**TESTIMONY**
**Of**
**Steve Harms**
**American Association of Crop Insurers**
**To**
**House Agriculture Subcommittee**
**General Farm Commodities and Risk Management**
**1300 Longworth House Office Building**
**Tuesday, May 1, 2007**

## Introduction

Good morning Chairman Etheridge, Ranking Member Moran and members of the Subcommittee. I am Steve Harms, President, Rain and Hail, L.L.C., which is headquartered in Johnston, Iowa, and markets the crop insurance program in all fifty of the United States. My testimony today is presented in my capacity as Chairman of the American Association of Crop Insurers (AACI).

Thank you for scheduling this hearing in your oversight of the federal crop insurance system as well as in your preparation for writing the 2007 Farm Bill. AACI, with members representing all segments of the private sector element of the crop insurance system, appreciates being invited to provide testimony and respond to questions from Members of the Subcommittee.

My testimony will make the following three points about the federal crop insurance program:

1. The program is working – and is more essential than ever as our farmers struggle to meet the nation's energy and food needs.
2. The program can be improved – continue with ARPA-type changes.
3. The program can be harmed – avoid wayward recommendations.

## The Program Is Working

**The modern federal crop insurance program is such a huge success that it is the envy of the world. Other nations, such as Brazil, France and Japan, are working toward the development of their own crop insurance programs.** Providing protection from risks that are beyond a farmer's control through a more affordable and stable insurance system has been the basic and fundamental goal of the federal crop insurance program from its very inception almost three-quarters of a century ago. In recent years, especially since passage of ARPA in 2000, USDA has routinely testified before Congress that the federal crop insurance program is highly successful, especially in increasing the number of acres insured and the level of protection or coverage per acre. Total net acres insured have increased from about 83 million in 1993 to about 242 million in 2006. For the 2006 crop insurance year, the program provided about 50 billion dollars of protection—a record level of coverage at that time, which was up from only about 11 billion in 1993. For the 2007 crop insurance year, projections indicate that farm risk protection will likely exceed 60 billion dollars.

**The modern federal crop insurance program is an indispensable risk management tool.** The program has grown more complex, including more policy choices and more stringent regulations, on its way to becoming an efficient and effective risk management tool. An important factor in the growth of crop insurance is the growth in the number of policy options available to farmers. These additional options provide farmers with the capacity and the flexibility to insure a wider array of agriculture enterprises. They also permit the customization of risk management strategies to individual farm and farmer needs and requirements. And it is acutely important to know and understand that the expansion in policy options was a direct result of farmer requests and demands for more coverage options in more specific enterprise situations. The result has been vast improvements in the matching of farmer risk management needs to actual coverage.

Along with more complexity there are more regulations. And while regulations are certainly burdensome, they do generally serve to help enhance program integrity, which is a fundamental requirement for continuing a high level of congressional and public support for the crop insurance program.

**The modern federal crop insurance program is an indispensable financing tool.** Without crop insurance, many farmers would be unable to obtain financing. Crop insurance makes the process of farmers obtaining annual operating loans much easier, simpler and efficient. In the case of farmers who have purchased crop insurance, banks usually require less collateral because they consider these farmers to be better protected. Many younger farmers with less collateral would be unable to obtain financing without crop insurance.

Farmers understand more and more that crop insurance is another cost of doing business. However, the purchasing cost of crop insurance provides certain benefits for the farming operation, including greater ability to finance land purchases, enter into land rental contracts and arrange production input purchases. Protection provided by the program gives lenders much more confidence in extending credit.

**The national commitment to greater energy self-sufficiency makes crop insurance much more important than ever.** Farmers will have to plant on every available acre in order to supply our energy as well as food and fiber needs. Furthermore, as the national alternative energy initiative focuses on renewable feedstock beyond corn for generating ethanol, farmers and their lenders will need a level of confidence in order to allocate sufficient land and other resources necessary to produce desired supplies of cellulosic feedstock. Thus, the federal crop insurance program must be an integral part of the government's effort to build a more self-sufficient domestic energy supply.

