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CROP INSURANCE

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

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Natural Resources and Environment

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Highlights

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

Why GAO Did This Study

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

This testimony is based on GAO's 2005 report, *Crop Insurance: Actions Needed to Reduce Program's Vulnerability to Fraud, Waste, and Abuse*, and May 2007 testimony, *Crop Insurance: Continuing Efforts Are Needed to Improve Program Integrity and Ensure Program Costs Are Reasonable*. GAO discusses (1) USDA's processes to address fraud, waste, and abuse; (2) extent the program's design makes it vulnerable to abuse; and (3) reasonableness of underwriting gains and other expenses. USDA agreed with most of GAO's 2005 recommendations to improve program integrity.

What GAO Recommends

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

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

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

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What GAO Found

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

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

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

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

Mr. Chairman and Members of the Subcommittee:

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

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

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

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

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

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

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

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

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

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

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

annual risk management practices, and some are addressing it strategically by assessing its potential long-term, industrywide impacts. However, the major federal insurance programs, including the crop insurance program, have done little to develop comparable information.

My testimony today focuses on the (1) effectiveness of USDA's procedures to prevent and detect fraud, waste, and abuse in selling and servicing crop insurance policies; (2) extent to which program design issues may make the program more vulnerable to fraud, waste, and abuse; and (3) reasonableness of underwriting gains and administrative and operating expenses USDA pays to the companies for program delivery. My testimony is based on published GAO products. We performed our work in accordance with generally accepted government auditing standards.

In summary, since the enactment of ARPA, RMA has taken a number of steps to improve its procedures to prevent and detect fraud, waste, and abuse in the crop insurance program. Most notably, RMA reports that data mining analyses and subsequent communication to farmers resulted in a decline of at least $300 million in questionable claims payments from 2001 to 2004. However, we found that, at the time our review, RMA was not effectively using all of the tools it had available and that some farmers and others continued to abuse the program. We identified weaknesses in four key areas: (1) field inspections, (2) data mining processes that exclude many large farming operations when farmers do not report their interest in them, (3) quality assurance reviews conducted by insurance companies, and (4) imposition of sanctions. Weaknesses in these areas left the program vulnerable to questionable claims, and the insurance companies and RMA could not always determine the validity of a claim to minimize fraud, waste, and abuse. RMA has taken steps on some of the recommendations we made. For example, RMA amended its crop insurance policy manual to provide information more frequently to FSA on suspect claims so that FSA is able to conduct timelier field inspections to detect potential abuse. In another case, we recommended that RMA promulgate regulations needed to fully utilize its expanded sanction authority provided under ARPA. In response, RMA developed draft regulations that, when final, will allow the agency to fully use this authority to sanction program violators.

We also found that the program's design, as laid out in RMA's regulations or as required by statute, can impede the efforts of RMA officials to prevent and detect fraud, waste, and abuse in a number of ways. In terms of RMA's regulations, farmers can insure their fields individually instead of insuring all fields combined, which makes it easier for them to switch production among fields, either to make false insurance claims or to build up a higher yield history on a particular field in order to increase its eligibility for higher future insurance guarantees. RMA disagreed with our recommendation to reduce the insurance guarantee or eliminate optional unit coverage for producers who consistently have claims that are irregular in comparison with other producers growing the same crop in the same location. RMA stated that our recommendation represents a disproportionate response, considering the small number of producers who switch the yield on a field each year. Nevertheless, we continue to believe that RMA could tailor an underwriting rule to target those relatively few farmers who file anomalous claims related to yield switching. In terms of statutory requirements, RMA is obligated by law to offer farmers "prevented planting" coverage—coverage that allows for insurance claims if an insured crop is prevented from being planted because of weather conditions, but it is often difficult to determine whether farmers had the opportunity to plant a crop. In our 2006 testimony,[7] we stated that Congress may wish to consider allowing RMA to reduce premium subsidies—and hence raise the insurance premiums—for farmers who consistently have claims, such as prevented planting claims, that are irregular in comparison with other farmers growing the same crop in the same location. To date, Congress has not granted RMA the authority to make such reductions.

