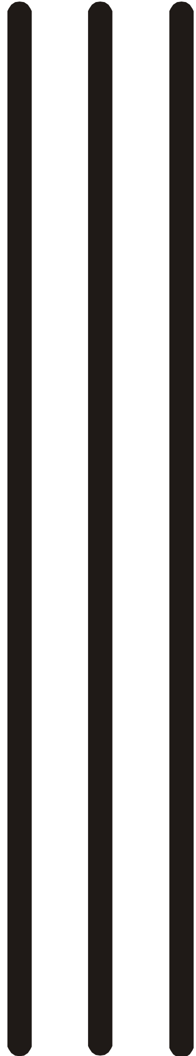
REPORT TO THE SECRETARY ON FEDERAL CROP INSURANCE PROGRAM REFORM DATED MARCH 15, 1999

REVISED AS OF APRIL 19, 1999

Based on subsequent discussions with and information provided by the U.S. Senate Committee on Agriculture, Nutrition, and Forestry; by the Risk Management Agency; and other groups familiar with the Federal Crop Insurance Program, we have revised sections of the report to redefine some of the terms that were used. We have also added some information to clarify our report.

Revisions or additions to the following pages are bracketed and highlighted in bold italics:

- Page 2 - revision to first paragraph
- Page 5 - added fourth and fifth paragraphs
- Page 9 - revisions to second and third paragraphs
- Page 10 - revision to second paragraph



U.S. Department of Agriculture
Office of Inspector General

Report To The Secretary On Federal Crop Insurance Reform

No. 05801-2-At
Revised as of
April 19, 1999

UNITED STATES DEPARTMENT OF AGRICULTURE

OFFICE OF INSPECTOR GENERAL

Washington D.C. 20250

March 15, 1999

REPORT TO THE SECRETARY ON FEDERAL CROP INSURANCE PROGRAM REFORM

FROM: Roger C. Viadero
Inspector General

SUBJECT: Review of Risk Management Agency's Federal Crop Insurance Program To Strengthen Its Program Integrity and Safety Net Provisions

This report provides our comments and suggestions on improving the Federal crop insurance program, as administered by the Risk Management Agency (RMA) and delivered by private reinsured companies in partnership with RMA. As a result of congressional and administration initiatives to enhance Federal crop insurance coverage, we prepared this report to offer these comments and suggestions, based on our prior audits and investigations, where we believe constructive changes are needed to improve risk management, keep premiums affordable, and make the program a more effective safety net for the Nation's producers.

RMA's current policy of underwriting most of the risk for crop losses has led to problems in program management by both RMA and the reinsured companies. By assigning immaterial risk to the reinsured companies, the Government has given company managers little incentive to administer the insurance policies in accordance with the Government's best interest. Because the reinsured companies incur minimal risks from reinsured losses, they have little reason to effectively monitor risky policyholders, little reason to deny claims of questionable losses, and no cause to find fault with their own practices. Currently, more Federal dollars are going to the reinsured companies than are helping producers recover from insurable losses.

If you have any questions or need further explanations regarding the issues presented in this report, my staff and I are available to meet with you at your convenience.

Table of Contents

Executive Summary 1

Purpose 1

Results in Brief 1

Suggested Corrective Actions 6

Recent History of the Crop Insurance Program 7

Program Delivery 9

Inequitable Risk-Sharing With Reinsured Companies Has Cost the Government Millions of Dollars 9

Issue 1 Company Revenue Increased At the Expense of Good Program Management 9

Suggested Corrective Actions 14

Issue 2 Conflicts of Interest Persist 14

Suggested Corrective Action 16

Issue 3 Loss Adjusters Have a History of Errors 17

Suggested Corrective Action 19

Policies and Procedures 20

RMA Policies and Procedures Do Not Always Protect the Government's Interest or Further Program Goals 20

Issue 4 RMA Needs To Properly Research and Develop Crop Insurance Policies 20

Suggested Corrective Action 25

Issue 5 Optional Unit Structure Encourages Improper Indemnities 26

Suggested Corrective Action 27

Table of Contents

Issue 6 Reinsured Companies Receive Substantial Gains from Imputed CAT Premiums at the Cost of Broader Program Participation 27

Suggested Corrective Action 29

Issue 7 RMA Needs to Provide Better Guidance to RMA Regions and Companies 30

Suggested Corrective Action 33

Compliance and Oversight 34

Issue 8 RMA Relied Too Heavily on Reinsured Company Quality Control Reviews to Ensure Compliance With Policy and Agreement Provisions 34

Suggested Corrective Action 37

References 38

Note: Page Nos. 2, 5, 9, and 10 were revised as of April 19, 1999, and the revisions are highlighted.

Executive Summary

Purpose

The purpose of this report is to provide comments and suggestions based on audits and investigations by the Office of Inspector General's (OIG) of the Federal crop insurance programs, as administered by the Risk Management Agency (RMA) and delivered by private reinsured companies in partnership with RMA. Congress and the Administration are developing initiatives to expand Federal crop insurance coverage with emphasis on market price protection. As part of the ongoing efforts, the Department is proposing to increase the Government's subsidization of premiums while holding losses steady. Because OIG has already found RMA policies concerning market protection and premium subsidization subject to abuse, we are offering this report as a guide to those areas in the program where we believe constructive changes are needed to improve risk management, keep premiums affordable, and make the program a more effective safety net for the Nation's farmers and producers.

Results in Brief

Over the past few years, RMA has tried to meet Congress' intent to expand the crop insurance program and make insurance available to more producers. Within these years the amount of insurance acreage has doubled, rising to 60 percent of the Nation's insurable acres. However, our reviews have also shown that some RMA policies, particularly those related to risk-sharing with the reinsured companies, have had the effect of increasing premium costs to producers. The increased premiums have resulted in reduced effectiveness of the Federal crop insurance program as a safety net for all producers, and especially for small and limited-resource producers. In addition, the cost to reimburse reinsured companies for the delivery of the program appears high in comparison to the benefits provided to insured producers. For example, the Catastrophic Risk Protection (CAT) program has resulted in about $2 in administrative payments to reinsured companies for every $1 paid to insured producers in the form of insurance indemnities.

RMA's current policy of underwriting most of the risk for crop losses has led to problems in program management by both RMA and the reinsured companies. By assigning low overall risk to the companies, the Government has given company managers little incentive to administer the insurance policies in accordance with the Government's best interests. Because the reinsured companies incur minimal costs from reinsured losses, they have little reason to effectively monitor risky policyholders, little reason to deny claims of questionable losses, and no cause to find fault with their own practices.

As a result of RMA's current risk-sharing policies, more Federal dollars are going to the reinsured companies than are helping producers recover from insurable losses. From 1995 to 1998, producers received a total of $5.4 billion in indemnities, but because only $3.4 billion of this was covered by producers' premiums, the Government paid the remaining $2 billion. At the same time, however, the Government paid reinsured companies a total of $2.8 billion for [***underwriting gains and administrative expenses, which is $800 million more than the Government's share of indemnities.***] Of the $2.8 billion paid to reinsured companies from 1995 to 1998 to deliver the program, about $510 million covered administration of the CAT program. Of the indemnities paid to producers during the same period, about $268 million represented CAT indemnities, most of which were paid by the Government.

Our nationwide reviews of the crop insurance program identified several types of abuses by reinsured companies that could be eliminated by greater risk-sharing by the companies.

- <u>Conflicts of interest persist</u>. Sales agents, loss adjustors, and others have been financially involved with the producers to whom they sold policies or for whom they verified claims. In one case, a sales agent wrote a policy for his employer, a tomato producer, and received about $284,000 in commissions from premiums totaling $1 million while, at the same time, receiving a $60,000-a-year salary from his employer. The employer's subsequent loss claims resulted in the employer receiving about $2.4 million in indemnities.

- <u>Pressure on loss adjustors to rubberstamp policyholders' loss claims</u>. Loss adjustment is a critical step in processing claims. Adjustors are responsible for verifying losses reported by producers and determining the indemnity amounts due. In the current system, loss adjustors are encouraged to approve questionable claims. For example, in our audit of raisin claims, we found that adjustors used unsupported yield figures to arrive at predetermined loss amounts. Insured raisin producers were able to inflate insured production in loss years to maximize indemnity payments, while their reported production in non-loss years served to minimize premiums.

- <u>Quality control reviews lack objectivity</u>. Reinsured companies' quality control (QC) reviews were found to be superficial and did not provide independent verification of proper claims activities. For example, in numerous audits, indemnities were found to have been improper and/or incorrect. However, the reinsured companies' QC reviews found no problems.

We concluded that reinsured companies do not have an adequate incentive to manage the crop insurance program in an actuarially sound manner. RMA needs to redesign its Standard Reinsurance Agreement to assign greater risk to the reinsured companies. By increasing the companies' risk of loss, we feel that loss adjustors would take greater care in verifying losses and companies would have a vested interest in ensuring compliance by producers and loss adjustors. Under these conditions, reinsured companies' revenue may become more reasonable, and producers' premiums may be more affordable and at less cost to the Government. In addition to evaluating risk sharing by the reinsured companies, RMA may need to evaluate the cost effectiveness of the current crop insurance program delivery system, including the possibility of a Government-administered delivery system (particularly with respect to the CAT Program).

