

# **Recommendations for the Standard Reinsurance Agreement**

*Submitted by National Crop Insurance Services, Inc.  
on behalf of the Approved Insurance Providers  
to the Federal Crop Insurance Corporation*

October 19, 2009

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# Executive Summary

This report summarizes the recommendations from five industry working groups on the new Standard Reinsurance Agreement (SRA) for the 2011 reinsurance year. In developing recommendations, the working groups were guided by the following essential general principles: (1) ensure universal availability of coverage to all eligible crop producers; (2) provide a range of individual insurance plans and coverage options available at premium rates set transparently and that are not excessive, inadequate or unfairly discriminatory; (3) provide Federal subsidies to cover delivery expenses and part of the risk premium to ensure that gains in participation and coverage are not lost; (4) provide Federal reinsurance to promote private sector delivery while addressing the social risk aspect of the program; (5) provide an opportunity for insurance companies to earn a reasonable return relative to other lines of insurance, accounting for their relative risks, while ensuring that taxpayers' interests are served; and (6) balance the responsibility for Federal regulation with the simplicity and program efficiencies that can be achieved by providing insurance companies as much autonomy and flexibility as practicable to enable them to operate consistent with market orientation and sound business principles while maintaining program integrity. Overall, crop insurance has been a success in terms of producer participation, coverage, delivery, oversight and compliance. In a new SRA, the strengths of the public-private partnership should be maintained and the weaknesses remedied. General recommendations and opinions expressed by the working groups are as follows:

**Working group on Financial Provisions:** The concerns expressed by the working group include: (1) the reductions and delays in A&O payments imposed by the 2008 Farm Bill on top of the prevailing A&O shortfall, which may adversely affect the efficiency, availability and accessibility of services provided to farmers; (2) the impact of these cuts and delays on producers as well as on the delivery of services in the underserved states; and (3) the alternative A&O mechanisms suggested in the Farm Bill, which would reduce A&O without addressing the underlying problem of price volatility. The working group offered an alternative solution to A&O volatility based on smoothing commodity prices over time.

The working group also addressed the issue of risk sharing by identifying those elements of the current SRA that should be maintained and those that can be improved. The recommendations include: (1) the basic structure of the current SRA should be maintained without change to the number or operation of the existing reinsurance funds, Assigned Risk cession limits or minimum retention percentages; (2) quota share should be eliminated with an offsetting adjustment to the underwriting gain and loss provisions; (3) underwriting gain and loss provisions could be revised to reduce the potential for large gains or losses, with no net change to the industry's total expected underwriting income. The working group also recognized that a fundamental change in premium rate methodology would nullify the expected financial outcome of an SRA. To address this issue, the SRA should allow for reconsideration of the reinsurance provisions following significant rate changes or the implementation of revised ratemaking methodologies. Finally, the industry recognized the difficulty of maintaining a marketing presence in underserved states. The industry identified a number of proposals to address this issue and is willing to work with the Federal Crop Insurance Corporation and the Risk Management Agency (FCIC/RMA) to address the difficulties of serving producers in these states.

**Working group on Plan of Operations (SRA Appendix II):** The working group focused on three primary areas: (1) reducing the amount of unnecessary information reported to FCIC/RMA; (2) eliminating redundant reporting requirements; and (3) requesting clarification from FCIC/RMA regarding certain required items and information. The specific recommendations are provided in the corresponding section in this report.

**Working group on Information Technology and Data (SRA Appendix III):** The process by which FCIC/RMA can modify Appendix III to reflect ongoing policy and procedural changes is paramount in defining the operational burden that AIPs undertake under the Standard and Livestock Price Reinsurance Agreements. Specific recommendations are provided in the corresponding section in this report.

**Working group on Quality Standards and Control (SRA Appendix IV):** The quality control and compliance responsibilities in Appendix IV represent the cornerstone of FCIC/RMA and industry efforts to ensure the integrity of the crop insurance program. With that as a basis for discussion, the Working Group recommended three major areas of improvement in the current Appendix IV process: (1) substitute strategic quality control data mining initiatives for the current set of repetitive and standard reviews; (2) definitions and procedures must be clearly and explicitly stated in order to ensure greater uniformity of program administration; and (3) promote a more proactive team approach between FCIC/RMA and industry in resolving program issues. Specific recommendations are provided in the corresponding section in this report.

**Working group on Education and Training (SRA Appendix IV):** Effective training strengthens the program and ensures uniformity of delivery. The working group recommends: (1) more effective timing of new program releases; (2) use of the terms “qualified agent” and “qualified adjuster” in the definitions; and (3) increasing the diversity of the program by targeting small, limited resource and socially disadvantaged farmers. Specific recommendations are provided in the corresponding section in this report.

Finally, the working groups consider this report to be simply the beginning of a further discussion with FCIC/RMA. As negotiations proceed, additional issues, concerns and recommendations are expected to be raised and addressed in the negotiating process. Furthermore, the recommendations presented here do not preclude any individual AIP from presenting its own recommendations to FCIC/RMA.

# Introduction

The recommendations presented in this paper are being submitted to the Federal Crop Insurance Corporation and the Risk Management Agency (FCIC/RMA) for consideration in the preparation of the new Standard Reinsurance Agreement (SRA) for the 2011 reinsurance year.

The SRA is a cooperative agreement between the FCIC, a government corporation within the U.S. Department of Agriculture, and an insurance company. The agreement becomes effective when an insurance company is approved to sell eligible crop insurance in the United States. Currently, 15 companies are approved insurance providers (AIPs) and have accepted the terms and provisions of the current SRA.

The terms and provisions of the SRA are periodically renegotiated between the FCIC/RMA and the AIPs. The SRA then renews each reinsurance year, unless amended, or FCIC/RMA gives at least 180 days advance notice to the AIPs that the SRA will not be renewed. The current SRA was renegotiated during 2004 and first put in place for the 2005 reinsurance year.

On September 8, 2009, the Administrator of FCIC/RMA advised Congress, in accordance with section 12017 of the Food, Conservation, and Energy Act of 2008 (2008 Farm Bill), that FCIC/RMA will renegotiate the SRA for the 2011 reinsurance year. FCIC/RMA indicated that the AIPs will be notified in December 2009 that the SRA in effect for the 2010 reinsurance year will not be renewed.

## *Antitrust issues*

As provided under Federal and State antitrust laws, and as clarified by the 2008 Farm Bill, the AIPs may confer with each other, and collectively with FCIC/RMA, during the renegotiation of the SRA. Consequently, the AIPs are allowed to confer about proposed terms and provisions of the SRA, but they must adhere to antitrust laws. In order to develop a new SRA, National Crop Insurance Services (NCIS) organized a process to develop proposals directed at improving the delivery of crop insurance for agricultural producers, the AIPs and the general public. The process is superintended by the General Counsel of NCIS, with assistance from third party antitrust legal experts, to ensure all AIP participants in the process adhere to antitrust laws at all times.

## *Industry process*

NCIS formed five working groups, chaired by and consisting of representatives from all the AIPs, to develop recommendations for the next SRA. The working groups and the subject matter they addressed are:

- **Financial Provisions**—administrative and operating expense (A&O) allowances and risk sharing
- **Plan of Operations**—SRA Appendix II
- **Information Technology and Data**—SRA Appendix III

- **Quality Standards and Control**—relevant part of SRA Appendix IV
- **Education and Training**—relevant part of SRA Appendix IV

The issues and the recommendations raised by the working groups and presented in this paper are not inclusive of all AIP concerns and recommendations. These specific recommendations have been developed as a work product of the collective efforts of each working group. As negotiations proceed, additional issues, concerns and recommendations are expected to be raised and addressed in the negotiating process. Furthermore, the recommendations presented here do not preclude any individual AIP from presenting its own recommendations to FCIC/RMA.

### ***Meetings with FCIC/RMA***

The working groups met during the spring and summer of 2009 in anticipation that the current SRA would be canceled. During these meetings, the groups reviewed the performance of the current SRA, assessing the terms and provisions that have worked effectively and those that have not. Each working group assembled recommendations for FCIC/RMA on key sections of the SRA that would benefit from change and on those sections that could be maintained.

On August 11, 2009, the four nonfinancial working groups met with FCIC/RMA representatives in Overland Park, KS, to provide and discuss information related to the current SRA. On September 17, 2009, the working group on financial provisions met with FCIC/RMA representatives in Overland Park, Kansas, to again discuss information related to the current and the upcoming SRA. At this latter meeting, and in preparation for their first draft of the new SRA, FCIC/RMA indicated they would consider recommendations submitted in writing by the working groups by October 19. This paper represents an initial submission of recommendations.

### ***Crop insurance industry principles***

Crop insurance has been a success in terms of producer participation, coverage, delivery, oversight and compliance. In a new SRA, the strengths of the public-private partnership should be maintained and the weaknesses remedied. In developing recommendations to improve upon the program, the working groups were guided by the following essential general principles:

- Ensure universal availability of coverage to all eligible crop producers.
- Provide a range of individual insurance plans and coverage options available at premium rates set transparently and that are not excessive, inadequate or unfairly discriminatory.
- Provide Federal subsidies to cover delivery expenses and part of the risk premium to ensure that gains in participation and coverage are not lost.
- Provide Federal reinsurance to promote private sector delivery while addressing the social risk aspect of the program.
- Provide an opportunity for insurance companies to earn a reasonable return relative to other lines of insurance, accounting for their relative risks, while ensuring that taxpayers' interests are served.
- Balance the responsibility for Federal regulation with the simplicity and program efficiencies that can be achieved by providing insurance companies as much autonomy and flexibility as

practicable to enable them to operate consistent with market orientation and sound business principles while maintaining program integrity.

### ***Future Risks to Program Performance***

The crop insurance program under a new SRA will face a number of obstacles that may significantly affect program performance. While some of these issues appear to lie outside the parameters of an SRA, they should be considered to the fullest extent possible in the negotiations due to their potential adverse impacts. A key issue is the set of changes made in the 2008 Farm Bill, which reduce program spending by \$6.4 billion over 10 years (measured from CBO's 2008 baseline). Lower A&O payments, which first took effect in 2009, represent a large portion of the spending reductions. However, mandated delays in A&O payments and net underwriting gains pose an added significant cost to insurance companies. Companies will have to secure credit and incur financing costs to meet operating expenses in 2011 and 2012—a challenge that was all but lost in the 2008 Farm Bill debate and not counted as part of the official costs of the Farm Bill changes. The Farm Bill imposes an additional cost on producers and insurers due to the accelerated premium billing date. Many producers will now be required to pay premiums prior to the harvest and sale of their crops. For insurers, late collection of premiums may adversely impact insurer surplus as a result of statutory accounting rules, which could potentially require insurers to purchase additional reinsurance in order to meet the regulatory standards for participation in the program.

