

April 2009

# CROP INSURANCE

## Opportunities Exist to Reduce the Costs of Administering the Program



GAO

Accountability \* Integrity \* Reliability



Highlights of [GAO-09-445](#), a report to congressional requesters

### Why GAO Did This Study

The U.S. Department of Agriculture (USDA) administers the federal crop insurance program with private insurance companies, which, in turn, work with insurance agencies that sell crop insurance. In 2008, according to USDA, the program cost \$6.5 billion, including about \$2.0 billion in allowances to insurance companies to cover their administrative and operating (A&O) expenses, such as salaries and sales commissions to agencies. GAO was asked to examine (1) the reasons for recent substantial increases in A&O allowances, and the purposes for which insurance companies use these allowances, and (2) insurance agencies' expenses for selling federal crop insurance policies, and questionable practices, if any, that agencies use to compete for business among farmers. GAO analyzed USDA and private insurers' data, among other things.

### What GAO Recommends

GAO recommends that USDA implement a methodology so that the A&O allowance more closely aligns with expenses, as it did before crop prices rose in 2006; require companies to annually report commissions to insurance agencies, by policy; and study costs of delivering crop insurance policies to establish a standard method for assessing agencies' reasonable costs. RMA agreed with two of our three recommendations, arguing that collecting commission data by policy may not be valuable. GAO believes that such data would better enable RMA to negotiate the A&O allowance it pays companies.

To view the full product, including the scope and methodology, click on [GAO-09-445](#). For more information, contact Lisa Shames at (202) 512-2649 or [shamesl@gao.gov](mailto:shamesl@gao.gov) or Susan Offutt at (202) 512-3763 or [offutts@gao.gov](mailto:offutts@gao.gov).

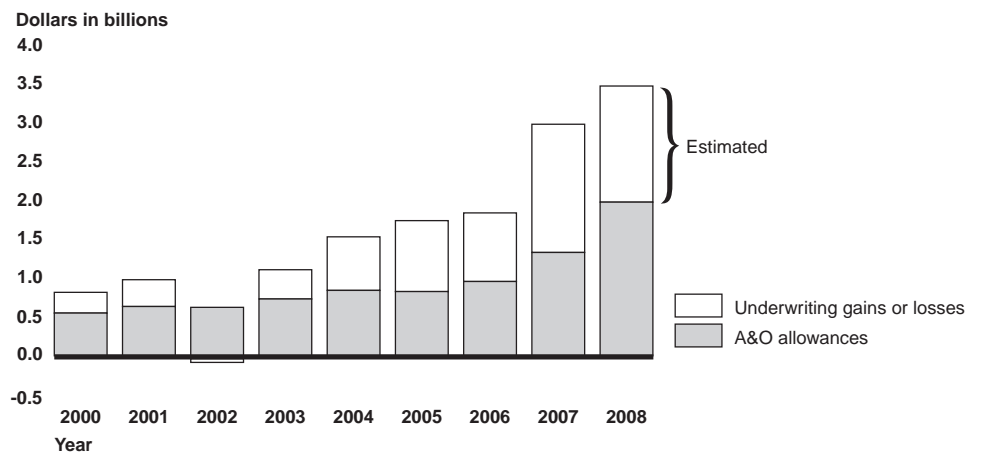
## CROP INSURANCE

### Opportunities Exist to Reduce the Costs of Administering the Program

#### What GAO Found

Between 2000 and 2009, companies' A&O allowances nearly tripled, primarily because USDA's calculation method for A&O allowances considers the value of the crop, rather than the crop insurance industry's actual expenses for selling and servicing policies, which generally remained stable. This increase in the A&O allowances occurred without a proportional increase in the number of policies, acres, or amount of insurance coverage purchased. The higher A&O allowances occurred because of higher crop prices since 2006. Per policy, the allowance rose from a national average of \$836 in 2006 to an expected \$1,417 in 2009. Companies have used most of the higher allowances to raise commissions, in an effort to compete for insurance agencies' portfolios of crop insurance policies. USDA data show that commissions increased more sharply in states with historically larger insurance underwriting gains, which add to company profits. For example, the average commission paid per policy in 5 Corn Belt states increased by 86 percent from 2006 to 2007, and by 43 percent in the other 45 states. Companies reported to USDA that their expenses to administer the program in 2007 exceeded their allowances. However, GAO determined that these expenses exceeded allowances largely because of the higher commissions paid to insurance agencies.

**A&O Allowances and Underwriting Gains or Losses Paid to Companies, 2000 through 2008**



Source: USDA.

According to GAO's analysis, crop insurance agencies' sales commissions have outpaced their expenses for selling policies. Commissions per policy increased by an average of about 16 percent per year from 2000 to 2009, compared with an increase of about 3 percent per year for insurance agents' wages, which are the largest factor in agencies' expenses. For 2007 through 2009, commissions will exceed wage-adjusted commissions by \$2.87 billion. According to USDA officials, higher commissions can create more incentive for rebating, which is the practice of offering something of monetary value to farmers to attract their business. USDA prohibits this practice, as do most states. USDA and state insurance regulators are working to reduce the potential for this practice.

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## Abbreviations

A&O	administrative and operating
NAIC	National Association of Insurance Commissioners
RMA	Risk Management Agency
SRA	standard reinsurance agreement
USDA	U.S. Department of Agriculture

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United States Government Accountability Office  
Washington, DC 20548

April 29, 2009

The Honorable Henry A. Waxman  
Chairman  
Committee on Energy and Commerce  
House of Representatives

The Honorable Edolphus Towns  
Chairman  
The Honorable Darrell Issa  
Ranking Member  
Committee on Oversight and Government Reform  
House of Representatives

The Honorable Jim Cooper  
House of Representatives

Federal crop insurance protects participating farmers against the financial losses caused by natural disasters, such as droughts, floods, and hurricanes, as well as declines in crop prices. In 2008, the crop insurance program provided about \$90 billion in insurance coverage for 272 million acres of farmland at a cost of \$6.5 billion to the federal government. To implement the federal crop insurance program, the U.S. Department of Agriculture's (USDA) Risk Management Agency (RMA) partners with 16 private insurance companies, which sell and service the insurance policies and share a percentage of the risk of loss and opportunity for gain associated with the policies. RMA pays insurance companies a percentage of the premiums on policies sold to cover the administrative and operating (A&O) expenses of selling and servicing these policies. These expenses are generally described in RMA guidance and can include company overhead, such as employee salaries, fees paid to insurance adjusters to verify claims, and sales commissions paid to the insurance agencies and their agents who sell crop insurance to farmers. These agencies and agents generally operate independently of the 16 insurance companies and can change companies from year to year.

We have reported for many years on the costs of the crop insurance program associated with A&O allowances. In May and June, 2007, we testified that RMA should ensure that expenses for delivering the crop

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insurance program are reasonable.<sup>1</sup> Specifically, we noted that the federal government spent more than \$6.8 billion from 2002 through 2006 to administer the program—with A&O allowances accounting for over half of these expenditures—and recommended that Congress authorize RMA to renegotiate its agreement with the companies that sell and service crop insurance policies. Subsequently, Congress, through the Food, Conservation, and Energy Act of 2008 (the 2008 Farm Bill), reduced the A&O allowance payment rate for most crop insurance policies by 2.3 percentage points, effective in 2009. This reduction is expected to result in financial savings of almost \$1 billion through 2013. The 2008 Farm Bill also directed RMA to consider alternative methods for determining A&O payment rates as well as other methods, taking into account current financial conditions, to ensure the continued availability of the program. In 2006, we identified the need for better oversight of the federal crop insurance program to ensure that its funds are spent as economically, efficiently, and effectively as possible.<sup>2</sup> Furthermore, in 1997, we reported that A&O allowances exceeded the companies' expenses that can be reasonably associated with selling and servicing crop insurance policies.<sup>3</sup> We noted that alternative arrangements for determining A&O allowances offered potential for savings. These alternative arrangements included paying companies a flat fee per policy, plus a lower percentage of the premium on the policy. Furthermore, we noted that USDA's Farm Service Agency had administered a type of crop insurance—catastrophic insurance—at a lower cost to the government than did private insurance companies.

While the 2008 Farm Bill reduced the A&O allowance rate, other factors also affect A&O allowances to insurance companies. Because allowances are a percentage of insurance premiums, they increase when the value of policies that companies sell increases, such as when crop prices rise. According to USDA, since 2007, the prices for major crops—such as corn, soybeans, and wheat—have been among the highest on record, and prices

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<sup>1</sup>GAO, *Crop Insurance: Continuing Efforts Are Needed to Improve Program Integrity and Ensure Program Costs Are Reasonable*, [GAO-07-944T](#) (Washington, D.C.: June 7, 2007); and *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).

<sup>2</sup>GAO, *Suggested Areas for Oversight for the 110th Congress*, [GAO-07-235R](#) (Washington, D.C.: Nov. 17, 2006).

<sup>3</sup>GAO, *Crop Insurance: Opportunities Exist to Reduce Government Costs for Private-Sector Delivery*, [GAO/RCED-97-70](#) (Washington, D.C.: Apr. 17, 1997).

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in 2009 and beyond are expected to remain relatively high.<sup>4</sup> In response to these rising crop prices, A&O allowances increased from about \$960 million in 2006 to about \$2 billion in 2008.

In this context, you asked that we examine (1) the reasons for the substantial increases in A&O allowances in recent years, and the purposes for which insurance companies use these allowances, and (2) insurance agencies' expenses for selling federal crop insurance policies, and questionable practices, if any, that agencies use to compete for business among farmers.

