FEDERAL CROP INSURANCE PROGRAM

PROFITABILITY AND EFFECTIVENESS ANALYSIS

2010 UPDATE

Prepared on behalf of National Crop Insurance Services, Inc.

By Grant Thornton, LLP

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INTRODUCTION

Grant Thornton LLP was engaged by National Crop Insurance Services, Inc. ("NCIS") to update the "Federal Crop Insurance Program Profitability and Effectiveness Analysis 2009 Update" with 2009 results.[1] The analysis benchmarks the Multi-Peril Crop Insurance ("MPCI") program against the Property & Casualty ("P&C") insurance industry.[2] The 2009 results are based on an aggregation of the data contained in surveys returned by the 15 MPCI companies participating in the program in reinsurance year 2009.

The Federal Crop Insurance program, commonly known as MPCI, has been offered to U.S. farmers since the 1930s. Originally available only through the Federal government, the program has operated since 1981 as a public-private partnership between members of NCIS, as direct insurers or their managing general agents, and the Federal Crop Insurance Corporation ("FCIC"), as their principal reinsurer. The basic terms of this relationship are set forth in a Standard Reinsurance Agreement ("SRA") signed by FCIC and each individual direct insurer. FCIC, a federally owned corporation, delegates the responsibility of managing the program to the Risk Management Agency ("RMA") of the U.S. Department of Agriculture ("USDA"). In crop year 2009, the MPCI program: provided coverage on 264 million acres of eligible acreage of major U.S. crops,[3] insured liability of $79.6 billion, generated total premiums of $8.9 billion (of which $5.4 billion were premium subsidies), and distributed $5.2 billion in indemnity payments.[4]

As a Congressionally authorized insurance program subsidized by the U.S. Treasury, FCIC and RMA have the responsibility for ensuring that the profitability of the MPCI program is reasonable in relation to the financial risk retained by the participating insurers. In addition, the government has a duty to taxpayers to ensure that the program is delivered to insured farmers in a cost effective manner. The purpose for this report is to evaluate how effectively the program and the private sector delivery system perform in meeting these objectives. The approach used in this analysis is to perform a benchmark comparison of the MPCI program to similar private sector industries. MPCI companies write policies which are a specific class

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1 This report was prepared for NCIS to be used by its members solely in evaluating aggregated, historical data using the general methodology from previous Grant Thornton reports at the request of NCIS. Our services were provided in accordance with the Statement on Standards for Consulting Services promulgated by the American Institute of Certified Public Accountants and, accordingly, do not constitute the compilation, review or audit of any information. The report does not express a view with regard to the results for any individual member of NCIS. This update primarily addresses the MPCI and P&C information for 2009. However, previous years' data was amended if more current information for any year was available from Best's Aggregates & Averages Property & Casualty ("Best's A&A") or RMA. We reserve the right to further update this analysis as we obtain additional information.

2 This report uses aggregate historical data on both the MPCI program and the P&C industry. MPCI data used in this report were taken from a survey by NCIS of its member companies and from public sources (USDA/RMA). Responses were received from 15 of the 16 MPCI companies surveyed in the form of financial data for the 2009 reinsurance year. Gross Premium, Retained Premium and Net Gain/(Loss) reported by RMA as of Nov 2010, http://www3.rma.usda.gov/apps/reins_public/, were within 4%, 2% and 2%, respectively, of amounts submitted by the survey respondents, demonstrating the consistency of our surveys with that of RMA. Data on the P&C industry were obtained from the industry publication Best's A&A. Data utilized from previous versions of Best's A&A have been updated with data from the 2010 edition where possible. Data were also obtained from the 2004 analysis prepared by Deloitte and from the 1997 and 1999 analyses prepared by PwC.

3 http://www.rma.usda.gov/pubs/rme/aboutrma.pdf as of 10-15-2009

4 http://www3.rma.usda.gov/apps/sob/current_week/sobrpt2007-2010.pdf as of 10-12-2010

of Property and Casualty ("P&C") insurance. As such, P&C industry-wide results or specific segments of the P&C industry were found to provide informative benchmarks for evaluating the profitability and expenses of the crop insurance industry. However, any comparison of crop insurance and P&C insurance, in general, needs to take into consideration the unusual operational and financial characteristics of the MPCI program, including the unique way in which crop insurers recover their delivery costs. These differences are described in the following table.[5]

	P&C Insurance	MPCI Program
Premium	Expense loaded – meaning administrative expenses are included in the premium charged.	Not expense loaded – administrative and overhead expenses are partially reimbursed to companies through A&O Reimbursements.
Premium Rates	Set by company, approved by State regulators. Rates will differ by company due to risk and administrative loads.	Set by RMA – the same rates apply to all companies.
Premium Payments	Upfront at time of sale. Held by company to generate investment income.	At harvest with companies turning over to RMA within 30 days. Minimal to no investment income. Credit risk to company of nonpayment by policyholders.
Underwriting	Ability to underwrite risks. Can choose whether or not to accept risks and to modify rates and coverage to amend participant risk profile.	No ability to underwrite risks. Must take all eligible participants regardless of risk profile.
Reinsurance	Private	Mixture of private and federal
Administrative Expenses	Set by company and approved by State regulators as part of the Premium rate.	Set by statute and RMA[6] – A&O Reimbursements may or may not cover actual expenses incurred.

5 Adapted from Crop Insurance Testimony by Ron Brichler to General Farm Commodities and Risk Management Subcommittee; House Committee on Agriculture, June 7, 2007.

6 The Food, Conservation, and Energy Act of 2008 ("2008 Farm Bill") reduces the amount of A&O Reimbursement paid in 2009. Please refer to the "Effect of the 2008 Farm Bill" section of this report for further discussion.

Given these differences, a comparison of the P&C industry to the MPCI program is only valid as long as the major differences between the latter specific line of coverage and the more general former lines of coverage are recognized, understood, and adjusted for appropriately. Our analysis takes the appropriate adjustments into consideration to the extent possible from the information sources utilized.

KEY FINDINGS

The key findings of our analysis can be summarized as follows:[7]

- **The MPCI program is not as profitable as the P&C industry and writing MPCI coverage entails greater risk.**
  - MPCI's ratio of Pretax Net Income as a percentage of Adjusted Retained Premium averaged 16.0% for the period 1992-2009. P&C's ratio of Pretax Net Income as a percentage of Adjusted Net Earned Premium averaged 17.3%. Furthermore, the volatility of MPCI's historical earnings was 10.2% compared to only 9.9% for the P&C industry. Therefore, for the period of 1992 – 2009, the MPCI industry was less profitable than the P&C industry, and its return more variable, indicating that the returns were riskier. (Please refer to the Profitability Analysis section of this report.)
- **MPCI Expense-Premium ratios are significantly below those of the P&C industry.**
  - MPCI's average ratio of Total Expenses was only 27.5% of Gross Premiums for the period 1992-2009, compared to P&C's ratio of 60.4% of Adjusted Direct Premiums Written for the period 1992-2009. (Please refer to the Effectiveness Analysis section of this report.)
- **Under the current SRA, A&O Reimbursements continue to be below actual MPCI expenses incurred by private insurers.**
  - For 2008, MPCI companies incurred Total Expenses equal to 22.1% of Gross Premiums while A&O Reimbursements only totaled 20.4% of Gross Premiums, resulting in an approximate 1.6% ($160.8 million) shortfall.
  - For 2009, MPCI companies incurred Total Expenses equal to 23.8% of Gross Premiums while the A&O Reimbursements only totaled 18.3% of Gross Premiums, resulting in an approximate 5.5% ($476.1 million) shortfall.

These findings are consistent with the findings contained in prior years' studies. All studies consistently show that the MPCI program is less profitable than the P&C industry as a whole in the area of profitability and more efficient than the P&C industry in the area of expense management. The remainder of this report provides a detailed discussion of the analysis supporting each of these key findings.

7 Profitability ratios for the MPCI program for the 2007-2010 Updates include an adjustment to retained premium for Quota Share for the years 2005-2009.

METHODOLOGY FOR BENCHMARK COMPARISONS

In this report, we measure the costs and profitability of the MPCI and P&C industries relative to its revenue, rather than its equity. An important advantage of this approach is that all of the information required for an analysis of the insurance industry is publicly available and assumptions are minimized.