A second set of risks involves key issues of the day. The global recession continues, with the effects of tighter lending standards by creditors for their borrowers, such as insurance companies. The recession has suppressed global food demand, which together with record-high yields, has reduced farm income and crop prices. The combined effect of lower income and lower prices has reduced acreage enrolled in crop insurance by 3% and insured liability by 12% in 2009 (based on the 10-05-09 Summary of Business). Forecasters are projecting a slow recovery for years to come, with high crop market volatility and crop prices averaging below recent levels (CBO's 2009 baseline projects average corn prices of \$3.69/bu. during 2010-2014, compared with an average of \$4.13/bu. for 2007-08). A second key issue is the continuing accumulation of evidence that global climate change will pose significant risks to producers and insurance companies. Recent research focuses on the detrimental impacts of extreme temperatures on susceptible crops such as corn and soybeans (e.g., Schlenker and Roberts, "[Estimating the Impact of Climate Change on Crop Yields: The Importance of Nonlinear Temperature Effects](#)," NBER, February 2008).

A third set of risks is embodied in the reviews and program changes that FCIC/RMA has underway. For example, FCIC/RMA is currently conducting two reviews of premium rate methodology. Any substantial change in rates as a result of these reviews would change the companies' income from the level expected under the SRA. However, the SRA will be negotiated prior to any adjustment FCIC/RMA may make in rate methods. Additional risks are posed by major regulatory changes, such as the yet-to-be released final rule on the Common Crop Insurance Policy (CCIP), by FCIC/RMA's yet-to-be completed Information Technology Modernization (ITM), and by the yet-to-be completed reporting of acreage by "field" (or common land unit—CLU), rather than by crop insurance units. Collectively, the changes in

statute, economic and climate expectations, and unconstrained costs imposed by operational changes increase company costs and risks and create substantial challenges for program performance in coming years.

***Organization of the remainder of the report***

The remainder of the report contains the reports of the five SRA working groups. In organizing the remainder of the report, an attempt has been made to retain the style and format of the individual working group minutes. However, each report is now organized into three basic sections: (1) Background, (2) Issues, and (3) Recommendations. The Recommendations section essentially follows the style and format of the original working group minutes.

# Financial Provisions

## *Overview*

The renegotiation of the SRA between the government and the AIPs offers an opportunity to discuss the industry's concerns related to the financial provisions of the program. This section documents the issues and concerns identified by the industry with regard to A&O allowances and risk sharing that FCIC/RMA should consider in its preparation of the first draft of the proposed SRA. While we recognize that FCIC/RMA is attempting to obtain the best agreement for the least cost, FCIC/RMA also needs to recognize that the industry is concerned about the inadequate profitability of the program relative to the Property and Casualty (P&C) insurance industry and the ongoing efforts by FCIC/RMA and Congress to reduce A&O and underwriting gains.

In its recently released 2009 update of its Profitability and Effectiveness Analysis of the Federal Crop Insurance Program (a copy of the report can be found at <http://www.ag-risk.org>), Grant Thornton compares the profitability of the companies participating in the Multiple Peril Crop Insurance (MPCI) program to their peers in the Property and Casualty industry. The results of the Grant Thornton study are clear: the crop insurance industry is not being overcompensated relative to the P&C industry. Not only is the MPCI program significantly less profitable than the P&C industry, the program is also riskier than P&C. Furthermore, the crop insurance industry is able to deliver the program more cost-effectively than the P&C industry can, measured in terms of the ratio of expenses to the benefits delivered to policyholders.

An alternative analysis of the profitability of the crop insurance industry was recently prepared by Milliman, Inc. on behalf of FCIC/RMA (copies of the two Milliman reports can be found at <http://www.rma.usda.gov/pubs/>). Unlike the Grant Thornton report, which relies on publicly available information and actual company expense data, the results presented in the Milliman reports require a vast number of assumptions and proxies for the many parameters needed to evaluate profitability. Starting with the use of GAAP (Generally Accepted Accounting Principles) surplus as a proxy for the market value of equity, Milliman continues by allocating GAAP surplus to individual lines of insurance, disregarding its own observation that “an insurer's surplus is inherently indivisible.” The allocation method relies on an arbitrary and rudimentary proxy for the risk of crop insurance relative to other P&C lines of insurance. The surplus imputed to the MPCI industry does not utilize the actual surplus of the AIPs and does not take into account the unique regulatory requirements that FCIC/RMA mandates for AIP surplus. Milliman then imputes the investment income that insurers would have earned if they held the amount of surplus that Milliman had imputed in the previous step. A serious concern with the Milliman analysis is highlighted by the fact that two distinct methods are needed to evaluate the cost of capital. Within each of these methods, Milliman developed the cost of capital as the average of multiple estimates. The use of multiple methods and estimates raises serious reservations about the value of the analysis.

Other shortcomings of the Milliman reports are that (1) the 2008 reinsurance year result overstates the actual underwriting gain by more than 100%, (2) the time period analyzed excludes key loss years and thus does not recognize the full potential of catastrophic risk to the

program, (3) the shortfall in A&O allowances and its effect on the profitability of the participating insurers are excluded from the analysis, and (4) the cost of private market reinsurance that companies need in order to satisfy the eligibility standards for participation in the program is not considered. Overall, these are estimated to have a 5 to 8 percentage point impact on the historical rate of return. In addition, the Milliman reports provide only a historical perspective on the performance of the program, ignoring the recent cuts to A&O allowances implemented in the 2008 Farm Bill as well as the financial impact of the delay in receiving A&O and underwriting gain payments beginning in the 2011 and 2012 reinsurance years. Perhaps the most troubling aspect of the study is that Milliman evaluated the cost of capital for MPCCI industry and the P&C industry on an inconsistent basis: P&C industry results reflect all costs, including private market reinsurance, whereas MPCCI industry results exclude the portion of the industry's costs represented by the A&O shortfall as well as the entire cost of private market reinsurance.

The concerns identified above suggest that the Milliman analysis should not be given a great deal of consideration in evaluating the profitability of the crop insurance industry. However, if appropriate corrections were made to Milliman to address these concerns, the conclusions of the report would be reversed. On this basis, the Milliman studies would corroborate the crop insurance industry's position that the historical rate of return for the crop insurance industry has been less than its reasonable rate of return.

### ***Administrative and operating expense allowances***

**Background:** AIPs are paid an allowance by FCIC/RMA for administrative and operating (A&O) expenses incurred in delivering crop insurance to farmers. These payments are made by FCIC/RMA on behalf of producers and would otherwise be included in the premium as an expense load. AIP delivery expenses include wages and salaries, agent commissions, loss adjustment costs and other operating and overhead expenses, ranging from information technology to rent.

A&O allowances are calculated as a fixed percentage rate of gross premiums, depending on the coverage level and insurance plan. Calculating delivery expenses as a percent of premiums is an accepted, long-standing method in the insurance industry. Because of persistent reductions in the A&O percentage rate by the government over many years, A&O rates have been steadily decreasing. The average A&O rate was 34.6% of gross premium in 1992, fell to 21.8% in 2000, and decreased further to 20.4% in 2008 (Grant Thornton, 2009). Actual A&O expenses, as reported by the AIPs, also had a downward trend as a percent of gross premiums, yet they remained higher than the A&O payment rates in every year from 1997 through 2008.

Gross premiums are based on insured liability, and both have grown steadily over the life of the program. Increases in participating area, higher coverage levels, new plans of insurance and rising market prices have contributed to the increase in liability and gross premiums over time. In particular, rising expected market prices of crops during the past few years increased liability and gross premiums, materially contributing to increased A&O allowances in dollar terms, especially from 2005 through 2008. While this led to rising A&O allowances per policy during that period, crop prices declined sharply during the 2008/09 crop years and are declining further during the 2009/10 crop years. These declines are resulting in lower A&O expense allowances

for 2009 and will do so in future years. In addition, the 2008 Farm Bill, enacted when crop prices were reaching record highs, reduced the A&O allowance rates. The 2008 Farm Bill's reductions in allowances, which take effect beginning with the 2009 reinsurance year, are equivalent to a 13% reduction in the dollar value of A&O payments.

**Issues:** The industry is facing the following issues regarding A&O payments:

- 1) *Shortfall:* A&O payments to the AIPs continue to be less than actual delivery expenses incurred. This shortfall in A&O payments has averaged nearly \$200 million (3.2% of the gross premium) annually from 2006 to 2008 (Grant Thornton, 2009). A&O payments are intended to cover delivery expenses, and they are not doing so.
- 2) *Cuts and Delays:* The AIPs have already taken deep cuts in A&O allowances that are just beginning to be implemented. The 2008 Farm Bill reduced A&O payment rates for buy-up coverages (except area plans) by 2.3 percentage points, with half of the reduction applying when a state loss ratio exceeds 1.2. The Catastrophic Coverage loss adjustment payment rate was reduced from 7% to 6% of gross premiums, and the A&O allowance for area plans of insurance was reduced from the existing range of 19.4% to 22.4% of gross premiums to 12% of gross premium. These reductions were implemented beginning with the 2009 reinsurance year. In addition, the 2008 Farm Bill delays the timing of the A&O payments in 2012 to after October 1, after the reinsurance year for which the payment was earned. This delay will, at the least, impose financing costs on the AIPs and represents an additional, real reduction in the A&O payment. The financial impact of the delays in A&O and underwriting gains is estimated to be worth as much as 1.5 percentage points on retained premiums.
- 3) *Alternative A&O Methods:* The 2008 Farm Bill recommends that FCIC/RMA consider three graduated alternative A&O provisions. The first alternative bases the A&O payment rates on the change in state premiums. As discussed during the development of the 2008 Farm Bill, this approach would reduce the A&O payment rate in a state as the ratio of the state's premium in the current year rises relative to a historical benchmark year. This approach is flawed in that it does not take account of the reason the premium is increasing. If the increase is due to desirable new products, higher area participation, or higher coverage levels, it would be inappropriate to reduce the A&O rate. Moreover, the selection of any one historical base year is arbitrary.

The second alternative would base the A&O payments on statewide loss ratios. Presumably, A&O payment rates would decrease as the state loss ratio decreases. This method is flawed because it relies on a measure of income to establish A&O rates, rather than on overall delivery expenses. In addition, a number of underserved states would see their A&O payments reduced, further lowering the incentive for AIPs to operate in these states. For example, based on the 15 years (1996 to 2008), the average loss ratio was 0.54 for New Jersey, 0.44 for Hawaii and 0.56 for Rhode Island.