To examine the reasons for the substantial increases in A&O allowances in recent years and the purposes for which insurance companies use these allowances, we interviewed RMA officials and officials from each of the 16 companies that participate in the federal crop insurance program. In addition, we reviewed and analyzed RMA and company data concerning companies' uses of the allowances from 2000 through 2007. The sources of these data included expense reports that the companies submitted to RMA listing the amounts that they charge to various expense categories. We also reviewed RMA's reporting guidelines for companies and discussed these guidelines with company officials. In addition, we reviewed examples of companies' contracts with insurance agencies. We selected these contracts on the basis of the volume of business between the insurance company and the agency and, when possible, regional diversity. For the purpose of this report, commissions include profit-sharing bonuses that an insurance company pays to an insurance agency on the basis of profits for a given year and transfer bonuses that a company pays to an agency that transfers its portfolio of crop insurance policies that it sells (book of business) to the company. To examine insurance agencies' expenses for selling federal crop insurance policies, and questionable practices, if any, that agencies use to compete for business from farmers, we interviewed officials of eight insurance agencies and reviewed documents that some of these officials provided. We also interviewed officials from trade associations representing insurance agents. In addition, we interviewed officials from RMA and the National Association of Insurance Commissioners (NAIC), an association of state insurance regulators, and discussed with RMA its investigations of questionable competitive practices.

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<sup>4</sup>USDA, Office of the Chief Economist and World Agricultural Outlook Board, *USDA Agricultural Long-Term Projections to 2018* (Washington, D.C.: February 2009).

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We conducted this performance audit from January 2008 through April 2009 in accordance with generally accepted government auditing standards. Those standards require that we plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions based on our audit objectives. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objectives. Appendix I contains more detailed information on our scope and methodology.

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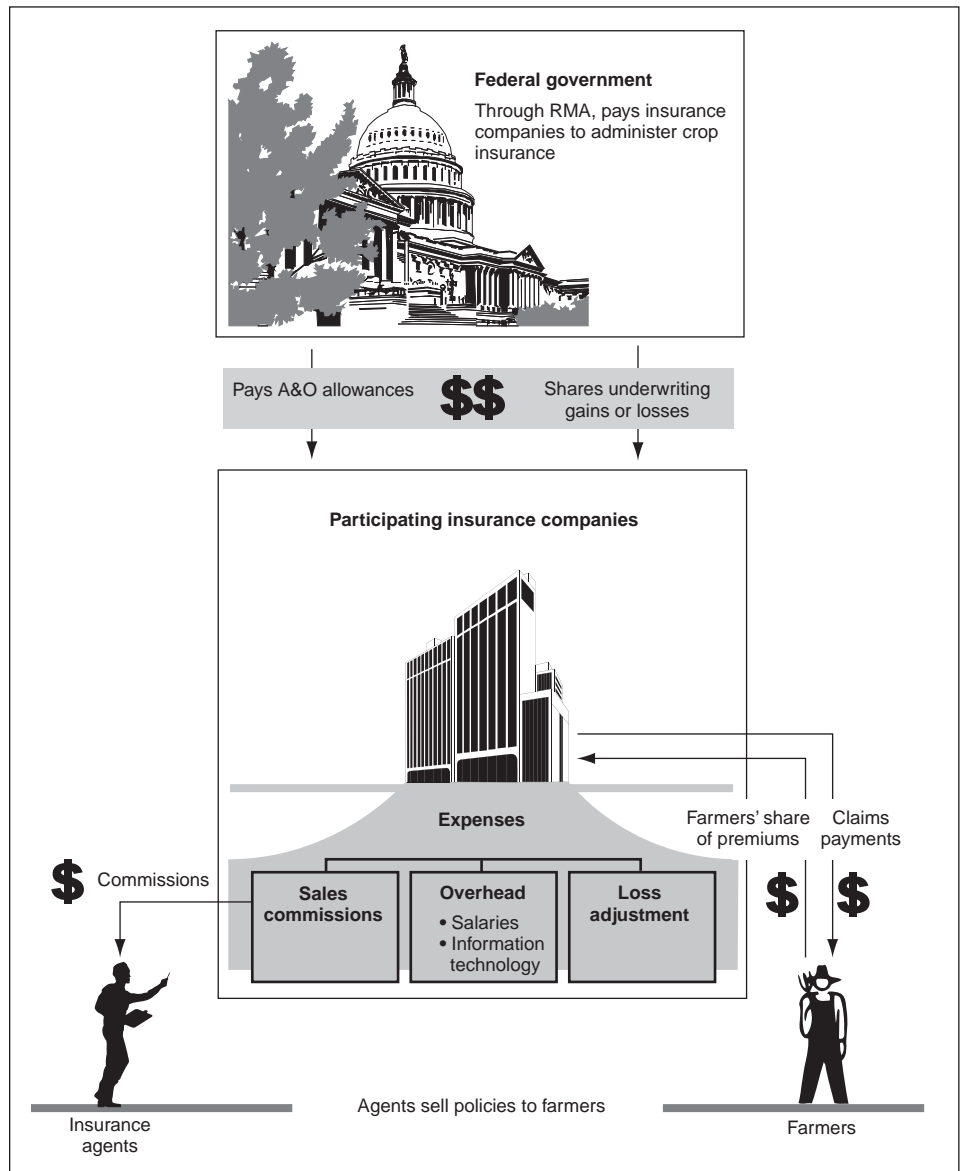
## Background

Farming is an inherently risky enterprise. In conducting their operations, farmers are exposed to financial losses because of production risks—droughts, floods, hurricanes, and other natural disasters—as well as price risks. For decades, the federal government has played an active role in helping to mitigate the effects of these risks on farm income by promoting the use of crop insurance.

Through the federal crop insurance program, farmers insure against losses on more than 100 crops. The federal government encourages farmers' participation by subsidizing their insurance premiums and acting as the primary reinsurer for the private insurance companies that take on the risk of covering, or "underwriting," losses to insured farmers. These companies achieve underwriting gains when insurance premiums exceed the claims they must pay farmers for crop losses, and they incur underwriting losses if claims paid on the policies exceed the premiums. To cover the expenses of selling and servicing crop insurance policies, the federal government pays companies an A&O allowance. In turn, insurance companies use this money to cover their overhead expenses, such as payroll and rent, and to pay commissions to insurance agencies and agents. Companies also incur expenses associated with verifying—adjusting—the amount of loss claimed. These loss adjustment expenses include, for example, travel expenses to farmers' fields. The relationships among the federal government, private insurance companies, agencies, agents, and farmers are illustrated in figure 1.



**Figure 1: How Money Flows through the Federal Crop Insurance Program**



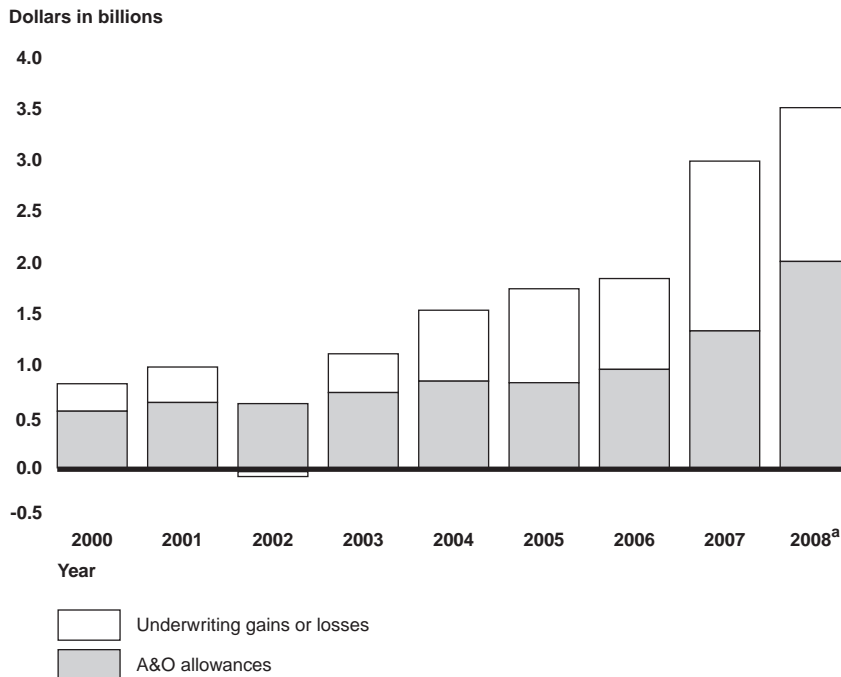
Sources: GAO; Art Explosion.

To encourage widespread participation in the crop insurance program, the federal government pays the costs of selling and servicing crop insurance policies through the A&O allowance. As designed, this allowance increases when companies sell policies to more farmers, insure additional acreage, or sell a higher level of insurance coverage on acres that are already

insured. However, A&O allowances can also increase as a result of higher crop prices without corresponding changes in the number of policies sold to farmers, insured acreage, or levels of coverage. Such increases in A&O allowances—when decoupled from the federal crop insurance program’s interest in promoting more insured acreage and higher levels of coverage—can create additional incentives for insurance companies to expand their market share by raising commission rates.

In 2008, RMA provided about \$2.0 billion in A&O allowances and an estimated \$1.5 billion in underwriting gains to crop insurance companies. Figure 2 shows the A&O allowances and underwriting gains or losses paid to companies for 2000 through 2008.

**Figure 2: Crop Insurance A&O Allowances and Underwriting Gains or Losses Paid to Companies, 2000 through 2008**



Source: RMA.

<sup>a</sup>Underwriting gains for 2008 are estimated, as of April 15, 2009.

Taking into account all payments, the crop insurance program cost taxpayers about \$31 billion for 2000 through 2008, according to the most recent available estimate from the Center for Agricultural and Rural

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Development at Iowa State University.<sup>5</sup> According to our analysis, RMA paid about \$1.93 for every \$1.00 in payments to farmers, with the other \$0.93 going to insurance companies over the period. Since 2006, when crop prices began to rise sharply, RMA has paid about \$2.29 for every \$1.00 that reached the farmer, with the balance going to insurance companies.