Finally, USDA paid the insurance companies underwriting gains of $2.8 billion, in total, from 2002 through 2006. The underwriting gains represent an average annual rate of return of 17.8 percent over this 5-year period.[8] This rate of return is considerably higher than the insurance industry average. According to insurance industry statistics, the benchmark rate of return for U.S. insurance companies selling private property and casualty insurance was 6.4 percent during this period. RMA officials told us that this benchmark rate can be considered a starting point for measuring the appropriateness of the underwriting gains in the crop insurance program. As previously noted, USDA renegotiated the financial terms of its SRA with the companies beginning with the 2005 planting season. Nonetheless, in 2005, USDA still paid insurance companies underwriting gains of $916 million—a rate of return of 30.1 percent. In 2006, USDA paid underwriting

[7] GAO, *Crop Insurance: More Needs to Be Done to Reduce Program's Vulnerability to Fraud, Waste, and Abuse*, GAO-06-878T (Washington, D.C.: June 15, 2006).

[8] In this testimony, we define rate of return as underwriting gains calculated as a percentage of premiums on the policies in which companies retain risk of loss.

gains of $886 million—a rate of return of 24.3 percent. The companies received these underwriting gains despite drought conditions in parts of the country in 2005 and 2006 that would normally suggest they would earn lower profits. In addition to underwriting gains, USDA paid the insurance companies $4 billion in cost allowances to cover administrative and operating expenses incurred for program delivery from 2002 through 2006. USDA expects the cost allowance paid per policy to increase by about 25 percent by 2008 because of higher crop prices, particularly for corn and soybeans. These higher crop prices increase the value of the policy. However, the companies and their affiliated sales agents will receive this substantially higher cost allowance without any corresponding increase in expenses for selling and servicing the policies. Congress has an opportunity in its reauthorization of the Farm Bill to provide USDA with the authority to periodically renegotiate the financial terms of the standard reinsurance agreement with the insurance companies so that the companies' rate of return is more in line with private insurance markets. USDA has requested the authority to renegotiate the SRA in its proposals for the Farm Bill.

Background

FCIC was established in 1938 to temper the economic impact of the Great Depression, and was significantly expanded in 1980 to protect farmers from the financial losses brought about by drought, flood, or other natural disasters. RMA administers the program in partnership with private insurance companies, which share a percentage of the risk of loss and the opportunity for gain associated with each insurance policy written. RMA acts as a reinsurer—reinsurance is sometimes referred to as insurance for the insurance companies—for a portion of all policies the federal crop insurance program covers. In addition, RMA pays companies a percentage of the premium on policies sold to cover the administrative costs of selling and servicing these policies. In turn, insurance companies use this money to pay commissions to their agents, who sell the policies, and fees to adjusters when claims are filed.

FCIC insures agricultural commodities on a crop-by-crop and county-by-county basis, considering farmer demand and the level of risk associated with the crop in a given region. Major crops, such as grains, are covered in almost every county where they are grown, while specialty crops such as fruit are covered in only some areas. Participating farmers can purchase different types of crop insurance and at different levels.

RMA establishes the terms and conditions that the private insurance companies selling and servicing crop insurance policies are to use through the SRA. The SRA provides for the cost allowance intended to cover administrative and operating expenses the companies incur for the policies they write, among other things. The SRA also establishes the minimum training, quality control review procedures, and performance standards required of all insurance providers in delivering any policy insured or reinsured under the Federal Crop Insurance Act, as amended.

Under the crop insurance program, participating farmers are assigned (1) a "normal" crop yield based on their actual production history and (2) a price for their commodity based on estimated market conditions. Farmers can then select a percentage of their normal yield to be insured and a percentage of the price they wish to receive if crop losses exceed the selected loss threshold. In addition, under the crop insurance program's "prevented planting" provision, insurance companies pay farmers who were unable to plant the insured crop because of an insured cause of loss that was general to their surrounding area, such as weather conditions causing wet fields, and that had prevented other farmers in that area from planting fields with similar characteristics. These farmers are entitled to claims payments that generally range from 50 to 70 percent, and can reach as high as 85 percent, of the coverage they purchased, depending on the crop.

RMA is responsible for protecting against fraud, waste, and abuse in the federal crop insurance program. In this regard, RMA uses a broad range of tools, including RMA's compliance reviews of companies' procedures, companies' quality assurance reviews of claims, data mining, and FSA's inspections of farmers' fields. For example, insurance companies must conduct quality assurance reviews of claims that RMA has identified as anomalous or of those claims that are $100,000 or more to determine whether the claims the companies paid comply with policy provisions.