As the current demand for ethanol feedstock drives up the price of corn and all other commodities that compete for the same and input resources, farm subsidy payments are projected to decline. Farmers will receive more of their income from the market and less from the government. However, this relationship works best for farmers who make a crop. As we know, crops fail many times. For example, we have already witnessed a series of crop disasters in 2007, from the citrus and avocado freeze on the West Coast in January to a series of hard freezes that badly damaged wheat in the Midwest, especially the south central part of Kansas, to the Easter freeze of a few weeks ago that has destroyed many farmers' apple and peach crops in the Southeast.

Thus, the role of federal crop insurance program is greater than at any time in its history. Without a strong program, farmers cannot be expected to grow the new as well as existing crops that are necessary to meet our energy needs and feed the nation. Certainly, a weaker federal crop insurance program would undermine America's drive to greater energy self-sufficiency while maintaining food security.

**The modern crop insurance program is an indispensable marketing tool.** Crop insurance allows producers to market in advance of production as well as harvest with an assurance that if the crop fails, they can buy replacement bushels to fulfill their contract. Today, it is more common place than ever, and the practice continues growing rapidly, for farm advisors to explore with producers how crop insurance offers the opportunity to more aggressively market, especially in times of high prices, extracting profits from markets, while they are available, in order to better control their financial destiny. With the confidence of this crop insurance backstop, producers can extract profits from the market place at no cost to the Government. The importance of crop insurance in marketing farm commodities today cannot be over emphasized, and if the program continues to grow, marketing assistance will become an even greater benefit in the future. Without crop insurance, farmers would be less likely to implement marketing strategies that allows farmers to take advantage of price increases that occur during the growing season.

One of the reasons farmers have not taken advantage of high market prices that have been available in past is the fear of not being able to satisfy the terms and conditions of any associated contract. Crop insurance, as we know it today, provides replacement-cost coverage that allows farmers to act on marketing opportunities. Increased numbers of farmers using marketing tools is a strong indication that, as a group, they are gaining confidence in making money from the market by forward marketing.

**Crop insurance works well because it is a unique public-private partnership.** History has demonstrated that without Government subsidies and reinsurance, farmers could not afford to pay the premiums that are necessary for a national crop insurance program. History has also demonstrated that without the private sector delivery system, the federal government could never sell and service the program efficiently.

From 1938 until 1981, the USDA was solely responsible for delivering the federal crop insurance program. However, in those years, crop insurance was not an extensive program and certainly not the national program that it is today. In fact, it was more or less only a token program – one that was available only for a few commodities in a few counties in a few states. In this time period, the private insurance industry marketed only crop hail policies.

Beginning in 1981 and continuing until the late 1980s, Congress authorized a transition period for the federal crop insurance program, during which it was delivered both by USDA, through a structure known as "master marketers," as well as private sector companies, through a structure known as the "standard reinsurance agreement" (SRA). During this period, the program was not considered successful and it never insured more than a third of the eligible acreage in the country. Not until it was completely delivered by the private sector and after receiving increased funding in the 1994 crop insurance legislation did the program begin to approach its current level of success.

Congressional funding for the program has also played a significant role in helping achieve the program's current level of success. Increases in premium subsidies have resulted in increased participation levels and increased coverage levels. Increases in coverage and participation have been shown to be directly linked to the amount of program funding. It can be assumed that any reduction in funding for the program will have negative impacts on farmers' participation and coverage under the program, resulting in a reduced safety net and an increased demand and need for other less efficient and more costly forms of Federal assistance.

## The Program Can Be Improved

With the program having successfully grown through a series of incremental developments, especially over the last 25 years, opportunities to continue expanding coverage and improving the value of the crop insurance program to farmers should be considered and evaluated with input from the private sector insurance delivery partners.

The "Gap Coverage," identified by USDA in its Farm Bill Proposals for Crop Insurance (now referred to as "Supplemental Deductible Coverage," (SDC) by RMA) identifies one option for providing additional disaster assistance. Although sufficient details are not available at this time to fully evaluate, AACI is concerned about the possibility the concept includes incentives for farmers to buy less individual coverage.