For the P&C insurance industry, revenue is defined as net premium after reinsurance. For the MPCI program, revenue is defined as retained premium after applying the SRA reinsurance provisions and quota share adjustment. The premium measures used in the above two definitions differ in that MPCI gross premiums represent just the expected benefits payable to policyholders, whereas P&C direct premiums also include a large loading to cover the insurer's expenses. In addition, P&C expense loadings differ widely for different lines of insurance.

In order to provide a valid comparison of the profitability of MPCI relative to the P&C industry, the premiums need to be restated on a common basis. One solution would be to add the actual expenses (or, possibly, the A&O reimbursements) of the crop insurance industry to the MPCI retained premiums. However, this type of adjustment would not eliminate the distortion in the comparison of the two industries in that crop insurance industry expenses are significantly less than P&C industry expenses in relation to premium. To address that issue, this report instead removes the expense loading from P&C industry premiums to derive adjusted P&C premiums. This is a more appropriate basis for comparing the two programs in that both the MPCI and the adjusted P&C premiums represent the expected benefits delivered to policyholders, which can be considered to be the true measure of the value provided to society by the programs.

In addition to providing the most appropriate basis for comparing profitability of the two programs, the use of adjusted P&C premiums is also the most appropriate basis for comparing the cost effectiveness of the delivery system. That is, each expense component is compared to the expected benefits delivered to policyholders. This differs from the traditional approach used to evaluate insurance industry expenses, which is to determine the ratio of expenses to total premium including the expense loading.

The following table illustrates how the P&C industry adjusted gross expense ratios used in this analysis were prepared. Historical expense ratios and premiums were obtained from data compiled by A.M. Best. The table below shows the calculations for the last five years. The final four columns of the table develop the adjusted gross expense ratios reported in **Exhibit 5.2**. A similar approach is used to develop the adjusted gross expense ratios for Homeowners and Private Passenger Auto Physical Damage shown in **Exhibit 7** as well as total net expenses shown in **Exhibit 2**.

Expenses Ratio Restatement Process
Illustration of how the Adjusted Expense Ratios are developed

P&C Industry Totals

				Amounts in Millions of Dollars			Ratios to Adjusted Direct Premiums Written			
Year	Gross Loss Adjustment Expense as a % of Direct Premiums Earned [a]	Gross Commissions & Brokerage Fees Incurred as a % of Direct Premiums Written [a]	Gross Other Underwriting Expenses Incurred as a % of Direct Premiums Written [a]	Direct Premiums Written [a]	Direct Premiums Earned [a]	Adjusted Direct Premiums Written [b]	Gross Loss Adjustment Expense	Gross Commissions & Brokerage Fees Incurred	Gross Other Underwriting Expenses	Total Gross Expenses
Formula	(1)	(2)	(3)	(4)	(5)	(6)	(7) = (1) *(5) / (6)	(8) = (2) *(4) / (6)	(9) = (3) *(4) / (6)	(10) = (7) + (8) + (9)
2005	14.3%	11.2%	13.0%	$ 487,054	$ 479,020	$ 300,687	22.8%	18.1%	21.1%	62.0%
2006	11.6%	11.3%	13.6%	$ 495,914	$ 486,513	$ 315,996	17.9%	17.7%	21.3%	56.9%
2007	11.1%	11.4%	14.1%	$ 497,424	$ 494,762	$ 315,662	17.4%	18.0%	22.2%	57.6%
2008	11.5%	11.4%	14.8%	$ 487,189	$ 489,668	$ 303,234	18.6%	18.3%	23.8%	60.7%
2009	12.4%	11.4%	15.0%	$ 468,290	$ 471,273	$ 286,224	20.4%	18.7%	24.5%	63.6%

Notes:

[a] Best's Aggregates & Averages 2009, Cumulative By Line Underwriting Experience, p. 385

[b] = (4) - { (1) * (5) + (2) * (4) + (3) * (4) }

PROFITABILITY ANALYSIS

Profitability is measured as a function of Pretax Net Income for both the P&C industry and the MPCI program. For the P&C industry, we measured Pretax Net Income as the sum of Net Underwriting Income (Loss), Net Investment Income and Realized Capital Gain (Loss). For the MPCI program, we measured Pretax Net Income as the sum of Net Underwriting Gain (Loss) and Net Expense Gain (Loss). Underwriting Gains are defined in the SRA as "the amount by which the Company's share of retained net book premium exceeds its retained ultimate net losses."[8] However, Underwriting Gains do not represent pure profit to the MPCI companies. As stated by former RMA Administrator Eldon Gould, *"It would be a mistake to consider them [Underwriting Gains (Losses)] pure profit or absolute loss for the reinsured companies. Underwriting Gains serve a number of functions – they cover partial delivery expenses for some companies, they are used to build reserves to meet the required policyholder surplus and they provide a return on equity."*[9] Therefore, the Net Expense Gain (Loss) must be included in the calculation of MPCI Pretax Net Income to arrive at a profitability measure.

Furthermore, the function that Underwriting Gains serve in building required policyholder surplus in the MPCI program is substantial. As part of RMA's financial integrity requirements, the insurance companies must maintain, at a minimum, adequate policyholder surplus to pay losses resulting from two consecutive years of a 500 percent loss ratio (losses equal to 500% of premiums).[10]

The policyholder surplus requirements are generally more stringent than those of state regulators for the P&C industry. As MPCI program premiums increase, the required policyholder surplus increases. The policyholder surplus requirement has implications for the amount of underwriting gains that would need to be retained in order to build the reserves to the required minimum level. It could also affect the amount of commercial reinsurance that MPCI insurers would need to purchase to maintain the required capitalization standard. In either case, this would reduce the available income that would otherwise be paid out to shareholders and reduce the financial incentive for new participants to enter the program. As Mr. Gould testified in June 2007, "*To put this requirement in perspective, the highest loss ratio the program has experienced was 2.39(239%) in 1988. The recent underwriting gains provide the surplus needed to cushion and plan for catastrophic weather events and years like 1988 and 1993. This is important as the companies today retain risk on almost 80 percent of the premiums written, with much of the retained premium in the riskiest Commercial Fund."*[11]

Exhibit 1 provides the data required to calculate Pretax Net Income for the MPCI program while **Exhibit 2** provides data required to calculate Pretax Net Income for the P&C industry as a whole. **Exhibits 3** and **3.1** compare the MPCI and P&C Pretax Net Income figures on a value and percentage basis, respectively.

8 SRA definition of Underwriting Gains from www.rma.usda.gov/pubs/ra/#09SRA

9 Statement by RMA Administrator Eldon Gould before the House Agriculture Subcommittee on General Farm Commodities and Risk Management, June 7, 2007.

10 Ibid.

11 Ibid.

In addition to the comparison of MPCI and P&C Pretax Net Income, we also analyzed MPCI and P&C returns and the risk associated with those returns in the form of their annual standard deviation.[12] To measure returns for the MPCI program, we divided aggregate annual Pretax Net Income by aggregate annual Retained Premiums.[13] To measure P&C returns, we divided aggregate annual Pretax Net Income by aggregate annual Net Earned Premiums[14] minus aggregate annual Total Net Expenses to obtain Adjusted Net Earned Premiums ("Adj. NEP"). As discussed in the methodology section above, premium data for MPCI and P&C lines are not stated on the same basis. P&C premiums are expense loaded, while MPCI premiums are not. Expenses for MPCI policies are intended to be reimbursed through the A&O Reimbursement. The removal of the expense loading from the P&C premiums ensures that comparisons of P&C and MPCI returns are developed on consistent bases, with denominators of each ratio representing the expected indemnities under each program.

Risk is typically measured as the standard deviation of values. If investors are risk averse, then they will require higher expected returns (or profits) when risks are greater. This is the typical "risk versus reward" analysis referred to in investing literature. In general, one would expect a higher return when taking on more risk.

Exhibits 1 and 2 provide weighted average returns and the standard deviation of those returns for the MPCI program and the P&C industry, respectively. For comparison, simple averages and simple standard deviations are presented as well.[15]

The MPCI program has a lower weighted average return of 16.0% compared to 17.3% for the P&C industry. Further, risk as measured by the weighted standard deviation is greater for the MPCI program (10.2% versus 9.9% for the P&C industry). Financial theory tells us that in general, investors will require higher expected returns when risks are greater. Therefore, when allocating their capital between the investment alternatives of the MPCI business or the P&C industry, a rational investor would be expected to choose to invest in the P&C industry, as over the long-term it has provided greater profits or returns with less variability or risk than the MPCI program.