The policies that insurance companies underwrite and service are sold by more than 12,000 insurance agents. Some insurance agencies sell only crop insurance, while others also sell other lines of property and casualty insurance, such as automobile insurance and homeowner's insurance. These agencies, which are generally independent contractors and receive sales commissions for selling the policies, can sell policies on behalf of multiple crop insurance companies. Farmers must purchase policies by certain "sales closing" dates. These dates correspond to a time before planting season for a given crop in a certain region of the nation.

RMA is responsible for administering the federal crop insurance program through a cooperative financial agreement called the standard reinsurance agreement (SRA), which can be renegotiated once during a 5-year period, or as directed by Congress. The SRA incorporates the terms and conditions by which the private insurance companies that sell and service crop insurance policies are to abide. Under the 2008 Farm Bill, RMA may renegotiate the financial terms and conditions of the SRA, effective for the 2011 reinsurance year, beginning July 1, 2010. According to RMA officials, this effort will begin in the spring of 2009. For 2008 and 2009, RMA approved 16 insurance companies to provide federal crop insurance.

Premiums for the policies are set by RMA and depend, in part, on the price of the insured crop, although premiums also vary according to the type of insurance plan and the coverage levels that farmers select. A&O allowances are calculated as a fixed percentage of the premium, and they vary depending upon the plan and coverage levels, as shown in table 1.

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<sup>5</sup>The cost of crop insurance to taxpayers is equal to A&O allowances, plus underwriting gains paid to companies, plus claims paid to farmers, minus the premiums that farmers pay.

**Table 1: A&O Allowance Rates, by Coverage Level, 2006 through 2008 and 2009**

Coverage level, by year	A&O allowance rate, by type of insurance plan		
	Revenue <sup>a</sup>	Area <sup>b</sup>	Yield <sup>c</sup>
<b>2006 through 2008</b>			
75 percent or less	20.8	22.4	24.2
80 percent	18.7	20.1	21.7
85 percent	18.1	19.4	21.0
<b>2009</b>			
75 percent or less	18.5	12.0	21.9
80 percent	16.4	12.0	19.4
85 percent	15.8	12.0	18.7

Source: GAO analysis of RMA information and the 2008 Farm Bill.

Note: The coverage level is the percentage of revenue or production that a farmer chooses to insure. This table does not show catastrophic insurance plans, which compensate farmers for losses in production exceeding 50 percent of their average historic production at a payment rate of 55 percent of the crop price. The 2008 Farm Bill reduced the A&O allowance rate for these plans from 8 percent to 6 percent.

<sup>a</sup>Revenue insurance plans protect farmers against losses in expected revenue.

<sup>b</sup>Area insurance plans protect farmers against losses in revenue or production, using a county index as the basis for determining a loss.

<sup>c</sup>Yield plans also include other insurance plans—such as pasture, rangeland, and forage plans—and protect farmers against losses in production.

For most policies, the 2008 Farm Bill reduced the A&O allowance rate by 2.3 percentage points beginning in 2009. However, the bill provides an exception to cover higher loss adjustment expenses when needed. Specifically, if a state’s losses are 20 percent higher than the total premiums for that state, only one-half of the 2.3 percentage-point reduction would apply. In addition, the reduction in the A&O allowance rate was larger for area insurance plans than for other plans.

The 2008 Farm Bill also repeals a provision of the Federal Crop Insurance Reform and Department of Agriculture Reorganization Act of 1994 that allowed providers to implement “premium reduction plans” with RMA approval. Through these plans, companies could offer a premium discount to farmers that is equal to the amount that the companies’ A&O expenses fell below their A&O allowances for a given year. Thus, these plans offered an incentive for companies to reduce A&O expenses, because they allowed companies to compete for more business by, in effect, reducing

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the premiums they charged farmers for crop insurance. RMA established guidelines for the submission of the plans in a final interim rule in the *Federal Register* on July 20, 2005. In commenting on this rule, state insurance regulators expressed concerns that the plans would result in industry consolidation, reducing competition in the long run, and that the plans could create pressure for insurance companies to reduce essential operating expenses, thereby disadvantaging newer companies compared with larger, established companies.

State insurance regulators also expressed concerns that the plans constituted a legal form of rebating, the practice of offering something of monetary value to farmers to attract their business. Rebating is generally prohibited by the SRA and by most states, and the 2008 Farm Bill limits the compensation an individual can receive for selling or servicing a crop insurance policy in which he or she has a substantial beneficial interest.

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## Higher Crop Prices Sharply Raised A&O Allowances, and Insurance Companies Used a Large Share of These Increases to Compete for More Business

Companies' A&O allowances nearly tripled from 2000 to 2009, primarily because the method that RMA uses to calculate A&O allowances considers the value of the crop and not the crop insurance industry's actual expenses for selling and servicing policies. Companies spent a large share of their higher A&O allowances on commission payments, in part in an effort to compete for business from insurance agencies. They also reported expenses that are not clearly related to selling and servicing policies, such as legal fees.

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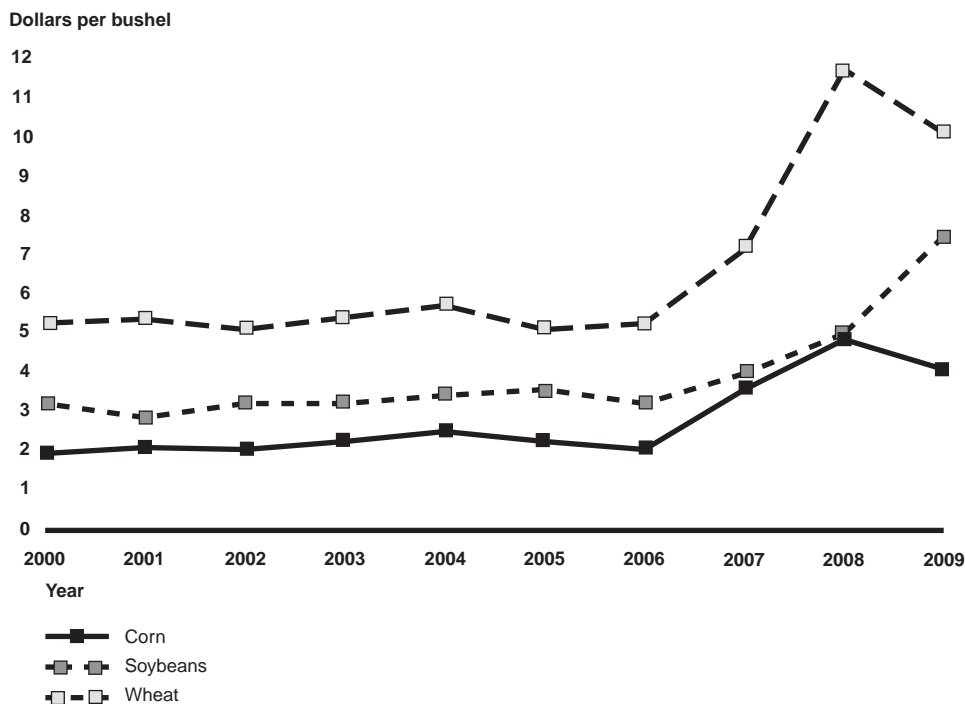
## Substantially Higher A&O Allowances Have Occurred Primarily Because of Sharp Increases in Crop Prices

A&O allowances nearly tripled—from \$552 million in 2000 to an estimated \$1.6 billion in 2009, according to our analysis of RMA data. The change from 2006 to 2009 was particularly large, rising from an average of \$836 per policy to an expected \$1,417 per policy. These increases occurred primarily because RMA calculates the allowance as a percentage of the premiums on crop insurance policies, rather than the crop insurance industry's actual expenses to sell and service policies. Crop insurance premiums change when crop prices change. Thus, the allowance increased sharply from 2006 through 2009, when the prices of major crops increased.

Figure 3 shows the prices for these crops—corn, soybeans, and wheat—that RMA used in calculating A&O allowances for 2000 through 2009.

These three crops represented about 71 percent of the crop insurance premiums in 2008.

**Figure 3: Corn, Soybean, and Wheat Prices That RMA Used in Calculating A&O Allowances, 2000 through 2009**



Source: RMA.

Note: Crop prices in this figure are for yield insurance plans, which were the plans most widely available for this period.

According to RMA, A&O allowances will decrease in 2009 because crop prices are expected to decrease and because of the reduction in the A&O allowance rate for most crop insurance policies, as mandated in the 2008 Farm Bill. However, the prices for corn, soybeans, and wheat—the top three crops in the crop insurance program, by premium—are expected to remain relatively high. Thus, using RMA’s estimate of premiums and the current allowance rate, we estimated that allowances in 2009 will be \$1,417 per policy, 69 percent higher than in 2006, although down from \$1,751 per policy in 2008.

The current method for calculating A&O allowances has caused allowance payments to increase along with crop prices, but without a proportional

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increase in the number of policies, acres, or coverage levels. For 2000 through 2008, A&O allowances increased sharply despite a 13 percent decrease in the number of crop insurance policies—the principal factor affecting companies’ workloads and costs.<sup>6</sup> This increase in A&O allowances has also been substantially greater than the increase in the number of acres covered by the program. Since 2000, the number of acres insured has increased slightly—by 7 percent—excluding insurance for pasture and rangeland. These types of insurance tend to cover large acreages in a single policy and, therefore, add many acres to the program without a proportional increase in the number of policies or in companies’ workloads. With the addition of pasture and rangeland insurance, the number of acres insured has increased by 32 percent since 2000, but these policies represent only about 1 percent of all crop insurance policies. Nor are coverage levels—which have increased from an average of about 61 percent of crop value in 2000 to an average of 67 percent of crop value in 2008—a major factor in the rapid increase in A&O allowances.

