



U.S. Department of Agriculture



Office of Inspector General
Great Plains Region

Audit Report

Risk Management Agency's Improved Financial Management Controls Over Reinsured Companies

Report No.05099-111-KC
October 2007



UNITED STATES DEPARTMENT OF AGRICULTURE

OFFICE OF INSPECTOR GENERAL

Washington D.C. 20250



DATE: October 23, 2007

REPLY TO
ATTN OF: 05099-111-KC

TO: Eldon Gould
Administrator
Risk Management Agency

ATTN: Michael Hand
Deputy Administrator for Compliance

FROM: Robert W. Young /s/
Assistant Inspector General
for Audit

SUBJECT: Risk Management Agency's Improved Financial Management Controls Over
Reinsured Companies

This report presents the results of our followup audit on the issues identified in prior reviews of the Risk Management Agency's (RMA) financial management controls over reinsured companies. Your written response to the draft report, dated August 23, 2007, is included in its entirety as exhibit B with excerpts and the Office of Inspector General's position incorporated into the Findings and Recommendations sections of the report where applicable.

We accept your management decision for Recommendation 1 in this report. Please follow your agency's internal procedures in forwarding final action to the Office of the Chief Financial Officer (OCFO). We are providing a separate memorandum to the agency and OCFO that provides specific information on the actions to be completed to achieve final action.

Based on your response, we do not accept management decision on Recommendation 2. In order to reach management decision, we need RMA's plan and timetable for expediting the implementation sharing agreement with the National Association of Insurance Commissioners and RMA's plan and timetable for further coordinating with individual State insurance regulators on their specific supplemental information needs.

In accordance with Departmental Regulation 1720-1, please furnish a reply within 60 days describing the corrective actions taken, or planned, and the timeframes for implementation for Recommendation 2. 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. Final action on the management decisions for recommendation should be completed within 1 year of the date of this report to preclude being listed in the Department's Performance and Accountability Report.

Executive Summary

Risk Management Agency's Improved Financial Management Controls Over Reinsured Companies (Audit Report No. 05099-111-KC)

Results in Brief

Since 2003, RMA has incurred over \$41.7 million in funding closeout operations for a failed reinsured company that had been the largest participant in the Federal crop insurance program.¹ In the wake of that failure, the Office of Inspector General (OIG) and the Government Accountability Office (GAO) evaluated RMA's financial management controls for obviating such situations. In general, OIG and GAO determined that RMA could strengthen its management control by increasing its financial oversight of reinsured companies, by routinely sharing information with State insurance departments, and by developing written policies and procedures to strengthen its operational and financial analysis. This current audit follows up to determine if RMA had implemented the recommended financial management controls and oversight of reinsured companies. During this audit, we tested and evaluated RMA's operational and financial analyses, and focused on those management controls adopted subsequent to OIG's and GAO's reviews.

For the 2005 reinsurance year, RMA approved 16 companies to write a total of \$5.5 billion in premium.² We determined that RMA has developed transition strategies to follow should these or future companies fail. RMA has expanded its financial and operational analyses of reinsured companies, as noted in the attached exhibit A.³ RMA has also initiated agreements that enable information sharing with State insurance departments as well as their national regulatory association, the National Association of Insurance Commissioners (NAIC). In addition, we examined RMA's procedures for evaluating reinsured companies plans of operation, operational analysis reports, financial analysis reports, financial failure contingency plans, etc., and determined that RMA's procedures identified to us were adequate; except, these policies and procedures still remain undocumented. However, nothing significant came to our attention to cause us to believe that RMA did not consistently follow the procedures described to us (see exhibit A) or that they were not functioning as intended.

RMA personnel stressed to us that each finding and recommendation contained in the GAO audit report had been fully addressed.⁴ However, we found that RMA's Reinsurance Services Division (RSD) still has not

¹ Reinsured companies are synonymous with private insurance companies and Approved Insurance Providers. The Code of Federal Regulations (CFR) generally refers to reinsured companies as approved crop insurance providers and RMA handbooks generally refer to reinsured companies as insurance providers.

² A reinsurance year runs from July 1 to June 30.

³ In addition to financial and operational analyses, which respectively examine reinsured companies' financial adequacy and organizational/operational structure (see Background), RMA conducts compliance reviews that determine if reinsured companies follow Federal and agency crop insurance regulations/policies. OIG is currently reviewing RMA's compliance activities under Audit No. 05601-11-AT.

⁴ "USDA Needs to Improve Oversight of Insurance Companies and Develop a Policy to Address Any Future Insolvencies", GAO-04-517 (June 1, 2004).

formalized and finalized the procedures it follows to conduct its operational analyses. Therefore, RSD cannot ensure their continued effectiveness or consistency. The review also disclosed that RMA has not completed policies or instituted measures detailing what information it should routinely and directly share with individual State insurance departments, or when and how the information should be shared. Certain confidential and/or proprietary information is not being shared with State regulators because RMA still perceives that there are privacy issues still needing to be addressed. Consequently, RMA remains vulnerable to the same conditions identified in our prior review.

Recommendations To further strengthen its procedures and policies, we recommended that RSD formalize written procedures for its operational analyses of reinsured companies. In addition, RMA needs to continue coordination with NAIC and individual State insurance departments to identify what specific supplemental information still needs to be addressed among RMA and the individual State insurance department regulators.

Agency Response In RMA's response to our audit report, RMA agreed to formalize its operational analysis procedures; however, it disagreed with the need for additional coordination and information-sharing with NAIC and individual State insurance departments.

OIG Position We concur with the proposed corrective actions for Recommendation 1 and have accepted the management decision for it. We disagree with RMA's position concerning our Finding and Recommendation 2. We have incorporated applicable portions of the written response into the draft report along with our position in the Findings and Recommendations section of this report. Our specific comments pertaining to the issues raised in RMA's response are presented in exhibit C.