The third alternative A&O method is based on individual policies and on the level of total premium for each policy. This alternative would be problematic relative to the current system and could result in perverse incentives in the delivery system. Under the current

system, A&O is a fixed percent of premium, which is both simple and transparent. Because the reimbursement rate is independent of specific AIP expenses, AIPs are not restricted in the general allocations of these payments. In addition, because the reimbursement rate is the same regardless of expenses, AIPs have an incentive to keep expenses down in order to maximize returns.

**Recommendations:** The industry is very much concerned that the cuts and delays in A&O payments in the 2008 Farm Bill, combined with declining crop prices, will adversely affect the efficiency, availability and accessibility of the services provided to farmers. Any further cuts on top of the already existing shortfall in recovering their expenses could force companies to reconsider staffing levels or lead to withdrawal from high-cost, low-return states. In addition to the effect of the Farm Bill reductions and the ongoing A&O shortfall, the industry views the A&O alternatives suggested in the Farm Bill as misdirected. They are blunt approaches to deal with the symptoms of a temporary problem that is resolving itself as prices decline. The current method (A&O as a percent of gross premiums) is uniform, simple and transparent and provides appropriate incentives for cost reduction and policy sales.

If changes are to be made to A&O despite the observations noted above, we need to recognize that the real issue with the current method is volatility in crop prices, which translates into volatility in premiums and thus A&O payments. To deal with this issue rather than its symptoms, the industry recommends the idea of smoothing prices for six major crops (corn, soybean, wheat, grain sorghum, cotton and rice), comprising almost 88% of the premium for the entire program, and using the smoothed prices to calculate adjusted premiums that would be used to calculate A&O payments. This proposal would have no effect on farmer-paid premium. By removing the noise from price data that is unrelated to the cost of delivery, this proposed method should stabilize A&O payments.

If a price smoothing approach is considered in the SRA to address the issue of crop price volatility, and FCIC/RMA concludes that A&O must be capped in years when policy prices decline below the smoothed prices, the industry recommends that some method be implemented that provides a cap on A&O payments when policy prices are sharply below the smoothed prices. Given the reductions in payments taken in the 2008 Farm Bill and the ongoing shortfall in the current payments, it would be inappropriate to ask the industry to take less in A&O payments in high price years and not augment their payments in low price years. Finally, in using smoothed crop prices, the industry prefers not to include current year prices in the computation as this would enable the determination of A&O payments early enough to help with budget planning and reduce uncertainty.

#### ***Technical correction to address the surplus penalty due to the accelerated billing date***

**Background:** Beginning with the 2012 reinsurance year, the 2008 Farm Bill changes the premium billing date to August 15<sup>th</sup>. Currently, the premium billing date can vary by state and crop, but is typically October 1<sup>st</sup>.

**Issue:** The industry is concerned that the change in billing dates could have an adverse effect on their business activities and their cost of doing business.

Under statutory accounting rules, uncollected premiums less than 90 days past due are treated as admitted assets. For a policy with an October 1<sup>st</sup> billing date, uncollected premiums as of December 31<sup>st</sup> of the calendar year are treated as admitted assets. Once the billing date is shifted to August 15<sup>th</sup>, all uncollected premiums as of December 31<sup>st</sup> will be treated as non-admitted assets. Every dollar of non-admitted assets reduces statutory surplus by one dollar.

State regulators and financial monitoring firms evaluate the financial stability of insurers based on the results from a series of financial tests. Among other things, the purpose of these tests is to evaluate the adequacy of an insurer's surplus. By accelerating the premium billing date, insurers may incur a penalty to their statutory surplus which could result in increased regulatory scrutiny or a downgrading of the company's financial position by the monitoring firms. This might lead to unneeded regulatory intrusion in the insurer's business activities or an increase in its borrowing costs, both of which would have an adverse effect on the company.

**Recommendation:** The industry recommends that FCIC/RMA work with the industry to develop a solution to this problem to ensure that the change in billing dates does not adversely affect insurers.

#### ***Maintain stability in the design of the program***

**Background:** Over time, companies and their reinsurers have gained considerable experience with the basic structure of the SRA and have learned to function effectively within the existing constraints. The current SRA allows companies to assign policies to one of seven reinsurance funds in each state, with proportional and non-proportional reinsurance provided on the business assigned to each fund.

**Issue:** Maintaining stability in the design of the program is essential for maintaining the confidence of the private sector participants. Significant changes to the design of the SRA that disrupt the ability of the private sector to evaluate risk and return might have an adverse effect on the program.

**Recommendation:** FCIC/RMA should avoid implementing sweeping changes to the SRA that might cause companies and their reinsurers to reconsider their participation in the program. We propose that the basic structure of the current SRA be maintained, with no change to the number or operation of the existing reinsurance funds, Assigned Risk cession limits, or minimum retention percentages.

#### ***Provide an option in the SRA to address changes in rate adequacy***

**Background:** FCIC/RMA recently issued a contract for an examination of all aspects of its rating methodology. The report summarizing the contractor's analysis is expected to be released in early 2010. Any modifications to rates or ratemaking methodology would be implemented after the signing of the SRA.

**Issue:** AIPs make their fund assignment decisions based on the expected profitability and risk of the insured policies. However, the underlying profitability of the business can be affected by FCIC/RMA decisions that materially change the rates being charged. The industry is concerned that the contracted study of rating methodology may have a material effect on future rates and profitability of the program. Due to the timing of the release of the study, these changes are outside of the scope of the current SRA renegotiations. Wholesale revisions to the rates or rating methodology may impact an AIP's ability to make optimal fund assignment decisions, adequately manage its risk, or achieve a competitive rate of return.

**Recommendation:** The industry's ability to renegotiate the SRA is based on the presumption that the profitability of the program will be unaffected by subsequent actions taken by FCIC/RMA. Negotiations would be rendered irrelevant if the private sector's opportunity to earn a profit could be altered at the government's discretion following the signing of the SRA. In particular, if the contracted rate study leads to a major realignment of rates or the introduction of a revised rating methodology, it has the potential of adversely affecting the future profitability of the program. This concern should be addressed by including a stipulation in the SRA that allows for modification of the reinsurance provisions to maintain the level of underwriting income expected at the time the SRA is signed. Modifications would be triggered by significant rate changes, revisions to the current rating structure, or the implementation of a revised ratemaking methodology. The language could be designed to exclude normal rate change activity from consideration. To distinguish between normal rate changes and major rate realignments, FCIC/RMA would be required to release an annual report documenting base rate change activity by state, crop, and plan of insurance. The report would provide annual rate changes as well as cumulative rate changes from a base year (2010). Normal rate activity would be those changes whose annual and cumulative effects are within a mutually agreed upon threshold.

### *Elimination of quota share*

**Background:** The current SRA imposes a 5% quota share provision on underwriting income.

**Issue:** The quota share provision is an arbitrary cost imposed on participating insurers. From a financial standpoint, quota share is equivalent to a tax on underwriting income. It also shifts risk from the industry to taxpayers and crowds out private reinsurance.

In its preparation for the current SRA renegotiations, FCIC/RMA contracted with Milliman to evaluate the historical profitability of the crop insurance program. The two Milliman studies measure profitability in terms of the industry's return on equity. If FCIC/RMA is basing its decisions on the results of the Milliman studies and believes that return on equity is the proper measure of profitability, then FCIC/RMA should be willing to acknowledge that quota share reduces the industry's profitability. FCIC/RMA cannot argue on one hand that the proper basis for evaluating profitability is the industry's return on equity while simultaneously arguing, as it has in the past, that the return on premium ratio is the proper basis for evaluating the effect of the quota share provision on the industry. The current SRA renegotiations provide an opportunity for correcting the damage done by imposing the quota share provision on the industry in the

previous SRA renegotiations without properly accounting for its effect on the industry's rate of return on equity.

**Recommendation:** Eliminate the quota share provision and revise the underwriting gain and loss provisions to compensate. To ensure that companies are able to earn a competitive rate of return, these revisions would be designed to achieve no net effect on the industry's total expected underwriting income. The adjustments need not be uniform across all loss ratio layers. The industry would prefer to offset the income effect of eliminating the 5% quota share with reductions to underwriting gains rather than increases to underwriting losses. However, the industry recommends that no changes be made to company retentions in the 65-100% layer. Any changes to the underwriting losses provisions should be minimal in order to avoid increasing disincentives to participate in the less profitable states.

### ***Revise the underwriting gain/loss provisions***

**Background:** The underwriting loss provisions of the SRA protect companies against catastrophic losses arising from widespread drought or other perils. The SRA also includes a provision for ceding a portion of an insurer's underwriting gains rather than charging a premium for protection against underwriting losses.

Under the current SRA, underwriting losses are allocated to four layers with different retention percentages for each layer. The layers correspond to retained loss ratios of 100-160%, 160-220%, 220-500% and excess of 500%. Underwriting gains are allocated to three layers with different retention percentages for each layer. The layers correspond to retained loss ratios of 0-50%, 50-65% and 65-100%.

**Issue:** One of the primary goals of the program is to ensure universal availability of coverage to all eligible crop producers. In certain situations, the government's objective may be in conflict with the goal of private insurers to earn a profit. Companies are willing to offer coverage if they have a reasonable opportunity to earn a profit in a state. States that are perceived to be more consistently profitable than other states tend to attract more competition. States that are less profitable or that have the potential for large underwriting losses tend to have fewer insurers willing to offer coverage. While the industry is committed to serving farmers in every state, the program provides an incentive for AIPs to focus on the more profitable states and a disincentive to write in the less profitable states. Not only would the long-term stability of the program be enhanced if the risk-return tradeoff were more consistent across all states, it might also improve the cost-effectiveness of the program.

**Recommendation:** Revise the underwriting gain and loss provisions to reduce the potential for unusually large gains or losses. In order to ensure that companies are able to earn a competitive rate of return, these changes would be designed to achieve no net change to the industry's total expected underwriting income. The proposed changes would help to mitigate the public perception issue that the industry is too profitable in certain regions of the country and reduce the disincentive for insurers to participate in the less profitable states.