Because crop prices are a principal factor in the method for calculating A&O allowances, the allowance fluctuates as crop prices rise and fall. Fluctuations make it more difficult for insurance companies to budget and operate effectively over the long term. Although USDA expects that crop prices will remain relatively high for the next several years, prices are also expected to be volatile because of energy markets, among other things. Crop prices are increasingly tied to these markets because of the growing production of ethanol. When oil prices increase, ethanol prices generally increase, which raises demand for corn, the primary ethanol feedstock.

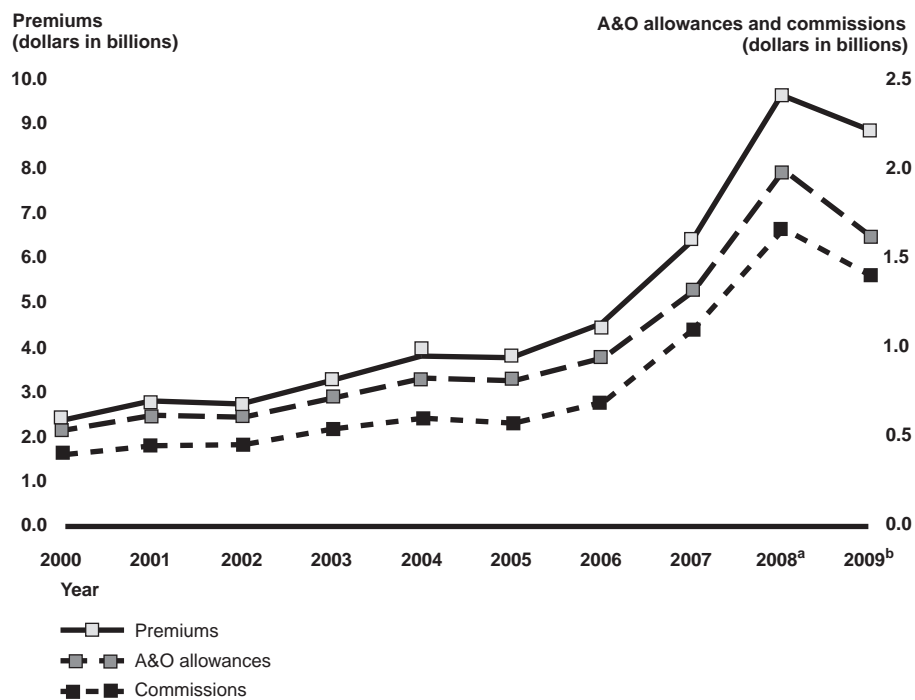
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<sup>6</sup>Specifically, crop insurance “units”—the individual farms that may be covered under a single policy—drive the companies’ workload. The number of units covered has remained relatively stable since 2000.

## Companies Have Used a Large Share of Higher A&O Allowances to Compete for More Business

Companies generally base insurance agencies' commissions on a percentage of the premiums that agencies bring to the companies. Thus, as crop prices have increased, so have commissions. Figure 4 shows the change in premiums, A&O allowances, and commissions from 2000 through 2009.

**Figure 4: Crop Insurance Premiums, A&O Allowances, and Commissions, 2000 through 2009**



Source: GAO analysis of data that the insurance companies provided to RMA.

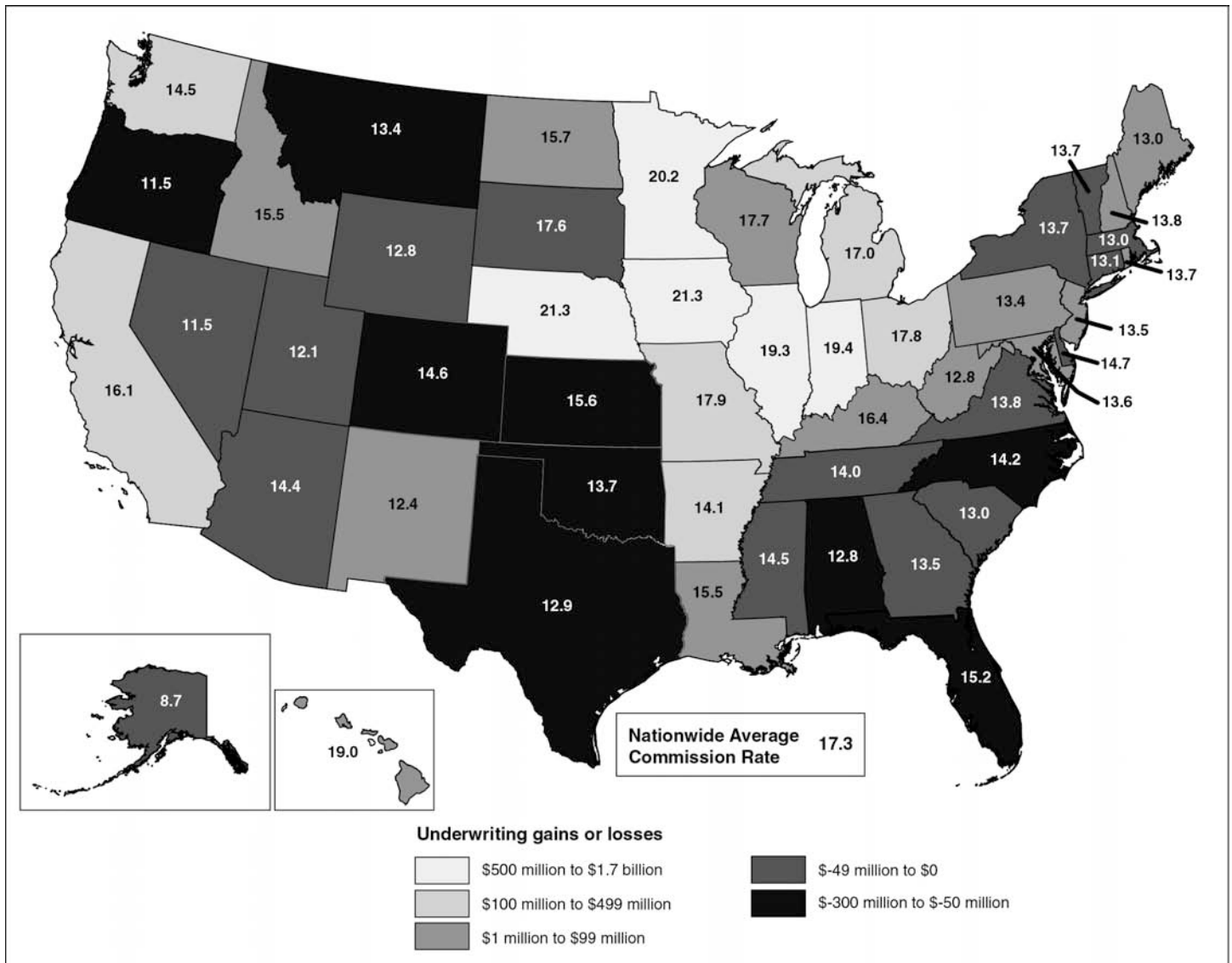
<sup>a</sup>For 2008, commissions are estimated on the basis of 2008 premiums and the assumption that commission rates remained the same as they were in 2007.

<sup>b</sup>For 2009, A&O allowances and commissions are estimated.

The geographic pattern in commission rates indicates that the companies are using their A&O allowances to attract insurance agencies' portfolios of insurance policies—their “books of business.” Obtaining more books of business helps companies increase their potential to earn underwriting gains. As figure 5 shows, the highest average commission rates are in the states that historically have had the largest underwriting gains.



**Figure 5: Commission Rates for 2007 and Historic Underwriting Gains or Losses, by State**



Sources: GAO analysis of RMA data and data that the insurance companies provided to RMA; Map Resources (map).

Note: Commission rates are commissions expressed as a percentage of premiums. Historic underwriting gains or losses are for 2000 through 2007, the latest data available.

While companies have paid higher commission rates in certain states, they have also increased the rates nationwide. For example, from 2006 to 2007 in 5 major Corn Belt states—Illinois, Indiana, Iowa, Minnesota, and

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Nebraska—the average commission rate increased from 17.6 percent of premium to 20.3 percent. In the other 45 states, the average commission rate increased from 13.0 percent of premium to 14.2 percent.

In terms of commission dollars, the average commission paid per policy from 2006 to 2007 increased more in the 5 major Corn Belt states overall than in the other states, rising by a total of 86 percent in these 5 states compared with 43 percent in the other 45 states. For 2007, in the 5 Corn Belt states, crop insurance companies paid a total of \$506 million in commissions—which is about \$9 million more than the total A&O allowance that the companies received from RMA for these states. According to crop insurance company officials, having used their A&O allowance for commissions, they rely on underwriting gains in such states to pay their overhead expenses and fees to insurance adjusters, who verify claims that are filed. Appendix II contains additional information on commissions paid in 2006 and 2007.

Company officials confirmed that they increased commission rates to compete for the insurance agencies' books of business. Obtaining more books of business helps companies increase their potential to earn underwriting gains.

Because RMA sets the premiums for crop insurance policies, companies cannot compete by reducing premiums. Nor do they often have the opportunity to insure new crop acres or sell more policies overall. Thus, one of the key ways for companies to increase their market share is to draw insurance agencies (and their books of business) away from competing companies by raising the agencies' commission rates. In addition, company officials told us that some insurance agencies have considerable leverage in negotiating with companies for sales commissions because these insurance agencies have long-standing relationships with farmers whose crop insurance policies have historically produced high underwriting gains. Thus, companies compete against one another, offering higher and higher commissions until the increase in A&O allowances is exhausted. Insurance agencies have benefited from the increases in A&O allowances without selling more policies.

In addition to increasing commission rates in certain states, some insurance companies seek to attract agencies' books of business by offering commission rates on the basis of the agency's size. That is, many of the commission contracts we reviewed provided higher commission rates to agencies that sell insurance in larger quantities.