Abbreviations Used in This Report

CFR	Code of Federal Regulations
DAS	Data Acceptance System
FCIC	Federal Crop Insurance Corporation
FOSD	Fiscal Operations & Systems Division
FRS	Financial Review Staff
GAAP	Generally Accepted Accounting Principles
GAO	Government Accountability Office
MGA	Managing General Agent
MOU	Memorandum of Understanding
NAIC	National Association of Insurance Commissioners
OCFO	Office of the Chief Financial Officer
OGC	Office of the General Counsel
OIG	Office of Inspector General
RMA	Risk Management Agency
RSD	Reinsurance Services Division
SAP	Statutory Accounting Procedures
SRA	Standard Reinsurance Agreement
USDA	U. S. Department of Agriculture

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Background and Objectives

Background

RMA administers and oversees the Federal crop insurance program, which is serviced by private reinsured companies. These reinsured companies are governed by the Standard Reinsurance Agreement (SRA). Among other things, the SRA requires reinsured companies to have adequate financial and operational resources to provide crop insurance.

RMA monitors the reinsured companies to ensure that they have these resources through its Fiscal Operations & Systems Division (FOSD) and its RSD. FOSD conducts financial analyses to determine if the reinsured companies have adequate financial conditions to provide crop insurance while RSD conducts operational analyses to determine if companies have adequate resources and organizational structures.

The two divisions base their analyses on information submitted by the reinsured companies in plans of operations. As required by the SRA, the plans must contain adequate information for the divisions to make their determinations. Such information includes financial statements, estimated expenses, anticipated premiums, identified material risks, organizational structures, etc. If the divisions identify deficiencies, the reinsured companies must provide additional information to resolve the issues. After completing their annual analyses, the divisions meet with other RMA units (e.g., RMA's compliance division, legal counsel, etc.) to recommend that RMA's Administrator approve or disapprove the companies to participate in the Federal crop insurance program. If approved, RSD and FOSD monitor the companies through quarterly and annual financial and operational analyses.

In June 2003, OIG and GAO initiated a joint review of the circumstances surrounding a reinsured company that became insolvent and failed the year before. Our efforts to assess RMA were hampered, however, by RMA's lack of comprehensive, documented policies and procedures. In November and December 2003, OIG issued memorandums that addressed RMA's financial management control weaknesses.^{5 6} In general, though, the memorandums concluded that RMA's management oversight was inadequate to effectively evaluate reinsured companies' overall financial condition.

In its June 2004 report, GAO also found RMA's financial oversight of reinsured companies to be inadequate.⁷ In general, GAO recommended that RMA develop: (1) a transition strategy to follow should reinsured

⁵ "RMA Activities to Renegotiate the Standard Reinsurance Agreement", Memorandum, Audit No. 05099-109-KC, dated November 14, 2003.

⁶ "Evaluation of Financial Management Controls Over Reinsured Companies", Memorandum, Audit No. 05801-3-KC, dated December 31, 2003.

⁷ "USDA Needs to Improve Oversight of Insurance Companies and Develop a Policy to Address Any Future Insolvencies", GAO-04-517 (June 1, 2004).

companies fail in the future, (2) written policies and procedures to improve its financial and operational analyses, and (3) agreements with State insurance regulators (or State insurance departments) to improve coordination and cooperation. In response to these three issues raised by GAO and OIG, RMA put in place management controls to increase its oversight of reinsured companies (see exhibit A).

Since 2002, the problems that led to the reinsured company's failure have not been repeated. From 2003 to 2006, reinsured companies have experienced strong underwriting gains, ranging between \$293 and \$983 million.

Objective

Overall, our objective was to follow up on the issues identified in prior reviews to determine if RMA has improved its financial management control of reinsured companies.

Findings and Recommendations

Finding 1 RMA Needs to Formalize and Finalize its Procedures for Operational Analyses

RMA's RSD still has not formalized written policies that document the procedures it follows to conduct its operational analyses. In addition, RMA relies on the expertise of RSD personnel who have historically carried out these duties. As a result, there is reduced assurance its operational analyses and the continuity of its financial management control of reinsured companies will be effective and consistent.

RMA uses financial and operational analyses by FOSD and RSD respectively to determine if reinsured companies should be approved to participate in the crop insurance program (and to monitor them after approval). These reviews serve as two of RMA's management controls to ensure that companies are in adequate financial condition for the program. Government standards for internal controls require that they be clearly documented in the form of written directives, policies, manuals, etc.⁸

GAO's report noted that RMA had not taken action to formalize existing financial policies and procedure practices into written comprehensive agency directives or handbook procedures.⁹ We followed up on RMA's corrective action to this issue and examined when and how FOSD and RSD scheduled reinsured companies to submit information, conducted analyses of the companies' financial statements and organizational structures, determined financial and operational fitness, and followed up to resolve identified deficiencies.

FOSD has developed written policies that specify how to conduct its financial analyses. However, RSD has not done so for its operational analyses. FOSD's policies and written procedures include direction for planning, scheduling, and conducting quarterly, annual, and onsite reviews. They also provide guidance about examining financial statements, plans of operations, and organizational structures, etc. Without documenting its operational analysis procedures, RMA has less assurance that RSD is effectively or consistently conducting its operational analyses. Should the expertise of current personnel be lost (e.g., due to retirement), then RSD's operational analyses will likely be hindered and, consequently,

⁸ "Standards for Internal Control in the Federal Government", GAO/AIMD-00-21.3.2 (November 1999).

⁹ "USDA Needs to Improve Oversight of Insurance Companies and Develop a Policy to Address Any Future Insolvencies", GAO-04-517 (June 1, 2004).

its ability to assess whether reinsured companies should participate in the crop insurance program.

RSD does have a flowchart, checklists, and evaluation worksheets related to its analysis process, but these do not provide step-by-step instructions for the complete analysis. For example, as part of its process, RSD creates an operational analysis template report based on data it receives, such as a company's estimated maximum possible underwriting loss. This report is an important element in RSD's determination if a company is fit to participate in the crop insurance program. However, RSD has not documented the procedures it follows to develop the report and so would have difficulty repeating them without the current staff. RSD staff indicated that they have been working on developing the necessary written procedures for the last couple of years, but have not fully developed the procedures to date and intend to do so in the near future.