An alternative to risk sharing is to consider returning the crop insurance program to a Government-administered delivery system. Such a change could be used to control costs. While reinsured companies received an estimated $759 million in 1998 to deliver and administer the Federal crop insurance program, the 1998 estimated budget for FSA (including its entire field office structure) was $721 million. We did not perform an in-depth analysis of this alternative to return to a Government-administered delivery system. Before this alternative is considered, RMA needs to assess these costs and determine the potential economy of a Government-administered delivery system.

While these more macro issues are being considered, RMA needs to take interim measures to strengthen its oversight by increasing its involvement in program activities. These interim measures are necessary and would include random spotchecks of adjustors' loss verifications (emphasizing large claims) and close monitoring of sales agents' and adjustors' compliance with conflict-of-interest requirements.

RMA also needs to change policies and procedures that have had an unacceptable impact on the program. Some policies actually encourage abuse. This impact will be even greater as Congress expands the program (particularly crop revenue or income protection coverage policies), and it will be felt especially in the area of "specialty" crops, like fruits, vegetables, and nursery stock, which often result in a greater per-acre loss value than program crops, like corn and wheat. (We observed nursery crops indemnified at over $1 million per acre.) Under current congressional initiatives, more specialty crops are being added to the program.

- RMA needs to properly research and develop crop insurance policies before implementing them. RMA has approved new programs or expanded existing programs without fully exploring the new proposals for all potential effects. As a result of RMA's incomplete research, producers have had incentives to plant crops based upon the potential for increased insurance indemnities rather than expected market conditions. In some cases, allegations have emerged that crops will be overplanted, reducing both domestic and international market prices and bringing international criticism of USDA's insurance policies.

  For example, RMA approved a new durum wheat policy (effective for the 1999 crop year) which was intended to compensate durum wheat producers for the expected premium in price for durum over other spring wheats. To arrive at this premium price, RMA approved using a 5-year average; however, we feel that 5 years does not provide adequate history for actuarial purposes. RMA ultimately approved a price guarantee that exceeded the actual futures market price for durum wheat by a significant amount. The price resulted in strong producer interest in the durum policy, insofar as the potential per-acre indemnities it could provide could exceed the incomes from other crops. This has led to speculation that more acres of durum will be planted than actual market conditions would encourage. This could give rise to international concerns of overproduction that will result in decreased world prices. RMA has instructed reinsured companies to reduce the price guarantee for 1999 in the northern durum wheat-producing regions (i.e., North Dakota and Montana).

- RMA should avoid policies that result in a moral hazard risk. Producers who abuse the program represent a moral hazard risk to RMA, and some policies encourage abuse. RMA's optional unit production policy, for example, allows a producer to subdivide his acreage into smaller units and later declare a disaster on some of the units, even though overall production was normal. The policy essentially allows the producer to isolate a "disaster" on a very small unit of land. It also encourages producers to dishonestly "shift" production from one unit to another to create a qualifying loss and to manipulate yields to create a false production history on some units for future claims of losses.

- RMA needs to ensure companies do not aim their sales activities at a select clientele. Because the Government uses reinsured companies to deliver the crop insurance program, the program becomes financially driven. Reinsured companies are paid administrative fees based on a percentage of premiums, and they are therefore motivated financially to promote insurance types that have a larger premium (e.g., Crop Revenue Coverage (CRC) policies) or seek out larger producers. There is less incentive for the reinsured companies to serve small producers.

This lack of incentive especially surfaces in the CAT program since "imputed" premiums (that is, what the Government's premium would have been for coverage at that level) are used to determine gains. Underwriting gains are the primary source of revenue to the reinsured companies and their agents for the sale of CAT policies. Therefore, producers with large acreage would result in larger "imputed" premiums and in potentially higher underwriting gains for reinsured companies. By focusing their sales and servicing on large producers, the reinsured companies have marginalized participation in crop coverage by producers at the lower income end of the farm community, thereby reducing the safety net of these programs for small and limited resource producers.

- RMA needs to provide better guidance and instructions to the reinsured companies. Better guidance was especially needed on servicing limited-resource producers. Reinsured companies did not market and sell CAT policies aggressively to limited resource producers. In respect to this, RMA only agreed to implement an outreach program. Participation by these CAT producers in the insurance program fell by 78 percent from 1997 to 1998, the time period when the reinsured companies assumed full responsibility for delivering the CAT Program.

Generally, RMA needs to establish a system for the sharing of both crop losses and underwriting gains that will induce the reinsured companies to establish good business practices in the delivery of the Federal Crop Insurance Corporation (FCIC) programs. This needs to include a system of distribution of underwriting gains that will encourage insurance agents to service small and low-income producers on an equal basis with larger producers. Also RMA needs to strengthen its oversight of the crop insurance program. Although RMA's compliance staff has identified and prevented some of the problems in the program, RMA needs to take a more proactive role in identifying and reporting weaknesses. Additionally, RMA should hold its staff and the reinsured companies accountable for ensuring integrity in the crop insurance program.

[***In 1997, RMA renegotiated the Standard Reinsurance Agreement with the reinsured companies decreasing the administrative reimbursement rate and increasing the reinsured companies' risk; the new agreement took effect for the 1998 crop year. However, based on the total reimbursements paid to the reinsured companies for 1998, further changes in the program may be warranted.***

(Note: The numbers used in this report generally reflect program activity as of early January 1999 when we drafted the report. Based on the information provided by RMA and others after the report was issued, we revised the report to redefine two items–our discussion of gross program costs and the total reimbursement to the reinsured companies for servicing the CAT program.)]

Suggested Corrective Actions

We suggest that RMA revise its Standard Reinsurance Agreement to increase the amount of risk assigned to the reinsured companies on crop insurance program policies. This would encourage economical and efficient management of programs by the companies and improve their quality control. Alternatively, RMA should evaluate options available for a more cost effective program delivery system, including the possibility of a Government-administered delivery system for the entire program or limited to a portion of the program, such as for the CAT Program.

While these more macro issues are being considered, RMA should strengthen its controls to preclude abuses by reinsured companies and producers. This would include greater monitoring of reinsured companies, sales agents, and loss adjustors. If the reinsured companies were to become full partners with RMA in program risk-sharing, we feel that the reinsured companies would implement the needed controls in their own program management.

Concurrently, RMA needs to assert a larger oversight and monitoring presence in the program by providing greater guidance to the reinsured companies, expanding RMA compliance oversight, and taking measures to improve the companies' quality control.

Additional suggestions for improving the crop insurance program are shown for each of the issues that follow.

Recent History of the Crop Insurance Program

The Risk Management Agency (RMA) was created by the Federal Agriculture Improvement and Reform (FAIR) Act of 1996, Public Law 104-127. Under the act, RMA was established as an independent agency to provide supervision to the Federal Crop Insurance Corporation (FCIC) and have oversight of all insurance programs. The FCIC is a wholly-owned Government corporation that publishes insurance regulations and manages the Federal crop insurance fund.

The crop insurance program is a joint effort by the private sector (reinsured companies) and RMA to deliver crop insurance to qualified producers. Reinsured companies are private insurance companies that market and service the crop insurance policies and that monitor delivery of the program. RMA works closely with the reinsured companies to implement the program, and is responsible for reviewing, analyzing, and evaluating crop insurance policies.

The Federal crop insurance program has been subsidized since its inception. In 1998, the reinsured companies received about $759 million from RMA for delivering the crop insurance program. In that same year, the insured producers received approximately $1.3 billion in indemnities, of which approximately $1 billion was covered by premiums paid by producers.

Producers pay $50 for basic Catastrophic Risk Protection (CAT) and, on average, about 60 percent of the cost of additional coverage, known as "buyup" coverage. RMA subsidizes the "buyup" coverage and pays the majority of all losses.

In the early 1990's, FCIC adjusted the administrative fees and underwriting gain/loss percentages to reduce program delivery costs and shift risk to the reinsured companies. During this period, the General Accounting Office (GAO) issued various reports on the need to reduce the payments made to reinsured companies and to shift additional risk to these companies. Despite these efforts, the reinsured companies still receive significant revenue, but share little of the risk.

The reinsured companies are responsible for providing oversight of the crop insurance program to assure that the program is being administered in accordance with the Standard Reinsurance Agreement (SRA), and with USDA-approved policies and procedures. The SRA is a cooperative agreement between RMA and the reinsured company to deliver multiple peril crop insurance (MPCI). This agreement establishes the terms and conditions under which RMA will provide premium subsidy, expense reimbursement, and reinsurance on MPCI policies sold or reinsured by the insurance company. When companies sign the SRA, they agree to administer the reinsurance program to ensure compliance with SRA requirements.

Recent initiatives within Congress and the Department to increase the number of crops and acres under insurance have resulted in an increase in the number of so-called "specialty crops" that qualify for coverage under MPCI. Historically, USDA has concerned itself with the traditional program crops--wheat, corn, cotton, and rice. Producers of these crops have been the major participants in the Government's crop insurance program. Specialty crops include fruits, nuts, vegetables, and other nonprogram crops, such as nursery plants. Because these crops are relatively new to Government programs, USDA has little history of their plantings and yields and must acquire current data on them to offer any realistic indemnification.