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Even as they compete for insurance agencies' books of business on commissions, companies can also try to retain their current agencies' business by providing in-kind services, such as policy processing services and mailings to inform farmers about policies. These services usually entail an investment in information technology, such as quoting software that calculates farmer-specific premiums that agencies can use to market the various policies.

RMA does not know how much an individual company spends on commissions to each of the agencies with which it does business. RMA guidelines for reporting under the SRA direct insurance companies to report only their total commissions for each state in which they operate, not commission amounts paid to individual agencies. Information by state does not provide sufficient detail on commission expenses because such data do not allow RMA to assess whether the compensation paid to agencies is appropriate in relationship to the cost of selling and servicing crop insurance. RMA would be better able to set the A&O allowance rate when it renegotiates the SRA with insurance companies if it had more detailed information on commissions provided to individual agencies, such as commission data at the policy level. With such information on agencies' commissions, as well as their costs, RMA could assess whether the A&O allowances are reasonable for program delivery but not excessive, and adjust allowances as needed. Data by policy would enable RMA to better understand how compensation to agencies varies with agency size and the characteristics of policies sold, such as the type of insurance plan and expected underwriting gains. This understanding would enable RMA to better anticipate the effects of adjustments in A&O allowances on agencies. For example, this analysis may show that agencies that do business primarily in a part of the state with historically high underwriting gains received higher commission rates than agencies that do business in a part of the state with lower underwriting gains.

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**Companies' Reported Expenses Exceeded A&O Allowances, but High Commissions and Expenses That Were Inconsistent with RMA Guidance Explain This Difference**

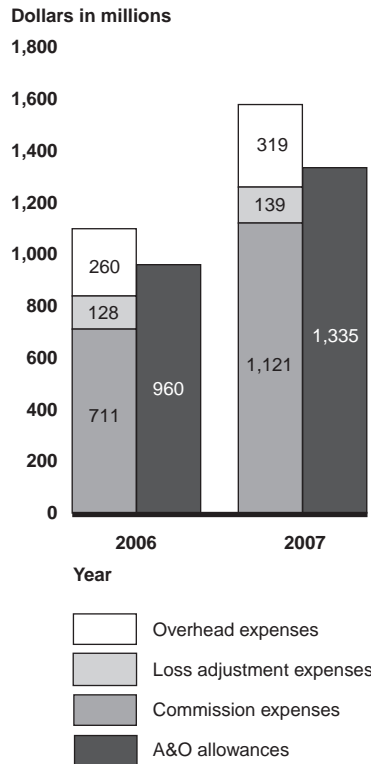
Despite the increases in A&O allowances, insurance companies reported to RMA that their expenses for delivering federal crop insurance for 2007 exceeded their A&O allowances by about \$244 million. Company officials told us that new RMA regulations and recent changes have added a significant administrative burden. For example, they noted, when RMA introduces an insurance product, companies must update their information systems, train staff, and take on additional work, and RMA provides what companies view as insufficient time for them to do so. Furthermore, although RMA guidelines have long directed companies to perform additional review of all claims of more than \$100,000, these

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reviews became more frequent when crop values started to increase significantly in 2007 and claim amounts rose accordingly. These activities made company operations more costly, according to company officials. Furthermore, insurance company officials told us that certain expenses vary by region of the country. For example, companies that operate in regions that tend to have crop losses more frequently incur higher overall A&O expenses because of higher loss adjustment expenses. Nevertheless, RMA officials noted that recent changes should have only marginally affected the cost of doing business.

We found that the amount by which companies' reported A&O expenses exceeded allowances was largely due to the increased spending on commissions, as well as to the reporting of expenses that was inconsistent with RMA guidance, rather than to greater administrative burdens. Although A&O allowances increased by 39 percent—from \$960 million in 2006 to about \$1.3 billion in 2007—companies increased the commissions they paid to agencies by 58 percent—from \$711 million to about \$1.1 billion. Figure 6 shows A&O expenses for 2006 and 2007 and the A&O allowances reported.

**Figure 6: A&O Expenses and A&O Allowances That Crop Insurance Companies Reported to RMA, 2006 and 2007**



Source: GAO analysis of data that the insurance companies provided to RMA.

For individual agencies, commissions can be large, both in terms of actual dollars and in relationship to A&O allowance rates. For example, in 2007, companies paid 60 insurance agencies commissions that were at least \$1.0 million and at least 20.0 percent of the premium value, which is about equal to the average A&O allowance rate of 20.4 percent paid to companies nationwide.

We also found that some insurance companies' reporting of program delivery expenses was inconsistent with RMA reporting guidance. For 2007, some companies reported profit-sharing bonuses, legal fees, and other expenses that were not directly related to the selling and servicing of crop insurance policies. RMA guidance states that these payments should not be included in the expense report, and, according to RMA officials, these payments are not program delivery expenses. For example, 10 of the 16 companies listed profit-sharing bonuses to insurance agencies as an expense to deliver the program. Similarly, 6 of the 16 insurance companies

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included reinsurance expenses that relate to business expansion, rather than to program delivery. Specifically, insurance companies pay premiums for commercial reinsurance to (1) reduce their risk of underwriting losses and (2) increase their capacity to sell more insurance. According to RMA guidance, reinsurance expenses should not be reported as A&O expenses. RMA officials told us that these types of expenses should be paid from underwriting gains because they are not associated with the direct sale and service of federal crop insurance to farmers. Finally, we found one company had included in its A&O expenses about \$1 million in legal fees to defend itself against a lawsuit from another crop insurance company. However, the guidance notes that legal fees associated with delivering the program should pertain to defending lawsuits related to servicing policies. RMA officials agreed that such legal fees should not be included as an A&O expense. RMA and company officials stated that RMA's guidance on allowable expenses should be clarified.

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### **Insurance Agencies' Commissions Have Outpaced Expenses, and Higher Commissions Can Create More Incentive for Rebating**

The modest increase from 2000 through 2009 in insurance agencies' expenses for selling policies has not been commensurate with the dramatic increase in their commissions. Consequently, many agencies have apparently seen substantial increases in their profits from their crop insurance books of business; this is particularly true for states that have had high underwriting gains, such as the Corn Belt states. The growth in commissions can create more incentives for agents to engage in rebating, although RMA has taken steps to reduce the potential for this practice.

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### **Insurance Agencies' Commissions Have Outpaced the Insurance Industry's Expenses, as Measured by Growth in Wages**

Insurance agents' responsibilities can include (1) adequately informing farmers about applicable crop insurance policy provisions and (2) accurately preparing and completing the farmer's insurance application, certification of production history, acreage reports, and other sales-related documents. Agents also must properly maintain the crop insurance contract files. While acknowledging that their commissions have increased, insurance agency officials stated that selling crop insurance policies generally entails more work for agents and thus higher expenses than for other lines of property and casualty insurance, and that those expenses have increased in recent years. Table 2 provides examples of the expenses that agencies incur in selling crop insurance.

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**Table 2: Examples of Insurance Agencies' Crop Insurance Expenses**

Type of expense	Example
Pay and benefits	Salaries, health insurance, and retirement
Education/Training	Training on software and changes in RMA regulations and requirements
Rent and equipment	Office space and vehicles
Information technology	Quoting software to help farmers select a crop insurance plan and coverage level that best meet their needs
Legal and professional	Liability insurance (errors and omissions insurance)

Source: GAO.

Much of the insurance agencies' work, according to the agency officials with whom we spoke, is related to the time required to help farmers choose the appropriate policy. These officials said agents generally (1) meet individually with farmers at various times during the year to update them on policies and compliance requirements, (2) mail farmers information on deadlines for reporting to the insurance agent on the number of acres planted and the amount of crop produced, and (3) provide seminars and annual meetings to help farmers understand the crop insurance options available to them. According to one insurance agency official, to service a crop insurance policy, an agent interacts with a farmer a minimum of six times a year. Another agency official told us that agents need to meet with the farmers at least four times a year.

In addition, some of agencies' crop insurance expenses are for services to farmers that are not described in RMA guidance but that help insurance agencies compete for farmers' business. Crop insurance agency officials told us that they compete on the basis of reputation, personal relationships, and additional services. These officials also noted that they advise farmers on how to best market their crops and increasingly provide advanced mapping services to farmers, such as creating and printing poster-size maps that display farmers' crop areas to help farmers manage their land. One insurance agency official said that the information technology needed for such services constituted the agency's biggest expense outside of payroll.

Although insurance agency officials told us that their crop insurance expenses are high, the documents they provided did not show that their sales expenses have increased at the same pace as their commissions. Because comprehensive information is not available on the expenses of the thousands of agencies that sell crop insurance, we examined the

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extent to which the growth in crop insurance commissions tracked trends in insurance industry expenses. We used 2000 as the base year in which crop insurance commissions are presumed to have been more closely aligned with expenses, before the increase in the A&O allowance. We then calculated what the commission per policy would have been for 2001 through 2009 if it had increased at the rate of change in insurance agents' wages. We used the rate of change in insurance agents' wages because, according to industry officials, wages account for agencies' largest expense. For this analysis, we used commission data from RMA and insurance agents' wage data for all lines of insurance from the Department of Labor's Bureau of Labor Statistics. In view of the 2008 Farm Bill's 2.3 percentage point reduction in A&O allowance rates for most insurance plans, we assumed that 2009 commission rates would decline by half of this amount—1.15 percentage points—relative to 2007, the most recent year for which RMA data on actual commission rates were available.<sup>7</sup>