To ensure its continuing ability to conduct adequate operational analyses, RMA should finalize documenting the processes whereby RSD reviews reinsured companies.

Recommendation 1

Instruct RSD to finalize comprehensive written procedures that document its operational analysis process, including scheduling, planning, reporting, and followup.

RMA Response

RMA concurs with this recommendation. RSD has developed comprehensive draft written procedures documenting its operational analysis process, including scheduling, planning, reporting, and followup. RSD plans to issue these procedures by January 1, 2008. RMA's response is included in its entirety (see exhibit B).

OIG Position

We accept management decision for this recommendation.

Finding 2

Information Sharing Among All Parties Needs To Be Strengthened

Although RMA has acted on GAO's recommendation to develop agreements with State insurance regulators (or State insurance departments) that facilitate the sharing of relevant information between itself, NAIC, and State insurance departments, RMA still does not effectively coordinate with individual State insurance departments. These agreements remove barriers preventing them from exchanging information, but RMA believes it should withhold certain confidential or proprietary information from State insurance departments. Furthermore, the information currently being shared with RMA by the NAIC is, in part, information that has been generally provided by insurance companies or available to RMA in the past. Therefore, the level of cooperation and coordination envisioned by the GAO has not been achieved because detailed examination results and supporting financial analyses of reinsured companies' financial condition are not yet being exchanged. As a result, RMA remains vulnerable to not being promptly informed should State insurance regulators find that reinsured companies' financial conditions are beginning to deteriorate.

According to GAO's report, RMA did not timely detect the reinsured company's failure in 2002 partly because it "did not routinely share information" with the company's State insurance regulator. The State insurance department was aware of the company's financial difficulties but was legally prohibited from informing RMA or sharing the information with RMA due to confidentiality issues. GAO therefore recommended that RMA develop written agreements with State insurance regulators to improve coordination and cooperation in overseeing the financial condition of companies selling crop insurance, and sharing examination results and supporting workpapers.

In response to the GAO recommendation, RMA developed two agreements. One, a standard agreement with individual States, permitted the confidential sharing of a reinsured company's financial and market conduct performance, State examination information, and other documentation held by the State. In turn, RMA would share its financial analysis information and documentation with the State. A second agreement with NAIC permitted the sharing of regulatory data reported to NAIC by individual States.

RMA entered into Memorandums of Understanding (MOU) with 29 State insurance departments. The MOUs allowed RMA and the State insurance departments to share relevant financial information, such as, the results of their financial and operational analyses of reinsured companies. They do not, however, identify what information should be exchanged or establish

a schedule or method for doing so because RMA intended the MOU provisions to be general in nature.

A June 12, 2006, press release announced an agreement between NAIC and RMA to share information relevant to both parties. It followed a memorandum between NAIC and RMA describing a three-phase plan for information sharing. During phase one, RMA would provide NAIC with up-to-date new agent/agency disciplinary/disbarment records. In phase two, NAIC would assist RMA/Federal Crop Insurance Corporation (FCIC) examiners in entering scheduled RMA/FCIC reinsured company examinations into the NAIC Exam Tracking System and share alerts from all State insurance departments regarding relevant reinsured company examinations they plan to perform. And in the third phase, RMA would provide satellite image records of relevant, potential fraudulent activities. As of March 2007, RMA and NAIC had completed phase one of the agreement; however, information sharing planned for the second and third phases was still pending.

NAIC now provides RMA a variety of information, such as quarterly financial statements, while RMA provides NAIC with information on anti-fraud efforts, examinations in process and compliance actions. However, according to NAIC personnel, some information needs of the State insurance regulators have not been addressed. They would like to receive RMA's overall ratings of the reinsured companies that have SRA agreements with USDA on an annual basis along with definitions or explanations of such ratings. NAIC also stated the RMA should communicate any of RMA's concerns with Managing General Agent (MGA) or agents, material issues/concerns noted during RMA's operational/financial reviews, and provide any formal reports. No final date has been determined for reaching a final agreement on the information to be exchanged.

In addition, personnel responsible for performing financial analyses at 12 State insurance departments told us they would like to receive RMA's periodic financial and operational analyses as well as the financial and operational reports submitted by the reinsured companies to RMA. However, since they do not know what specific information RMA collects or obtains from the reinsured companies, they have limited their inquiries to specific questions, such as if a company has problems servicing policies.¹⁰

RMA has relied on NAIC as its primary mechanism for information sharing. Therefore, it has not, in our view, effectively coordinated with individual State insurance departments on what specific information they should forward to RMA or vice versa, nor has it sufficiently consulted

¹⁰ We judgmentally selected 12 of the 29 State insurance departments with MOUs with RMA to contact because they had reinsured companies domiciled in their States and, therefore, had regulatory authority over the companies.

individual State insurance regulators to learn what additional information they need to facilitate their regulatory responsibilities. RMA personnel believe that privacy issues must first be addressed as part of any information sharing efforts. In other words, despite RMA's efforts, the actual direct information sharing between RMA and individual State insurance regulatory agencies has remained substantially unchanged since the cited insurance company's failure.

Until coordination efforts among RMA, NAIC, and individual State insurance departments fully address the information needs of all parties, RMA has not met the full intent of GAO's recommendation to improve proactive coordination and cooperation in overseeing the financial condition of the reinsured companies, especially the sharing of confidential information such as examination results and supporting working papers.

Recommendation 2

Expedite the implementation of the information sharing agreement with NAIC and coordinate with individual State insurance regulators to further tailor those additional or specific supplemental information needs that still need to be addressed among RMA and the individual State insurance regulators and how this information sharing will be specifically carried out to complement the NAIC mechanism.