Inequitable Risk-Sharing With Reinsured Companies Has Cost the Government Millions of Dollars

Issue 1 Company Revenue Increased At the Expense of Good Program Management

The revenue of reinsured companies increased over the last 4 years at the expense of good program management. Because RMA assigned the companies little risk of exposure on crop losses, the companies' incentive has been to increase sales and keep clients happy through favorable loss adjustments. Because of these practices, the insurance companies' gains continue to increase despite the increase in the Government's liability.

Under RMA's current risk-sharing policies, the CAT program has become a windfall for the companies, is not cost effective from a delivery standpoint, and will need future adjustments in program delivery costs and producer coverage if it is to become an effective safety net for producers. [***From 1995 to 1998, the CAT program was transferred from a Government-delivery system program to a fully private delivery program. Over this 4-year period, total costs for the reinsured CAT program were estimated to be about $778 million. Of this amount, $510 million was paid to the reinsured companies for underwriting gains, excess loss adjustment expenses, and other administrative fees.***] For additional coverage (also termed "buy-up") greater than CAT coverage, company revenue was even higher.

[***For 1998, gross Government costs are estimated to be about $2.1 billion, which included $1.3 billion in indemnities to producers, $759 million in administrative expenses and underwriting gains paid to the reinsured companies, and $82 million in USDA administrative and related costs. According to RMA's estimates as of March 1999, producers' indemnities were estimated to be $1.6 billion.***]

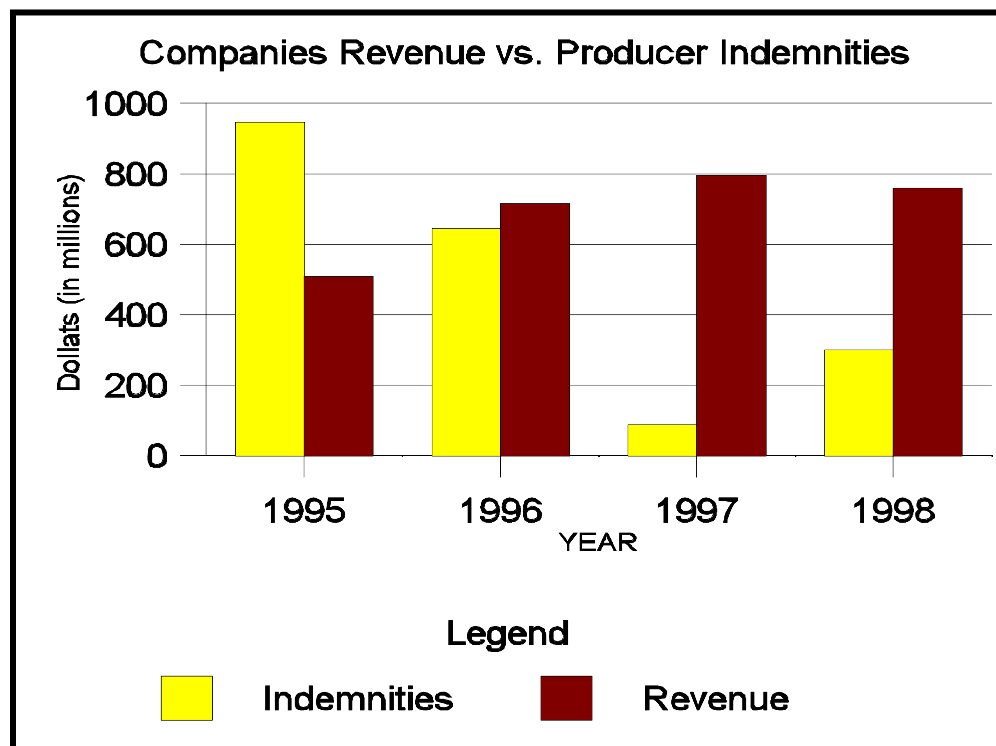
The companies received these large returns at the same time Congress had to pass supplemental appropriations of $6 billion for reduced farm prices and for insured and uninsured crop losses resulting from widespread disaster. (The crop loss portion of the $6 billion was about $2.4 billion.)

In 1997, GAO reported that the cost to the Government for reinsured company delivery of CAT was about $203 per crop policy in 1995 ($76 for administrative expenses and $127 for underwriting gains). Therefore, since 1995, CAT program costs have more than doubled on a per-policy basis, from $203 in 1995 to about $443 in 1998.

For reinsurance years 1995 though 1998, [***gross Government costs totaled about $8.8 billion, which consisted of $5.4 billion in indemnities paid to producers, $2.8 billion for administrative expenses and underwriting gains to reinsured companies, and $325 million in USDA administrative and related costs.***]

The following chart shows the relationship between the revenue received by the reinsured companies from RMA and the indemnities received by producers, exclusive of producer-paid premiums.

Figure 1: Companies' Revenue Exceeds Indemnities



Note: During 1995 and 1996, the CAT Program was administered by both FSA and the reinsured companies. Beginning in 1997, the program was administered exclusively by reinsured companies in 14 States. In 1998, the program in the remaining States was also transferred to the

reinsured companies. This change resulted in significant increases in revenue to the reinsured companies. (See Issue 6.)

While their revenues for delivering Federal crop insurance have been increasing, companies have not always followed sound actuarial practices. Because the companies receive a percentage of the total premium, it is in their financial interest to increase sales; and because the companies bear an immaterial share of the risk, they have little incentive to protect the Government's interest. Indeed, we found that companies have a greater incentive to retain clients through favorable loss adjustments. The inequitable distribution of risk between RMA and the reinsured companies contributed to the following practices.

- Sales agents, loss adjustors, and others were involved in conflicts of interest. (See Issue 2.)

- Loss adjustors felt pressure to rubberstamp policyholders' loss claims. (See Issue 3.)

- Quality control reviews were superficial and generally did not disclose improper or inefficient practices. (See Issue 8.)

The increasing costs to the Government for the Federal crop insurance program has had little impact on reinsured companies' revenue. For the period 1981 through 1998, reinsured companies, as a whole, have had underwriting gains in 14 of 18 years. During the 18 year-period, the companies received a total of about $5 billion in revenues, consisting of approximately $3.8 billion in administrative fees and $1.2 billion in underwriting gains. For the most recent 4 years, 1995 through 1998, the reinsured companies received a total of $2.8 billion in revenues, consisting of $1.7 billion in administrative fees and $1.1 billion in underwriting gains. As shown by the chart below, the reinsured companies have had no underwriting losses during this 4-year period.

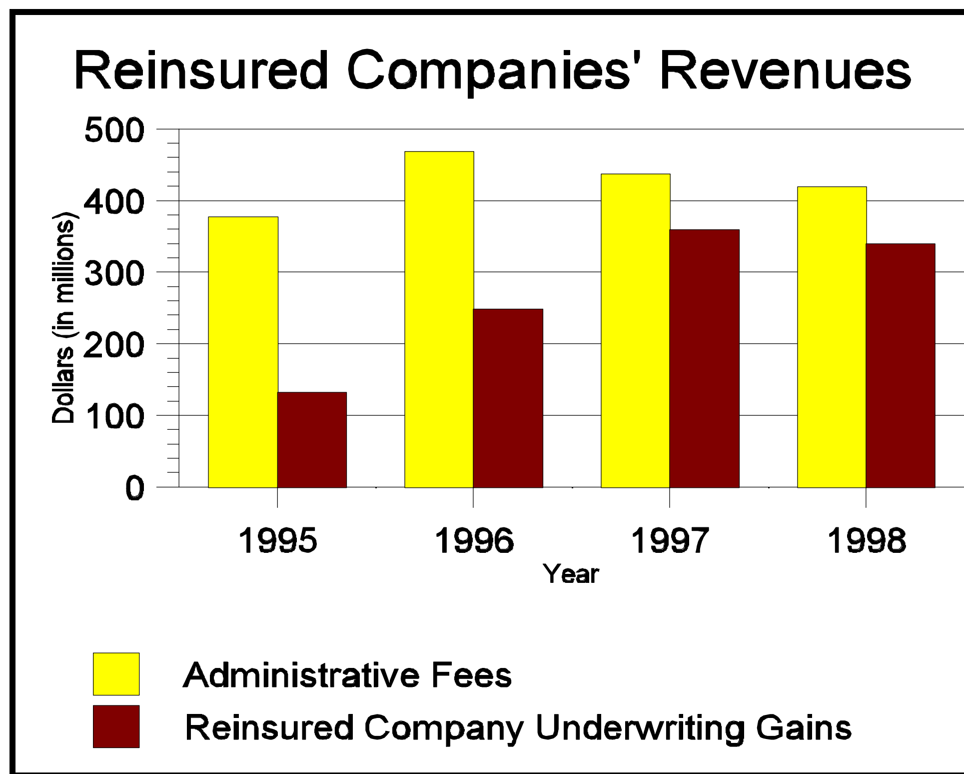
For the 1995 through 1997 reinsurance years, reinsured companies ceded about $1.4 billion in premiums and $1.9 billion in indemnities to RMA for policies with a combined loss ratio of 1.36 (that is, the policies required an indemnity payment of $1.36 for every $1 collected in premiums). Reinsured companies have become very proficient at assigning policies to the various pools to maximize underwriting gains on low-risk policies and to minimize underwriting losses on high-risk policies.

Currently, Congress has shown an interest in gaining control of program losses by setting a loss ratio target of 1.075 (a nearly dollar-for-dollar exchange of premiums and indemnities).