Congress enacted ARPA, amending the Federal Crop Insurance Act, in part, to improve compliance with, and the integrity of, the crop insurance program. Among other things, ARPA provided RMA authority to impose sanctions against producers, agents, loss adjusters, and insurance companies that willfully and intentionally provide false or inaccurate information to FCIC or to an insurance company—previously, RMA had authority to impose sanctions only on individuals who willfully and intentionally provided false information. It also provided RMA with authority to impose sanctions against producers, agents, loss adjusters, and insurance companies for willfully and intentionally failing to comply with any other FCIC requirement. In addition, it increased the percentage share of the premium the government pays for most coverage levels of crop insurance, beginning with the 2001 crop year. The percentage of the premium the government pays declines as farmers select higher levels of coverage. However, ARPA raised the percentage of federal subsidy for all levels of coverage, particularly for the highest levels of coverage. For example, the government now pays more than one-half of the premium for farmers who choose to insure their crop at 75-percent coverage.

RMA Has Strengthened Procedures for Preventing Questionable Claims, but the Program Remains Vulnerable to Potential Abuse

RMA has taken a number of steps to improve its procedures to prevent and detect fraud, waste, and abuse, such as data mining, expanded field inspections and quality assurance reviews. In particular, RMA now develops a list of farmers each year whose operations warrant an on-site inspection during the growing season because data mining uncovered patterns in their past claims that are consistent with the potential for fraud and abuse. The list includes, for example:

- farmers, agents, and adjusters linked in irregular behavior that suggests collusion;
- farmers who for several consecutive years received most of their crop insurance payments from prevented planting indemnity payments;
- farmers who appear to have claimed the production amounts for multiple fields as only one field's yield, thereby creating an artificial loss on their other field(s); and
- farmers who, in comparison with their peers, file unusually high claims for lost crops over many years.

Since RMA began performing this data mining in 2001, it has identified about 3,000 farmers annually who warrant an on-site inspection because of anomalous claims patterns. In addition, RMA annually performs about 100 special analyses to identify areas of potential vulnerability and trends in the program.

RMA also provides the names of farmers from its list of suspect claims for inspection to the appropriate FSA state office for distribution to FSA county offices, as well as to the insurance companies selling the policies to farmers. As a result of these inspections and other information, RMA reported total cost savings of $312 million from 2001 to 2004, primarily in the form of estimated payments avoided. For example, according to RMA, claims payments to farmers identified for an inspection decreased nationwide from $234 million in 2001 to $122 million in 2002. According to RMA, some of the farmers on the list for filing suspect claims bought less insurance and a few dropped crop insurance entirely, but most simply changed their behavior regarding loss claims.

However, as we testified in 2006, RMA was not effectively using all of the tools it had available and that some farmers and others continued to abuse the program, as the following discussion indicates.

Inspections during the growing season were not being used to maximum effect. FSA was not providing RMA with inspection assistance in accordance with USDA guidance. For example, between 2001 and 2004, farmers filed claims on about 380,000 policies annually, and RMA's data mining identified about 1 percent of these claims as questionable and needing FSA's inspection. Under USDA guidance, FSA should have conducted all of the 11,966 requested inspections, but instead conducted only 64 percent of them; FSA inspectors said that they did not conduct all requested inspections primarily because they did not have sufficient resources. Moreover, between 2001 and 2004, FSA offices in nine states did not conduct any of the field inspections RMA had requested in one or more of the years. Until we brought this matter to their attention in September 2004, FSA headquarters officials were unaware that the requested inspections in these nine states had not been conducted. Furthermore, FSA might not have been as effective as possible in conducting field inspections because RMA did not provide it with information on the nature of the suspected abusive behavior or the results of follow-up investigations. Finally, these inspections did not always occur in a timely fashion during the growing season. Because of these problems, the insurance companies and RMA could not always determine the validity of a claim.

USDA has implemented some of our recommendations to improve inspection practices. For example, we recommended that RMA more consistently inform FSA of the suspect claim patterns that it should investigate. RMA amended its crop insurance policy manual to provide information more frequently to FSA on suspect claims, as we recommended, so that FSA can conduct timelier field inspections to detect potential abuse. Specifically, RMA now provides a list twice a year—in the fall for crops such as wheat, and in the spring for crops such as corn and soybeans. However, FSA disagreed with our recommendation that it conduct all inspections called for under agency guidance, citing insufficient resources as the reason. Nevertheless, we believe that conducting these inspections would achieve potentially substantial savings for the crop insurance program by identifying cases of fraudulent claims.