RMA Response

RMA does not concur with the recommendation. The findings supporting this recommendation do not reflect the actions taken by RMA to strengthen its information sharing efforts. RMA does have, in place and operational, sufficient information sharing agreements and does coordinate with individual State insurance regulators where necessary using sufficient methods to permit the confidential sharing of a reinsured company's financial and market conduct performance, State examination information, and other documents held by a State. It is RMA's position that its initiatives to act on GAO's 2004 recommendations are sound, reasonable, and are leading to the level of coordination envisioned by GAO. RMA's response is included in its entirety (see exhibit B).

OIG Position

We cannot accept management decision for the recommendation. In order to reach management decision, we need the following information. First, we need RMA's plan and timetable for expediting the implementation of the second and third information sharing phases as agreed to in the agreement with NAIC. Secondly, we need RMA's plan and timetable for further coordinating with individual State insurance regulators on their specific supplemental information needs. Lastly, we need RMA's plan and

corrective action for how it expects to share the supplemental information needs with the State insurance departments, besides its ongoing coordination and communication with NAIC. As part of its corrective action, RMA may need to address and resolve any confidential or proprietary information issues.

We continue to believe that RMA has not sufficiently coordinated with individual State insurance departments and their staff regulators to learn what specific information they need from RMA to facilitate their regulatory responsibilities. Instead, RMA has relied on establishing NAIC as the primary mechanism for information sharing among entities. Notwithstanding the additional information that RMA provided after its official written response, we still believe additional coordination and communication efforts are needed between RMA and individual State insurance departments, especially identifying and sharing information in a proactive manner. RMA asserts that its data and analyses are being shared, its MOUs with each State remove the potential legal barriers to sharing of information, and the general nature of the MOU provisions allow RMA and the States the flexibility each requires to adapt information-sharing needs.

However, RMA's position appears to be contradictory in that it states sharing certain information, even under a MOU with provisions to protect confidential information, poses legal risks to RMA. RMA further asserts that NAIC and the State insurance departments have certain internal, proprietary analyses and tools that they are unwilling to share with RMA because of legal concerns. We acknowledge that information sharing among RMA, NAIC and the State insurance departments, relative to the annual Plan of Operations evaluation process, as well as financial data such as quarterly financial statements, information on anti-fraud efforts and examination schedules, etc. has increased. However, our contacts with the State insurance departments and their regulatory staff disclosed that they still had need for supplemental information from RMA; some of this information may involve confidential and other propriety information. Their comments to us were further ratified in our subsequent discussions with a representative of NAIC. Based on our discussions with the Office of the General Counsel, we believe that sharing of such confidential and proprietary information would be allowable under the MOU as long as such exchanges are performed under the appropriate MOUs and are between only those regulatory entities with a need to know.

RMA's response stated "...that the likelihood for being promptly informed of an insurance company solvency problem by State regulators is not particularly related to the quantity or level of financial information shared by RMA. Rather, notice is more likely to occur if confidentiality barriers have been removed and there is routine communications with the State. RMA accomplished the first by establishing the information sharing

MOUs and the second through engaging the State in the annual Plan of Operations evaluation process and whenever RMA detects a material concern.” However, RMA’s response is internally inconsistent because it further stated that it has opted not to share many of its analyses because it believes they would not be of particular value to some State insurance regulators and the sharing of certain proprietary or confidential information such as its internal rating system, even under a confidential information sharing MOU, poses an unacceptable legal risk to RMA.

Therefore, we concluded the present information sharing arrangement does not meet the intent and level of cooperation and coordination recommended by GAO and, in fact, still leaves RMA vulnerable to the same circumstances experienced at the time of the former reinsured company’s insolvency in 2002. Namely, RMA was unaware of the reinsured company’s deteriorating financial condition until notified by the responsible State insurance regulators that they had discovered the reinsured company’s failing condition and were initiating actions to take control of its insurance business. Our specific comments to RMA’s response to this finding and recommendation are detailed in exhibit C to this report.

Scope and Methodology

The audit was conducted at RMA's offices in Washington, D.C., and Kansas City, Missouri, and the NAIC's office in Kansas City, Missouri. To solicit input regarding RMA's financial management control of reinsured companies, we also contacted officials from the Department of Agriculture's (USDA) Office of the General Counsel and Office of the Chief Economist, as well as the Board of the Federal Crop Insurance Corporation in Washington, D.C., and 29 State insurance departments nationwide.¹¹

We conducted the audit by researching the applicable laws, regulations, policies, procedures, manuals, and instructions that govern reinsured companies. We reviewed FOSD's procedures for conducting annual and quarterly financial analyses; we also reviewed RSD's procedures for conducting annual and quarterly operational analyses. In addition, we reviewed the applicable Federal regulations, agency guidance, and the SRA.

We identified and assessed the financial management controls that RMA put in place since GAO and OIG's joint review of the failed reinsured company (see exhibit A). We also interviewed officials in RMA, NAIC, and State insurance departments to obtain their views about these controls and about sharing confidential business and regulatory information with RMA. Lastly, we reviewed the 2005 plans of operation for 4 of the 16 reinsured companies that participated in the crop insurance program in 2005, which we judgmentally selected because they were the largest reinsured companies approved to sell Federal crop insurance policies for RMA that year. In total, these 4 companies were approved to write \$3.85 billion in premiums, which represented just under 70 percent of the total approved for crop reinsurance year 2005.

We conducted our fieldwork from November 2005 to August 2006. We conducted our audit in accordance with generally accepted Government auditing standards.

¹¹ RMA entered into and signed MOUs with 29 different States based on States that had active domiciling reinsured companies operating in the State and those States that managed large amounts of RMA crop insurance activity.