Private sector partners certainly want to work with Congress and the administration to identify positive changes and continue improving the crop insurance program for the benefit of the nation's farmers, including the development of an additional, workable disaster assistance option. Properly structured, we believe an insurance-based program would successfully provide additional or bonus disaster assistance in county-wide natural disaster instances. Crop insurance companies and agencies are interested and ready to work with all parties to accomplish this goal.

In that regard, AACI recommends establishing, as an additional disaster assistance provision for farmers, the County Crop Disaster Plan (CCDP), with the following objectives and benefits:

- Provide a crop insurance solution to demands for additional disaster assistance payments.
- Encourage crop insurance participation.
- Encourage producers to move to and maintain a significant level of crop insurance coverage on an MPCI or revenue coverage plan.
- Use the private sector crop insurance system to deliver the additional disaster assistance payments.
- Provide additional disaster assistance payments when the crop county loss ratio exceeds a trigger level to farmers who have received indemnity payments.
- Benefits of this option include a built-in qualification test and no increase in moral hazard.

Another opportunity to improve the program is in updating provisions of existing legislation that are no longer relevant given the economic realities. In this regard, AACI believes Section 508(e)(3), known as the Premium Reduction Plan (PRP) that was added by P.L. 103-354 in 1994, is a provision of the Federal Crop Insurance Program that should be eliminated, as the current farmer participation levels and A&O subsidy amounts are vastly different than when the provision was incorporated into law, and the provision is no longer necessary or relevant.

## **The Program Can Be Harmed**

The crop insurance program operates, for the most part, under legislation that is separate from the Farm Bill. A case can be made that the program successes noted earlier have been enabled by the legislative authority being separate from farm bill provisions. Successful insurance programs rely on stability, and crop insurance legislation that is separate and insulated from the recurring farm bill process has helped ensure the stability of the crop insurance program. We suggest that changes to the crop insurance provisions should only occur in legislation apart from the farm bill process as was the case in 1994 and 2000.

Some Farm Bill proposals for crop insurance regurgitates policy changes that have either been tried in the past and found wanting or have been proposed in the past and have been rejected because they would take the program in the wrong direction. Some newer proposals are simply wayward in nature and should be avoided. Proposals that would take the crop insurance program in the wrong direction should be rejected. **In this regard, the following USDA proposals especially should be rejected:**

a. Increase the net book quota share from the current 5 percent to 22 percent and provide ceding commission to the reinsured companies of 2 percent of premium.

b. Cuts to the farmer subsidy to deliver the program such as reducing the administrative and operating expense reimbursement by 2 percentage points for all policies other than CAT policies.
c. A mandatory purchase requirement for farmers who participate in commodity programs.
d. Cuts to premium subsidies that reduce participation.

**Crop insurance is a federal government program developed to satisfy certain public policy objectives regarding aspects of risk management inherent to production agriculture enterprises.** Companies are required to sell and service a predetermined and pre-approved program to all farmers, ranchers and growers. They are not free to turn away higher –risk farmers or smaller farmers whose premiums are not large enough to cover the cost of sales and service. They are required to sell to all farmers and for all insurable commodities in a state where they do business.

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

Some reports raise questions about certain aspects of the cost of the modern federal crop insurance program. Federal cost of the program includes funds to pay a portion of the farmers' premium amount for each policy and funds to pay approved insurance providers' (AIPs) total expenses for selling and servicing policies. Therefore, in general, increased federal cost of the program reflects implementation of congressional intent to expand and enhance coverage of farmers across the nation.

**The congressional objective has been to have a federal crop insurance program that is an efficient and effective production agriculture risk management tool equally and universally available to all farmers across the nation.** Therefore, premium support cost will always be consistent with the level of farmer participation in the program. To the degree that the congressional objective is more fully satisfied, meaning more farmers participating and purchasing more protection, premium support cost increases.