We concluded that to reach the loss ratio targeted by Congress, as well as to correct the abuses we found in policy sales and loss adjustments, RMA must assign a greater share of risk to the reinsured companies. We are therefore recommending that RMA revise its Standard Reinsurance Agreement to increase the amount of risk assigned to the reinsured companies.

Other options may also be available for a more cost effective delivery of the crop insurance program. RMA may want to study the feasibility and cost effectiveness of alternative program delivery systems for the crop insurance program including the possibility of a Government-administered delivery

Figure 2: Reinsured Companies' Revenues



system (for the entire program or limited to part of the crop insurance program, such as the CAT Program). Evidence suggests that a Government delivery system of the program may be more cost efficient than that currently provided by reinsured companies. While reinsured companies received approximately $759 million in 1998 to deliver and administer the Federal crop insurance program, the estimated budget for FSA, the agency that could likely deliver the program for the Government, was $721 million. This includes salaries and related costs for almost 15,000 employees located in 2500 field offices throughout the country. FSA field office employees have had crop

insurance experience and, as recently as 1997, jointly delivered, administered, and serviced the CAT program.

We want to emphasize that we have made no in-depth analysis of the costs of a Government-delivered insurance program. However, it would appear that the costs could very well be less than the $759 million paid to the reinsured companies in 1998. Although the comparative figures suggest a significantly higher costs in delivery by the reinsured companies, we recognize that there are many complex factors to consider in making such a comparison. We believe such a comparison should be done because any savings that could be realized in the cost of delivery of the crop insurance program could be passed on to producers as reductions in premiums.

Further indications that such a comparison should be made is found in a GAO report, issued in April 1997,[1] which stated that in 1995, the total cost to the Government to deliver CAT insurance was less when provided through the U.S. Department of Agriculture (USDA) than through reinsured companies. The primary reason attributed to by GAO for the higher costs for delivery by the reinsured companies was the underwriting gains paid by the Government to the reinsured companies.

At the 1999 midwinter legislative meeting, the National Association of State Departments of Agriculture discussed various proposals calling for major improvements in crop insurance. In one of its recommendations, the National Association of State Departments of Agriculture specifically cited that FSA should be the primary deliverer of basic crop insurance coverage.

While these more macro issues are being evaluated, we suggest that RMA take steps to control program abuse by reinsured companies and producers through increased oversight and monitoring.

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[1] Report No. GAO/RCED-97-70, Crop Insurance - Opportunities Exist to Reduce Government Costs for Private-Sector Delivery.

Suggested Corrective Actions

RMA needs to revise its Standard Reinsurance Agreement to increase the amount of risk assigned to the reinsured companies on crop insurance program policies; or

RMA should evaluate the feasibility and conduct an in-depth analysis of the cost effectiveness of alternative delivery systems, including the possibility of a Government-administered delivery system (for the entire program or limited to a portion of the program, such as for the CAT Program). In the interim, RMA needs to strengthen controls to preclude producer and company abuse of the program by implementing the suggested corrective actions cited at the end of Issues 2, 3, and 8.

Issue 2 Conflicts of Interest Persist

Reinsured companies did not have effective controls to prevent or detect situations that allowed employees, including contractors, to be involved in conflict-of-interest situations. This caused substantially increased risk to the crop insurance program. As a result, RMA could not be assured that policies sold or losses adjusted were proper, and it could not be assured that premiums and indemnities determined by these employees were accurate.

We noted that reinsured companies' employees and contractors (sales agents/loss adjustors) were performing duties that conflicted with crop insurance program requirements. We identified reinsured company staff who were engaged in activities which violated the conflict-of-interest requirements of the SRA. For example, we found that sales and claims supervisors supervised both sales agents and loss adjustors.[2] The supervisors had direct control over loss adjustments on policies sold by agents whom they also supervised. The reinsured company also allowed sales agents to adjust claims on policies they either sold or assisted in the sale.

The SRA states that "the reinsured company may not permit its sales agents * * * to adjust losses, or supervise, or otherwise control loss adjustors, nor to participate in the determination of the amount or cause of any loss nor to verify yields of applicants for the purpose of establishing any coverage or guarantee, if the eligible crop insurance contracts are serviced by or through the sales agent.[3]

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[2] Audit Report No. 05099-2-KC, RMA - Quality Control for Crop Insurance Determinations, issued July 14, 1998.

[3] Standard Reinsurance Agreement between the FCIC and the insurance company, effective July 1, 1994.

RMA Headquarters officials argued that their controls to prevent and detect conflicts of interest were adequate, but we found this not to be the case at the local levels. Reinsured companies did not use their quality control (QC) operations to detect these conflicts. During one review,[4] we found that 22 of 42 sales supervisors and 22 of 51 claims supervisors supervised both sales agents and loss adjustors. We also noted that 41 sales agents at one company were authorized both to sell policies as agents and adjust claims as loss adjustors. Personnel responsible for supervising or closing sales should not be in a position to influence the amount of indemnities disbursed on those sales.

In another audit, we found a questionable relationship between a sales agent and loss adjustors. The sales agent had a customer base of about 350 policies, only 4 of which did not receive an indemnity for 1997. The sales agent, who collected over $350,000 in indemnities himself that year, provided free office space to two loss adjustors who also verified his loss. The loss was based on the agent's claim that a disaster prevented him from planting his crop, whereas we found evidence that the land had been under water at various times involving several years prior to the loss and could not have been planted. Records also showed that the claim was not adjusted until 5 months after the loss.

Additionally, as reported in an audit of the crop insurance program for fresh market tomatoes, sales agents were employed by producers to whom they sold crop insurance.[5] One sales agent, also employed as the comptroller for the producer whom he sold crop insurance to, was responsible for providing production information to loss adjustors used for determining indemnity amounts. As a result, the sales agent/comptroller could have manipulated indemnity amounts by providing misinformation to loss adjustors.

During crop-years 1995 and 1996, this sales agent received crop insurance sales commissions totaling $284,000 in addition to his comptroller salary of about $120,000, while his employer, the producer, received indemnities totalling about $2.4 million. Both RMA and reinsured company officials were aware of this situation; however, they did not consider it to be a conflict of interest.

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[4] See previously mentioned Audit Report No. 05099-2-KC, RMA - Quality Control for Crop Insurance Determinations.

[5] Audit Report No. 05099-1-At, RMA Crop Insurance on Fresh Market Tomatoes, issued September 30, 1997.

We also found in a 1998 audit, "Prevented Plantings of 1996 Insured Crops", that two adjustors performed loss adjustments of an insured producer's prevented planting claim with whom they had a financial interest.[6] In addition, the insured producer was a sales agent who had sold the prevented planting coverage policy to himself. He also provided necessary production and loss documentation to the adjustors used to determine indemnity amounts. As a result, RMA cannot be assured indemnities totaling over $100,000 received by the insured producer were proper and correct.

In this situation, the sales agent rented land from the adjustors. This relationship between the adjustors and the insured/sales agent is prohibited by RMA's loss adjustment manual[7] which states, the adjustor must not adjust any claims which are sold by any party that the adjustor has a material or financial interest with.

Suggested Corrective Action

RMA needs to require sales agents and loss adjustors to attest to complying with the SRA, specifically conflict-of-interest requirements. Sales agents and loss adjustors should also be required to submit a financial disclosure statement to the reinsured companies which includes employer information, farming interests, other business interests, financial interests, etc. The reinsured companies, using the disclosure statement, should be required to ensure that a conflict-of-interest situation does not exist.

[6] Audit Report No. 05601-5-Te, Prevented Plantings of 1996 Insured Crops, issued March 1999.

[7] RMA Loss Adjustment Manual, part 1, section 1, paragraph 91 P, dated May 1995.

Issue 3
Loss Adjusters Have a History of Errors

Loss adjustment is a critical step in loss claims processing; loss adjustors are responsible for verifying the losses reported by producers and determining the indemnity amounts due. Our reviews have documented a history of verification errors by loss adjustors who have cost the Federal crop insurance program excessive indemnity payments. The adjustors have not performed all the required duties when determining if a loss occurred and an indemnity was due, and reinsured companies have provided minimal oversight and ineffective quality control. Moreover, reinsured companies have no incentive to protect the Government's interests; rather, they have a greater incentive to retain the insured's continued business by performing loss adjustments favorable to the insured producers.

We identified questionable indemnities caused by improper loss adjustment activities in a number of recent audits. In a summary report of 11 audit and evaluation reports and 17 investigation reports issued in 1996 and 1997,[8] OIG determined that RMA needed to improve its reviews of large loss claims. We found questionable indemnities totaling about $980,000 of the $11 million reviewed. Inadequate loss adjustment activities included errors made when (1) calculating crop income and production-to-count, (2) determining insured acreage, (3) verifying unit structure, and (4) determining producer compliance with policy requirements.

For example, adjustment verification of many raisin loss claims in California were completely erroneous.[9] Raisin insurance policies and loss adjustment procedures did not limit insured production to a producer's history of production. Thus, producers and loss adjustors could potentially inflate insured tonnage in loss years. In loss years, producers are motivated to demand higher insured tonnages when their claims are adjusted to receive higher indemnity payments, and loss adjustors may be pressured by sales agents and company management to allow higher tonnages to keep the insured producers happy. Our reviews found that loss adjustors working raisin loss claims in California used bogus yield figures to arrive at predetermined loss amounts. Insured raisin producers were able to inflate insured production in loss years to maximize indemnity payments, while their reported production in non-loss years served to minimize premium payments.