Exhibit A – Procedures Before and After Company’s Failure in 2002

Division	Before Failure	After Failure
FOSD	<p>Reviews were done periodically, which included the following:</p> <ul style="list-style-type: none"> • Reviewed escrow and bank reconciliation. • Reconciled premium and losses in the reinsured company system to RMA’s accepted data in the data acceptance system (DAS). • Verified that premium collections were reported to RMA timely. • Monitored company processing from accounting standpoint via reports, escrow, monthly accounting, late sales, etc. 	<p>In addition to the steps listed in the “Before Failure” section (to the left), FOSD:</p> <ul style="list-style-type: none"> • Expanded the plan of operation’s appendix II requirements in the 2005 SRA such as revenue and expense forecast data, planned acquisitions, roles of parent/subsidiary companies. • Established financial review staff (FRS) in May 2003, with primary focus on company oversight. The staff was initially made up of two senior level accountants but has expanded to three senior level accountants and two financial specialists. • Expanded financial and operations reviews. In addition to the items listed in the “Before Failure” section (to the left), FRS performs an indepth review of the following: <ul style="list-style-type: none"> ○ The reinsured company’s structure and work flow. ○ The reinsured companies’ statutory accounting procedures (SAP) financial statements, and generally accepted accounting principles (GAAP) financial statements. ○ The managing general agent’s GAAP financial statements. ○ The sales agents’ agreements, and commission schedules and payments.

Exhibit A — Procedures Before and After Company's Failure in 2002

Division	Before Failure	After Failure
FOSD Continued		<ul style="list-style-type: none"> ○ The reinsured companies' reinsurance agreements, which are used to determine secondary credit risks. ○ The company's system, error resolution, accounting controls, and processing in accordance with the SRA's appendix III. ○ The reinsurance companies' operational procedures, manuals, and handbooks. ○ The credit balance process, which verifies timely refunding of overpayments to the producer. ○ The issuance of bills. ○ The debt process, including payment agreements, bankruptcies, terminations, reporting of ineligible producers, 1099's (an Internal Revenue Service form that reports miscellaneous taxable income), overpaid indemnities, and interest/penalty attachments. ○ The claims process including the structure, timeframe for processing a claim, workloads, loss adjustment expense, and the company's method for setting reserves. ○ The reinsured companies' litigation and arbitration cases. <ul style="list-style-type: none"> ● Expanded the annual financial analyses used for approving companies' plans of operation and for recommending approval or denial of companies' requests to participate in the crop insurance program.

Exhibit A – Procedures Before and After Company’s Failure in 2002

Division	Before Failure	After Failure
FOSD Continued		<ul style="list-style-type: none"> • Conducts quarterly financial analyses to continuously monitor reinsured companies. • Entered into an information sharing agreement with NAIC in November 2004. This agreement promoted cooperation, coordination, and information sharing between RMA and NAIC. • Requires companies to submit detailed contingency plans. • Monitors companies through automatic email alerts of their financial status.
RSD	<ul style="list-style-type: none"> • RSD account executives reviewed reinsured companies’ plans of operation and ensured that it received all necessary documents. • The RSD approval process consisted of ensuring reinsured companies met the requirements of 7 CFR 400 subpart L. Specifically, RSD: <ul style="list-style-type: none"> ○ Ensured that companies correctly calculated 14 financial ratios, which together indicate companies’ overall financial condition. (If companies did not, they had to address the failure to RMA’s satisfaction.) 	<p>In addition to the steps listed in the “Before Failure” section (to the left), RSD:</p> <ul style="list-style-type: none"> • Requires more information in reinsured companies’ plans of operation (beginning in the 2004 reinsurance year), including risk assessments, contingency plans, and additional financial and operational information. • Requires plans of operation to include commission and loss adjustment expenses by State, and total expenses for a three-year period. • Implemented plans of operation evaluation worksheets.

Exhibit A – Procedures Before and After Company’s Failure in 2002

Division	Before Failure	After Failure
RSD Continued	<ul style="list-style-type: none"> ○ Ensured that companies’ maximum possible underwriting losses were calculated to determine whether they were qualified to write the requested premium volume. ○ Tracked the rating agency reports on the companies, reinsurers, and industry. ● Detected company weaknesses and resolved them. 	<ul style="list-style-type: none"> ● Evaluates companies’ operational capacities, resources, and strengths and weaknesses. ● Consults with the domicile State insurance departments regarding market conduct and solvency issues. ● Developed the operational analysis template, which summarizes RSD’s operational analysis and includes an approval/disapproval recommendation, underlying rationale, and key concerns. ● Along with FOSD, conducts an analysis of financially weakening companies. ● Reviews contracts with third-party administrators to ensure that responsibilities are appropriate. ● Reviews reinsured companies’ organizational structure to ensure appropriate management positions exist and that duties are separated to avoid conflict of interest. ● Reviews insurance regulatory information system ratios (which give an indepth financial picture), and company failures and explanations for the failures.

Exhibit A – Procedures Before and After Company’s Failure in 2002

RSD Continued		<ul style="list-style-type: none">• Reviews contracts with third-party administrators to ensure that responsibilities are appropriate.• Reviews reinsured companies’ organizational structure to ensure appropriate management positions exist and that duties are separated to avoid conflict of interest.• Reviews insurance regulatory information system ratios (which give an indepth financial picture), and company failures and explanations for the failures.• Requires a guarantee from each reinsured company’s parent company (if applicable), which commits the parent’s resources to fulfill SRA obligations.
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Exhibit B – RMA Response to the Draft Report

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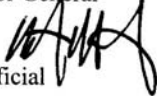
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TO: Robert W. Young
Assistant Inspector General for Audit
Office of Inspector General

AUG 23 2007

FROM: Michael Hand 
Audit Liaison Official

SUBJECT: Office of Inspector General (OIG) Draft Audit Report 05099-111-KC
Risk Management Agency's Improved Financial Management Controls
Over Reinsured Companies

Outlined below is the Risk Management Agency's (RMA) response to each of the recommendations contained in the subject report.

RECOMMENDATION NUMBER 1:

Instruct RSD to finalize comprehensive written procedures that document its operational analysis process, including scheduling, planning, reporting, and followup.

RMA Response:

RMA CONCURS. RSD has developed comprehensive draft written procedures documenting its operational analysis process, including scheduling, planning, reporting, and followup. RSD plans to issue these procedures by January 1, 2008.

RMA requests management decision for this recommendation.