RMA's data analysis of the largest farming operations was incomplete. RMA's data mining analysis excluded comparisons of the largest farming operations—including those organized as partnerships and joint ventures. These entities may include individuals who are also members of one or more other entities. Because it did not know the ownership interests in the largest farming operations, RMA could not readily identify potential fraud. For example, farmers who are members of more than one farming operation could move production from one operation to another to file unwarranted claims, without RMA's knowledge that these farmers participate in more than one farming operation. RMA could not make these comparisons because it had not been given access to similar data that FSA maintains. However, ARPA required the Secretary of Agriculture to develop and implement a coordinated plan for RMA and FSA to reconcile all relevant information received by either agency from a farmer who obtains crop insurance coverage.

Using FSA data, we examined the extent to which (1) farming operations report all members who have a substantial beneficial interest in the operation, (2) these farming operations file questionable crop insurance claims, and (3) agents or claims adjusters had financial interests in the claim.[9] By comparing RMA's and FSA's databases, we found that 21,310 farming entities, or about 31 percent of all farming entities, did not report one or more members who held a beneficial interest of 10 percent or more in the farming operation holding the policy. RMA should be able to recover a portion of these payments because, according to RMA regulations, if the policyholder fails to disclose an ownership interest in the farming operation, the policyholder must repay the amount of the claims payment that is proportionate to the interest of the person who was not disclosed.[10] According to our analysis, RMA should be able to recover up to $74 million in claims payments for 2003. USDA has since implemented our recommendation that FSA and RMA share information on policyholders to better identify fraud, waste, and abuse. In addition, of the 21,310 entities failing to disclose ownership interest in 2003, we found 210 entities with suspicious insurance claims totaling $11.1 million. Finally, we identified 24 crop insurance agents who sold policies to farming entities in which the

[9]The Center for Agribusiness Excellence conducted this analysis at our request. The Center, located at Tarleton State University in Stephenville, Texas, provides research, training, and resources for data warehousing and data mining of agribusiness and agriculture data. The Center provides data mining of crop insurance data for RMA.

[10]7 C.F.R. § 457.8.

agents held a substantial beneficial interest but failed to report their ownership interest to RMA as required. USDA initially implemented our recommendation, and FSA and RMA shared information on policyholders in 2006 to better identify fraud, waste, and abuse. However, since then, the agencies have stopped sharing this information while issues related to producer privacy are resolved.[11] Furthermore, RMA has not implemented our recommendation to recover claims payments to ineligible farmers or to entities that failed to fully disclose ownership interest.

RMA was not effectively overseeing insurance companies' quality assurance programs. RMA guidance requires insurance companies to provide oversight to properly underwrite the federal crop insurance program, including implementing a quality control program, conducting quality control reviews, and submitting an annual report to FCIC. However, RMA was not effectively overseeing insurance companies' quality assurance programs, and for the claims we reviewed, it did not appear that most companies were rigorously carrying out their quality assurance functions. For example, 80 of the 120 insurance files we reviewed claimed more than $100,000 in crop losses or met some other significant criteria; RMA's guidance states that the insurance provider must conduct a quality assurance review for such claims. However, the insurance companies conducted reviews on only 59 of these claims, and the reviews were largely paper exercises, such as computational verifications, rather than comprehensive analysis of the claim. RMA did not ensure that companies conducted all reviews called for under its guidance and did not examine the quality of the companies' reviews. RMA agreed with our recommendation to improve oversight of companies' quality assurance programs, but we have not yet followed up with the agency to examine its implementation.

RMA has infrequently used its new sanction authority to address program abuses. RMA had only used its expanded sanction authority granted under ARPA on a limited basis. It had identified about 3,000 farmers with suspicious claims payments—notable policy irregularities compared with other farmers growing the same crop in the same county—each year since the enactment of ARPA. While not all of these policies with suspicious claims were necessarily sanctionable, RMA imposed only

[11]According to an RMA official, FSA must provide a notice of routine use to producers that states that information they provide related to their participation in commodity programs may be shared with RMA. This is not one of the routine uses currently listed in the relevant regulation.

114 sanctions from 2001 through 2004. According to RMA officials, RMA requested and imposed few sanctions because it had not issued regulations to implement its expanded authority under ARPA. Without regulations, RMA had not established what constitutes an "FCIC requirement" and not explained how it would determine that a violation had occurred or what procedural process it would follow before imposing sanctions. RMA agreed with our recommendation that it promulgate regulations to implement its expanded authority, and issued proposed regulations on May 18, 2007 for public comment. Once final, these regulations will allow the agency to fully use this authority to sanction program violators.