### *Improve incentives for companies to provide service in underserved states*

**Background:** In the Federal Register Notice published on April 8, 2009, FCIC/RMA announced cooperative agreements to provide crop insurance education and information in Targeted States. The 16 Targeted States are described as "...historically underserved with respect to crop insurance." Designated states include: Connecticut, Delaware, Hawaii, Maine, Maryland, Massachusetts, Nevada, New Hampshire, New Jersey, New York, Pennsylvania, Rhode Island, Utah, Vermont, West Virginia and Wyoming. In the following, the term "underserved states" is used to refer to the Targeted States listed above plus the state of Alaska.

**Issue:** The number of AIPs can vary widely by state. The factors having the greatest impact on the number of companies providing insurance in a state appear to be (1) the size of the agricultural sector, (2) farmer participation in crop insurance, and (3) actuarial performance of the state. Relatively few providers offer coverage in states with small agricultural sectors because these states offer a limited opportunity for companies to grow their books of business, spread their overhead costs over a large group of policyholders, and earn a reasonable profit. Low farmer participation similarly tends to limit the number of insurance providers. The actuarial performance of a state affects insurer participation in that insurers have an incentive to participate in the more profitable states and have a disincentive to participate in states where insurers believe they would be unable to earn a reasonable profit in relation to their risk.

In investigating these factors, we found that low farmer participation in the underserved states may be due to a greater emphasis on specialty crops and forage. Data provided by FCIC/RMA shows that participation rates for staple crops (barley, grain corn, grain sorghum, peanuts, pima cotton, potatoes, rice, soybeans, tobacco, upland cotton and wheat) in these states is relatively high. Compared to the U.S. 2006-2008 average participation rate of 79.5%, participation rates for staple crops were 70.2% in Wyoming, 72.0% in Connecticut, 72.2% in Maine, 75.7% in Vermont and 77.2% in Alaska (staple crops are not grown in Hawaii). These exceed the participation rates for certain states not included among the underserved, such as 63.7% for Kentucky and 64.0% for Wisconsin.

We also reviewed the number of AIPs operating in the underserved states. The number of AIPs is relatively low but varies widely. For reinsurance year 2010, an average of five companies operate in each of the underserved states, ranging from one company in Alaska to ten in Wyoming. As might be expected, only a small number of agents are licensed in these states, though the ratio of agents to policy counts appears to be reasonable. Based on counts from FCIC/RMA's Agent Locator system, the number of agents per policy is 0.30 in Nevada, 0.09 for Utah, 0.57 for Rhode Island, 0.20 for Hawaii, 0.06 for Massachusetts and 0.10 for Alaska. For comparison, the number of agents per policy in Iowa is just 0.04. However, a company's overhead cost for maintaining a marketing presence in states with only a few agents can be prohibitive. In addition, the lack of proximity and accessibility of agents can negatively impact a farmer's awareness of the program. For example, only two agents operate in Alaska, both of whom are located in Oregon. In Hawaii, only three out of 22 agents are physically located in the state.

One of the government's primary objectives for the crop insurance program is to ensure universal availability of coverage to all eligible farmers. Private sector delivery is integral to this goal in that the private sector has the ability to respond to financial incentives that serve to maximize farmer participation. However, incentives for insurer participation vary across states, endangering the goal of universal availability. This is especially the case for low premium volume states where the potential for underwriting gains may be insufficient to offset the higher relative cost of operating in these states. The withdrawal of a single provider in a state with a small number of participating companies may create market disruptions for farmers and their agents. To address this issue, profit opportunities should be more consistent across states than at present. At the same time, the government should avoid creating excessive incentives for insurers to enter states with small agricultural sectors that are adequately served by the current insurance providers. The goal should be to minimize the disincentives for current providers to withdraw from a state rather than maximize the incentives for new providers to enter a state. Increasing the number of providers in a state with a small agricultural sector would be counterproductive in that it would limit the ability of providers to spread their overhead costs over a large group of policyholders, negating the benefit of the increased incentives.

**Recommendation:** The AIPs are committed to providing service to any producer who wants to purchase crop insurance. The primary problem AIPs face in underserved or low premium states is the high cost of providing service in the face of limited demand for service. Three options were considered: (1) Gain/Loss rebalancing, (2) A&O rebalancing, and (3) Pooling.

- 1) Gain/Loss rebalancing to address profitability in the underserved states was considered to be ineffective due to the high operating and marketing costs in relation to the premium in these states.
- 2) A&O rebalancing to address the expense issue in the underserved states raised several concerns. First, it is unclear whether FCIC/RMA has the authority to revise A&O in light of the statutory language in the 2008 Farm Bill that reduced A&O payment percentages. Second, it is uncertain whether the limitations on A&O allowances apply on a per policy basis or on a book of business basis. If A&O limitations apply on a book of business basis, it may be feasible to shift a portion of the A&O to a select group of targeted states. However, FCIC/RMA should first investigate its legal authority to increase A&O allowances to the targeted states without reducing A&O in the remaining states. The changes would be implemented in a manner to ensure that it leads to improved service to producers, including more extensive risk management education as well as agent and adjuster training.
- 3) Pooling risks in the underserved or small premium volume states would allow the results for these states to be spread across the entire industry. This would be similar to a Joint Underwriting Authority mechanism used in a number of states to ensure availability of coverage to individuals unable to obtain coverage in the private market. However, this alternative was not preferred since the absence of competition and the reduced financial incentives to control indemnity costs in the underserved and small premium volume states would work against the goal of program integrity.

The industry believes that increasing awareness of and demand for crop insurance in low premium volume states is an important goal for the program. To that end, the industry supports educational and informational programs such as the FCIC/RMA Targeted States program. However, the industry is concerned that A&O cuts and delays may potentially undermine the resources to maintain service in the underserved states. The industry is willing to discuss with FCIC/RMA possible additional A&O compensation arrangements to improve the AIP's incentives to sell and service producers in these states.

**References:**

GAO Report. April 2009. Crop Insurance Opportunities Exist to Reduce the Cost of Administering the Program.

Grant Thornton, LLC. 2009. Federal Crop Insurance Program Profitability and Effectiveness Analysis, 2009 Update. <http://www.ag-risk.org>.

Milliman, Inc. August 18, 2009. Historical Rate of Return Analysis. <http://www.rma.usda.gov/pubs/2009/millimanhistoricalrate.pdf>.

Milliman, Inc. June 23, 2009. Rate of Return Update – 2008: Reasonable Rate of Return, Section 3.1. <http://www.rma.usda.gov/pubs/2009/millimanreasonabletrate.pdf>.

## Plan of Operations (SRA Appendix II)

**Background:** The “Plan of Operations” refers to the documents and information an AIP must provide FCIC/RMA to meet the requirements of the SRA, specifically Section IV.F.2, Appendix II and any other applicable procedures. Documentation and informational requirements for Appendix II cover all aspects of company operations. AIPs must complete approximately ten to fifteen Exhibits ranging from company contact information, agent compensation, expense reporting, SRA fund designations, to compliance with various federal non-discrimination provisions.

**Issues:** The goal of the Plan of Operations Workgroup was to review Appendix II to determine if efficiencies could be achieved in the process. Specifically, the workgroup focused on three primary areas: (1) reducing the amount of unnecessary information reported to FCIC/RMA; (2) eliminating redundant reporting requirements; and (3) request clarification from FCIC/RMA regarding certain required items and information.

**Recommendations:** The workgroup reviewed each individual item in Appendix II and has the following recommendations or clarifications:

Language in the first paragraph should be modified if it is the intent of FCIC/RMA to require a completely new submission of the Plan of Operations rather than just submitting “*any revisions to the Plan for each subsequent reinsurance year in which it participates. All items are to be resubmitted each Plan Year, even if the SRA agreement does not change.*”

Plan of Operations Items 3 and 4: These two items could be combined into one item and remove the request for “*a copy of all the agreements between the managing general agent and the company that relates to business conducted under this agreement.*”

Plan of Operations Item 5: Currently AIPs provide a hard copy signature document. This contradicts language within Item 28 whereby AIPs are expected to demonstrate compliance with the Freedom to E-File ACT and the acceptance of an electronic copy of a signed Operations Report.

Plan of Operations Item 6: The wording in this item should be changed to be similar with the wording in Item Five which states “*officer or employee authorized by the company.*”

Plan of Operations Item 7: Because many records are currently stored electronically, this item could be modified to reflect the location of electronically stored files. Clarify the location requirement of official policy documents recognizing that the original hard copy signature document may not be the document retained as the official record if the hard copy document has been scanned and retained electronically. Remove the requirement to provide addresses and telephone numbers of locations other than the AIPs. This information is submitted through DAS via Appendix III. The term “official documents” needs to be defined.

Plan of Operations Item 10: Items such as the Statutory Annual Statement are already being retrieved electronically by FCIC/RMA from external sources such as the NAIC and do not need to be submitted by the AIPs. NAIC items should be grouped together even though AIPs do not report to NAIC.

Plan of Operations Item 10: Update Appendix II, rather than have informational memorandums that state that certain reporting items are no longer required under Item 10.

Plan of Operations Item 10c: Add the wording “*when available*” to this item after the statement ... “*from an independent auditor.*”

Plan of Operations Item 10i (Organizational Chart): Language should recognize that the annual statement yellow book provides entity relationships of the AIP. Clarify that the organizational chart of the AIP state the names of personnel directly involved in the program.

Plan of Operations Item 10j: Eliminate this item since FCIC/RMA is already receiving this information on a quarterly basis from the AIPs. The original requirement was also 30 days but should be extended to 45 days.

Plan of Operations Item 10m (Commission Template): Commissions should not be required to be transmitted through DAS on a policy basis. Policy submission through DAS and per policy commission payment to the agent serves no viable purpose in the overall evaluation of program delivery.

Plan of Operations Item 10n (Loss Adjustment Expense Template): The allocation of adjuster expenses is difficult to verify because all AIPs do not record their adjuster expenses in the same manner. Claims expenses may include full time staff, part time staff, as well as independent contractors. Also, these expenses are allocated over different product lines by the AIP.

Plan of Operations Item 10q: This item is already being captured by the Certification Statement in the Standard Reinsurance Agreement (SRA), and this item could be removed from the Plan of Operations.

Plan of Operations Item 10r: Item 10r and Item 20 could be combined.

Plan of Operations Item 12: FCIC/RMA needs to clarify the reporting requirements of Item 12 to distinguish between an AIP who may or may not be licensed in a particular state versus an AIPs decision to participate in a particular state. The workgroup expressed concern about the requirement to provide all plans of insurance within a given state, in particular, the release of new pilot programs near the sales closing date (see recommendations of Training and Education workgroup).

Plan of Operations Items 15 and 16: Although FCIC/RMA prefers these items be submitted annually, the workgroup recommended these items be re-submitted only if there is a change from the previous year.