The greater risk of the MPCI program is inherent in its structure. As previously detailed, the P&C industry has greater control over its ratemaking and underwriting activities.[16] Insurers can respond

12 Standard deviation is a standard statistical measure of spread in a distribution of values. Previous versions of this report calculated the unweighted standard deviation of the returns. This report calculates the weighted standard deviation. In this report, the weights equal Retained Premiums (or Adjusted Net Earned Premiums) in a given year divided by the total Retained Premiums (or Adjusted Net Earned Premiums) observed between 1992 and 2009, inclusive, for the MPCI industry (or the P&C industry). The weighted standard deviation is computed by taking the square root of the sum of the square of the difference between actual returns and expected returns multiplied by the appropriate weight.

13 2005-2009 adjusted for Quota Share.

14 We chose to differ from Deloitte's methodology by using Adj. NEP in the denominator of the return ratio rather than Adjusted Direct Earned Premiums ("Adj. DEP"). We made this change as Net Earned Premium for the P&C industry is after reinsurance ceded as is Retained Premiums after Federal Reinsurance for the MPCI industry.

15 Milliman presents simple averages in their reports. A comparison of the simple averages for the MPCI program and the P&C industry from Exhibits 1 and 2 in this report, respectively, generates even stronger support for the conclusion that is described in the next paragraph.

16 Please refer to chart on page 2.

to underwriting losses by increasing their rates in subsequent years and/or limiting coverage. In comparison, MPCI companies must adhere to ratemaking decisions of and policy provisions established by FCIC/RMA, regardless of underwriting loss experience.

The overall findings are consistent with the general findings of the previous years' studies. Historically, the MPCI industry has had no overall economic advantage over the P&C industry. The results of the current and previous studies are presented on the following page. Please note that the Grant Thornton, Deloitte, and PwC numerical results are not directly comparable due to differences in methodologies used and the time periods covered. The focus is on the overall results of the various studies.[17]

17 This table updates the standard deviation to be weighted standard deviations for all Grant Thornton reports.

Profitability		P&C Industry			MPCI Industry		
Report	Period	Metric	Wtd. Avg.	Std. Dev.	Metric	Wtd. Avg.	Std. Dev
Grant Thornton 2010 Update	1992-2009	Pretax Net Income/Adj. NEP	17.3%	9.9%	Pretax Net Income/ Retained Premium[18]	16.0%	10.2%
Grant Thornton 2009 Update	1992-2008	Pretax Net Income/Adj. NEP	17.5%	10.2%	Pretax Net Income/ Retained Premium[19]	14.2%	10.0%
Grant Thornton 2008 Update	1992-2007	Pretax Net Income/Adj. NEP	18.6%	9.9%	Pretax Net Income/ Retained Premium[20]	14.7%	11.1%
Grant Thornton 2007 Update	1992-2006	Pretax Net Income/Adj. NEP[21]	17.4%	9.4%	Pretax Net Income/ Retained Premium[22]	12.5%	10.5%
Deloitte 2004	1992-2002	Pretax Net Income/Adj. DEP	12.7%	8.9%	Pretax Net Income/ Retained Premium	7.9%	12.9%
PwC 1999	1988-1997/8	Pretax Net Income/Surplus	16.6%	7.6%	Pretax Net Income/ Surplus[23]	15.8%	10.1%
PwC 1997	1988-1995	Pretax Net Income/Surplus	14.1%	7.3%	Pretax Net Income/ Surplus[19]	11.7%	10.4%

As detailed in the above table, the P&C industry has consistently reported higher profitability, usually with less variability in results. In general, this indicates that the participants in the overall P&C industry have the ability to generate greater returns with less risk, and therefore hold a competitive advantage over the MPCI program.

18 2005-2009 MPCI adjusted for Quota Share.

19 2005-2008 MPCI adjusted for Quota Share.

20 2005, 2006 and 2007 MPCI adjusted for Quota Share.

21 P&C 2006 updated for final AM Best figures.

22 2005 and 2006 MPCI adjusted for Quota Share.

23 Surplus is assumed by PwC to be 130% of Retained Premium. Deloitte and Grant Thornton chose to use Retained Premium rather than an assumed Surplus in this ratio for the 2004, 2007, 2008, 2009 and 2010 Updates. Retained Premium is a publicly available figure which can be verified through published sources. This differs from statutory Surplus, which cannot be assigned to an individual line of insurance such as MPCI.

EFFECTIVENESS ANALYSIS

A second basis for comparison between the MPCI program and the P&C industry is their expense ratios. Although there are similarities in the types of expenses incurred by both businesses, expenses incurred by MPCI companies are unique in the insurance industry and involve some costs not usually incurred in other insurance lines, such as loss adjustment training for a wide variety of crops.

We have defined the MPCI Expense ratio as Total Expenses divided by Gross Premiums, while the P&C Expense ratio is defined as Total Expenses divided by Direct Premiums Written net of Expenses ("Adjusted DPW").[24] As previously stated, expenses are removed from P&C premiums in order to restate those premiums on a consistent basis with MPCI premiums, which are not expense loaded. Total Expenses include Loss Adjustment Expense, Commissions and Other Expenses incurred while selling and servicing business.[25] Total premiums for a line of business such as MPCI or P&C will be impacted by the price of each policy –- which is established by RMA for MPCI policies on an annual basis –- and the number and type of policies sold.

Exhibit 4 shows the Total Expense to Gross Premium ratio for the MPCI program has declined significantly over time. Since 1993, MPCI Total Expense ratios have never been above 34.2%, and since 2005, they have not exceeded 25.1%. **Exhibit 4** also shows that the Total Expense ratio for the MPCI program is well below the Total Expense ratio observed for the P&C industry. The wide gap between the two programs is due to the fact that P&C industry expenses average close to a third of the total premium. After removing expenses from the premium, the P&C expense ratio rises to roughly 60% of the expected benefits delivered to policyholders. The major categories of expense used in our analysis are Commissions, Loss Adjustment Expense, and Other Expenses, which include salaries of company employees, IT support and overhead expenses. **Exhibit 5** provides a breakdown of the components of the Total Expense ratio; the three additional ratios presented are Loss Adjustment Expense/Premium, Commission/Premium and Other Expense/Premium. Overall, the MPCI program has lower expense ratios in all three categories.

The decline in MPCI Expense-Premium ratios presented in **Exhibits 4 and 5** is consistent with improved cost effectiveness of the industry as program participation has grown.[26] This decline has occurred even under stringent governmental requirements for insurers to provide service to all eligible producers regardless of the cost. Because of this requirement, private companies are precluded from taking many actions that other types of insurers use to contain costs and enhance

24 As previously noted, in order to compare the P&C expense ratios to those of the MPCI program, we need to account for the fact that the MPCI premium is not expected to cover expenses. In contrast, P&C industry premiums are expected to cover both losses and expenses. To ensure that ratios were comparable, we reduced the P&C Direct Written Premiums by the associated expenses. Expense ratios for the P&C industry were calculated from those adjusted figures. MPCI expense ratios were calculated based on Gross Premiums.

25 Commission expense is the part of an insurance premium paid by the insurer to an agent or broker for his services in procuring and servicing insurance. Loss adjustment expenses are expenses incurred to investigate and compute losses. Because Direct Earned Premiums are used in this Section, Gross Expenses are deducted rather than the Net Expenses that were deducted in the prior Section.

26 Program participation rates (defined as the ratio of net insured acres to total eligible acres) have increased dramatically in the past two decades. In 1980, the participation rate was less than 10%. By 1990, participation rates had increased to around 40%, where they hovered in the early 1990s. In 1995, participation rates jumped to over 80%. The jump in participation rates from 1994 to 1995 is coincident with the Federal Crop Insurance Reform Act of 1994, which made enrollment in the crop insurance program a precondition for participating in many of USDA's benefit support programs. Though participation rates decreased some after 1995, they were 80% in 2006, 77% in 2007, 80% in 2008, and more than 80% in 2009.

economic viability. As a result, MPCI companies are required to offer coverage to growers with poor insurance experience, small acreage or other characteristics that may make them impossible or difficult to serve profitably. While this requirement may significantly increase overall program costs, it does support the social goal of making crop insurance available to all eligible farmers.

Exhibit 6 focuses on commission payments to agents and brokers, which constitute more than one-half of Total Expenses for the MPCI program. It indicates that Commission to Premium ratios for the MPCI program have never exceeded those for the P&C industry as a whole.