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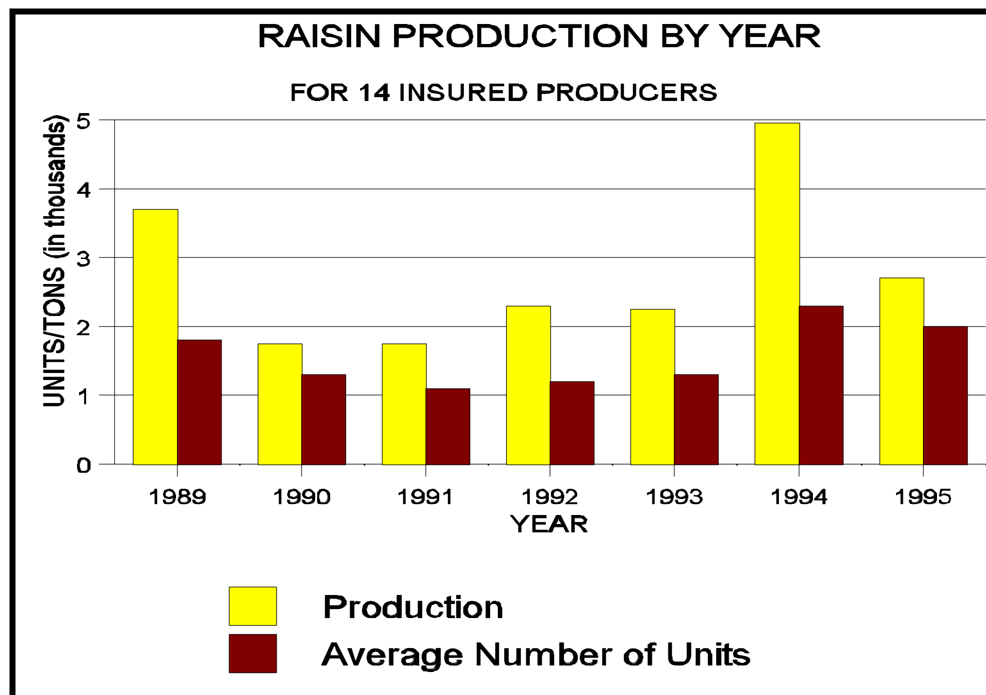
[8] Audit Report No. 05601-3-Te, RMA Federal Crop Insurance Claims, issued February 1998.

[9] Audit Report No. 03099-3-SF, RMA 1994 Reinsured Raisin Losses in California, issued September 30, 1996.

Figure 3: Insured Production Increases in Loss Years



California raisin losses occurred in 1989 and 1994. The chart above shows a comparison of insured units and insured production for 14 California producers from 1989 to 1995.

As indicated by the chart, insured production for the 14 producers increased in the disaster years 1989 and 1994. It more than doubled from 1993 to 1994.

OIG encountered another example of poor loss adjustment practices during an audit of nursery crop loss claims. In a December 1998, report on the Nursery Crop Insurance Program, we reported that the loss adjustor did not verify that the cause of loss actually occurred.[10] The producer had reported that a tornado damaged his greenhouse in 1996, which resulted in the loss of his orchid inventory due to excessive sunlight. Through interviews with reinsured company sales agents, loss adjustors, neighboring orchard owners, and weather station officials, and as a result of conflicting statements made by the producer and greenhouse repair officials, we concluded that a tornado did not strike the nursery as reported by the producer. Because the loss adjustor did not substantiate the cause of loss, we questioned the $243,000 indemnity paid to the producer.

[10] Audit Report No. 05099-2-At, RMA Nursery Crop Insurance Program, issued December 16, 1998.

During an audit of prevented plantings in Texas, we found that loss adjustments were performed months after the losses occurred.[11] Claims were paid based on the reported losses shown on acreage reports filed 30 days after the crop planting dates and adjusted months later when it was not possible to verify conditions that caused prevented plantings. We reviewed 75 policies with indemnities totaling about $1.8 million and questioned $158,000 relating to 32 policies.

Reinsured companies have little incentive to make proper loss adjustments because they incur marginal costs associated with losses and their profits are generated from sales of insurance policies. Favorable loss adjustment decisions generate repeated sales for the reinsured company as farmers learn of the lenient loss adjustment decisions resulting in substantial indemnities. Reinsured companies are aware of this and may use the deficient loss adjustments as a means not only to maintain their customer base, but also to entice new farmers to purchase their crop insurance policies.

Suggested Corrective Action

RMA should take a proactive role in monitoring reinsured company oversight and quality control reviews of loss claims, especially claims that exceed a specified high-dollar threshold.

[11] Audit Report No. 05601-5-Te, Prevented Plantings of 1996 Insured Crops, issued March 1999.

RMA Policies and Procedures Do Not Always Protect the Government's Interest or Further Program Goals

Issue 4
RMA Needs To Properly Research and Develop Crop Insurance Policies

RMA's operating system does not provide for sufficient research and development of crop insurance policies before those policies are implemented, and it does not ensure that potential consequences of changes in the crop insurance program are adequately addressed before those changes go into effect. This systemic flaw has resulted in unreasonably high yield figures in such program crops as cotton and corn, but it has also resulted in poorly written policies for some specialty crops, such as nursery plants and popcorn. Because many specialty crops are new to the program and do not have the histories of program crops, little information about their production is available to RMA. Also, because specialty crops may have a higher loss value per acre than program crops (nursery plants, for example, may be insured for up to $1 million an acre), loss potential must be measured accurately. As more specialty crops are brought into the insurance program, RMA must be prepared to research the expected yields of these crops and the conditions under which they may be grown before the Government can underwrite reasonable policies for them.

Weaknesses in RMA's policy research also renders the crop insurance program susceptible to abuses by reinsured companies and producers. Flawed crop insurance policies create increased moral hazard risks.[12] Before new policy requirements and instructions are implemented, they should be evaluated to ensure the moral hazard risk has been minimized. We found several instances in which producers took advantage of flaws in RMA policies that tended to reward risky behavior.

[12] Moral hazard is defined as risk resulting from uncertainty about the insured's veracity.

Crop Insurance on Fresh Market Tomatoes[13]

RMA procedures used to administer the insurance program (Dollar Plan) allow indemnities to be paid to producers who did not experience a loss in quantity or quality of production, but instead, suffered financial losses due to low market prices, even though this was not intended under the policy. We noted that producers were choosing not to harvest marketable tomatoes because of low prices, for which they received an indemnity, even though they did not suffer a loss of production. We found a memo in one producer's records which stated, "we elected not to pick this field for the packing house because the market price was below harvest and packing costs." The producer received a $41,430 indemnity for this 16.7-acre field of tomatoes.

RMA asked the Office of the General Counsel (OGC) to review the tomato policy regarding payment of indemnities based on low market prices, even though this was not intended. OGC responded in a letter to RMA which stated that RMA did not have the authority under the tomato policy to pay a claim based solely on loss of market price. OGC also stated that OIG identified flaws in the tomato policy, and that the provisions of the policy must be revised as soon as possible to bring it back in conformance with the Federal Crop Insurance Act.

Crop Insurance Coverage for Pima Cotton, Popcorn, and Corn in Texas[14]

RMA provided producers in three separate areas of Texas with nonirrigated crop insurance coverage when there was little likelihood that a crop could be produced without irrigation because of climatic conditions. Also, RMA established crop insurance yields and rates for the insured crops that were significantly higher than could realistically be expected from harvesting the crops. For these reasons, producers without past production histories obtained crop insurance coverage to "farm the insurance program" rather than plant with realistic expectations of bringing the crop to harvest. RMA paid indemnities of over $20 million for losses associated with this insurance coverage. This coverage included nonirrigated pima cotton in West Texas counties (Glasscock, Midland, Reagan, and Upton counties), popcorn in the Rio Grande Valley (Cameron, Hidalgo, and Willacy counties), and corn in Tom Green County.

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[13] Audit Report No. 05099-1-At, RMA Crop Insurance on Fresh Market Tomatoes, issued September 30, 1997.

[14] Audit Report No. 05001-2-Te, RMA - Crop Insurance Coverage for Pima Cotton, Popcorn, and Corn in Texas, discussion draft dated January 21, 1999.

- Pima Cotton in West Texas Farmers in four counties were offered 1998 crop year coverage for nonirrigated pima cotton in areas where it was not feasible to grow cotton without irrigation. Also, the growing season in this area was too short to produce a pima cotton crop. The RMA regional office in Texas raised concerns about this coverage, but RMA's research division would not rewrite the policies. There were 359 policies in effect with associated premiums of about $4.4 million. RMA subsidized $1.9 million of these premiums. In addition, RMA paid indemnities of $14.9 million to 334 of the 359 producers for losses on 71,850 acres.

- Popcorn in Rio Grande Valley In 1997, farmers were offered dryland crop insurance coverage for popcorn in an area where the normal rainfall was not sufficient to produce a crop. Also, the high yields and payment rates for this coverage caused producers to plant the popcorn for insurance purposes rather than for harvest. RMA records showed that for the 1997 crop year there were 113 policies (as opposed to 3 policies in 1996) with premiums of about $843,000 involving about 49,300 acres of planted popcorn (47,800 nonirrigated acres and 1,500 irrigated acres). Indemnities totaling about $5.5 million were paid on 77 of the 113 policies.