RMA's Regulations and Some Statutory Requirements Hinder Efforts to Reduce Abuse in the Crop Insurance Program

While RMA can improve its day-to-day oversight of the federal crop insurance program in a number of ways, the program's design, as laid out in RMA's regulations or as required by statute, hinders the agency's efforts to administer certain program provisions in order to prevent fraud, waste, and abuse, as the following discussion indicates.

RMA's regulations allow farmers the option of insuring their fields individually rather than combined as one unit. Farmers can insure production of a crop on an individual field (optional units) or all their fields as one unit. Farmers may want to insure fields separately out of concern that they could experience losses in a certain field because of local weather conditions, such as hail or flooding. If farmers instead insure their entire crop in a single basic insurance unit, the hail losses might not cause the production yield of all units combined to be below the level guaranteed by the insurance and, therefore, would not warrant an indemnity payment. Although insurance on individual fields provides farmers added protection against loss, this optional unit coverage increases the potential for fraud and abuse in the crop insurance program.

Insuring fields separately enables farmers to "switch" production among fields—reporting production of a crop from one field that is actually produced on another field—either to make false insurance claims based on low production or to build up a higher yield history on a particular field in order to increase that field's eligibility for higher future insurance guarantees. We reported that of the 2,371 farmers identified as having irregular claims in 2003, 12 percent were suspected of switching production among their fields.

According to a 2002 RMA study, losses per unit (e.g., a field) increase as the number of separately insured optional units increases.[12] However, according to an RMA official, gathering the evidence to support a yield-switching fraud case requires considerable resources, especially for large farming operations. RMA disagreed with our recommendation to reduce the insurance guarantee or eliminate optional unit coverage for farmers who consistently have claims that are irregular in comparison with other farmers growing the same crop in the same location. It stated that our recommendation represents a disproportionate response, considering the small number of producers who engage in yield switching each year, and that the adoption of our recommendation would not be cost effective. Nevertheless, we continue to believe that RMA could tailor an underwriting rule so that it would target only a few producers each year and would entail few resources. Such a tool would provide RMA another means to discourage producers from abusing the program.

Minimal risk sharing on some policies, as set by statute, may not provide insurance companies with a strong incentive to carry out their responsibilities under the program. In some cases, insurance companies have little incentive to rigorously challenge questionable claims. Insurance companies participating in the crop insurance program share a percentage of the risk of loss or opportunity for gain on each insurance policy they write, but the federal government ultimately bears a high share of the risk. Under the SRA, insurance companies are allowed to assign policies to one of three risk funds—assigned risk, developmental, or commercial. The SRA provides criteria for assigning policies to these funds. For the assigned risk fund, the companies cede up to 85 percent of the premium and associated liability for claims payments to the government and share a limited portion of the gains or losses on the policies they retain. For the developmental and commercial funds, the companies cede a smaller percent of the premium and associated liability for claims payments to the government.

Economic incentives to control program costs associated with fraud, waste, and abuse are commensurate with financial exposure. Therefore, for policies placed in the assigned risk fund, companies have far less financial incentive to investigate suspect claims. For example, in one claim file we reviewed, an insurance company official characterized the farmer

[12] *Final Research Report For Multiple Year Coverage*, Task Order # RMA-RED-01-06, Watts and Associates, Inc., June 27, 2002.

as filing frequent, questionable claims; however, the company paid a claim of over $500,000. The official indicated that if the company had vigorously challenged the claim, the farmer would have defended his claim just as vigorously, and the company would have potentially incurred significant litigation expenses, which RMA does not specifically reimburse. With this cost and reimbursement structure, in the company's opinion, it was less costly to pay the claim.

RMA and insurance companies have difficulty determining potential abuse associated with statutory coverage for prevented planting. Under the Federal Crop Insurance Act, as amended, RMA must offer prevented planting coverage. RMA allows claims for prevented planting if farmers cannot plant owing to an insured cause of loss that is general in the surrounding area and that prevents other farmers from planting acreage with similar characteristics. Claims for prevented planting are paid at a reduced level, recognizing that farmers do not incur all production costs associated with planting and harvesting a crop. However, determining whether farmers can plant their crop may be difficult. Annually, RMA pays about $300 million in claims for prevented planting.