Exhibit 7 compares 5-year averages (2005 – 2009) of Loss Adjustment Expense, Commission Expense and Other Expense ratios for MPCI to selected P&C lines, as well as Total P&C industry. This is intended to address the concern that the comparison of expenses to the total P&C industry might not be appropriate due to the inclusion of insurance products intended for commercial customers. The two P&C lines, Homeowners Multiple Peril and Private Passenger Automobile Physical Damage coverage, were selected on the basis that they represented insurance coverages sold to individuals rather than to businesses. An additional criterion was to select coverages with low levels of litigation activity to ensure that the MPCI program was compared to P&C coverages that use a similar approach for adjusting claims. The exhibit indicates that Loss Adjustment and Other expense ratios for MPCI are less than either of the selected P&C lines as well as Total P&C industry. While the Commission expense ratio for the Private Passenger Auto Physical Damage line was slightly less than MPCI, the MPCI Commission expense ratio was below that for Homeowners Multiple Peril as well as the P&C industry as a whole.

A&O REIMBURSEMENT SHORTFALL

As shown in **Exhibit 1**, column (1), the crop insurance industry's Net Expense Gain (Loss) from the listed sources indicate that the amount of the MPCI expenses has exceeded A&O Reimbursements every year since 1997. Renegotiations of the SRA and the passage of the Agricultural Research, Extension and Education Reform Act of 1998 have significantly reduced A&O Reimbursements over time. Since 1998, the A&O Reimbursements have fallen short of MPCI incurred expenses by more than $100 million annually. In 2002, 2006 and 2007 the unreimbursed amounts exceeded $200 million, and in 2009 the unreimbursed amount exceeded $450 million. **Exhibit 8** compares the historical level of expenses incurred in delivering crop insurance by the MPCI companies to the historical level of A&O Reimbursements. It indicates that although the MPCI companies have reduced expenses over time through efficiencies, the A&O Reimbursements have regularly fallen short of covering the expenses incurred. The inadequacy of the A&O Reimbursements is absorbed by the MPCI companies through a reduction in their pre-tax net income.

EFFECT OF THE 2008 FARM BILL

The Food, Conservation, and Energy Act of 2008 ("2008 Farm Bill") introduced changes starting with the 2009 reinsurance year which further diminish the profitability of MPCI companies by

reducing the amount of A&O Reimbursement and delaying payment by FCIC of both A&O Reimbursement and Underwriting Gains as noted below:

7 U.S.C. § 1508 (b) (11) CAT Loss Adjustment Expense Reimbursement:

- Reduced the maximum rate of reimbursement for "expenses incurred by the approved insurance provider or agent for loss adjustment" from 7.0%[27] to 6.0% of "the premium for catastrophic risk protection that is used to define loss ratio."

7 U.S.C. § 1508 (k) (4) Reinsurance A&O Reimbursement:

- Effective beginning with the 2012 reinsurance year, delays the reimbursement of allowable A&O costs to October of the following reinsurance year. Reimbursements covering the 2012 reinsurance year ending June 30, 2012 will not be paid until October 2012.
- For the 2009 and 2010 reinsurance year, reduced the rate of reimbursement of allowable A&O costs (originally 24.2%) by 2.3 percentage points. Only half of the reduction will apply "to the total premium written in a State in which the State loss ratio is greater than 1.2."
- Effective beginning with the 2009 reinsurance year, reduced the reimbursement rate for area policies and plans of insurance to 12.0% of the gross (net book) premium.

7 U.S.C. § 1508 (k) (9) Due Date for Payment of Underwriting Gains:

- Effective beginning with the 2011 reinsurance year, delays the payment of underwriting gains to October 1 of the following calendar year. Payments for underwriting gains covering the 2011 reinsurance year ending June 30, 2011 would not be paid until October 1, 2012.

THE 2011 STANDARD REINSURANCE AGREEMENT

RMA and the crop insurance industry renegotiated the terms of the Standard Reinsurance Agreement during late 2009 and the first half of 2010. These changes became effective on July 1, 2010, the start of the 2011 reinsurance year. The major changes included a sharp reduction in underwriting gain potential in certain states, modest changes in gain and loss potential in other states, and the introduction an upper limit on the amount of A&O reimbursements to be paid to the companies participating in the program. Since these changes are prospective in nature, they have no impact on the historical results through the 2009 reinsurance year shown in this report. An evaluation of their impact on the program will be addressed in future reports.

27 The 2008 Farm bill states the reduction is from 8% to 6%; however, the 2005 SRA had previously reduced the actual reimbursement rate from 8% to 7%.

SUMMARY AND CONCLUSIONS

This report analyzes the profitability and effectiveness of the MPCI program, based on certain available data. Specifically, it presents Pretax Net Income, risk and return profiles for the MPCI industry and the more general P&C industry. It also compares expense ratios for these two lines of insurance. It further examines MPCI's historical subsidies for A&O Reimbursements and their shortfall when compared to actual expenses incurred by the MPCI companies.

The results of this analysis continue to indicate that the MPCI program does not possess risk-return advantages relative to the P&C industry. The P&C industry has had an annual net loss in only one year in its history, 2001 (largely due to the extraordinary losses related to September 11). In contrast, the MPCI program as a whole lost money in two years between 1992 and 2009 alone (1993 and 2002). The delivery cost of the MPCI program as measured by the ratio of expenses to adjusted premium continues to be substantially below that for the P&C industry, and total A&O Reimbursements have fallen short of MPCI companies' total expenses for all years since 1997. The results of this analysis may be updated and augmented as additional data and information become available.

Exhibit 1

Profitability of the MPCI Program
(in millions)

Calendar Year	Net Expense Gain/(Loss) [a]	Net Underwriting Gain/(Loss) [b]	Pretax Net Income	Pretax Net Income after Quota Share	Retained Premium [c]	Retained Premium Adjusted for Quota Share	Pretax Net Income after Quota Share / Retained Premium	Pretax Net Income after Quota Share / Adjusted Retained Premium
Formula	(1)	(2)	(3) = (1) + (2)	(4)	(5)	(6)	(7) = (4)/(5)	(8) = (4)/(6)
1992	$ 5.4	$ 21.8	$ 27.2	$ 27.2	$ 465.6	$ 465.6	5.8%	5.8%
1993	2.6	(83.3)	(80.7)	(80.7)	434.5	434.5	-18.6%	-18.6%
1994	(4.1)	103.3	99.2	99.2	534.5	534.5	18.6%	18.6%
1995	20.3	131.7	152.1	152.1	768.5	768.5	19.8%	19.8%
1996	1.3	247.5	248.8	248.8	1,155.1	1,155.1	21.5%	21.5%
1997	(60.5)	352.1	291.6	291.6	1,263.1	1,263.1	23.1%	23.1%
1998	(109.7)	279.2	169.6	169.6	1,591.7	1,591.7	10.7%	10.7%
1999	(113.5)	271.8	158.2	158.2	1,836.9	1,836.9	8.6%	8.6%
2000	(140.1)	281.8	141.8	141.8	1,894.2	1,894.2	7.5%	7.5%
2001	(179.9)	345.9	166.0	166.0	2,373.0	2,373.0	7.0%	7.0%
2002	(200.3)	(47.4)	(247.7)	(247.7)	2,295.0	2,295.0	-10.8%	-10.8%
2003	(164.8)	378.4	213.6	213.6	2,607.1	2,607.1	8.2%	8.2%
2004	(134.0)	692.0	558.0	558.0	3,145.2	3,145.2	17.7%	17.7%
2005	(160.9)	964.6	803.6	755.4	3,045.1	2,892.9	24.8%	26.1%
2006	(201.2)	886.7	685.5	641.2	3,686.2	3,501.9	17.4%	18.3%
2007	(233.5)	1,681.4	1,447.9	1,363.8	5,156.5	4,898.7	26.4%	27.8%
2008	(160.8)	1,163.3	1,002.5	944.3	8,151.4	7,743.8	11.6%	12.2%
2009	(476.1)	2,343.6	1,867.5	1,750.3	6,975.4	6,626.6	25.1%	26.4%
Totals	$ (2,309.7)	$ 10,014.3	$ 7,704.6	$ 7,352.7	$ 47,379.1	$ 46,028.4		
1992-2009	**Simple Average**						12.5%	12.8%
	Simple Standard Deviation						12.1%	12.4%
	Weighted Average						15.5%	16.0%
	Weighted Standard Deviation						9.7%	10.2%

Sources:

[a] Expenses:
1992-1998: PwC 1999 Update Exhibit 4 and Deloitte 2004 Report Exhibit 5.1
1999-2009: Surveys of NCIS member companies