RECOMMENDATION NUMBER 2:

Expedite the implementation of the information sharing agreement with NAIC and coordinate with individual State insurance regulators to further tailor those additional or specific supplemental information needs that still need to be addressed among RMA and the individual State insurance regulators and how this information sharing will be specifically carried out to complement the NAIC mechanism.

RMA Response:

RMA DOES NOT CONCUR. The findings supporting this recommendation do not reflect the actions taken by RMA to strengthen its information sharing efforts. RMA does have in place and operational sufficient information sharing agreements, and does coordinate with individual State insurance regulators where necessary using sufficient methods to permit the confidential sharing of a reinsured company's financial and market conduct performance, State examination information, and other documents held by a State. It is RMA's position that its initiatives to act on GAO's 2004 recommendations are sound, reasonable, and are leading to the level of coordination and coordination envisioned by GAO. Outlined below are comments by RMA concerning those findings supporting the



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above recommendation where RMA does not agree with OIG, and the basis for our disagreement.

Comment 1 – On page 5 OIG states, “...RMA still does not routinely communicate with individual State insurance departments.”

RMA strongly disagrees with the finding. Early in the process of implementing the information sharing agreements with the States, it was obvious to RMA that its relationship with NAIC should receive special attention. RMA placed a high priority on receiving financial information provided to the States by crop insurance companies. However, virtually all financial information on the companies collected by the States flows up to and through NAIC. Moreover, the tools and expertise available to effectively analyze State financial information resides with NAIC. Indeed, NAIC provides the data, tools, and expertise that each State employs. Consequently, RMA determined that focusing on NAIC should be the primary resource for obtaining, evaluating, and interpreting financial information from the States. The OIG report minimizes both NAIC’s important role in supporting effective financial analyses of crop insurance providers and RMA’s efforts in fostering this important resource.

In addition to the financial information and assistance it receives from NAIC, RMA does share routine information directly with those States in which insurance providers or their managing general agents are domiciled. The annual evaluation of an insurance provider’s Plan of Operations requires that the RSD Account Executive assigned to a company contact the State in which the company is domiciled to discuss the financial, market conduct findings of State examiners, and document the resulting information. RSD provided sample emails documenting such routine exchanges between RSD and State personnel to OIG during the audit. However, the report does not mention such routine information sharing.

RMA also contacts and works with the respective State insurance departments any time an insurance provider undergoes a significant change, be it financial or operational. RMA can produce additional documentation to support its routine and “special case” information sharing efforts with individual States, if needed.

It is accurate to say that RMA does not routinely share information with those States that do not have regulatory responsibilities for approved insurance providers or their managing general agents. However, RMA does not believe such sharing would be particularly productive in addressing the concerns expressed in the 2004 GAO recommendation.

Comment 2 – On page 5 OIG states, “... the level of cooperation and coordination envisioned by the GAO has not been achieved because detailed examination results and supporting financial analyses of reinsured companies’ financial condition are not yet being exchanged. As a result, RMA remains vulnerable to not being promptly informed should State insurance regulators find that reinsured companies’ financial conditions are beginning to deteriorate.”

RMA disagrees. The key data and analyses of reinsured companies are being shared. RMA also conducts many financial analyses that assist it in evaluating the condition and performance of insurance providers with respect to one line of insurance—Federal crop

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insurance. RMA has chosen to not share many of these analyses because they would not be of much particular value to State regulators who are focusing on an insurance provider's entire book of business. Similarly, State regulators have many financial analyses that would be of little value to RMA because they are prepared solely to meet State regulatory needs and do not address the overall solvency of the company or have implications for the Federal crop insurance line.

It is RMA's position that the likelihood of being promptly informed of a insurance company solvency problem by State regulators is not particularly related to the quantity or level of detail of financial information shared by RMA. Rather, notice is more likely to occur if confidentiality barriers have been removed and there is routine communications with the State. RMA accomplished the first by establishing information sharing MOUs and the second through engaging the State in the annual Plan of Operations evaluation process and whenever RMA detects a material concern.

Comment 3 – On page 6 OIG states, *"They [information sharing MOUs between RMA and State insurance departments] do not, however, identify what information should be exchanged or establish a schedule or method for doing so because RMA intended the MOU provisions to be general in nature."*

RMA disagrees with the implication that the MOUs should, in fact, contain specific details regarding information-sharing content and process. RMA's disagreement is two-fold: First, the primary purpose of the agreements is to address the serious issue identified in the GAO report concerning the case of the failed insurance provider in 2002. In that report GAO indicated that State insurance department officials believed they were legally prohibited from sharing information with RMA due to confidentiality issues. The MOU removes this potential legal barrier to the sharing of information for cases in which either RMA or the State of domicile for an insurance provider has information regarding a company's financial or operational problems.

Second, by not being locked in to what, when, and how information should be shared, RMA and the State preserves the flexibility they require to adapt information sharing to evolving needs.

Comment 4 – On page 6 OIG states, *"...according to NAIC personnel, some information needs of the State insurance department regulators have not been addressed. They would like to receive RMA's overall ratings of the reinsured companies that have SRA agreements with USDA on an annual basis along with definitions or explanations of such ratings."*

RMA does not have a formal request from NAIC personnel to obtain reinsured companies ratings. Even if it were to receive such a request, however, RMA has been advised by the Office of General Counsel that the sharing of an internal rating system with another party, even under a confidential information sharing MOU, would pose an unacceptably large legal risk to RMA. Consequently, RMA would be, on advice of legal counsel, prevented from adopting this facet of OIG's findings and recommendations. Similarly NAIC and States have certain internal, proprietary analyses and tools that they are not willing to share because of similar legal concerns.

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It is important to emphasize that not sharing proprietary rating systems or other proprietary evaluation tools does not preclude RMA or State regulators from alerting each other whenever its respective systems indicates an area of serious concern. In such cases, RMA would eagerly share with the State the data, information, and analyses upon which its rating was generated. Similarly, under the terms of the information sharing MOU, a State can alert RMA to problems with an insurance provider and provide data, information, and analyses without having to disclose a proprietary tool that the State might employ to uncover such problems.