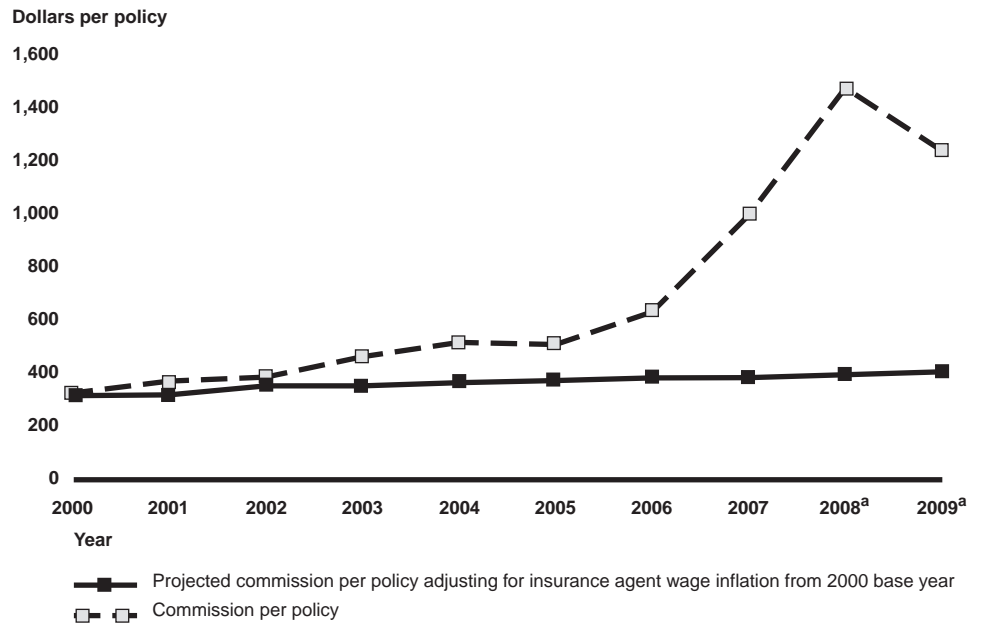
On the basis of these assumptions, we found that the rate of increase in commission per policy to crop insurance agencies has significantly outpaced the rate of increase in insurance agents' wages. That is, the actual commissions increased by an average of about 16 percent per year from 2000 through 2009, compared with an increase of about 3 percent per year for commissions assumed to increase at the same rate as insurance agents' wages. Figure 7 shows these comparisons.

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<sup>7</sup>Company officials told us that although they could not predict the commission rate for 2009, they did not expect that it would decline by the full 2.3 percentage points.



**Figure 7: Actual Commission per Policy Compared with Projected Commission per Policy Adjusted for Insurance Agent Wage Inflation, 2000 through 2009**



Source: GAO analysis of Bureau of Labor Statistics data and data that the insurance companies provided to RMA.

<sup>a</sup>Commission per policy is estimated for 2008 and 2009.

As figure 7 shows, with 2000 as a base year, if commissions had increased at the rate of increase in insurance agents' wages, the commission per policy in 2007 would have been \$382, but the actual commission per policy that insurance companies paid to agencies in 2007 was \$985—a difference of \$603 per policy. According to our analysis, in 2007, with about 1.14 million crop insurance policies, actual commission payments exceeded the adjusted commissions by about \$687 million. For 2007 through 2009, estimated commission payments exceed the adjusted commissions by about \$2.87 billion.

Crop insurance industry officials with whom we spoke generally acknowledged that insurance agencies received higher profits as a result of increased commissions in 2007 and 2008. While some officials said agencies' more profitable financial years are balanced by less profitable years, others said that the method for calculating A&O allowances needs to be modified to bring it more in-line with reasonable expenses for delivering the crop insurance program. Finally, a number of insurance

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company officials supported limiting commissions, although they had differing views on the best way to implement such limits.

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### Higher Commission Payments for Insurance Agencies Can Create More Incentive to Use Rebating to Compete for Farmers' Business

According to RMA and NAIC officials, higher commissions have increased the incentives for rebating. The RMA officials indicated that as commissions have increased, the number of anecdotal reports of rebating has also increased. They also observed that rebating is more prevalent in states with higher commission rates. A number of insurance agency officials told us that they lost business to competitors that they believed engaged in rebating. According to RMA officials, rebating disrupts the crop insurance market and discriminates against farmers who purchase smaller policies. State insurance regulators also consider rebating unfair to policyholders because it results in pricing based on the policyholder's relationship to an agent, rather than on risk.

RMA has determined that the incidence of illegal rebating of crop insurance premiums has grown in recent years. To combat rebating, RMA and NAIC have sought to improve communication and coordination between RMA and states on complaints, ongoing investigations, data analyses, and enforcement. In December 2007, RMA issued a bulletin directing crop insurance companies to notify agencies that state regulators and RMA were aware that rebating schemes were proliferating and that RMA and states would work cooperatively to discover and eliminate such schemes. In addition, in July 2008, RMA issued guidance on a 2008 Farm Bill provision that bars compensation to an individual for selling or servicing crop insurance if two conditions are met. Compensation is not allowed, either directly, or indirectly through an entity, if (1) the individual or a member of the individual's family has a substantial beneficial interest in the policy or plan of insurance and (2) total compensation from that policy or plan exceeds 30 percent or the percentage specified in state law, whichever is less, of the total of all compensation the individual receives directly or indirectly for selling or servicing crop insurance. RMA and NAIC officials told us that enforcing antirebating laws is difficult because rebating is only uncovered when complaints are made, but these officials believe that their recent actions will reduce the potential use of this practice.

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## Conclusions

Federal crop insurance plays an important role in protecting farmers from losses due to natural disasters, and the private insurance companies that participate in the program are integral to its success. Nevertheless, in view of increasing pressure to reduce federal budget deficits, A&O allowances

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present an opportunity to reduce government spending without compromising the crop insurance program's safety net for farmers.

Because A&O allowances are linked to crop prices, the A&O calculation method and higher crop prices have significantly increased A&O allowances, and companies—competing for underwriting gains—have passed a larger proportion of this allowance to insurance agencies, especially in the Corn Belt. As a result, many insurance agencies have experienced a kind of windfall. Although the 2008 Farm Bill reduces A&O allowance rates, these allowances, as well as commissions for 2009, are still likely to be well above the levels that occurred before crop prices increased in recent years. In addition, because crop prices have become increasingly volatile, the allowances are subject to large declines, which could make it more difficult for insurance companies and agencies to budget and operate effectively.

A&O allowances can better reflect reasonable business expenses, adjusted for costs in different regions of the country. Linking A&O allowances to reasonable expenses would also help stabilize the allowances that insurance companies receive. Furthermore, the 2008 Farm Bill directs RMA to consider alternative methods to determine the A&O allowance rate that would also provide savings for taxpayers. This effort could be more effective if RMA were to collect information on the commissions that companies have paid to individual agencies, as well as the individual agencies' expenses. This information would enable RMA to appropriately modify the A&O calculation method and monitor whether this revised method produces sufficient allowances to cover reasonable expenses.

Finally, many companies reported expenses to RMA that were not clearly related to selling and servicing crop insurance policies. Such reporting is due, at least in part, to inadequate guidance. Improved guidance would enable RMA to accurately track the insurance companies' crop insurance delivery expenses.

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## Recommendations for Executive Action

To better ensure that the A&O allowances provided to the crop insurance industry are sufficient for program delivery, but not excessive, we recommend that the Secretary of Agriculture direct the Administrator of the Risk Management Agency to develop a new methodology for calculating the A&O allowance so that it is more closely aligned with expenses, in terms of dollars per policy, as was the allowance in place before 2006, when crop prices increased sharply. SRA renegotiations should achieve this goal. Once this alignment is completed, the

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Administrator should minimize annual fluctuations in A&O allowances that are unrelated to business expenses, while recognizing variations in delivery expenses across regions of the country.

To assist in maintaining the relationship between A&O allowances and reasonable business expenses, we further recommend that the Secretary of Agriculture direct the Administrator of the Risk Management Agency to require that companies annually report the commissions they paid to insurance agencies, by policy, to the Risk Management Agency. The agency should also conduct a study of the costs associated with selling and servicing crop insurance policies to establish a standard method for assessing agencies' reasonable costs in selling and servicing policies.

Finally, to accurately track the insurance companies' expenses for delivering crop insurance, we recommend that the Secretary of Agriculture direct the Administrator of the Risk Management Agency to clarify the current guidance on reporting these expenses and specify what expenses are permitted.

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## Agency Comments and Our Evaluation

We provided the Risk Management Agency with a draft of this report for review and comment. RMA agreed with our findings and two of our three recommendations. RMA did not agree with our recommendation that it require companies to annually report the commissions they paid to insurance agencies by policy. RMA expressed concern that collecting commission data by policy would significantly increase its administrative burden and that of insurance companies because some of the compensation that companies pay to agencies is not usually paid by policy. However, we believe that gathering and reporting data by policy need not significantly increase the "administrative burden" that RMA described. First, RMA, which currently collects commission data aggregated at the state level, could require that companies report two additional data fields in the policy records they currently submit to RMA—commission and other compensation. These records can already contain over 300 such data fields. Once these changes are implemented, the recurring costs should be minimal. In conjunction with these changes, RMA could develop and provide allocation guidance to prorate compensation that is not provided on a per-policy basis so that this compensation could be apportioned to individual policies. Second, providing policy-level data would eliminate the need for companies to provide data aggregated at the state level, which could offset the additional burden that RMA believes would result.

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RMA also stated that more detailed commission data may not be valuable in identifying true program delivery costs or in improving the A&O reimbursement structure. Although we agree that commission data are not an accurate reflection of true program delivery costs, we believe such data would be valuable in improving the methodology that RMA uses to calculate A&O allowances. Tracking commissions by state, as RMA does currently, does not provide RMA with sufficient detail to take into account differences among agencies, such as location and size. For example, more detailed commission data may enable analysis showing that agencies that do business primarily in a part of the state with historically high underwriting gains received higher commission rates than agencies that do business in a part of the state with lower underwriting gains. This kind of information could enable RMA to better anticipate the effects of adjustments in A&O allowances on agencies. Finally, given the magnitude of commission payments—an estimated \$1.7 billion in 2008—additional reporting would result in analyses that would strengthen transparency and accountability in the use of taxpayer funds.