- Corn in Tom Green County In 1998, producers were offered crop insurance coverage for nonirrigated corn. RMA established unreasonable yields for their insurance coverage, attracting producers who took advantage of the program by planting corn for insurance. Prior to 1998, there were only seven producers who carried crop insurance coverage for corn, while the county itself devoted only 100 acres to the crop, all irrigated. (Irrigation is necessary because the county receives an average of only 20 inches of rain a year.) As of October 28, 1998, 80 producers had received about $2.3 million in indemnities. In 1998, there were about 19,000 acres of corn reported planted for insurance purposes.

1994 Reinsured Raisin Losses in California.[15]

The raisin insurance policy allowed producers to sell their damaged raisin crop as salvage material instead of requiring them to recondition the raisins, which substantially increases their value. As the value of reconditioned raisins increases, the indemnity amount decreases. Producers who were aware of the policy flaws chose to sell whatever production was harvested as salvage even though the raisins may have been reconditionable. One major raisin packager we reviewed bought some of the raisins at salvage prices, then reconditioned them to sell as fresh product. We reviewed indemnities totaling $20.9 million; of that amount, $8 million could have been saved had the policy been more restrictive and prevented the producers from taking advantage of the program.

Guaranteed Prices for 1999 Durum Wheat Under Crop Revenue Coverage.

In establishing a guaranteed price for a new durum wheat policy for the Crop Revenue Coverage (CRC) Program, RMA used a simple 5-year price average[16] that resulted in a guaranteed price substantially above current market predictions. The price was intended to reflect a normal price premium for durum wheat over other spring wheat; however, even the reinsured company that asked RMA to approve the durum wheat policy acknowledged that the premium for durum wheat over spring wheat has historically been hard to determine. The company said that over the 5-year period RMA used for an average, the premium has been as high as $2.66 a bushel and as low as 99 cents a bushel.

Since the establishment of the CRC Program for durum wheat, many concerns have been raised about its adverse effects. Critics have noted that RMA's guaranteed price for durum is excessive in comparison with the market price, and they have alleged that producers will plant excessive acreage of durum because of the potential for large insurance indemnities. The potential oversupply of durum is also seen as adversely impacting durum prices for producers who normally grow durum wheat and as having an adverse impact in world markets as well. Although we have not reviewed this program to verify these allegations, it appears that they may have merit since there has been considerable discussion of this issue in the farm trade news. RMA has worked with the reinsured companies to reduce the price guarantee for the

[15] Audit Report No. 03099-3-SF, RMA 1994 Reinsured Raisin Losses in California, issued September 30, 1996.

[16] As represented on the Minneapolis Exchange.

1999 crop, but any change now may have legal ramifications because many of the insurance contracts had already been purchased at the higher guarantee.

We concluded that policies like the durum wheat policy are being developed or expanded without sufficient marketing or loss history. In those instances where information is not available, RMA should be cautious during the approval process and consider pilot projects before fully implementing new programs.

Initiatives By Reinsured Companies Also Need Oversight

Recently we became aware of at least one case in which a reinsured company has offered an add-on product to RMA's basic CRC policy. This product has created a major controversy in the crop insurance industry. There are allegations that the product is being offered by the company to gain unfair market shares over its competition, and that the product itself encourages overplanting of some crops and is disrupting the world marketing and production of some commodities. The product is called "CRC-Plus." Although the product's name suggests it is part of RMA's CRC Program, it is not. It is a policy offered by a reinsured company and is not supposed to increase RMA's liability under the CRC policy. Nevertheless, the reinsured company's CRC-Plus policy would not be offered if it were not for RMA's basic CRC policy, and it will only be sold in conjunction with the CRC program. RMA does not approve add-on policies, such as CRC-Plus; however, RMA is required to make a determination that the add-on policies do not increase the Government's liability under the basic policy. It is our understanding the CRC-Plus policy may have been sold before RMA made this determination.

CRC-Plus has been widely promoted and accepted in the areas covered by the CRC crop insurance program for rice. CRC-Plus is only available from one reinsured company, and that company has been requiring producers to carry the basic CRC policy from them. Therefore, if a rice producer had purchased CRC insurance in prior years from another reinsured company, that producer would have to change reinsured companies to qualify for the CRC-Plus policy for the 1999 rice crop year. The CRC-Plus policy was originally advertised at 3 cents per pound over the CRC-guaranteed price of 8.5 cents per pound, representing about a 35 percent increase. At the current time, the market price for rice is substantially below both the CRC-guaranteed price and the CRC-Plus price, igniting a large interest in the CRC-Plus program. As in the case of durum wheat, there have been allegations that producers were seeking land to produce rice because of the potential of a large insurance indemnity payment due to low market prices. This in turn can increase production, which can also keep market prices low and disrupt world marketing.

With the sale of the CRC-Plus policies, other reinsured companies, which have been losing business, have expressed concerns about unfair marketing practices. The companies have voiced these concerns to RMA because the CRC-Plus policy is only available in conjunction with RMA's CRC policy. Recent developments with CRC-Plus policies have also brought criticism from rice growers. The farm news network is now reporting that the reinsured company is lowering the 3-cent additional guarantee to 1.5 cents. Rice producers now face a lower rate after they have already committed their insurance business to the reinsured company offering CRC-Plus. The president of the Louisiana Rice Growers Association has been reported as saying it looks like a bait-and-switch operation.

Situations such as this have the potential of creating bad publicity for the Secretary and the Department. RMA needs to be aware of the potential effect that any add-on policies have on insurance marketing and on production. Since these policies are unavailable without the basic RMA insurance policies, RMA needs to determine if add-on policies should be allowed at all. Because the operations of reinsured companies are the same under the basic policy, most add-on policies are designed so a particular reinsured company may gain some type of marketing advantage. Consequently, RMA needs to ensure that any actions it takes does not create the appearance of favoritism.

It is also questionable what impact these type of policies have on RMA's basic policy. If the add-on has the effect of reducing market prices for the commodity, as the CRC-Plus may have with rice, the lower market price will impact upon RMA's liability under the basic CRC policy.

Suggested Corrective Action

RMA needs to perform more extensive analyses of crop insurance policies before implementation, particularly as to the effect on RMA's liability. Specifically, RMA should work with the reinsured companies to develop and use a computer model adaptable to all crops which would test as many scenarios as possible. RMA should also apprise itself of the effects that any reinsured company's initiative may have on the marketplace if that initiative requires any approval from RMA.

Issue 5
Optional Unit Structure Encourages Improper Indemnities

Policies that encourage program abuse by producers are said to create a moral hazard risk. Such is the case with RMA's optional unit policy. This policy allows producers to manipulate their unit structures to benefit themselves when determining if losses actually occurred. This weakness in the policy increases administrative and premium costs and allows producers to shift production specifically to maximize production losses to increase indemnity amounts.

FCIC instructions allow land that would otherwise be one basic unit to be divided into optional units. For land to be eligible for unit division, (1) producers must have independently verifiable planting, production, and harvesting records necessary for determining the production guarantee for the optional units, and (2) a clear and discernible break must occur at the boundaries of the optional units. Optional units enable producers to separately insure various segments or portions of their overall operation and to receive indemnity payments if some of those units have losses even though others may have production equal to or greater than the guarantee. Generally, combining units on multiple unit policies will reduce the amount of indemnity paid, while separating the units will increase the possibility of an insurable loss.

The main function of RMA's optional unit policy has been as a marketing tool for reinsured companies. By offering optional unit coverage at slightly higher premiums, the reinsured companies can attract business from producers who may be willing to pay more for the greater likelihood that they can collect from the Government on loss claims. Generally, the optional unit policy, with its higher-than-average loss claims, has resulted in overall higher premiums within the program and higher administrative costs.[17] Based on our review of a random sample of 60 policies with indemnities, we statistically projected that, for crop year 1991, the net costs[18] to the Government could have been reduced by as much as $336.7 million if the units had been limited to one per county or to basic units.

In an ongoing audit of claims involving optional units, we found that producers were paid indemnities on optional units that did not meet the criteria which

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[17] Audit Report No. 05600-6-Te, RMA Crop Year 1991 Unit Evaluation, issued September 30, 1994.

[18] Net costs include the indemnity paid plus the administrative expenses less producer-paid premiums.

allow basic units to be divided into optional units.[19] Specifically, producers were not able to provide supporting documentation that showed from which optional units the production actually was harvested. As a result, the optional units must be combined back into the basic unit structure and the loss computed based on the basic unit.

Suggested Corrective Action

To strengthen program integrity, RMA should consider rescinding its optional unit policy or revise policies and procedures to compare production from the original basic unit to total production from the optional unit divisions to ensure that a loss of production actually occurred. If total production from optional units equals or exceeds the normal production from the basic unit (from which the optional units originated), an indemnity should not be approved.