A&O Reimbursement:
1992-2006: MPCI data from RMA charts, August 14, 2007 as provided by NCIS
2007-2009: Surveys of NCIS member companies

[b] 1992-1994: MPCI data from RMA charts, August 14, 2007 as provided by NCIS
1995-2006: Underwriting gain/loss data from RMA, excludes CAT business written by FSA
2007-2009: Surveys of NCIS member companies

[c] 1992-2006: From Underwriting gain/(loss) data per RMA adjusted to remove CAT business written by FSA
2007: RMA Reinsurance runs as of October 2008
2008-2009: Surveys of NCIS member companies

Exhibit 2

Profitability of the Property & Casualty Insurance Industry
(in millions)

Calendar Year	Net Underwriting Gain/(Loss) [a]	Net Investment Income [a]	Realized Capital Gain/(Loss) [b]	Pretax Net Income	Net Earned Premium [c]	Total Net Expenses [d]	Adjusted Net Earned Premium	Pretax Net Income / NEP	Pretax Net Income / Adjusted NEP
Formula	(1)	(2)	(3)	(4) = (1)+(2)+(3)	(5)	(6)	(7) = (5) - (6)	(8) = (4) / (5)	(9) = (4) / (7)
1992	$ (36,260)	$ 33,734	$ 9,874	7,348	$ 225,778	$ 92,288	$ 133,490	3.3%	5.5%
1993	(18,094)	32,645	10,153	24,704	235,514	94,910	140,604	10.5%	17.6%
1994	(22,083)	33,687	1,620	13,224	244,230	98,557	145,673	5.4%	9.1%
1995	(17,375)	36,834	5,997	25,456	254,048	104,074	149,974	10.0%	17.0%
1996	(17,162)	37,962	9,249	30,049	266,552	106,147	160,405	11.3%	18.7%
1997	(6,030)	41,499	11,068	46,537	275,801	110,275	165,526	16.9%	28.1%
1998	(17,669)	41,097	17,506	40,934	280,335	115,450	164,885	14.6%	24.8%
1999	(24,750)	40,071	13,034	28,355	285,501	118,804	166,697	9.9%	17.0%
2000	(32,143)	42,650	16,484	26,991	298,233	121,790	176,443	9.1%	15.3%
2001	(52,692)	39,849	6,978	(5,865)	317,596	129,303	188,293	-1.8%	-3.1%
2002	(32,347)	41,099	2,824	11,576	358,551	142,043	216,508	3.2%	5.3%
2003	(5,230)	41,147	6,519	42,436	399,128	153,895	245,233	10.6%	17.3%
2004	1,692	41,776	9,191	52,659	423,663	162,831	260,832	12.4%	20.2%
2005	(6,676)	51,879	12,121	57,324	428,763	167,915	260,848	13.4%	22.0%
2006	34,086	54,801	3,585	92,472	442,730	171,653	271,077	20.9%	34.1%
2007	18,806	57,681	8,984	85,471	445,226	174,159	271,067	19.2%	31.5%
2008	(21,331)	54,115	(21,133)	11,651	443,406	173,320	270,086	2.6%	4.3%
2009	(2,726)	50,563	(8,080)	39,757	422,282	170,408	251,874	9.4%	15.8%
Totals	$ (257,984)	$ 773,089	$ 115,974	$ 631,079	$ 6,047,337	$ 2,407,823	$ 3,639,514		

1992-2009	**Simple Average**	10.0%	16.7%
	Simple Standard Deviation	5.9%	9.8%
	Weighted Average	10.4%	17.3%
	Weighted Standard Deviation	6.0%	9.9%

Sources:

[a] 1992-2002: Best's Aggregates & Averages 2007, Industry Operating Results, p. 407, includes State Funds
2003-2004: Best's Aggregates & Averages 2008, Industry Operating Results, p. 407, includes State Funds
2005-2009: Best's Aggregates & Averages 2010, Industry Operating Results, p. 367, includes State Funds

[b] 1992-1996: PriceWaterhouseCoopers 1999 Update, Exhibit 1 (used in Deloitte 2004 report Exhibit 2)
1997-2000: Best's Aggregates & Averages 2002, QAR p. 106
2001: Best's Aggregates & Averages 2006, QAR, p. 89
2002-2004: Best's Aggregates & Averages 2007, QAR, p. 91
2005-2009: Best's Aggregates & Averages 2010, QAR, p. 81

[c] 1992-1995: Best's Aggregates & Averages 2002, Cumulative By Line Underwriting Experience, Net Premiums, p. 278
1996: Best's Aggregates & Averages 2006, Cumulative By Line Underwriting Experience, Net Premiums, p. 407
1997 & 2000: Best's Aggregates & Averages 2007, Cumulative By Line Underwriting Experience, Net Premiums, p. 417
1998-1999 & 2001-2002: Best's Aggregates & Averages 2008, Cumulative By Line Underwriting Experience, Net Premiums, p. 417
2003-2009: Best's Aggregates & Averages 2010, Cumulative By Line Underwriting Experience, Net Premiums, p. 377

[d] 1992-1995: PriceWaterhouseCoopers 1999 Update, Exhibit 1 (used in Deloitte 2004 report Exhibit 2)
1996: calculated from ratios in Best's Aggregates & Averages 2006, Cumulative By Line Underwriting Experience, Net Premiums, p. 407
1997 & 2000-2001: calculated from ratios in Best's Aggregates & Averages 2007, Cumulative By Line Underwriting Experience, Net Premiums, p. 417
1998-1999 & 2002-2003: calculated from ratios in Best's Aggregates & Averages 2008, Cumulative By Line Underwriting Experience, Net Premiums, p. 417
2004-2009: calculated from ratios in Best's Aggregates & Averages 2010, Cumulative By Line Underwriting Experience, Net Premiums, p. 377
The values derived from ratios in Best's Aggregates and Averages could differ from actuals due to rounding.

Exhibit 3 Comparison of Pretax Net Income

Figure 1: MPCI Pretax Net Income 1992-2009

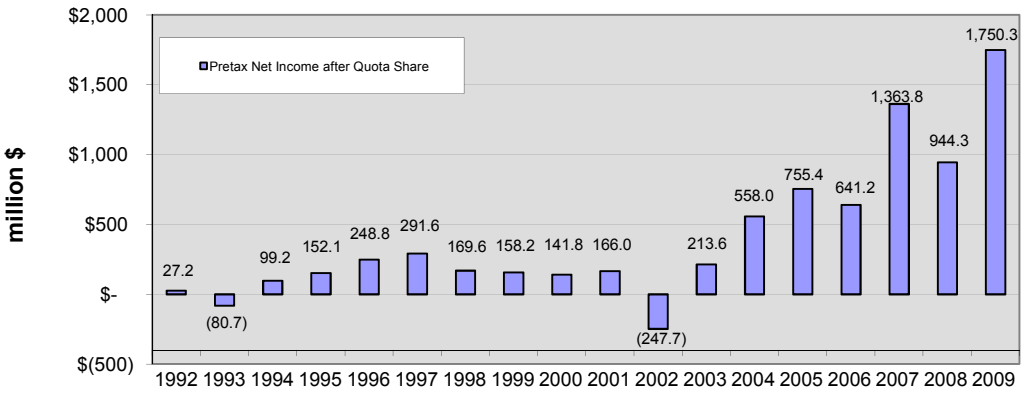
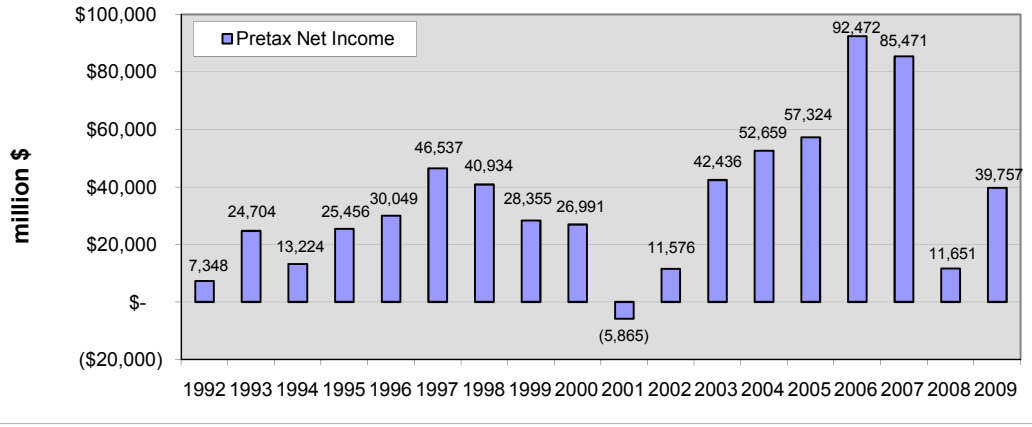
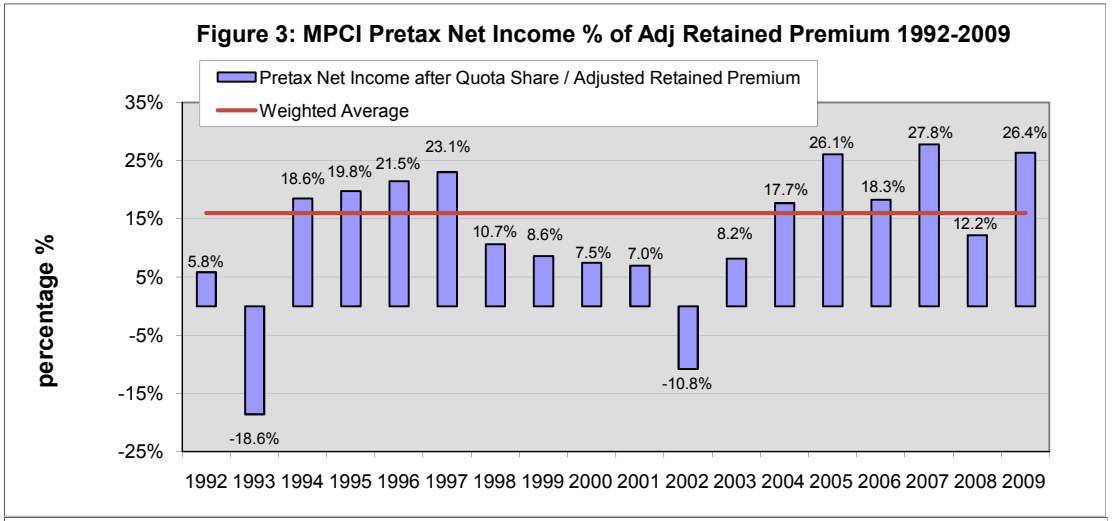