We also added examples to this report to elaborate on the justification that we provided in our draft report to RMA for this recommendation.

RMA also provided technical corrections that we incorporated into this report as appropriate. RMA's written comments and our responses are presented in appendix III.

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As arranged with your offices, unless you publicly announce its contents earlier, we plan no further distribution of this report until 30 days from its issue date. At that time, we will send copies of this report to appropriate congressional committees; the Secretary of Agriculture; the Director, Office of Management and Budget; and other interested parties. In addition, this report will be available at no charge on GAO's Web site at <http://www.gao.gov>.

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If you or your staffs have any questions about this report, please contact Lisa Shames at (202) 512-2649 or [shamesl@gao.gov](mailto:shamesl@gao.gov) or Susan Offutt at (202) 512-3763 or [offutts@gao.gov](mailto:offutts@gao.gov). Contact points for our Offices of Congressional Relations and Public Affairs may be found on the last page of this report. Key contributors to this report are listed in appendix IV.



Lisa Shames  
Director, Natural Resources  
and Environment



Susan Offutt  
Chief Economist

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# Appendix I: Objectives, Scope, and Methodology

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We were asked to examine (1) the reasons for the substantial increases in administrative and operating (A&O) allowances in recent years, and the purposes for which insurance companies use these allowances, and (2) insurance agencies' expenses for selling federal crop insurance policies, and questionable practices, if any, that agencies use to compete for business among farmers.

To examine the reasons for the substantial increases in A&O allowances in recent years, and the purposes for which insurance companies use these allowances, we interviewed U.S. Department of Agriculture (USDA) officials from the Risk Management Agency (RMA) and officials from each of the 16 insurance companies that participate in the federal crop insurance program. In addition, we reviewed and analyzed RMA and company data concerning companies' uses of the allowances from 2000 through 2007. The sources of these data included expense reports that the 16 companies submitted to RMA listing the amounts that they charge to various expense categories. We also reviewed reports that the companies submitted to RMA listing the amount of commission and the commission rate paid to insurance agencies by state during 2006 and 2007. For the purpose of this report, commissions include profit-sharing bonuses that an insurance company pays to an insurance agency on the basis of profits for a given year and transfer bonuses that a company pays to an agency that transfers its business to the company. In addition, we analyzed data from RMA's *Summary of Business* and reviewed RMA's analysis of companies' financial data.

For our analysis of company data, we used both data reported directly to RMA as well as data from company expense reports. RMA data on premiums were complete for all years. Company expense report data on both premiums and commissions were complete for 2006 and 2007, but were only partially complete for the other years (85 percent complete for 2000, 89 percent complete for 2001, 70 percent complete for 2002, 71 percent complete for 2003, 85 percent complete for 2004, and 89 percent complete for 2005). Data were missing largely because of changes in company structure, such as mergers, acquisitions, and companies' going out of business. We took the following steps to correct for the missing data to avoid overstating any change over time (since data were more often missing in earlier years). We assumed the data on commissions, as reported in company expense reports, were missing to the same extent as the data on premiums reported in the same place. We therefore adjusted the data on total commissions paid, by year, by the same fraction necessary to adjust the premiums reported on the company expense

reports to bring it up to the amount of premiums reported to RMA, which we knew to be the more reliable number.

We also reviewed examples of companies' contracts with insurance agencies. We selected these contracts on the basis of the volume of business between the insurance company and the agency and, when possible, regional diversity. Furthermore, we reviewed RMA's reporting guidelines for crop insurance companies and discussed these guidelines with company officials. In addition, we interviewed National Association of Insurance Commissioners (NAIC) officials to better understand allowable expenses.

To examine insurance agencies' expenses for selling federal crop insurance policies and questionable practices, if any, that agencies use to compete for business from farmers, we interviewed officials of eight insurance agencies and reviewed documents that some of these officials provided, including their income statements. We based our selection of insurance agencies on premium volume, regional location, crop type, and proximity to crop insurance companies. We examined the extent to which the growth in crop insurance commissions tracked trends in insurance industry expenses. We used 2000 as the base year in which crop insurance commissions are presumed to have been more closely aligned with expenses, before the increase in the A&O allowance. We then calculated what the commission per policy would have been for 2001 through 2009 if it had increased at the rate of change in insurance agents' wages. We used the rate of change in insurance agents' wages because, according to industry officials, wages account for agencies' largest expense. For this analysis, we used commission data from RMA and insurance agents' wage data for all lines of insurance from the Department of Labor's Bureau of Labor Statistics. In view of the Food, Conservation, and Energy Act of 2008's 2.3 percentage point reduction in A&O allowance rates for most insurance policies, we assumed that 2009 commission rates would decline by half of this amount—1.15 percentage points—relative to 2007, the most recent year for which RMA data on actual commission rates were available. We then calculated what the commission per policy would have been for 2001 through 2009 if it had increased at the rate of change in insurance agents' wages. We also interviewed officials from trade associations representing insurance agents. In addition, we interviewed officials from RMA and NAIC and discussed with RMA its investigations of questionable competitive practices.

In addressing the objectives, we also reviewed prior GAO work and additional relevant academic studies assessing the federal crop insurance



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program. Furthermore, we reviewed analyses of premium reduction plans as well as the *Federal Register* listing and associated comments regarding these plans. We did not independently verify the Bureau of Labor Statistics, RMA, and company data, but we discussed with agency and company officials, as appropriate, the measures they take to ensure the accuracy of these data. For the purposes for which these data were used in this report, these measures seemed reasonable. We conducted this performance audit from January 2008 through April 2009 in accordance with generally accepted government auditing standards. Those standards require that we plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions based on our audit objectives. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objectives.

# Appendix II: Commissions, Percentage Change in Commission per Policy, and Underwriting Gains or Losses

State	Commissions <sup>a</sup>			Percentage change per policy	Underwriting gains or losses 2000 through 2007
	Year		Change		
	2006	2007			
Illinois	\$78,412,807	\$119,829,350	\$41,416,542	61.2%	\$1,440,877,198
Iowa	63,736,297	127,604,411	63,868,114	106.6	1,680,044,379
Minnesota	55,246,417	105,270,295	50,023,877	92.9	982,031,875
North Dakota	54,469,829	83,846,615	29,376,786	56.5	11,015,469
Nebraska	51,187,444	95,367,265	44,179,821	93.6	757,012,039
Texas	49,519,189	60,393,008	10,873,819	9.8	(216,112,758)
South Dakota	42,668,604	74,586,111	31,917,506	76.7	(36,492,553)
Kansas	39,891,250	68,827,161	28,935,911	76.6	(289,751,007)
Indiana	33,780,007	58,304,916	24,524,908	76.2	659,564,954
California	26,778,219	30,044,334	3,266,116	13.5	498,321,632
Florida	21,385,507	19,295,620	(2,089,887)	(1.7)	(212,135,483)
Ohio	21,121,885	34,418,894	13,297,008	63.5	262,618,216
Missouri	20,461,507	33,626,430	13,164,923	63.1	400,298,610
Wisconsin	16,912,717	27,967,272	11,054,555	69.3	51,497,302
Colorado	13,261,396	20,134,952	6,873,555	47.7	(163,381,278)
Montana	12,269,982	16,088,903	3,818,921	34.9	(163,126,743)
Georgia	12,184,145	12,398,701	214,556	(4.0)	(38,377,197)
Michigan	12,049,758	19,751,624	7,701,866	67.7	140,498,209
North Carolina	11,588,482	15,484,827	3,896,345	31.6	(146,898,874)
Oklahoma	8,053,897	12,154,386	4,100,489	47.7	(144,451,805)
Washington	6,917,606	8,309,144	1,391,538	24.1	104,710,814
Arkansas	6,693,417	8,660,735	1,967,318	16.3	131,815,766
Mississippi	6,238,658	8,675,622	2,436,964	20.3	(42,324,473)
Kentucky	5,937,255	9,887,195	3,949,941	61.5	29,311,314
Idaho	5,840,670	6,668,574	827,904	9.4	97,428,583
Louisiana	5,421,460	7,982,734	2,561,274	39.8	37,685,157
Alabama	4,624,019	5,054,420	430,402	5.9	(66,285,056)
Tennessee	4,605,565	6,541,555	1,935,991	33.4	(3,110,142)
Pennsylvania	4,054,763	5,984,085	1,929,322	57.5	25,969,560
South Carolina	4,008,829	5,017,032	1,008,203	23.2	(42,446,340)
Virginia	3,370,504	5,139,069	1,768,565	50.8	(22,158,038)
Oregon	2,428,333	2,804,002	375,668	16.7	(85,129,309)

**Appendix II: Commissions, Percentage  
Change in Commission per Policy, and  
Underwriting Gains or Losses**

State	Commissions <sup>a</sup>			Percentage change per policy	Underwriting gains or losses 2000 through 2007
	2006	2007	Change		
New York	2,315,523	2,990,658	675,135	34.4	(2,260,430)
Maryland	2,205,660	3,253,648	1,047,988	51.1	21,445,930
New Mexico	1,391,397	1,755,658	364,261	28.0	16,163,333
Arizona	1,221,424	1,055,695	(165,729)	(5.0)	(6,313,709)
Wyoming	903,310	1,675,054	771,744	90.2	(39,087,279)
Delaware	771,875	1,282,352	510,478	63.9	(876,791)
Maine	649,107	700,797	51,690	13.8	3,304,735
Connecticut	427,090	549,218	122,127	32.9	(9,580,108)
New Jersey	331,242	571,616	240,374	76.7	13,121,040
Massachusetts	280,498	378,626	98,128	41.5	(12,479,868)
Utah	234,411	257,585	23,174	26.9	(4,473,986)
Hawaii	183,442	340,909	157,467	42.4	4,451,873
West Virginia	164,075	236,474	72,399	52.2	727,834
Vermont	115,109	198,056	82,947	83.6	(1,309,708)
Nevada	109,527	92,555	(16,972)	(4.4)	(5,231,273)
New Hampshire	41,727	52,269	10,541	35.8	287,382
Rhode Island	7,797	11,562	3,765	71.5	211,129
Alaska	2,803	3,080	276	19.0	(44,194)
<b>Total</b>	<b>\$716,476,439</b>	<b>\$1,131,525,055</b>	<b>\$415,048,616</b>	<b>59.3%</b>	<b>\$5,616,575,931</b>


Source: GAO analysis of the data that the insurance companies provided to RMA.