Issue 6 Reinsured Companies Receive Substantial Gains from Imputed CAT Premiums at the Cost of Broader Program Participation

We feel that reinsured companies are not utilizing the substantial underwriting gains received under the FCIC crop insurance programs to encourage and expand crop insurance coverage to as many producers as possible, regardless of size. This is especially the case for the CAT Program, which serves as one of USDA's safety net to small and limited-resource producers. Under congressional mandate, RMA began transferring the CAT sales function from FSA county offices to reinsured companies in 1997, and, starting in 1998, only reinsured companies could sell and service CAT policies. In one of our recent audits, we found a substantial reduction (78 percent) in CAT policies sold to limited-resource producers from 1997 to 1998. And over the period from 1995 to 1998, reinsured companies received $305 million in underwriting gains.

In calculating the reinsured companies' underwriting gains or losses, RMA is authorized by statute to credit the reinsured companies for imputed premiums which is based upon the amount of premium the insured would have paid if he/she had purchased comparable CAT coverage. Underwriting gains provide another source of revenue to the reinsured companies for administering the CAT Program in addition to the current $50 administrative fee and excess loss adjustment payments. But the fixed administrative fee and excess loss adjustment payments do not provide sufficient financial incentive to reinsured companies to sell CAT policies. Therefore, to increase the potential underwriting gains under the CAT program, reinsured companies have tended to focus their sales and servicing activities towards larger producers or producers with high-value crops. With these type of producers, reinsured companies will generate larger imputed premiums and, thereby, increase their potential CAT underwriting gains. At the same time, the

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[19] Audit Report No. 05001-1-Te, RMA - Crop Year 1997 Insurance Claims Involving Optional Units, ongoing.

reinsured companies have overlooked producers at the lower income end of the farm community (since this results in smaller underwriting gains). This practice has reduced the effectiveness of the crop insurance program as a safety net for all producers, especially for small and limited-resource producers.

In our audit of CAT servicing activities, we noted that reinsured companies did not instruct their agents to contact transferred limited-resource producers to explain that they were eligible for administrative-fee waivers and would not be charged for the CAT coverage.[20] As a result, many limited-resource producers dropped out of the 1998 CAT Program even though they were eligible for insurance coverage at no cost. Limited-resource producers' participation in the CAT Program declined about 78 percent from 1997 to 1998. We also questioned whether the CAT Program represents a viable risk management tool for limited-resource and socially-disadvantaged producers, because of the lack of financial incentives of the reinsured companies to service these producers and the limited coverage (50 percent of production) provided by CAT policies.

We also reported that limited-resource producers were not adequately encouraged to purchase coverage by the reinsured companies.[21] These producers tend to be very small operators. Reinsured companies realize little or almost no benefit from these producers' imputed CAT premiums and consequently have little incentive to serve them. RMA itself has made minimal efforts to correct this situation. In our current review of CAT servicing efforts, we noted that RMA continues to demonstrate an ineffective administration of the CAT Program and an inability to increase participation by limited-resource producers.[22]

Reinsured companies received about $1,079 million in underwriting gains during 1995 through 1998. Of this total, $305 million was from CAT insurance and $774 million from all other insurance policies.

To function effectively as a safety net, the Federal crop insurance program must be attractive to all producers. In order to do this, funding to the reinsured companies for the CAT Program must be designed in such a

[20] Management Alert, Audit No. 05099-6-KC(1), Servicing of CAT policies, dated June 26, 1998.

[21] Audit Report No.05099-1-KC, RMA - Transfer of CAT Policies to Reinsured Companies, issued March 3, 1998.

[22] Audit Report No. 05099-6-KC, Servicing of CAT Policies, ongoing.

manner to encourage them to make CAT policies available to all producers, including small and limited- resource producers. We suggest that RMA could assign a greater value to imputed premiums of small and limited-resource farmers. This would result in a larger impact by CAT policies held by small and limited-resource producers when calculating the reinsured companies' underwriting gain for CAT and a smaller impact for large producers and producers of high value crops. This would provide an incentive for the reinsured companies to seek out small and limited-resource producers and provide small and limited-resource producers with the insurance coverage, thereby increasing the effectiveness of USDA safety net to all producers.

Suggested Corrective Action

To promote the crop insurance program as a "safety net" for all qualified producers, RMA should consider (1) assigning an increased value to CAT imputed premiums of small producers so that reinsured companies are given comparatively greater incentives to increase their efforts in marketing CAT policies to small and limited-resource farmers, (2) adjusting the formula for determining reinsured companies's share of gains and losses for CAT policies based on the higher imputed premium values, and (3) ensuring revenues realized from CAT imputed premiums are used to reduce premiums and to fund outreach programs which would encourage good producers to remain in the program and influence qualified small and limited resource producers to participate in the crop insurance program.

Issue 7
RMA Needs To Provide Better Guidance to RMA Regions and Companies

The guidance provided to program officials and to private insurance companies is inadequate to administer the crop insurance programs. USDA consolidations made existing program handbooks obsolete, and RMA has not replaced the handbooks with current procedures. In the absence of proper guidance, RMA's regional service offices have not monitored the program to ensure all premiums are properly established, and reinsured companies have not ensured that the Federal program is available to producers of all income levels.

Weaknesses in management controls over program operations by reinsured companies.[23]

RMA did not take an active role in monitoring the transfer and servicing of CAT Program policies from FSA to the reinsured companies. The agency did not require the reinsured companies to disseminate information to limited resource producers transferred from FSA about available fee waivers. RMA flagged the limited resource producers in the CAT Program files provided to the companies, but did not provide guidance to the reinsured companies for handling the special servicing needs of these producers. Furthermore, RMA did not require reinsured companies to contact the limited resource producers to ensure they were offered CAT coverage for their farming operations. (See Issue 6.)

We also noted that RMA did not provide reinsured companies with appropriate guidance concerning producers with abnormal loss histories.

In a December 1998 audit of the Nursery Crop Insurance Program,[24] we identified a producer who had a history of receiving large questionable indemnities while continuing to purchase insurance coverage at the normal premium rates. RMA used data provided to its Nonstandard Classification System (NCS) by reinsured companies for identifying and sanctioning producers with abnormal loss histories. This producer had circumvented the system by providing different names and identifying numbers to the reinsured company. RMA did not inform the reinsured companies about the limitations of NCS and did not require the companies to report producers by their original enrollment names.

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[23] Management Alert, Audit No. 05099-6-KC(1), Servicing of CAT Policies, dated June 26, 1998.

[24] Audit Report No. 05099-2-At, RMA Nursery Crop Insurance Program, issued December 16, 1998.

This producer employed a former FCIC official as a loss adjustment consultant to facilitate the claim process. The consultant may have been aware of the weaknesses in the program and may have advised the producer to use different names each year. Had the system been effective, the producer's premiums would have increased from about $82,000 to $1.9 million and from $91,000 to $1.3 million for 1997 and 1998, respectively. This producer received indemnities totalling about $1.65 million for 1997 and 1998 and continues today to be able to purchase insurance coverage at normal premium rates. The consultant's fee for her services was 3 percent of the indemnity amounts paid to the producer.

RMA eliminated the NCS for all crops for the 1999 crop-year, but its replacement system is not applicable for certain crops which do not require an actual production history (APH), such as nurseries. RMA stated that because of the limited number of insured nurseries selected for NCS, a new system for nurseries may not be necessary. We pointed out that NCS was deficient and that was largely the reason more nurseries were not selected for NCS. RMA continues to review the need for a system to replace NCS for non-APH crops.

Weaknesses in management controls over administrative and program operations at the regional service offices (RSO).[25]

RMA did not have a current directives system for RSO operations. The Federal Crop Insurance Reform Act of 1994 created FSA which included FCIC. In 1996, the FAIR Act created RMA and removed insurance operations from the FSA. However, FSA's administrative services retained responsibility over RMA administrative and personnel functions. These changes have created confusion at the RSO's as to applicability of existing administrative procedures. Also, RMA program handbooks are outdated and not applicable to current reinsurance operations.

RMA needs to issue guidance to RSO's in the following areas:

Reviews of loss descriptions should be required. Underwriters were not required to redetermine if premium rates set for insured producers on FCI-33 supplements represented actual loss conditions. FCI-33 supplements are individually-approved premium rate adjustments (based on planting or soil conditions of farm land) for insured producers. The adjustment can result in the insured's premium rate being reduced on an exception basis. RMA procedures do not require any followup on written agreements to ensure agreement conditions were met. FCI-33 supplements should be subsequently reviewed to ensure producers are not receiving reduced premium rates on land that continues to have unfavorable loss ratios.

[25] Audit Survey No. 05099-9-KC, RMA Regional Service Office Operations (Survey Results).

Service offices need the capability to monitor high risk land. This capability has not existed within RMA since 1996, when RMA decided not to enter legal descriptions for crop units in its Data Acceptance System. Currently, the RSO's show high risk areas on maps. This data is sent to the reinsured companies in legal description format, who in turn provide the information to their agents for premium quotes. To ensure that agents properly compute the quote, reinsured companies recompute the premium using RMA's mapping. However, since RMA no longer has a data base system with legal descriptions, its underwriters are unable to track premiums related to high risk land or construct a history of the losses attributed to individual parcels of land. As a result, controls over establishing premium rates for high risk land are not fully functioning.

RMA should invite service office expertise. RSO's were not required to provide input or participate in new product development even though the crop coverage could be significant in their region. For example, the RSO's for three of the largest melon producing States did not participate in the new coverage development for melons. As a result, coverage was developed without the input and guidance from the RSO's that have considerable experience with melons.