**Federal reimbursements for delivering the crop insurance program do not cover the costs of the private sector.** Normally, insurance premiums are expense loaded, which means the administrative costs of selling, servicing and delivering the coverage are loaded into and are a part of the premium. This is not the case with crop insurance. Rather, the government pays these costs on behalf of policyholders. This policyholder subsidy, known as administrative and operating (A&O) reimbursement, is paid to private sector companies that deliver the program to offset the costs of selling and servicing of policies. However, the A&O amounts paid fall short of covering companies' expenses for delivering the program. Currently, the average percentage A&O reimbursement rate is approximately 20 percent of premium, which is down from an average high of more than 32 percent in the early 1990s. Companies indicate that the current A&O reimbursement rate does not cover all policy selling and servicing expenses.

Company statements regarding their total selling and servicing cost are consistent with the conclusion of an April 1997 GAO Report to Congressional Committees in which the analysis indicated that the reimbursement rate would need to be 26.5 percent of premium to "adequately reimburse companies for their reasonable expenses of selling and servicing crop insurance."

**Administrative and operating (A&O) reimbursements and underwriting gain opportunities are the elements for attracting and keeping private companies, agencies and capital in the business.** To the extent that A&O reimbursements are insufficient for the sale and servicing of crop insurance, these expenses must be met through underwriting gains.

**The press often makes the mistake of reporting underwriting gains as profits, thus conveying the false impression that the industry is making huge profits.** Both A&O reimbursements and underwriting gains are **gross revenue** earned by approved crop insurance providers (crop insurance companies) under the terms and conditions of the USDA developed and approved SRA that each company must agree to and sign in order to be an eligible program participant. **They are not profits. All businesses, including approved crop insurance companies and affiliated agencies, must subtract all expenses from their gross revenue in order to determine their profits.** These expenses include unreimbursed delivery expenses, reinsurance premiums, the building of reserves for loss years, taxes on earnings and other expenses.

**Reimbursement of delivery expenses and the potential for underwriting gains do not over compensate for the risk taken by crop insurance companies.** Crop insurance is a risky business, especially when compared to other lines of insurance and taking into consideration the nature of the risk associated with production agriculture enterprises relative to the risk in other insured ventures. Multiple studies have shown that crop insurance profitability is lower and more volatile than other lines of property and casualty insurance (Deloitte and Touché 2004, Price Waterhouse Coopers 1999 and 1997, Milliman and Roberts 2002). Indeed any analysis of Best's Aggregates and Averages will demonstrate this fact. The Deloitte and Touché study reported a 10 year profitability measure of 7.9 percent for the crop insurance program with a standard deviation of 12.9 percent while other lines of property and casualty insurance ran a 12.7 percent return with an 8.9 percent standard deviation (1992 – 2002).

**The increased cost of operating a successful, nationwide crop insurance program should not be viewed as a large "piggy bank" from which to take money to fund other programs.** Crop insurance cost is driven largely by the level of success of the program in meeting Congress' public policy objectives for the program to be an efficient and effective risk management tool that is fairly and equitably available to all farmers regardless of size, location or enterprise. However, in addition to participation rates, commodity price changes have a significant impact on program cost, resulting from the impact on total amount of liability protection provided to farmers that companies have to properly manage. A historical characteristic of commodity prices is that they do change – increasing as well as, unfortunately, decreasing. Regardless of whether prices are increasing or decreasing and regardless of whether resulting A&O reimbursements fully cover costs, companies must effectively manage program liability to be viable in the long-term to have the capacity to provide stable and dependable service and protection to farmers.

Keith Collins, Chief Economist at USDA, testified in March, 2006, before a House Agriculture Subcommittee that program liability or coverage is up about one-third and program acres is up about one-fifth since the passage of ARPA in 2000. In that testimony, <u>Collins also stated, "Recent increases in the administrative and operating expense reimbursement and underwriting gains have strengthened the financial performance of the companies and encouraged new entrants and we believe that will help increase service to producers."</u>

**<u>Any raids on the crop insurance funds will result in higher premium costs and less service for farmers. They would signal a retreat from all the gains in building the best crop insurance program in the world. It would be a retreat from ARPA and all the efforts made in previous legislation and program changes to provide essential risk management for America's farmers, ranchers and growers that would also be readily accepted by lending institutions and commodity markets.</u>**

## <u>Closing</u>

Thank you for this opportunity to present AACI's views about the federal crop insurance program. I look forward to further discussion with Members of the Subcommittee today.