Note: Companies report commissions each year by state. Companies also submit to RMA an expense report, in which total commissions represent one of several itemized expenses. The total commissions in the two reports are not equal because RMA guidance stipulates that companies include commissions based on profit-sharing in the state commission report but not in the expense report. Therefore, the total commissions in this table, which are based on the state commission report, are not equal to the total commissions noted elsewhere in this report.

<sup>a</sup>Commissions are rounded to the nearest dollar.

# Appendix III: Comments from the U.S. Department of Agriculture

Note: GAO comments supplementing those in the report text appear at the end of this appendix.

<p>United States Department of Agriculture</p> <p>Risk Management Agency</p> <p>1400 Independence Avenue, SW Stop 0801 Washington, DC 20250-0806</p>		<p>US GAO</p>	<p>APR 3 2009</p>
		<p>2009 APR -8 AM 11: 06</p>	
	<p>Ms. Lisa Shames Director, Natural Resources and Environment Government Accountability Office 441 G Street, NW Washington, DC 20548</p>		
	<p>Dear Ms. Shames:</p>		
	<p>Thank you for the opportunity to review and provide comments on the Government Accountability Office's (GAO) draft report on <i>Crop Insurance: Opportunities Exist to Reduce the Costs of Administering the Program</i> (GAO-09-445).</p>		
	<p>The Risk Management Agency (RMA) provides the following response and comments to the recommendations contained in the draft report:</p>		
	<p><u>GAO Recommendation 1:</u> Develop a new methodology for calculating Administrative and Operating (A&amp;O) subsidy so that it is more closely aligned with actual delivery expenses in terms of dollars per policy. Once this alignment is completed, RMA should minimize annual fluctuations in A&amp;O allowances that are unrelated to business expenses while recognizing variations in delivery expenses across regions of the country.</p>		
	<p><u>RMA Response:</u> RMA has considered the GAO recommendations regarding the alignment of A&amp;O subsidy with actual delivery expenses, and considers the recommendations generally consistent with the direction and guidance provided within the 2008 Farm Bill. As part of the next renegotiation with the private insurance companies, RMA will be evaluating potential alternative A&amp;O calculation methodologies for establishing an appropriate reimbursement for services performed.</p>		
	<p><u>GAO Recommendation 2:</u> Require that companies annually report to RMA the commissions they paid to insurance agencies, by policy.</p>		
	<p><u>RMA Response:</u> RMA has two major concerns with the recommendation that the companies annually report commissions they pay to insurance agencies by policy. First, companies often pay insurance agencies' commissions or other compensation on a basis other than by policy. Compensation is sometimes paid when an agency transfers a book of business to the company, reaches aggregate premium volume thresholds, achieves overall success in meeting reporting deadlines, or meets policy retention goals, as just a few</p>		

Ms. Lisa Shames

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See comment 1.

examples. Meeting the recommendation for reporting by policy would require the companies or RMA to devise an allocation system for commissions that are not usually paid on a per policy basis. Consequently, gathering and reporting this data by policy would represent a significant administrative burden both for the companies and RMA.

See comment 2.

Second, it is not clear that such detailed data would be valuable in attempting to identify true program delivery costs or in devising a better A&O reimbursement structure. Since 2005, RMA has collected information on the amount each company spends for agent compensation in each state. This information, along with informed estimates of true delivery costs, or the results of the study recommended by GAO, can form the basis for aligning the A&O reimbursement structure more closely to actual delivery costs. It is unclear how access to policy-level data on company compensation payments would add significantly to this effort.

See comments 3 and 4.

During the exit conference, RMA raised this issue. Neither in the conference nor in the draft report does GAO explain or provide examples of how such detailed information would contribute significantly to the objective of aligning the A&O reimbursement with true delivery costs. Consequently, until more explanation and rationale are given, RMA is not inclined to agree to this recommendation.

GAO Recommendation 3: Conduct a study of the costs associated with selling and servicing crop insurance policies to establish a standard method for assessing agencies' reasonable costs in selling and servicing policies.

RMA Response: RMA agrees that a study of the costs associated with selling and servicing crop insurance policies can be useful in evaluating commission expenses paid by insurance companies and in establishing an appropriate rate of reimbursement. RMA will pursue initiating a study contingent on the availability of funds.

GAO Recommendation 4: Clarify the current guidance on expense reporting and specify what expenses are permitted.

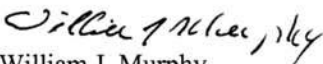
RMA Response: RMA agrees to clarify the expense reporting guidance for the 2011 reinsurance year.

Ms. Lisa Shames

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RMA appreciates the opportunity to work with your staff during the course of this audit. Should you have any questions regarding this response, please contact Michael Hand, RMA Deputy Administrator for Compliance/Audit Liaison Officer at 202-720-0642.

Sincerely,

  
William J. Murphy  
Acting Administrator

Following are GAO's comments on the Risk Management Agency's letter dated April 3, 2009.

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## GAO Comments

1. We do not agree that gathering and reporting data on commissions paid to insurance agencies by policy would significantly increase the "administrative burden" on RMA and insurance companies. First, RMA, which currently collects commission data aggregated at the state level, could require that companies report two additional data fields in the policy records they currently submit to RMA—commissions and other compensation. These records can already contain over 300 such data fields. Once these changes are implemented, the recurring costs should be minimal. In conjunction with these changes, RMA could develop and provide allocation guidance to prorate compensation that is not provided on a per-policy basis so that this compensation could be apportioned to individual policies. Second, providing policy-level data would eliminate the need for companies to provide data aggregated at the state level, which could offset the additional burden that RMA believes would result. Furthermore, given the magnitude of commission payments—an estimated \$1.7 billion in 2008—additional reporting would result in analyses that would strengthen transparency and accountability in the use of taxpayer funds.
2. We disagree with RMA's statement that more detailed commission data may not be valuable. With data on commissions paid to insurance agencies by policy, RMA would be better able to establish whether the compensation paid to agencies is appropriate in relationship to the agencies' costs of selling and servicing crop insurance. Tracking commissions by state, as RMA does currently, does not provide RMA with sufficient detail to take into account differences among agencies, such as location and size.
3. We disagree with RMA's assertion that we did not adequately justify this recommendation in the draft provided to RMA. We noted the following in the draft:
  - RMA does not know how much an individual company spends on commissions to each of the agencies with which it does business.
  - Information by state does not provide sufficient detail on commission expenses. RMA would be better able to set the A&O allowance rate when it negotiates the standard reinsurance agreement (SRA) with

insurance companies if it had more detailed information on commissions provided to individual agencies.

- With information on agencies' commissions, as well their costs, RMA could assess whether the A&O allowances are reasonable for program delivery but not excessive, and adjust allowances as needed.

Nonetheless, we have provided additional examples in the report to make our explanation more explicit.

4. During the exit conference with RMA officials, we explained, as we had in the draft report, that information at the policy level would inform RMA of the amounts that companies pay agencies for selling and servicing policies and thus would improve RMA's position in renegotiating the SRA. An RMA official told us that RMA knew from commission data currently collected at the state level that agencies in a given state earn commissions that are higher on average than those in other states. We responded, however, that RMA cannot determine, solely on the basis of state-level data, whether commissions vary across agencies within a state.



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# Appendix IV: GAO Contacts and Staff Acknowledgments

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## GAO Contacts

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## Staff Acknowledgments

In addition to the individuals named above, Thomas M. Cook, Assistant Director; Alisa Beyninson; Kevin S. Bray; Gary T. Brown; Barbara J. El-Osta; James R. Jones, Jr.; Anne Rhodes-Kline; Benjamin Shouse; Carol Herrnstadt Shulman; Nathaniel Taylor; and Marie Webb made key contributions to this report. Also contributing to this report were Carl Barden, Kim M. Raheb, and Jeremy Sebest.

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# Related GAO Products

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*Crop Insurance: Continuing Efforts Are Needed to Improve Program Integrity and Ensure Program Costs Are Reasonable.* [GAO-07-944T](#). Washington, D.C.: June 7, 2007.

*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.

*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.

*Crop Insurance: Actions Needed to Reduce Program's Vulnerability to Fraud, Waste, and Abuse.* [GAO-05-528](#). Washington, D.C.: September 30, 2005.

*Crop Insurance: USDA Needs to Improve Oversight of Insurance Companies and Develop a Policy to Address Any Future Insolvencies.* [GAO-04-517](#). Washington, D.C.: June 1, 2004.

*Department of Agriculture: Status of Efforts to Address Major Financial Management Challenges.* [GAO-03-871T](#). Washington, D.C.: June 10, 2003.

*Crop Insurance: USDA Needs a Better Estimate of Improper Payments to Strengthen Controls Over Claims.* [GAO/RCED-99-266](#). Washington, D.C.: September 22, 1999.

*Crop Insurance: Increases in Insured Crop Prices and Premium Rates Raise the Administrative Expense Reimbursement Paid to Companies.* [GAO/RCED-98-115R](#). Washington, D.C.: March 20, 1998.

*Crop Insurance: Opportunities Exist to Reduce Government Costs for Private-Sector Delivery.* [GAO/RCED-97-70](#). Washington, D.C.: April 17, 1997.

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