Plan of Operations Item 17: AIPs requested a copy of the signed escrow agreement be returned to the AIP after FCIC/RMA has signed the agreement.

Plan of Operations Items 18u - Exhibit B (Expense Reporting Format): AIPs requested this item be eliminated since it is already being provided to FCIC/RMA in the AIPs' annual statement submission.

Plan of Operations Item 19: AIPs requested the timing of this item be changed because not all reinsurance contracts are completed by this date although the item indicates the reinsurance documentation be submitted "when available".

Plan of Operations Item 22: AIPs questioned why this item is required in the Plan of Operations since it is also a requirement of Appendix IV – Quality Control Guidelines.

Plan of Operations Item 22a: Item 22a and Quality Control requirements in Appendix IV should be clarified and combined.

Plan of Operations Item 22b: This requirement should be removed since these records are being submitted through DAS.

Plan of Operations Items 23, 24, and 26: These items are redundant to Sections I, II and IV of Appendix I of the SRA and could be eliminated.

Plan of Operations Item 25: This is redundant with Appendix I, Section II and could be eliminated.

Plan of Operations Item 27: This item needs to be updated to reflect current rebating laws and expectations of FCIC/RMA.

Plan of Operations Item 27c: It is difficult to meet this requirement because not all State Insurance Departments will provide a letter of compliance.

Plan of Operations Item 28 (E-Business Implementation Plan): This item needs to be updated. This should be consistent with the Livestock Price Reinsurance Agreement.

## Livestock Price Reinsurance Agreement Plan of Operations

The first 16 items in Appendix II – Plan of Operations are similar in nature and the AIPs recommended that a reference be made to “see Exhibits in the Plan of Operations for the Standard Reinsurance Agreement” instead of supplying the same information for both Agreements.

Exhibit 12: This exhibit should be changed to make it similar to the requirements made in Exhibit 12 of the Plan of Operations for the Standard Reinsurance Agreement.

### Discussion Items and Questions

Discussion items and questions that the workgroup would like to address in regard to the Plan of Operations.

#### Questions:

- 1) Can the submission date of the Plan of Operations be moved to a later date, such as May 1 or May 15th? Complete claims information is not always available by April 1<sup>st</sup> of the current year and neither are all reinsurance agreements completed by that time.
- 2) Where are the Non-Disclosure Statements addressed in the Plan of Operations?
- 3) Could there be an exhibit that states what 508H crops that a company wants to opt out of?
- 4) The last sentence under # 3 Crop Insurance Expertise should actually be the last sentence for #2 Computer and Information Systems on Page 6 of the Informational Memorandum – 2010 Plan of Operations Submissions Guidance.
- 5) Can we have a checklist of items that an AIP is completing rather than submitting a document that says ‘not applicable’?
- 6) Can there be a Q/A on the FCIC/RMA website with responses that would impact all companies rather than the answer being just returned to the one company.
- 7) Can Accounting Reports be submitted electronically or via email?

## Information Technology and Data (SRA Appendix III)

**Background:** The Appendix III “Data Acceptance System Manual” (AIII) provides both the contractual and detailed technical specifications for submitting policy data to FCIC/RMA, along with specifications for the accounting processes that support AIP reimbursements and payments with FCIC/RMA. AIII requirements encompass nearly 1000 fields to be reported on as many as 26 different record types that collectively represent the sales, production history reporting, acreage reporting, loss adjustment, premium payments and quality control efforts of AIPs. Transactions required to be submitted by AIPs in support of these policy servicing activities for the 1.9 million crop policies in effect each reinsurance year are in excess of 750 million records annually. Currently, FCIC/RMA is upgrading its data processing and information systems platform under the auspices of the Information Technology modernization (ITM) project. The ITM project will ultimately impact all crop insurance policyholders, all AIPs and related USDA agencies.

**Issues:** The goal of the Appendix III Workgroup was to review Appendix III and related definitions and data collection sections within the SRA to determine where improvements in the data reporting standards could be made. The process by which FCIC/RMA can annually modify AIII to reflect ongoing policy and procedural changes can significantly increase the operational burden that AIPs undertake. Therefore an effective change control methodology is of paramount concern. Coupled with an effective change control methodology is a desire by AIPs to separate the contractual requirements outlined in AIII that should not be subject to annual revision from those components of AIII that are subject to revision as policy and procedural changes occur. ITM development should focus on modernizing FCIC/RMA’s current computer environment and only those higher volume processes that would benefit from an automated system should be developed. A number of specific recommendations to improve data collection, reporting and statistical analysis capabilities are provided below. The workgroup felt that FCIC/RMA should initiate AIII changes needed to implement the 2008 Farm Bill payment revisions along with any necessary FISMA compliance requirements and that any data reconciliation standards should be established as part of the Quality Control requirements within Appendix IV.

### Recommendations:

- 1) ITM timeline precedes SRA Renegotiations.
  - The focus of ITM priorities needs to center on replacing the current DAS reporting requirements within FCIC/RMA’s proposed ITM timeline rather than FCIC/RMA attempting to reengineer business processes
    - Reporting requirements or processes outside those necessary to implement the Common Crop Insurance Policy (CCIP) and current DAS/RAS processing within ITM should be delayed until 2012 or subsequent RYs
  - Proposed reporting requirements should be supported by the CCIP policy (or current policy for non-CCIP crops) and procedures (CIH, LAM, etc.)
  - Proposed reporting requirements should not impose additional operational burdens on AIPs outside of the SRA renegotiations (i.e. Data Reconciliation, FSA data collections, etc.)

- 2) Separate the contractual issues for data reporting requirements into a new streamlined Appendix III and develop a new Data Reporting Standards manual to specify data records, elements and edit requirements.
  - Current SRA Section IV (A) could be rewritten to require data reporting per the guidelines established in Appendix III
  - Section IV (B) (1) and (9) should remain in the SRA as part of the new Section IV (A)
  - Section IV (B) (11) should remain as a separate General Provision
  - Create a new Appendix III from the following:
    - The current Section IV (A) and all remaining items of Section IV (B) should be moved to the new Appendix III
    - Section 1-4, Section 2, and potentially portions of Section 4, Section 6 and Section 7-2 from the current Appendix III should remain in the new Appendix III. All other components of the current Appendix III would be moved to the new data reporting standards handbook.
    - Ideally the new Appendix III would be less than 15 pages or so.
- 3) Inherent in the new Appendix III would be a change control methodology that governs how the Data Reporting Standards manual is maintained. FCIC/RMA changes outside of those specified in Appendix III should wait until the next renegotiation of the SRA or mutual consent must be obtained to implement the proposed change.
- 4) The new Appendix III should contain a hierarchy of governing documents to resolve discrepancies between conflicting documents.
- 5) Draft Data Reporting Standards manual revisions should be issued with the new/modified policy documents
  - These should include, APH, acreage and loss instructions along with comprehensive data reporting examples, rounding rules, etc.
  - The Data Reporting Standards manual should not include requirements that are not supported by the approved policy and procedures.
  - The Data Reporting Standards manual should not include reserved, optional, no edit or other “placeholder” fields, as the manual is designed to be continuously updated as the new policy and procedural requirements are issued.
  - FCIC/RMA should explain to AIPs their reason for rejecting AIP recommendations to proposed changes in the Data Reporting Standards manual similar to what is used for the proposed rule comment process.
- 6) FCIC/RMA’s utilization of CIMS will result in additional reporting and processing issues:

- FCIC/RMA has yet to answer the question if the policy compels the producer to report acres by CLU, and FCIC/RMA must define procedures for the collection and maintenance of this data should the policy support this data reporting requirement.
  - Secondary, FCIC/RMA will have to address if the policy supports collecting “FSA Data” and define procedures for its collection and maintenance
- 7) The Appendix IV Workgroup should address the ARPA data reconciliation requirements that will be imposed under CIMS.
    - a. Modifications to the Type 57 record will have to be made after the Appendix IV Workgroup identifies recommended changes to the Quality Control review requirements in Appendix IV. Those changes would then be incorporated into the Type 57 record within the Data Reporting Standards manual.
  - 8) If the policy or procedures allow producer elections at acreage reporting that are different than those established on the application, then LSR should not apply to these policy changes.
  - 9) Fund designations for assigned risk and development policies should remain as the only required submission (i.e. no mandatory fund designations for policies in the commercial fund).
  - 10) All premium and fee payments should be due to FCIC/RMA by the month following the billing date rather than when collected as it is now. This simplifies the loss credit process and eliminates the current cash payment reporting process.
  - 11) Eliminate the full book process or limit it to a one-time requirement six months after annual settlement.
    - The current mini-40 report mitigates the need for the full book process, and the Workgroup recommends the mini-40 file should be retained with ITM.
    - FCIC/RMA’s proposed use of internally recomputed values for accounting purposes should negate the need for the Full Book reporting process, and therefore the full book requirement could be deleted from the proposed A-III. The full book would essentially be replaced by the data returned with each submission, as it is proposed to contain the AIP reported and FCIC/RMA determined values on a line basis. Language to affect this impact on the accounting reports should be incorporated into Appendix III.
  - 12) RO Exceptions automation within ITM needs to be reviewed for cost efficiencies and implementation of the various new reporting requirements should be staggered over several

reinsurance years with those automated processes which provide the greatest mutual benefit being implemented first.

- Only some facets of the proposed reporting requirement may be automated while other facets which have no material benefit could continue to be handled under its current “manual” reporting process (i.e. automate the WA request, but continue to supply maps and other supporting documents manually).
  - These principals will guide AIP review of FCIC/RMA’s ITM proposals that are occurring outside of SRA renegotiations. However, the proposed Appendix III should address how FCIC/RMA implements new data reporting requirements being imposed on AIPs.
- 13) The new Appendix III should include a requirement for FCIC/RMA to provide a policy detail statistics file by no later than March following the 2011 reinsurance year and annually thereafter.
    - Historical “bazillion file” data should be provide by no later than March following the 2012 reinsurance year.
  - 14) Appendix III should require FCIC/RMA to provide AIPs “web services” or back-end data and GIS files that are required to sell and service new or pilot products.
  - 15) Appendix III should give AIPs access to FCIC/RMA’s data mining “Dashboard” products.
  - 16) Appendix III should establish a timeframe in which FCIC/RMA determinations are made (i.e. excessive yield determinations, LSR modification requests, etc.). FCIC/RMA should be limited to 90 days to deny the request or the request is automatically approved.
  - 17) Appendix III should dictate that FCIC/RMA will not provide policy servicing front ends/graphical user interfaces for validation systems (i.e. eDAS front-end should be shut off while the web services remain operational effective with the 2011 RY).
  - 18) The calendar week and transaction cutoff date definitions should be uniform.
  - 19) The Workgroup wishes to know what Appendix III modifications FCIC/RMA will be proposing for the 2012 Reinsurance Year to implement the 2008 Farm Bill changes on timing of A&O reimbursements, underwriting gains and premium billing.
  - 20) The Workgroup wishes to know if FCIC/RMA will be proposing Appendix III language to implement necessary FISMA compliance requirements.