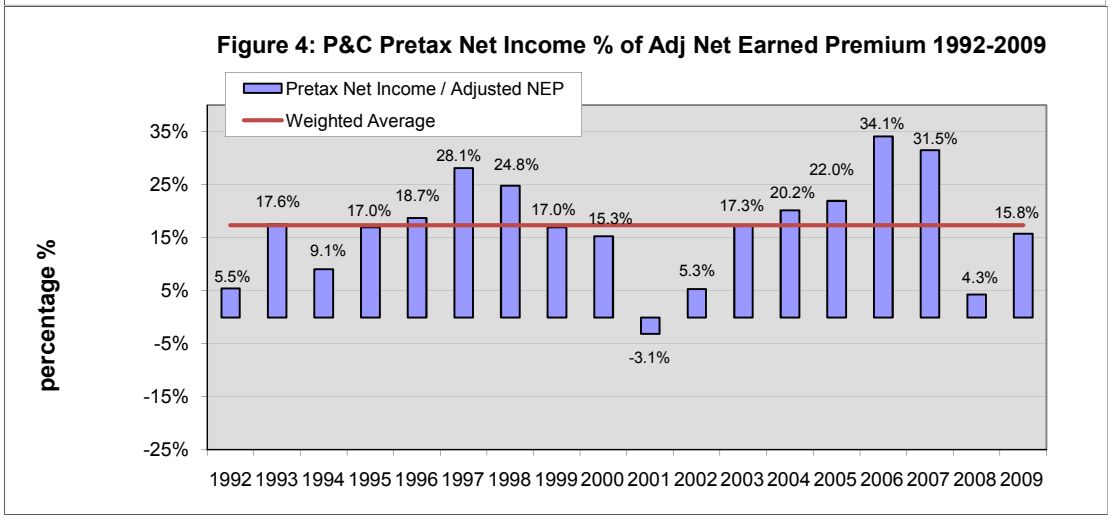
Figure 2: P&C Pretax Net Income 1992-2009



Sources: See Exhibits 1 and 2 for sources

Exhibit 3.1 Comparison of Pretax Net Income as a Percentage of Adjusted Retained Premiums or Adjusted Net Earned Premiums

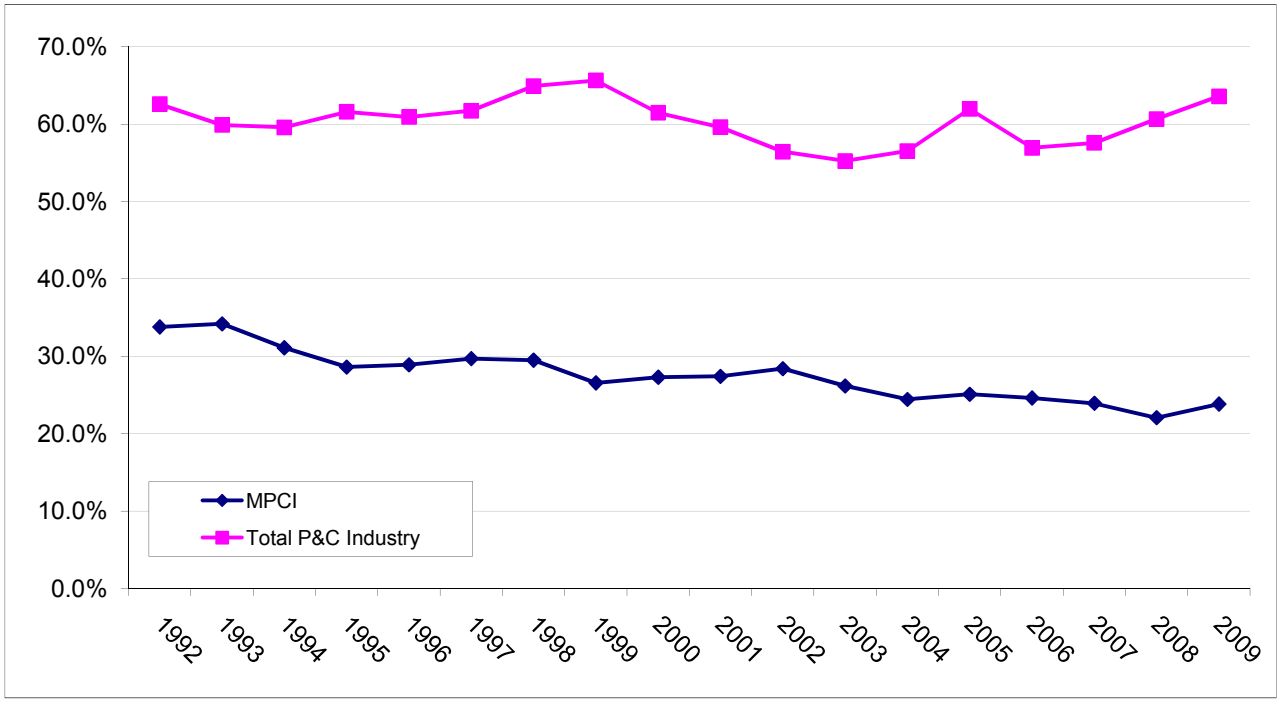




Sources: See Exhibits 1 and 2 for sources

Exhibit 4

Total Expense to Premium Ratio
MPCI vs. Property & Casualty



Sources:

MPCI 1992-1998: PwC 1999 Update Exhibit 4 and Deloitte 2004 Report Exhibit 5.1
1999-2009: Surveys of NCIS member companies

P&C 1992-1995: PwC 1999 Update Exhibit 4 and Deloitte 2004 Report Exhibit 5.2
1996: A.M. Best's Aggregates & Averages 2006,
1997 & 2000: A.M. Best's Aggregates & Averages 2007, and
1998-1999 & 2001-2003: A.M. Best's Aggregates & Averages 2008
2004-2009: A.M. Best's Aggregates & Averages 2010

Expense ratios from A.M. Best's Aggregates & Averages were converted to adjusted Direct Premiums Written (Direct Premiums Written less Total Expenses) to provide a base comparable to MPCI Gross Premiums. See our report for further explanation.

