for monitoring the company's servicing of CAT policies.

If there are any questions, please contact Alan Sneeringer on (202) 720-8813 or Tracey Mock on (202) 690-6020.