In addition to these recommendations, the following draft documents are available upon request: (1) applicable draft SRA data reporting language; (2) prototype Appendix III; and (3) prototype data reporting standards manual.

## Quality Standards and Control (SRA Appendix IV)

**Background:** Because the crop insurance program is a public-private partnership which entails the outlay of sizeable Federal expenditure, the role of oversight and quality control monitoring has grown with the expansion of the program. In terms of the SRA, much of this activity is a joint effort between industry and FCIC/RMA and is explicitly stated in Appendix IV. Sections III, IV, and V contain the specific AIP and FCIC/RMA requirements for monitoring the quality control of the program. This quality control function encompasses comprehensive review requirements, verification procedures, conflict of interest disclosures, along with AIP responsibilities for reporting program fraud, waste, and abuse. In essence, Appendix IV (along with its training and education requirements) represents the cornerstone of FCIC/RMA and industry efforts to ensure integrity of the crop insurance program.

**Issues:** With the extraordinary growth of the crop insurance program has brought forth a myriad of complexities that were not envisioned when the underlying quality control program was conceived. Advances in technology, FCIC/RMA's depth of data and recent geospatial advancement bring tools to assist the efforts of FCIC/RMA and the industry in upholding their responsibilities as administrators of the crop insurance program.

Over time the current quality control platform has evolved into a mix of rules, procedures and interpretations that are at best poorly explained and often misunderstood. The Workgroup efforts, through the negotiation of the Appendix IV portion of the 2011 SRA, are in the spirit of designing a proactive quality control program that is grounded in the data mining technology FCIC/RMA has developed. From this, a quality control program can be designed that is clearly understood by both FCIC/RMA and AIP personnel. As partners in delivering this great program to the American Farmer, FCIC/RMA and each AIP can responsibly protect the integrity of the program and provide assurance to the tax payer that the industry is diligent in its administration of the crop insurance program.

The industry's design is premised on an active partnership with the FCIC/RMA wherein the quality control program is driven by data mining but is annually reviewed with targeted emphasis placed around areas of concern of both FCIC/RMA and the AIPs. This would be a quality control program that is clearly defined and in a true spirit of partnership yet still recognizes FCIC/RMA's regulatory oversight responsibility and authority.

**Recommendations:** The following outline with attached terms, definitions and procedures provides a starting point for discussions with FCIC/RMA.

These Appendix IV Q/C Workgroup recommendations and the attached supplement address Sections III, IV, V and relevant definitions in Section I of the current Appendix IV along with associated definitions and applicable portions of the SRA.

**I. The Quality Control/Compliance program is composed of two fundamental parts, the overarching principles and the actual review categories and required procedures. These should be clearly defined within Appendix IV.**

A. The overarching principles are separated into two broad categories as follows:

1. AIP/Company responsibilities.

a) Currently located under Section III.A. of Appendix IV. Much of this section needs to be changed to eliminate redundancy and to encompass the more proactive approach to quality control as outlined below. The AIP's purpose in carrying out an adequate quality control program is two fold. To assure internal compliance with the requirements under the SRA and to help maintain program integrity through a process for identifying and addressing fraud, waste, abuse and other program vulnerabilities. This process for maintaining program integrity must be better defined and will require a partnership relationship between FCIC/RMA and the AIP. Recommendations to further enhance this process are explained below in more detail.

2. FCIC/RMA responsibilities.

a) Currently described under Section III.B. of Appendix IV. The responsibilities and actions of FCIC/RMA need to be stipulated in greater detail. More information needs to be included regarding FCIC/RMA's timing, procedures and processes when they conduct a National Operations Review (NOR) on a company. This will assure that all NORs are conducted equitably and consistently across AIPs and regions.

FCIC/RMA's responsibility is to monitor and evaluate an AIP's compliance to the requirements under the SRA. FCIC/RMA also has a responsibility to maintain program integrity through a process for identifying and addressing fraud, waste, abuse and other program vulnerabilities. However, in order to assure effective remedial action, certain aspects of this process require a responsibility on FCIC/RMA's part for maintaining a partnership relationship between FCIC/RMA and the AIP. This partnership process needs to be defined and included.

B. The review categories and required procedures must be concise and clearly defined. Specific recommendations are provided in the attached Recommendations Supplement.

1. Restructuring Appendix IV into a more logical format will provide a more practical set of procedures. This will be achieved by distinguishing review categories from review procedures and by enhancing the definitions section.
  - a) The definitions section will contain appropriate terms, including recommended necessary additional terms. To the extent feasible, defined terms should be consistent across all program aspects (e.g. policies, manuals, guides, and procedures, etc.).
  - b) The review categories will be a section classifying all reviews such as is currently attempted under Section III.C. of Appendix IV. The applicable review procedures will be stipulated for each category.
  - c) The review procedures will be a section listing the specific review or inspection types, such as APH, field, file, GSI, etc. and stipulate for each what is to be done.

## **II. The SRA Appendix IV must be all inclusive of the required quality control elements and reviews.**

- A. In support of simplification, all minimum Q/C requirements must be stipulated in Appendix IV. This includes all responsibilities, review categories, types and procedures, etc.
  1. Review requirements that may currently be located in external manuals, handbooks or guides must be removed.
  2. AIP internal quality control functions are supplemental, at the discretion of the individual AIP, and not included as a requirement under the terms of the SRA.

## **III. Quality Control must be a pro-active process that utilizes current technologies, incorporates efficiencies and reduces redundancies.**

- A. Data mining through CAE (or successor entity) must become the primary conduit or baseline for the Q/C program. With the present ability to “mine” for anomalies, the recommendation is to move data mining to the forefront as the principle means for identifying program aspects that merit monitoring or review by the AIP. Obviously, the existing Federal functions through CAE would still remain but an additional aspect of the AIP-FCIC/RMA partnership should be formalized. This process will require appropriate designated personnel representing both FCIC/RMA and the SRA holder. The current “Program Reviews” category must be clarified and redefined accordingly.

1. Identification of anomalies that suggest abnormal or unusual underwriting or loss performance needs to include the addition of a process whereby the AIPs are involved. This will allow for better understanding and more specific classification of the CAE identified concern. With respect to reviews identified via the FSA Spot check list:
  - a) Inspections are to be solely identified as requiring either a Growing Season Inspection or a Pre-Harvest Inspection.
  - b) Appropriate timing for receipt of identified reviews must be assured.
  
2. Inefficient random reviews are replaced with “targeted” reviews identified via data mining. These reviews are defined and agreed upon between FCIC/RMA and the AIP designees on an annual or semiannual basis. Effect of current or past reviews will be analyzed and discussed allowing for quicker identification of program vulnerabilities and recommended resolution (i.e. policy change, procedural change, training, etc.). This process also creates efficiencies by eliminating redundancies and allows for a more fluid and flexible quality control program as it moves through time. For example, if a review series produces no meaningful result, it can be terminated or replaced. As new policies or concepts are introduced into the program, concerns can be identified and responded to faster and more appropriately.
  - a) This would include situations involving Simplified Claims, APH Tolerances, Consecutive Loss Adjusters, GRP/GRIP, 508h or Pilot programs, or any other areas of concern not addressed by the remaining recommended standard review categories (see below). This will include concerns identified by either FCIC/RMA or the industry. Responsibilities and criteria need to be defined and included for dealing with OIG Hotline complaints.
  - b) Appropriate timing for receipt of identified reviews will be determined.
  - c) Based on the identified concern, appropriate review procedures will be determined (e.g. APH review, field inspection, file review, GSI, PHI).
  
- B. Certain current review categories have merit and should remain as standard required reviews. Additional recommended procedural detail for each are provided in the attached Recommendations Supplement.
  1. Program Reviews (described above).
  2. High Dollar Reviews (this is a recommended term for the current “\$100,000” reviews).
    - a) A payable Claim Type that is equal to or exceeds \$200,000 but is less than \$500,000.
  3. Large Claim Reviews.
    - a) A payable claim type that is equal to or exceeds \$500,000.

4. Conflict of Interest Reviews.
  - a) A review that may be either mandatory or AIP Discretionary as determined by the procedures (currently, MGR-08-001) and is conducted on a payable Claim for Indemnity.
5. AIP Discretionary reviews.
  - a) A review conducted on an eligible crop insurance contract at the sole discretion of an Approved Insurance Provider (AIP).

C. Cost Containment.

1. The current Appendix IV is void of any meaningful criteria by which an AIP could budget in advance for an expected workload. The concern is not about doing more work or less work but about establishing some parameters or limits which would serve as a reasonable basis for an AIP in predicting workload and associated costs. Obviously some components cannot be predicted like actual number of high dollar or large claims that will occur in a given year but an AIP can at some point know the number of policies with high enough liability to be able to reasonably prepare for those potential reviews. The same goes for COI reviews. However, the potential reviews that could be generated under the Program Review category could be extensive. The following parameters are recommended:
  - a) Program Reviews to be conducted during the current reinsurance year will not exceed the greater of 110% of an individual AIP's previous years' program reviews or 3% of the total paid indemnities on a crop/county basis for the current crop year. This amount can only be exceeded if additional reviews are determined to be necessary in accordance with recommended item III.A.2. above and agreed to by FCIC/RMA and the AIP.

**IV. Certain Specific Program Concerns Must Be Addressed.**

- A. Timely response to issues that may arise on an ad hoc basis.
  1. A "Jump Team" concept must be formalized as part of the needed AIP and FCIC/RMA partnership responsibilities described above. This is a process whereby once an issue has been identified, the appropriate industry representation will be able to react with timely concise decisions and agreed-upon solutions. FCIC/RMA's current method where the Risk Management Services Division and/or the Product Administration and Standards Division react to these issues is often inconsistent, much too time-consuming, or either lacks or ignores appropriate industry involvement. A better understanding of what constitutes official FCIC/RMA guidance is also needed.
- B. Producer Certifications.

1. Much of the information that is to be verified by an AIP is producer certified. As such, insured responsibilities must be recognized and distinguished apart from the AIP's responsibilities.