Comment 5 – On page 7 OIG states, “RMA has relied on NAIC as its primary mechanism for information sharing. Therefore, it has not coordinated with individual State insurance departments on what specific information they should forward to RMA or vice versa, nor has it consulted individual State insurance regulators to learn what information they need to facilitate their regulatory responsibilities... In other words, despite RMA’s efforts, the actual information sharing between RMA and individual State regulatory agencies has remained substantially unchanged since the cited insurance company’s failure.”

RMA strongly disagrees. (Refer to response to item No. 1, above.) RMA has substantial documentation and provided it during the audit to demonstrate that the frequency and quantity of information shared with the States that have regulatory responsibility for reinsured companies is substantially greater currently than what was shared prior to the cited insurance company’s failure.

Should you have any questions, require additional information, or would like to discuss this response in more detail please contact Alan Sneeringer at (202) 720-8813.

RMA’s Comments on Recommendation Number 2 and OIG’s Position

OIG RECOMMENDATION NUMBER 2:

Expedite the implementation of the information sharing agreement with NAIC and coordinate with individual State insurance regulators to further tailor those additional or specific supplemental information needs that still need to be addressed among RMA and the individual State insurance regulators and how its information sharing will be specifically carried out to complement the NAIC mechanism.

RMA Response:

Outlined below are comments by RMA concerning those findings supporting the above recommendations where RMA does not agree with OIG and the basis for our disagreement with their comments.

Comment 1 - *On page 5 OIG states, “...RMA still does not routinely communicate with individual State insurance departments.”*

RMA strongly disagrees with the finding. Early in the process of implementing the information sharing agreements with the States, it was obvious to RMA that its relationship with NAIC should receive special attention. RMA placed a high priority on receiving financial information provided to the States by crop insurance companies. However, virtually all financial information on the companies collected by the States flows up to and through NAIC. Moreover, the tools and expertise available to effectively analyze State financial information resides with NAIC. Indeed, NAIC provides the data, tools, and expertise that each State employs. Consequently, RMA determined that focusing on NAIC should be the primary resource for obtaining, evaluating, and interpreting financial information from the States. The OIG report minimizes both NAIC’s important role in supporting effective financial analyses of crop insurance providers and RMA’s efforts in fostering this important resource.

In addition, to the financial information and assistance it receives from NAIC, RMA does share routine information directly with those States in which insurance providers or their managing general agents are domiciled. The annual evaluation of an insurance provider’s Plan of Operations requires that the RSD Account Executive assigned to a company contact the State in which the company is domiciled to discuss the financial, market conduct findings of State examiners, and document the resulting information. RSD provided sample emails documenting such routine exchanges between RSD and State personnel to OIG during the audit. However, the report does not mention such routine information sharing.

RMA also contacts and works with the respective State insurance departments any time an insurance provider undergoes a significant change, be it financial or operational. RMA can produce additional documentation to support its routine and “special case” information sharing efforts with individual States, if needed.

It is accurate to say that RMA does not routinely share information with those States that do not have regulatory responsibilities for approved insurance providers or their managing general agents. However, RMA does not believe such sharing would be particularly productive in addressing the concerns expressed in the 2004 GAO recommendation.

OIG Position

Based on documentation provided by RMA after our review, we acknowledge that the RMA account executives have asked the selected State insurance departments whether they have or had any market concerns or financial solvency issues with the reinsured company as part of the annual review cycle for the reinsured companies' Plan of Operations. Therefore, we have made an editorial change to further clarify that RMA does periodically communicate with individual State insurance departments. However, after reviewing the latest submitted information as well as information that we obtained during the review, we remain concerned that the routine communication between RMA and the States cited still appears to show an ineffective sharing of information between RMA and individual States regarding specific analyses, conclusions, examinations, or specific concerns. Also, it should be noted that RMA believes it had provided substantial documentation during our field review to demonstrate the frequency and quantity of information shared with the States; however, we did not receive this information during field work.

Even though RMA's response states it believes that focusing on NAIC (rather than the State insurance departments) should be the primary resource for obtaining, evaluating, and interpreting financial information from the States, we continue to believe that RMA needs to actively communicate with the State insurance departments and NAIC. Active and frequent communication is necessary to build a strong working relationship; furthermore, certain proprietary information can only be exchanged with the State insurance regulators.

RMA Comment 2 - *On page 5 OIG states, "...the level of cooperation and coordination envisioned by the GAO has not been achieved because detailed examination results and supporting financial analyses of reinsured companies' financial condition are not yet being exchanged. As a result, RMA remains vulnerable to not being promptly informed should State insurance regulators find that reinsured companies' financial conditions are beginning to deteriorate."*

RMA disagrees. The key data and analyses of reinsured companies are being shared. RMA also conducts many financial analyses that assist it in evaluating the condition and performance of insurance providers with respect to one line of insurance—Federal crop insurance. RMA has chosen to not share many of these analyses because they would not be of much particular value to State regulators who are focusing on an insurance provider's entire book of business. Similarly, State regulators have many financial analyses that would be of little value to RMA because they are prepared solely to meet State regulatory needs and do not address the overall solvency of the company or have implications for the Federal crop insurance line.

RMA's position that the likelihood for being promptly informed of a insurance company solvency problem by State regulators is not particularly related to the quantity or level of detail of financial information shared by RMA. Rather, notice is more likely to occur in confidentiality barriers have been removed and there is routine communications with the State. RMA accomplished the first by establishing information sharing MOUs and the second through engaging the State in the annual Plan of Operations evaluation process and whenever RMA detects a material concern.