Exhibit 5 Expense to Premium Ratios for MPCI and Property & Casualty

5.1: MPCI

Year	Loss Adjustment Expense / Gross Premium	Commission / Gross Premium	Other Expense / Gross Premium	Total Expense / Gross Premium	A&O Reimbursement / Gross Premium	A&O Reimbursement Excess / (Shortfall)
1992	4.2%	16.0%	13.6%	33.8%	34.6%	0.8%
1993	5.4%	16.8%	12.0%	34.2%	34.6%	0.4%
1994	3.9%	17.0%	10.3%	31.1%	30.7%	-0.4%
1995	3.9%	14.9%	9.8%	28.6%	30.2%	1.6%
1996	3.6%	15.9%	9.4%	28.9%	29.0%	0.1%
1997	3.4%	15.6%	10.6%	29.7%	26.1%	-3.6%
1998	3.7%	16.6%	9.2%	29.5%	23.7%	-5.8%
1999	3.1%	15.5%	8.0%	26.6%	21.6%	-4.9%
2000	3.5%	15.9%	7.9%	27.3%	21.8%	-5.5%
2001	3.7%	15.7%	8.1%	27.4%	21.4%	-6.0%
2002	4.2%	15.8%	8.4%	28.4%	21.5%	-6.9%
2003	3.3%	15.9%	6.9%	26.2%	21.4%	-4.8%
2004	2.8%	15.6%	6.0%	24.4%	21.2%	-3.2%
2005	3.3%	15.2%	6.6%	25.1%	21.0%	-4.1%
2006	2.9%	15.6%	6.2%	24.6%	20.3%	-4.3%
2007	2.3%	17.0%	4.6%	23.9%	20.4%	-3.6%
2008	1.8%	16.8%	3.0%	22.1%	20.4%	-1.6%
2009	2.5%	17.0%	4.1%	23.8%	18.3%	-5.5%
Averages 1992-2009	3.4%	16.0%	8.0%	27.5%	24.3%	-3.2%

Sources:

Expenses:
1992-1998: PwC 1999 Update Exhibit 4 and Deloitte 2004 Report Exhibit 5.1
1999-2009: Surveys of NCIS member companies

A&O Reimbursement:
1992-2006: MPCI data from RMA charts, August 14, 2007 as provided by NCIS
2007-2009: Surveys of NCIS member companies

5.2: Total P&C Industry

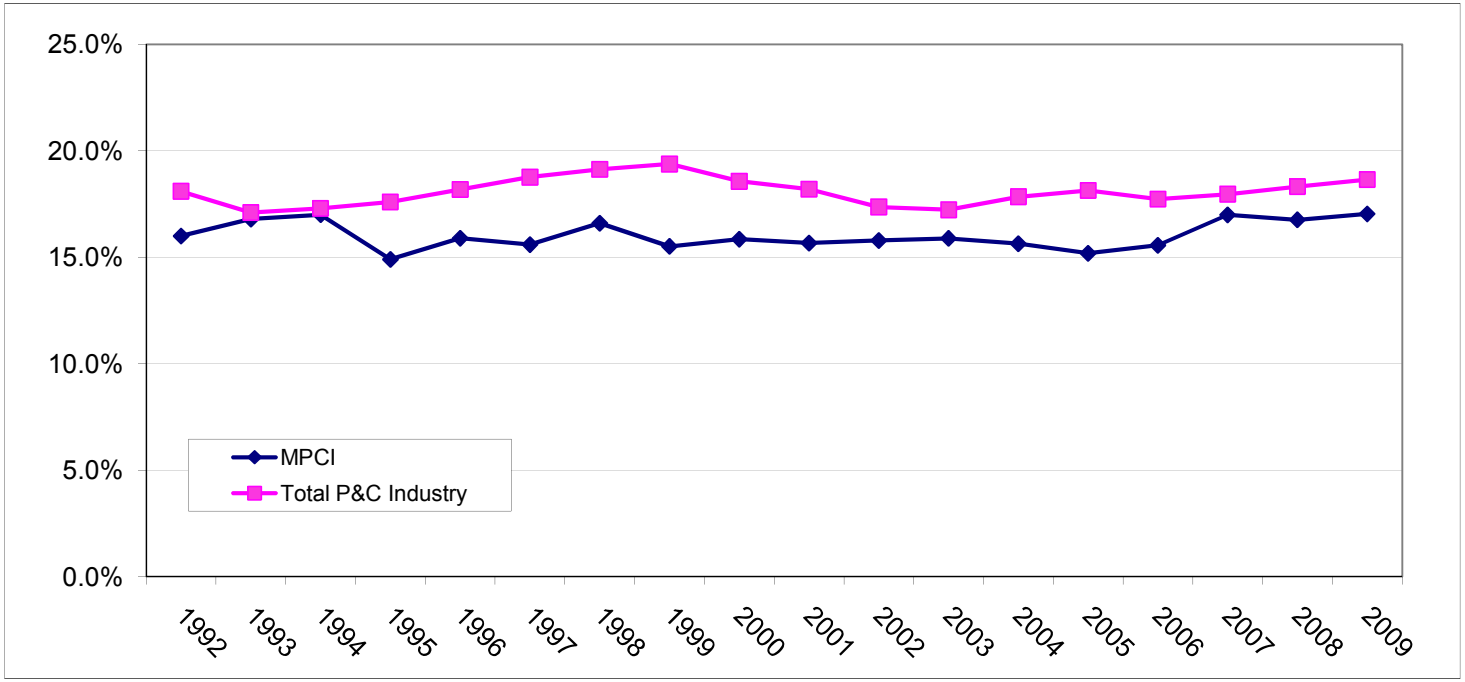
Year	Gross Loss Adjustment Expense / Adjusted DPW [a]	Gross Commission / Adjusted DPW [a]	Gross Other Expense / Adjusted DPW [a]	Total Gross Expense / Adjusted DPW [a]
1992	21.7%	18.1%	22.8%	62.6%
1993	20.0%	17.1%	22.7%	59.9%
1994	20.1%	17.3%	22.3%	59.6%
1995	20.8%	17.6%	23.1%	61.6%
1996	20.1%	18.2%	22.7%	60.9%
1997	19.5%	18.8%	23.5%	61.8%
1998	21.2%	19.1%	24.6%	64.9%
1999	20.9%	19.4%	25.3%	65.7%
2000	19.3%	18.6%	23.6%	61.5%
2001	19.7%	18.2%	21.7%	59.6%
2002	18.6%	17.4%	20.5%	56.4%
2003	18.0%	17.2%	20.0%	55.3%
2004	18.8%	17.8%	19.9%	56.5%
2005	22.8%	18.1%	21.1%	62.0%
2006	17.9%	17.7%	21.3%	56.9%
2007	17.4%	18.0%	22.2%	57.6%
2008	18.6%	18.3%	23.8%	60.7%
2009	20.4%	18.7%	24.5%	63.6%
Averages 1992-2008	19.8%	18.1%	22.5%	60.4%

Sources:
1992-1995: PwC 1999 Update Exhibit 4 and Deloitte 2004 Report Exhibit 5.2
1996: A.M. Best's Aggregates & Averages 2006, expense ratios converted to adjusted Direct Premiums Written
1997 & 2000: A.M. Best's Aggregates & Averages 2007, expense ratios converted to adjusted Direct Premiums Written
1998-1999 & 2001-2003: A.M. Best's Aggregates & Averages 2008, expense ratios converted to adjusted Direct Premiums Written
2004-2009: A.M. Best's Aggregates & Averages 2010, expense ratios converted to adjusted Direct Premiums Written