C. Tolerances.

1. Due to the vast complexity and certification aspects of the program, valid tolerances that grant a degree of equitable relief for a discrepancy or inadvertent error must be incorporated. The current level of implied precision is unreasonable from a cost benefit perspective. A reasonable tolerance can be allowed under certain conditions (e.g. monetary and APH) that will provide greater efficiencies yet still maintain program integrity. Additional recommended procedural detail, tolerance application and corrective action is provided in the attached Recommendations Supplement.

D. APH Reviews.

1. APH review procedures need to be defined for Appendix IV purposes. The current mandatory three year review criteria with zero tolerance is burdensome, time consuming and generally inefficient. The current procedures must be redefined utilizing a more reasonable and cost effective approach. Data Mining should be utilized to identify APH anomalies along with AIP discretionary identification. Once identified, only the anomalous certified yields would need be reviewed for the year certified, whether a current or prior year as allowed by the record retention requirements. Anomaly identification via data mining along with the other yield edits currently required by procedures should eliminate the need to do a three year review on every high dollar claim. Only the previous year's certified actual yields, on a county crop contract basis, would require an APH review when conducting a High Dollar, Large Claim, or Conflict of Interest review. Additional recommended procedural detail, tolerance application and corrective action is provided in the attached Recommendations Supplement.

E. Large Claims (\$500K).

1. Additional clarification is needed regarding the timing of reporting to FCIC/RMA (e.g. dealing with early season losses well under the \$500K threshold), level of information required with notification, when FCIC/RMA will or will not elect to participate, and if electing to participate, the amount of time FCIC/RMA is allowed to approve or deny the claim after insured's signature is obtained.

**V. Suspected Misrepresentation, Fraud, Waste, and Abuse.**

- A. These terms need to be individually defined. Recommended definitions are provided in the attached Recommendations Supplement. As such, misrepresentation and fraud are distinguishable enough from waste and abuse that separate reporting requirements and procedures are necessary. Misrepresentation and fraud deal more with criminal activity

whereas waste and abuse deal more with program issues or vulnerabilities. With respect to suspected misrepresentation and fraud, some level of protection for self reporting needs to be incorporated. In all cases where, based on competent evidence, fraud or misrepresentation is suspected, the AIP needs to be able to report it. In addition, a mechanism is needed whereby FCIC/RMA can share appropriate information between AIPs.

## **VI. System Tracking.**

- A. As the Appendix III Type 57 record is a real time reporting mechanism, the need to submit the annual report should be eliminated. The Type 57 data elements will need to be redefined in accordance with the new SRA Appendix IV requirements. Additionally:
  - 1. If a policy transfers from one AIP to another, the assuming AIP needs to have access to appropriate information from the Q/C reviews conducted in a prior year.
  - 2. The Type 57 record is all inclusive of all reviews. These are only the reviews required under Appendix IV.
  - 3. The Appendix III Type 57 record must not to be used to determine the program error rate. This is due to the complexity and difficulty of attributing a dollar amount to the results of many of the reviews.

## **VII. National Operations Reviews.**

- A. Error rates are to be determined as a result of the FCIC/RMA conducted National Operations Review process and are based on a comparison of the premium and indemnity before and after the review.

## Education and Training (SRA Appendix IV)

**Background:** In this appendix training responsibilities and requirements are specified. General company training responsibilities and procedures are delineated including: needs identification, timing, duration, documentation, and curriculum development. Curriculum requirements for both sales agents and adjusters are specified. These minimum requirements cover all eligible crop insurance contracts the company indicates it will be selling in its Plan of Operations, and cover all agents, adjusters, and applicable company employees. Expectations of using structured training to promote program integrity and to encourage participation by limited resource and/or underserved producers are also included.

**Issues:** Because of the expansion of the crop insurance program, the importance of comprehensive training and education requirements and expectations cannot be overstated. Moreover, the sophistication and technical nature of the components of the program make it more difficult for an individual to stay current as changes and updates to the program are made, or as new program products are introduced. To provide the best possible service to consumers of the program, sufficient time is required to adequately train all involved in the delivery chain.

Having established training curriculum and requirements creates industry uniformity and consistency of quality across companies and programs. Training standards need to be flexible enough to accommodate innovations in technology and individual company training needs. The advent of distance learning technology and online delivery mechanisms is having a revolutionary impact on training programs and tools. These tools need to be integrated into formal training procedures to capture the economic and time savings offered.

Effective program delivery includes accommodating those producers in difficult to reach areas and/or who may be small scale, limited resource, or socially disadvantaged producers. Education can be effective tool in helping these producers take advantage of existing crop insurance products. However, the economic incentives and effective product availability barriers need to be addressed.

### **Recommendations:**

- 1) Release of new programs should be timed more effectively. FCIC/RMA should either set a deadline for release of new programs by private submitters, or if that date has passed, to require submitters to have an adequate ready-for-training program already developed.
- 2) Incorporate the required livestock SRA training into the crop SRA training for companies selling both products. This would allow companies the flexibility to provide the most beneficial training to their agents and adjusters.
- 3) Change the definition of experienced agent to “qualified agent”, and experienced adjuster to “qualified adjuster”. Qualified is more descriptive of what is intended by the definition and a truer representation of training requirement completion.

- 4) Rewrite the definitions of new agents and adjusters to accommodate those who complete training, but have not sold or adjusted a loss during a full calendar year. Some individuals perform functions that require licensing by the state, but do not perform sales, or do not adjust crops.
- 5) Reduce mandatory minimum hours of annual training for experienced (qualified) adjusters from 18 to 16 hours, and increase classroom hours from 6 to 8 hours. This modification would result in cost savings by allowing for training to be accomplished in two rather than three days.
- 6) FCIC/RMA, the private crop insurance industry, and limited resource farmer organizations should work together to develop products that will better meet their risk management needs.

## Quality Standards and Control Recommendations Supplement

| Term              |            |   |
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| <b>Abuse</b>      | Definition | <b>Abuse</b> is the improper or excessive use of authority. Abuse refers to administrative violations of Departmental, agency, or program regulations that impair the effective and efficient execution of programs. These violations may result in Federal losses or they may result in denial or reduction in lawfully authorized Federal benefits to participants.   |
|                   | Procedure  | <b><i>[Additional discussion is needed.]</i></b>  |
|                   | Discussion | Abuse is currently undefined within the SRA. The recommended definition is identical to the one currently located in the 4-RM. Waste and abuse need to be defined, reported and addressed separately from fraud and misrepresentation.  |
| <b>APH Review</b> | Definition | <b>“APH Review”</b> - means the AIP verification of actual yields as certified by an insured in support of their Yield Based policy’s Actual Production History.  |
|                   | Procedure  | <p>At a minimum, the review process will entail the verification of information or data certified by an insured to determine whether the information or data was timely submitted and accurate. If a discrepancy in the certified actual yield is determined by the AIP during the review process and the discrepancy is within tolerance, corrections may be made for the current crop year at the discretion of the AIP but are required for the following crop year(s). If the discrepancy is out of tolerance, corrections must be made for the current crop year and the following crop year(s).</p> <p>On a county crop contract basis, an APH review will be specific to the actual yields certified for the crop year of any anomalous actual yields identified via FCIC/RMA Data Mining. On a county crop contract basis, an APH review will be specific to actual yields certified for the previous crop year for any current crop year Large Claim Review, High Dollar Claim Review, or mandatory Conflict of Interest Review.</p> |

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| <b>APH Review (cont.)</b>                    | Discussion | <p>The procedure needs to support anomaly identification through data mining as well as incorporation of a reasonable tolerance. The yields being reviewed are, after all, the producer certified yields for non-loss units. Expecting an insured to understand and incorporate all of the complexities (for example, quality adjustment) involved with determining production to count in accordance with the procedures during a non-loss year or on a non-loss unit is unreasonable.</p> <p>Focus should be on the insured certified “actual yields” (as defined by the CCIP) for a targeted review year (e.g. anomalous year as identified by data mining or AIP discretionary or prior year if for Large or High Dollar Claims or COI mandatory reviews). Recommendation is to apply the tolerance at the individual year per acre level. When the tolerance is applied at the individual year level, concern at the “average” or “approved” yield level will go away.</p> |
| <b>Affiliate</b>                             | Definition | <p><b>Affiliate.</b> Persons are affiliates of each other if, directly or indirectly, either one controls or has the power to control the other, or, a third person controls or has the power to control both. Indicia of control include, but are not limited to: interlocking management or ownership, identity of interests among family members, shared facilities and equipment, common use of employees, or a business entity organized following the disqualification, suspension or debarment of a person which has the same or similar management, ownership, or principal employees as the disqualified, suspended, debarred, ineligible, or voluntarily excluded person.</p>   |
|  | Discussion | <p>There should not be multiple program definitions for the same term. The recommendation is to replace the current SRA definition with the one from the General Administrative Regulations; Subpart R, Administrative Remedies for Non-Compliance.</p>   |
| <b>AIP Discretionary Review</b>              | Definition | <p>“<b>AIP Discretionary Review</b>” means a review conducted on an eligible crop insurance contract at the sole discretion of an Approved Insurance Provider (AIP).</p>  |
|  | Procedure  | <p>These reviews may consist of either an APH Review, a Conflict of Interest Review, a Field Inspection, a File Review, a Growing Season Inspection, or a Pre-Harvest Inspection as determined by the AIP.</p>  |
| <b>Area or Group Based Plan of Insurance</b> | Definition | <p>“<b>Area or Group Based Plan of Insurance</b>” means those plans of insurance that do not require a production history data base or verification of an insured’s actual production, inventory or revenue and includes Plans 12, 13,14, and 73, and 84.</p>   |