Statutorily high premium subsidies may inhibit RMA's ability to control program abuse. ARPA increased premium subsidies—the share of the premium paid by the government—but this increase may hamper RMA's ability to control program fraud, waste, and abuse. Premium subsidies are calculated as a percentage of the total premium, and farmers pay only between 33 to 62 percent of the policy premium, depending on coverage level. High premium subsidies shield farmers from the full effect of paying higher premiums. Because premium rates are higher in riskier areas and for riskier crops, the subsidy structure transfers more federal dollars to those who farm in riskier areas or produce riskier crops.

In addition, by regulation, premium rates are higher for farmers who choose to insure their fields separately under optional units, rather than all fields combined, because the frequency of claims payments is higher on the separately insured units. Again, however, because of high premium subsidies, farmers pay only a fraction of the higher premium. Thus, the subsidy structure creates a disincentive for farmers to insure all fields combined. Over one-half (56 percent) of the crop insurance agents responding to the survey conducted for our 2005 report believed that charging higher premiums for farmers with a pattern of high or frequent claims would discourage fraud, waste, and abuse in the crop insurance program. In our 2006 testimony, we stated that Congress may wish to consider allowing RMA to reduce premium subsidies—and hence raise the insurance premiums—for farmers who consistently have claims that are irregular in comparison with other farmers growing the same crop in the same location. To date, no action has been taken.

Compensation to Insurance Companies Has Been Excessive

From 1997 through 2006, USDA paid over $10.9 billion to companies that participate in the federal crop insurance program in cost allowances and underwriting gains, as table 1 shows. The $10.9 billion in total payments to the companies represents 42 percent of the government's cost of the crop insurance program—about $26 billion—over this period. That is, more than 40 cents of every dollar the government spent on the federal crop insurance program went to the companies that deliver the program, while less than 60 cents went to farmers. While we provide 10 years of data to offer a broad perspective and to even out annual losses and gains, the most recent 5 years of data—2002 to 2006—show similar results.

Table 1: Cost Allowances and Underwriting Gains Paid to Insurance Companies, and Government Costs, 1997 through 2006

Dollars in millions

	Payments to insurance companies			
Year	Company cost allowance	Company underwriting gain (loss)	Total payments to insurance companies	Government cost for the crop insurance program[a]
1997	$437.8	$352.1	$789.9	$1,095.9
1998	443.3	279.2	722.5	1,373.8
1999	500.7	271.8	772.5	1,782.7
2000	552.1	267.8	819.9	2,175.1
2001	642.0	345.9	987.9	3,162.6
2002	625.9	(47.5)	578.4	3,465.6
2003	733.9	377.9	1,111.8	3,588.7
2004	890.0	691.9	1,581.9	3,125.7
2005	829.6	916.2	1,745.8	2,698.5
2006	949.8	885.9	1,835.7	3,462.0
Total—1997 to 2006	**$6,605.1**	**$4,341.2**	**$10,946.3**	**$25,930.6**
Total—2002 to 2006	**$4,029.2**	**$2,824.4**	**$6,853.6**	**$16,340.5**

Source: GAO's analysis of RMA's data.

Notes: (1) Cost data are reported on a fiscal year basis. (2) Payments to companies are reported on a crop year basis. (3) Totals may not add due to rounding.

[a]Government costs also include total indemnities and other administrative and operating expenses, including certain costs for research, development, and other activities. This total is reduced by the premiums and administration fees that farmers pay.

As discussed earlier, USDA pays both underwriting gains and cost allowances, as negotiated in the SRA. Since the crop insurance program was revised under ARPA—that is, from 2002 through 2006—USDA has paid the insurance companies a total of $2.8 billion in underwriting gains. In terms of profitability, these underwriting gains represent an average annual rate of return of 17.8 percent over this 5-year period.[13] According to industry statistics, the benchmark rate of return for U.S. insurance companies selling private property and casualty insurance was 6.4 percent during this period.[14] RMA officials told us that this benchmark rate can be considered a starting point for measuring the appropriateness of the underwriting gains in the crop insurance program. However, they stated that this program should have a somewhat higher rate of return because of the (1) high volatility of underwriting gains for this program compared with the relatively steady gains associated with the property and casualty insurance industry, and (2) lack of investment opportunities when participating in the program because premiums are paid to the companies at harvest, not when farmers purchase a policy. But these officials also said that current rates of return are excessive. USDA renegotiated the financial terms of its SRA with the companies beginning with the 2005 planting season. In 2005, USDA paid the insurance companies underwriting gains of $916 million—a rate of return of 30.1 percent. In 2006, USDA paid them underwriting gains of $886 million—a rate of return of 24.3 percent. The companies received these underwriting gains despite drought conditions in parts of the country in 2005 and 2006. Adverse weather conditions, such as drought, normally suggest that insurance companies would earn lower profits because of greater producer losses.