# STEVEN C. HARMS - PRESIDENT AND CHAIRMAN OF THE BOARD

**RAIN AND HAIL L.L.C.**
**RAIN AND HAIL INSURANCE SERVICE, INC.**
**AGRI GENERAL INSURANCE COMPANY**

## BACKGROUND

Born and raised in Sumner, Iowa

Bachelor of Arts degree from Upper Iowa University in Fayette, Iowa

High school teacher and coach for three years at Grinnell, Iowa

1976 joined Rain and Hail as Field Supervisor

1987 became Manager of Rain and Hail's Mid-West Division handling the states of Iowa and Missouri

1990 returned to Corporate Headquarters as Vice President

1991 became Senior Vice President and Secretary of Agri General Insurance Company

1992 became Executive Vice President of Rain and Hail

1996 elected as President of Rain and Hail Insurance Service International, Inc.

1999 elected as President of Rain and Hail Insurance Corporation (Canadian Company)

2001 elected as President of Rain and Hail L.L.C.

2002 elected as President of Rain and Hail Insurance Service, Inc. and
President of Rain and Hail Insurance Service, Ltd.

2005 elected as President and Chairman of the Board of Rain and Hail L.L.C., Rain and Hail Insurance Service, Inc., and Agri General Insurance Company

Steve's responsibilities at Rain and Hail include the corporate oversight of eight U.S. crop division offices and one agribusiness property and casualty division office, as well as international offices in Regina, Saskatchewan, Canada and Sao Paulo, Brazil. All offices combined generate premiums in excess of $1.2 billion in crop and agribusiness property and casualty in 2006.

## CROP INSURANCE INDUSTRY INVOLVEMENT

Served on Program Development Committee of NCIS since its inception in the early 1990's
2005 to present – serves on Board of Directors of AACI and NCIS
2006 - 2007 elected Chairman of AACI
2006 - 2007 elected Vice-Chairman of NCIS

## Other

2000 to present - appointed to Board of Upper Iowa University
2005 to present - appointed to Advisory Board of Bankers Trust Company

**Committee on Agriculture**
**U.S. House of Representatives**
**Required Witness Disclosure Form**

**House Rules* require nongovernmental witnesses to disclose the amount and source of Federal grants received since October 1, 2004.**

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**Organization you represent (if any):** American Association of Crop Insurers (AACI)

1. **Please list any federal grants or contracts (including subgrants and subcontracts) you have received since October 1, 2004, as well as the source and the amount of each grant or contract. House Rules do NOT require disclosure of federal payments to individuals, such as Social Security or Medicare benefits, farm program payments, or assistance to agricultural producers:**

**Source:** ____________________ **Amount:** __________

**Source:** ____________________ **Amount:** __________

2. **If you are appearing on behalf of an organization, please list any federal grants or contracts (including subgrants and subcontracts) the organization has received since October 1, 2004, as well as the source and the amount of each grant or contract:**

**Source:** ____________________ **Amount:** __________

**Source:** ____________________ **Amount:** __________

**Please check here if this form is NOT applicable to you:** X

**Signature:** Steve Harms

* Rule XI, clause 2(g)(4) of the U.S. House of Representatives provides: *Each committee shall, to the greatest extent practicable, require witnesses who appear before it to submit in advance written statements of proposed testimony and to limit their initial presentations to the committee to brief summaries thereof. In the case of a witness appearing in a nongovernmental capacity, a written statement of proposed testimony shall include a curriculum vitae and a disclosure of the amount and source (by agency and program) of each Federal grant (or subgrant thereof) or contract (or subcontract thereof) received during the current fiscal year or either of the two previous fiscal years by the witness or by any entity represented by the witness.*

**PLEASE ATTACH DISCLOSURE FORM TO EACH COPY OF TESTIMONY.**