Documentation needs to be standardized. Procedures were not always in place for underwriters to use in standardizing the documentation of new or expanded crop programs. One RSO did not use a centralized filing system for the documentation of new or expanded programs. Rather, individual underwriters kept key program documentation in their own files. As a result, the supporting documentation may be lost and not be available for future use when personnel changes are made in these offices.

Suggested Corrective Action

RMA should assess and evaluate its policy and procedure handbooks and, where applicable, replace and/or update handbooks for compliance with current program requirements. In addition, RMA should develop a system of preparing and issuing updates when changes occur, to include a methodology for ensuring that all handbooks and updates are properly and timely disseminated to applicable RMA and insurance company officials. In addition, RMA should design and implement a system to replace the NCS for non-APH crops.

Issue 8

RMA Relied Too Heavily on Reinsured Company Quality Control Reviews to Ensure Compliance With Policy and Agreement Provisions

The quality control review program carried out by reinsured companies has not been effective in identifying and preventing problems in the program, and the oversight provided by RMA's Risk Compliance, while improving, needs to be strengthened to ensure more effective program integrity.

During performance of OIG audits and other reviews, we reported deficiencies in the quality control functions and compliance of the crop insurance program. Specifically, in a July 1998 audit of RMA's quality control process, OIG reported that reinsured companies' QC systems were not used effectively as controls to help improve program delivery, ensure program integrity, or measure and report on program performance.[26] The report also stated that RMA did not provide effective oversight of reinsured companies' QC operations to ensure that QC processes achieved their intended results. Both the RMA and the insurance industry have made efforts to correct deficiencies, but conditions still exist which indicate that improvement in the oversight of the crop insurance program is still needed.

Quality Control Reviews Have Not Been Effective

Reinsured companies' internal QC reviews did not always identify problems and prevent improper indemnities, and the companies did not use the QC results to improve overall program performance or to ensure the integrity of the programs. These reviews were superficial and were performed by people who lacked independence. We concluded that RMA could not rely on the reinsured companies' QC process as an effective system of oversight.

The reinsured companies are responsible for providing oversight of the crop insurance program to assure that the program is being administered in accordance with SRA and with USDA-approved policies and procedures. The SRA is a cooperative agreement between the FCIC and the reinsured company to deliver multiple peril crop insurance (MPCI) which establishes the terms and conditions under which RMA will provide premium subsidy, expense reimbursement, and reinsurance on MPCI policies sold or reinsured by the insurance company. When companies sign SRA's, they agree to administer the reinsurance program in a manner which ensures compliance with SRA requirements.

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[26] Audit Report No. 05099-2-KC, RMA - Quality Control for Crop Insurance Determinations, issued July 14, 1998.

Reinsured companies address their oversight responsibility through their QC reviews. The QC reviews are designed to provide assurances that insurance company procedures, systems, and programs are effective and adequate. The QC reviews are also used to expose intentional program abuse and to identify discrepancies, inconsistencies, or errors. Finally, the QC program is also used to identify the need for enhancing existing or developing additional internal controls, training programs, and/or implementing necessary corrective actions, if required.

Our September 1997 audit noted that reinsured company QC reviews of loss claims of seven policies did not identify deficiencies that were later identified and reported by our reviewing the seven policies. The QC reviews were found to be too superficial to detect or correct questionable practices by the reinsured companies and their employees. The review consisted largely of a series of questions requiring only a "yes" or "no" answer. To complete the questionnaire, the reviewer was supposed to rework the loss as if it were being done for the first time. However, we did not find evidence that the loss had been reworked.

We have already noted in Issue 2 of this paper that company QC reviews were inadequate to detect and prevent conflicts of interest among sales agents and loss adjustors. During our evaluation of reinsured companies' QC reviews, we found that 8 of 41 sales agents in one company were in conflict of interest, and that 44 of 93 sales and claims supervisors were in potential conflict of interest. An effective QC process should have detected these situations and exposed the vulnerability of MPCI programs to potential and real conflicts of interest.

In a February 1998 report, we concluded that reinsured companies' reviews of large claims were not effective in identifying and correcting program violations.[27] In this audit, 17 of the 35 loss claims of $100,000 or more were questioned. All of these claims were required to have had QC reviews performed by the reinsured companies, but the reviews did not acknowledge any of the deficiencies identified by us.

RMA's Risk Compliance is Not Being Fully Utilized

RMA needs to take a more proactive role in identifying and reporting weaknesses by utilizing more effectively its Risk Compliance. Additionally, RMA must be held accountable for ensuring that responsible program officials and reinsured companies address and correct the deficiencies

RMA's Risk Compliance is responsible for providing internal oversight of the nationwide crop insurance program by ensuring reinsured companies and other providers are performing in accordance with the terms of their

[27] Audit Report No. 05601-3-Te, RMA Federal Crop Insurance Claims, issued February 1998.

agreements, contracts and FCIC-approved policies and procedures. Additionally, Risk Compliance is responsible for assessing program vulnerabilities and providing internal control of program abuses. These tasks are accomplished through RMA's performance of (1) operational reviews of reinsured companies, (2) inspections of policy servicing and claims activities, (3) reviews of alleged program violations, and (4) reports of findings, including conclusions and recommendations.

Despite these activities, compliance problems by reinsured companies continue to occur. For example, in our audit of the crop insurance program for fresh market tomatoes, we reported there is a need for RMA to be more heavily involved in the oversight of the crop insurance program activities.[28] In the September 1997, report, OIG recommended that RMA revise its current system of monitoring crop insurance activities to include more direct involvement by RMA.

OIG recently performed a review of RMA's Risk Compliance[29] to evaluate its controls over the agency's crop insurance program. In the January 25, 1999, report, we reported that the agency could enhance the function of its Risk Compliance staff by (1) more effective use of its review results, (2) greater involvement and accountability by other RMA divisions, (3) initiating a system to analyze review results to determine trends and areas vulnerable to abuse, and (4) a more effective system to track program abuse complaints and corrective actions taken by the responsible RMA division. The report also stated that by providing the Risk Compliance staff oversight of operational activities, the staff would be able to act preemptively and identify potential problems before they result in improper indemnities and/or appeals board actions.

To assist RMA's Risk Compliance in assessing the integrity of the crop insurance program, an independent system of evaluating reinsured companies' delivery and administration of the program is needed. A method to rate reinsured company's performance of managing the crop insurance program is also needed. Once the rating methodology is developed and implemented, a standard of acceptable performance should be established. RMA could then readily identify and sanction poorly performing companies and reward those companies which exceed the acceptable performance level.

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[28] Audit Report No. 05099-1-At, RMA Crop Insurance on Fresh Market Tomatoes, issued September 30, 1997.

[29] Audit Report No. 05005-1-Ch, RMA Controls Over Monitoring of Private Insurance Companies, issued January 25, 1999.

Suggested Corrective Action

RMA should develop and implement a system of ongoing reviews of reinsured companies' QC activities to assess their effectiveness in identifying and correcting program weaknesses. In addition, RMA and reinsured companies should take a more proactive role in the crop insurance program by performing vulnerability assessments of all crop policies. RMA should also develop a methodology for ensuring that identified program weaknesses are assigned and addressed by applicable RMA officials and reinsured companies.

RMA should also consider developing a system for rating reinsured companies' delivery and administration of the crop insurance program. As part of this system, RMA should provide monetary rewards to reinsured companies or sanction them, based on their performance compared to an accepted standard of satisfactory performance. This could be accomplished by adjusting rates in computing retained gain amounts.

References

The issues discussed in this paper were reported in the following documents issued by OIG.

1. Audit Report No. 05099-1-KC, RMA - Transfer of CAT Policies to Reinsured Companies, issued March 3, 1998.
2. Audit Report No. 05099-2-KC, RMA Quality Control for Crop Insurance Deter-minations, issued July 14, 1998.
3. Audit Report No. 05099-6-KC, Servicing of CAT Policies, ongoing.
4. Management Alert, Audit No. 05099-6-KC(1), Servicing of CAT policies, dated June 26, 1998.
5. Audit Survey No. 05099-9-KC, RMA Regional Service Office Operations (Survey Results).
6. Audit Report No. 05099-1-At, RMA Crop Insurance on Fresh Market Tomatoes, issued September 30, 1997.
7. Audit Report No. 05099-2-At, RMA Nursery Crop Insurance Program, issued December 16, 1998.
8. Audit Report No. 05001-1-Te, RMA - Crop Year 1997 Insurance Claims Involving Optional Units, ongoing.
9. Audit Report No. 05601-3-Te, RMA Federal Crop Insurance Claims, issued February 1998.
10. Audit Report No. 05601-5-Te, Prevented Plantings of 1996 Insured Crops, issued March 1999.
11. Audit Report No. 05600-6-Te, RMA Crop Year 1991 Unit Evaluation, issued September 30, 1994.
12. Audit Report No. 03099-3-SF, RMA 1994 Reinsured Raisin Losses in California, issued September 30, 1996.
13. Audit Report No. 05005-1-Ch, RMA Controls Over Monitoring of Private Insurance Companies, issued January 25, 1999.
14. GAO Report No. GAO/RECED-97-70, Crop Insurance Opportunities Exist to Reduce Government Costs for Private Sector Delivery.