[a] Adjusted DPW is Direct Premium Written less Total Expenses

Exhibit 6

Commission Expense to Premium Ratio
MPCI vs. Property & Casualty

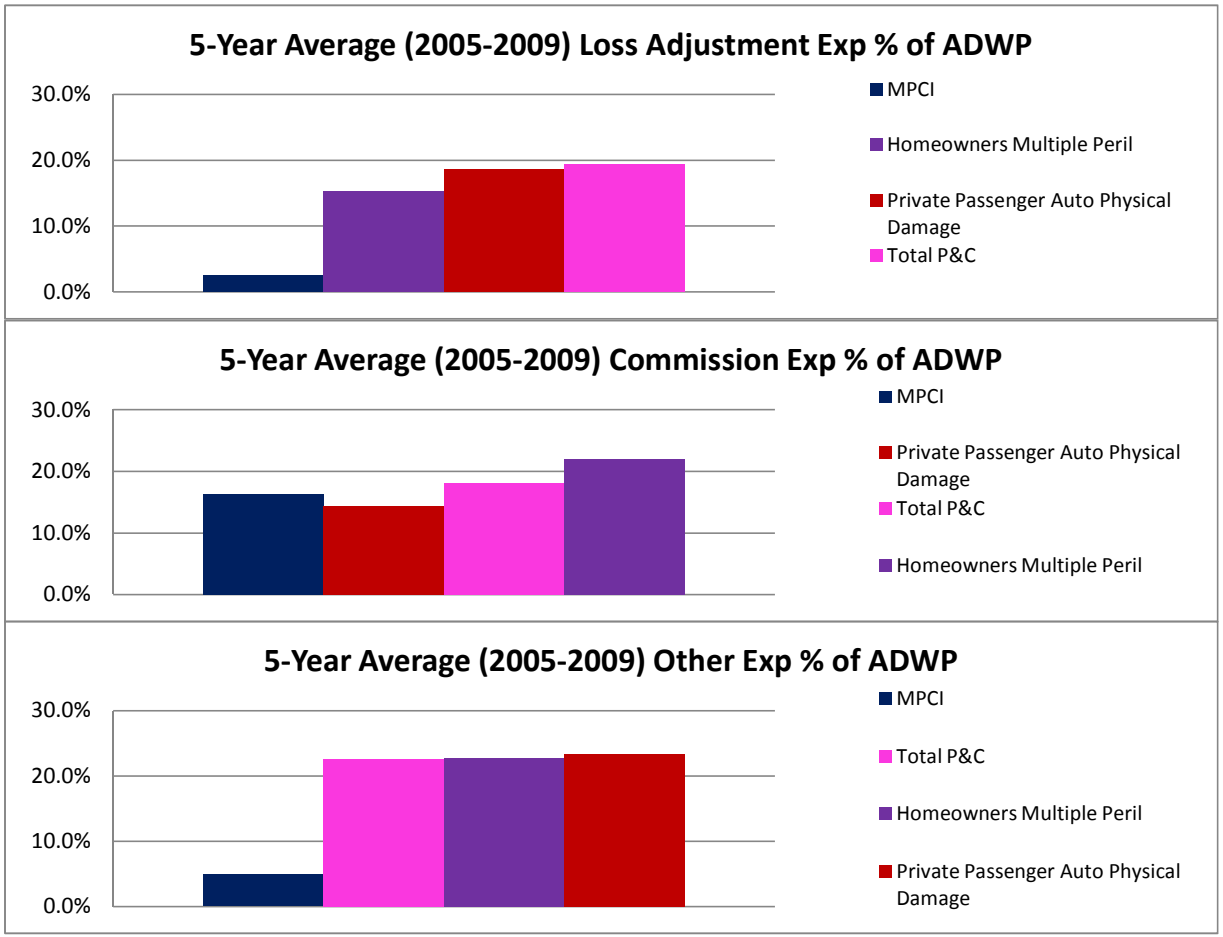


Sources:

MPCI 1992-1998: PwC 1999 Update Exhibit 4 and Deloitte 2004 Report Exhibit 5.1
1999-2009: Surveys of NCIS member companies

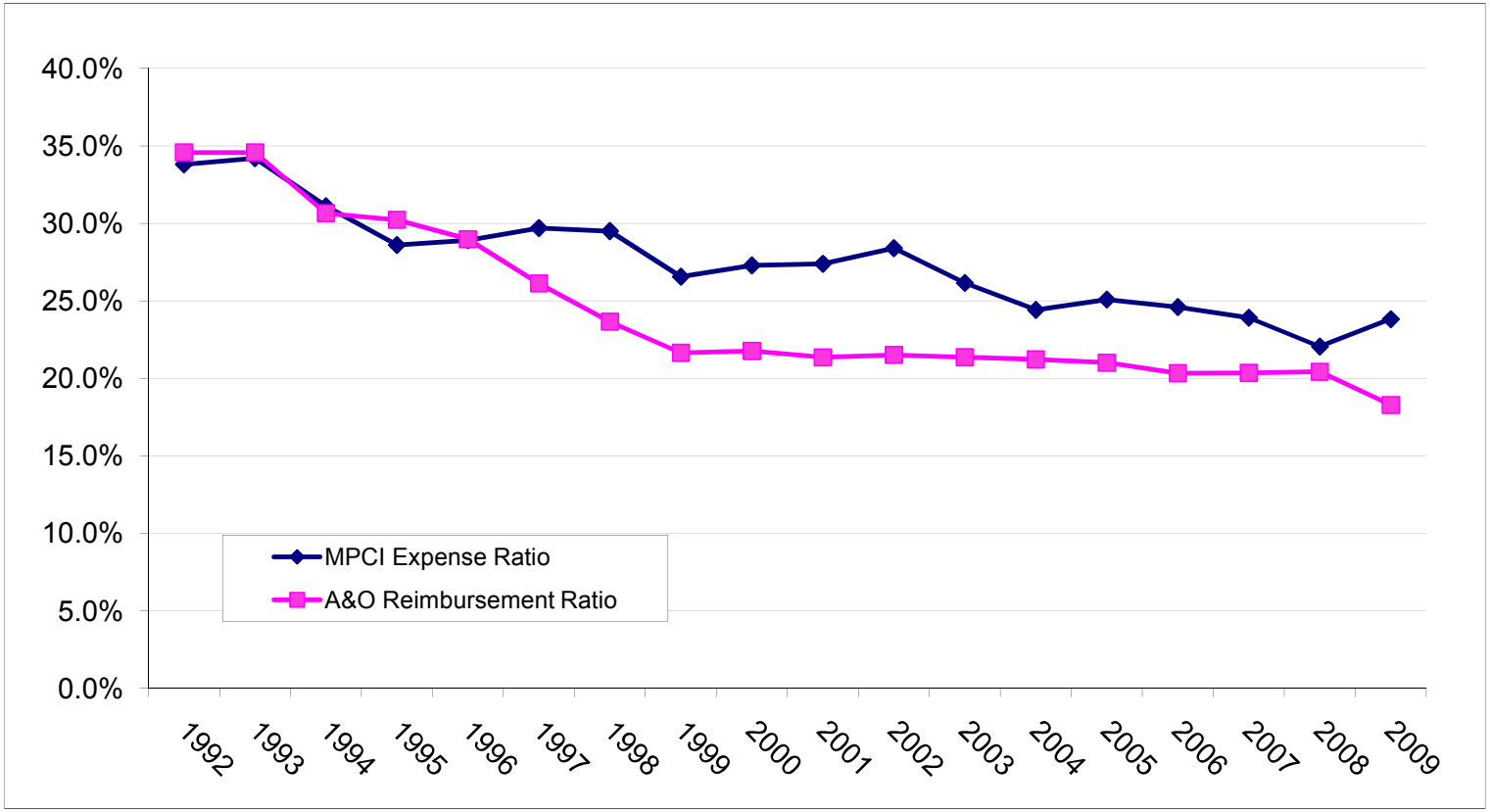
P&C 1992-1995: PwC 1999 Update Exhibit 4 and Deloitte 2004 Report Exhibit 5.2
1996: A.M. Best's Aggregates & Averages 2006,
1997 & 2000: A.M. Best's Aggregates & Averages 2007, and
1998-1999 & 2001-2007: A.M. Best's Aggregates & Averages 2008, expense ratios converted to adjusted Direct Premiums Written
2008-2009: A.M. Best's Aggregates & Averages 2010 expense ratios converted to adjusted Direct Premiums Written (Direct Premium Written less Total Expenses) to provide a base comparable to MPCI Gross Premiums.
See our report for further explanation.

Exhibit 7 Comparison of MPCI Expense Ratios to Various Property & Casualty Insurance Lines 5-yr Average of Loss Adjustment, Commission and Other Expenses to Premium Ratios



Sources: **Homeowners Multiple Peril, Private Passenger Auto Physical Damage, and Total P&C (Total All Lines):**
2005-2009: A.M. Best's Aggregates & Averages 2010 pgs 380, 383, 385.
MPCI
2005-2009: Surveys of NCIS member companies

Exhibit 8 Comparison of A&O Reimbursement to Gross Premium with Ratio of Total Expense to Gross Premium



Sources: **Expenses:**

1992-1998: PwC 1999 Update Exhibit 4 and Deloitte 2004 Report Exhibit 5.1
1999-2009: Surveys of NCIS member companies

A&O Reimbursement:

1992-2006: MPCI data from RMA charts, August 14, 2007 as provided by NCIS
2007-2009: Surveys of NCIS member companies