In addition to underwriting gains, RMA pays companies a cost allowance to cover program delivery expenses. The allowance is calculated as a percentage of total premiums on the insurance policies that they sell. Because the cost allowance is not tied to specific expenses, the companies can use the payments in any way they choose. From 2002 through 2006, USDA paid the insurance companies over $4 billion in cost allowances.

[13] Similarly, over the 10-year period, from 1997 through 2006, USDA paid companies participating in the crop insurance program underwriting gains of $4.3 billion, which represents an average annual rate of return of 17.8 percent.

[14] *Best's Aggregates and Averages: Property/Casualty, United States and Canada.* (Oldwick, New Jersey: 2006). According to this publication, the benchmark rate of return for property and casualty insurance for the 10-year period ending in 2005 (the most recent year data were available) was 6.9 percent. For calculating the rate of return, we used Best's ratio of pre-tax operating income to net premium earned.

Because the cost allowance is a percentage of the premiums, it also increases when the value of policies companies sell increases, as it does when crop prices rise. For example, USDA expects the value of policies, and thereby the cost allowances paid to companies, to increase by about 25 percent from 2006 through 2008. USDA expects these higher policy values, and ultimately higher cost allowances, because of external factors, including higher crop prices, particularly for corn and soybeans. Consequently, the companies and their affiliated sales agents will receive substantially higher cost allowances without any corresponding increase in expenses for selling and servicing the policies. Substantially higher cost allowances provide these companies and their agents with a kind of windfall. Greater insurance coverage results in higher premiums and ultimately higher cost allowances; yet, the purpose of this allowance is to reimburse program delivery expenses.

In this context, USDA has requested the authority to renegotiate the SRA in its proposals for the Farm Bill. Specifically, USDA recommends renegotiating the SRA financial terms and conditions once every 3 years. According to USDA, the crop insurance program's participation has grown significantly since the implementation of ARPA. Because higher participation rates have resulted in more stable program performance, the reinsured companies have enjoyed historically large underwriting gains in the last 2 years of the program. Granting USDA authority to renegotiate periodically would also permit USDA to renegotiate the SRA if the reinsured companies experience an unexpected adverse impact.

Conclusion

In conclusion, Mr. Chairman, federal crop insurance plays an invaluable role in protecting farmers from losses due to natural disasters, and the private insurance companies that participate in the program are integral to the program's success. Nonetheless, as we mentioned before, we identified crop insurance as an area for oversight to ensure that program funds are spent as economically, efficiently, and effectively as possible. Furthermore, a key reason that we identified crop insurance, as well as other farm programs, for oversight is that we cannot afford to continue business as usual, given the nation's current deficit and growing long-term fiscal challenges.

RMA has made progress in addressing fraud, waste, and abuse, but the weaknesses we identified in program management and design continue to leave the crop insurance program vulnerable to potential abuse. Furthermore, as our work on underwriting gains and losses has shown, RMA's effort to limit cost allowances and underwriting gains by renegotiating the SRA has had minimal effect. In fact, it offers insurance companies and their agents a windfall. We believe that the crop insurance program should be delivered to farmers at a reasonable cost that does not over-compensate insurance companies participating in the program. A reduced cost allowance for administrative and operating expenses and a decreased opportunity for underwriting gains would potentially save hundreds of millions of dollars annually, yet still provide sufficient funds for the companies to continue delivering high-quality service while receiving a rate of return that is closer to the industry benchmark.

Congress has an opportunity in its reauthorization of the Farm Bill to provide USDA with the authority to periodically renegotiate the financial terms of the SRA with the insurance companies so that the companies' rate of return is more in line with private insurance markets. Such a step can help position the nation to meet its fiscal responsibilities.

Mr. Chairman, this concludes my prepared statement. I would be happy to respond to any questions that you or other Members of the Subcommittee may have.

Contact and Staff Acknowledgments

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