OIG Position

We agree that RMA's MOUs with the State insurance departments and NAIC are key to removing confidentiality barriers and establishing communication. However, RMA has not sufficiently coordinated with individual State insurance regulators to establish what detailed confidential or proprietary information needs to be shared directly between the affiliated parties. RMA officials at the exit conference still expressed concerns that the sharing of its internal rating system with only State insurance regulators, even under a confidentiality information sharing MOU, still poses an unacceptably large legal risk to RMA. However, our discussions with the Office of the General Counsel (OGC) disclosed this concern may be unfounded since the State insurance regulators are no longer considered the "public" and are considered as other government regulators of the companies. Therefore, there should be no legal impediment to RMA sharing proprietary information with those individual State insurance regulators having a need for the data or information.

We disagree with RMA's assertion that the likelihood for being promptly informed of a reinsured company solvency problem by State insurance regulators is not particularly related to the quantity or level of detail of financial information shared by RMA. There needs to be a proactive approach to share and communicate information rather than waiting to be informed of solvency problems by State insurance regulators after the fact.

RMA Comment 3 - *On page 6, OIG states, "They [information sharing MOUs between RMA and State insurance departments] do not, however, identify what information should be exchanged or establish a schedule or method for doing so because RMA intended the MOU provisions to be general in nature."*

RMA disagrees with the implication that the MOUs should, in fact, contain specific details regarding information-sharing content and process. RMA's disagreement is two-fold: First, the primary purpose of the agreements is to address the serious issues identified in the GAO report concerning the case of the failed insurance provider in 2002. In that report GAO indicated that State insurance department officials believed they were legally prohibited from sharing information with RMA due to confidentiality issues. The MOU removes this potential legal barrier to the sharing of information for cases in which either RMA or the State of domicile for an insurance provider has information regarding a company's financial or operational problems.

Second, by not being locked in what, when, and how information should be shared, RMA and the State preserves the flexibility they require to adapt information sharing to evolving needs.

OIG Position

We are in agreement with RMA that the MOU removes this potential legal barrier to the sharing of information for cases in which either RMA or the State of domicile for a reinsured company has confidential or proprietary information regarding a company's financial or operational problems. RMA, however, has misunderstood the intent of our recommendation. Our recommendation is that RMA identify those supplemental information needs that still need to be addressed and determine how this information sharing will be carried out. We are not recommending that all financial information must be shared and specifically incorporated into the MOUs.

RMA Comment 4 - *On page 6 OIG states, "...according to NAIC personnel, some information needs of the State insurance department regulators have not been addressed. They would like to receive RMA's overall ratings of the reinsured companies that have SRA agreements with USDA on an annual basis along with the definitions or explanations of such ratings."*

RMA does not have a formal request from NAIC personnel to obtain reinsured companies ratings. Even if it were to receive such a request, however, RMA has been advised by the Office of General Counsel that the sharing of an internal rating system with another party, even under a confidentiality information sharing MOU, would pose an unacceptable large legal risk to RMA. Consequently, RMA would be, on advice of legal counsel, prevented from adapting the facet of OIG's findings and recommendations. Similarly NAIC and States have certain internal, proprietary analyses and tools that they are not willing to share because of similar legal concerns.

It is important to emphasize that not sharing proprietary rating systems or other proprietary evaluations tools does not preclude RMA or State regulators from alerting each other whenever its respective systems indicates an area of serious concern. In such cases, RMA would eagerly share with the States the data, information, and analyses upon which its rating was generated. Similarly, under the terms of the information sharing MOU, a State can alert RMA to problems with an insurance provider and provide data, information, and analyses without having to disclose a propriety tool that the State might employ to uncover such problems.

OIG Position

RMA has misunderstood the intent of our recommendation. Additional communication is necessary between RMA and the individual States to identify what confidential or proprietary information is available and what information needs to be directly shared. In regards to the sharing of an internal rating system, State insurance department personnel from several States indicated that they would like to receive that information. OGC told us that there may be no legal impediment to sharing such information with the individual States. RMA cannot just rely on

coordinating data, such as financial information, only through NAIC, because the sharing of confidential or proprietary information, such as an internal rating system, must be directly between RMA and the individual State; not through NAIC.

RMA Comment 5 - On page 7 OIG states, “RMA has relied on NAIC as its primary mechanism for information sharing. Therefore, it has not coordinated with individual State insurance departments on what specific information they should forward to RMA or vice versa, nor has it consulted individual State insurance regulators to learn what information they need to facilitate their regulatory responsibilities...In other words, despite RMA’s efforts, the actual information sharing between RMA and individual State regulatory agencies has remained substantially unchanged since the cited insurance company’s failure.”

RMA strongly disagrees. (Refer to response to item No. 1, above.) RMA has substantial documentation and provided it during the audit to demonstrate that the frequency and quantity of information shared with the States that have regulatory responsibility for reinsured companies is substantially greater currently than what was shared prior to the cited insurance company’s failure.

OIG Position

We agree that since the cited reinsured company’s failure, RMA has initiated the framework for coordination between RMA, the State insurance departments, and NAIC through the MOUs. In regards to RMA’s disagreement with the statement that RMA has relied on NAIC as its primary mechanism for information sharing, RMA’s response in Comment 5 contradicts RMA’s response in Comment 1, where RMA stated, “Consequently, RMA determined that focusing on the NAIC should be the primary resource for obtaining, evaluating, and interpreting financial information from the States.”

Also, contrary to its response that RMA provided substantial documentation during the audit to demonstrate the frequency and quantity of information shared with the States that have regulatory responsibility, OIG did not receive this information during field work. The information that RMA recently provided in September 2007 does support that RMA has been contacting the individual State insurance departments regularly since May 2005. The information requested by RMA always relates to the approval of the reinsured companies’ plans of operations and only requests information from the applicable States as to whether the States know of any market concerns or financial solvency issues. This information request is in one direction (RMA requesting information from the States) and is used in the approval of the Plans of Operations. The information provided in September 2007, does not evidence any other routine contacts with the States on the financial viability of the reinsured companies other than that shown at the time of the approval of the Plans of Operations.

Informational copies of this report have been distributed to:

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Government Accountability Office	(1)
Office of Management and Budget	(1)
Office of the Chief Financial Officer	
Director, Planning and Accountability Division	(1)