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| <b>Area or Group Based Plan of Insurance (cont.)</b> | Discussion | Policy types or plans need to be defined for Appendix IV purposes so that it is very clear as to which is applicable under the various reviews or inspections. There may be a better means but for the sake of clarity and space, specific current plan codes that fit the criteria have been identified for now in lieu of listing all of the applicable individual policies. There may be changes due to the pending GRP/GRIP CCIP Policy.   |
| <b>Claim for Indemnity</b>                           | Definition | <b>Claim for Indemnity</b> – A claim made on our form by you for damage or loss to an insured crop and submitted to us not later than 60 days after the end of the insurance period.   |
|  | Discussion | There should not be multiple program definitions for the same term. The recommendation is to replace the current SRA definition for “claim” with the definition of “claim for indemnity” from the Common Crop Insurance Policy. With clarifying language for the specific review categories being recommended plus by adding a definition for “claim type,” the current confusion over what constitutes a “claim” should be eliminated.  |
| <b>Claim Type</b>                                    | Definition | <p>“<b>Claim Type</b>” refers to claim(s) for indemnity aggregated on a county crop contract basis for a crop year and distinguished separately by whether the request for indemnification or payment was due to coverage under an Area or Group Based Plan of Insurance, or coverage under a Non-Yield Based Plan of Insurance. For coverage under a Yield Based Plan of Insurance, Claim Type is distinguished separately by whether the request for indemnification or payment was due to either:</p> <ul style="list-style-type: none"> <li>• prevented planting, or</li> <li>• loss of production and/or revenue.</li> </ul> <p>Replant payments are excluded from all claim types.</p>   |
|  | Discussion | Currently, prevented planting and production losses are cumulative and revenue losses are separate for the purpose of identifying high dollar claims for review for crops insured under Plan Codes of 25, 44, 42, and 45 of the Yield Based Plans of Insurance (CRC, RA, IP and IIP). However, there is still confusion on how to distinguish the revenue portion. The recommendation is to instead address prevented planting payments separately for all plans to allow for contemporaneous reviews but then go cumulative on production and revenue dollar amounts for crops insured under Plan Codes of 25, 44, 42, and 45 of the Yield Based Plans of Insurance (CRC, RA, IP and IIP or terminology as may be appropriate under the CCIP Policy). |
| <b>Conflict Of Interest</b>                          | Definition | <b><i>[Additional discussion is needed. Concern still exists over the complexity of the current process.]</i></b>  |

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| <b>Conflict Of Interest Review</b> | Definition | <b>“Conflict Of Interest Review”</b> means a review that may be either mandatory or AIP Discretionary as determined by the procedures (currently, MGR-08-001) and is conducted on a payable Claim for Indemnity.  |
|                                    | Procedure  | A mandatory Conflict of Interest review will consist of a File Review for Area or Group Plans of insurance and a Field Inspection, File Review and as applicable, an APH Review for Yield Based or Non-Yield Based Plans of Insurance. AIP Discretionary (elective) Conflict of Interest review or inspection types are determined by the AIP. Replant payments are excluded.   |
| <b>Data Mining</b>                 | Definition | <b>“Data Mining”</b> means working in partnership with the Center for Agricultural Excellence (CAE) or successor interest, FCIC/RMA, and Approved Insurance Providers (AIPs) by incorporating the latest advances in database technology into a single, centralized “data warehouse” of all the crop insurance-related data in FCIC/RMA databases over time. Federal Investigators, or FCIC/RMA staff, or AIPs in cooperation with FCIC/RMA staff will use this centralized data warehouse to search, or “mine,” existing data records to compare policies and/or detect individual producers whose policies demonstrate atypical or anomalous patterns. Data mining will also be used to analyze and uncover larger national patterns that may indicate patterns of fraud, misrepresentation, waste, or abuse.   |
| <b>Error</b>                       | Definition | <b>“Error”</b> For the purpose of the reviews or field inspections conducted in accordance with Appendix IV and Type 57 Quality Control Reporting conducted in accordance with Appendix III, only discrepancies that exceed an allowable tolerance will constitute an Error.  |
|                                    | Procedure  | If a discrepancy is within an established tolerance, it will not be considered an error. All discrepancies that cause the monetary tolerance to be exceeded must be corrected for the crop year in which the error occurred. Monetary discrepancies within tolerance may be corrected at the discretion of the AIP. APH actual yield discrepancies exceeding tolerance must be corrected for the current crop year. APH actual yield discrepancies within tolerance may be corrected for the current crop year at the discretion of the AIP but are required for the following crop year. APH discrepancies exceeding tolerance for a prior year’s certified yields would only require correction for the prior year’s data calculations (including the premium and any indemnities) if the APH discrepancies also cause the monetary tolerance to be exceeded. |

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| <b>Error (cont.)</b>    | Discussion | <p>Concerning APH corrections, current crop year means the present crop year. Assume the present crop year is 2009. If a discrepancy is discovered (i.e. incorrect reported acres and/or production, etc.) when reviewing the prior year's certified actual yields, a discrepancy within tolerance may or may not be corrected at AIP discretion for the 2009 (current) crop year but must be corrected for the 2010 and subsequent crop years. However, a discrepancy exceeding the APH tolerance must be corrected for the 2009 and subsequent crop years.</p> <p>As another example, if a discrepancy is discovered (i.e. incorrect reported acres and/or production, etc.) when reviewing the actual yields certified in 2007, a discrepancy within tolerance may or may not be corrected at AIP discretion for the 2009 (current) crop year but must be corrected for the 2010 and subsequent crop years. However, a discrepancy exceeding the APH tolerance must be corrected for the 2009 and subsequent crop years. If the discrepancy would also cause the monetary tolerance to have been exceeded for a crop year (i.e. 2007 crop year net premium and indemnity), then all corrections must be made for that crop year forward.</p> |
| <b>Field Inspection</b> | Definition | <p><b>“Field Inspection”</b> means an onsite visit to the policyholder's farming operation.</p>   |
|                         | Procedure  | <p>When a Field Inspection is performed, necessary findings may be made and may include findings to determine eligibility, compliance with program terms and conditions, the correct premium and any indemnity, prevented planting or replant payment, whether agents and loss adjusters have complied with all applicable procedures and include, but are not limited to, reviews for preliminary and final loss adjustment, pre-harvest or growing season inspections, and pre-acceptance inspections, the verification of adequate records, a determination that the reported practice is being carried out in accordance with good farming practices, a determination of whether the crop has been replanted, or to evaluate agent or loss adjuster conduct or the circumstances of a loss.</p>   |
|                         | Discussion | <p>Current Appendix IV definition and procedure split apart. The procedure portion has been clarified slightly to provide greater flexibility.</p>  |
| <b>File Review</b>      | Definition | <p><b>“File review”</b> means a review of documents contained in a policyholder's file maintained by the Company or an affiliate.</p>   |

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| <b>File Review (cont.)</b>       | Procedure  | When a File Review is performed, appropriate documents will be reviewed to verify that the information to support that a claim's approval or denial is appropriate and accurate based on information required to be obtained under the applicable procedures and that supporting documents have been properly used in document completion.   |
|                                  | Discussion | Current Appendix IV definition and procedure split apart. The procedure portion has been clarified slightly to allow for review of documents specific to the plan of insurance being reviewed.   |
| <b>Fraud</b>                     | Definition | <b>"Fraud"</b> is the intentional, wrongful obtaining or attempt of obtaining either money or some other advantage or benefit from governmental programs. Fraud includes but is not limited to, theft, embezzlement, false statements, illegal commissions, kickbacks, conspiracies, and obtaining contracts through collusive arrangements. |
|                                  | Procedure  | <i>[Additional discussion is needed.]</i>  |
|                                  | Discussion | Fraud is currently undefined within the SRA. The recommended definition is identical to the one currently located in the 4-RM. Waste and abuse need to be defined, reported and addressed separately from fraud and misrepresentation. Fraud needs to be defined separately from misrepresentation.  |
| <b>Growing Season Inspection</b> | Definition | <b>"Growing Season Inspection"</b> means a visit to the policyholder's farming operation during the insured crop's growing season.   |
|                                  | Procedure  | When a Growing Season Inspection is performed, it will be for the purpose of making findings which may include but are not limited to whether good farming practices are being carried out on the insured crop.  |
| <b>High Dollar Claim</b>         | Definition | <b>"High Dollar Claim"</b> Means a payable Claim Type that is equal to or exceeds \$200,000 but is less than \$500,000.  |
|                                  | Discussion | Currently referred to as the "\$100,000" claims. The recommendation is to tie the trigger to the definition of "Claim Type" rather than "claim" and, in recognition of present day increased commodity prices, increase the threshold to \$200,000. A greater emphasis on anomaly identification should be used for lesser amounts.          |

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| <b>High Dollar Claim Review</b> | Procedure  | <p><b>“High Dollar Claim Review”</b> This review will consist of:</p> <ul style="list-style-type: none"> <li>• a File Review for an Area or Group Based Plan of Insurance, or</li> <li>• a Field Inspection and File Review for a Non-Yield Based Plan of Insurance including a review of the previous year’s certified revenue for plans 61 and 63 (AGR and AGR-Lite), or</li> <li>• a Field Inspection, File Review and APH Review for a Yield Based Plan of Insurance including a review of the previous year’s certified revenue for plan 47 (ARH). However, an APH review will not be required for crops insured under Plan Codes of 25, 44, 42, and 45 of the Yield Based Plans of Insurance where the sole cause of loss code is 01 (Decline of Price) and the production to count for the unit exceeds the Approved Yield.</li> </ul>  |
|                                 | Discussion | <p>Policy types or plans need to be defined for Appendix IV purposes so that it is very clear as to which is applicable under the various reviews or inspections. There may be a better means but for the sake of clarity and space, specific current plan codes that fit the criteria have been identified for now in lieu of listing all of the applicable individual policies. Plan codes listed above are for RA, CRC, IP and IIP and will likely change due to the CCIP Policy.</p>   |
| <b>Inspection</b>               | Discussion | <p>This term can be deleted. Recommendation is to instead clearly define the specific Appendix IV reviews, inspections and associated procedures.</p>  |
| <b>Large Claim</b>              | Definition | <p><b>“Large Claim”</b> Means a payable claim type that is equal to or exceeds \$500,000.</p>  |
| <b>Large Claim Review</b>       | Procedure  | <p><b>“Large Claim Review”</b> A Large Claim that FCIC/RMA has elected to participate in will not require any additional review to be conducted by the AIP. A Large Claim that FCIC/RMA has declined to participate in will require a Large Claim Review that will consist of:</p> <ul style="list-style-type: none"> <li>• a File Review for an Area or Group Based Plan of Insurance, or</li> <li>• a Field Inspection and File Review for a Non-Yield Based Plan of Insurance including a review of the previous year’s certified revenue for plans 61 and 63 (AGR and AGR-Lite), or</li> <li>• a Field Inspection, File Review and APH Review for a Yield Based Plan of Insurance including a review of the previous year’s certified revenue for plan 47 (ARH). However, an APH review will not be required for crops insured under Plan Codes of 25, 44, 42, and 45 of the Yield Based Plans of Insurance where the sole cause of loss code is 01 (Decline of Price) and the production to count for the unit exceeds the Approved Yield.</li> </ul> |

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| <p><b>Large Claim Review (cont.)</b></p> | <p>Discussion</p> | <p>Policy types or plans need to be defined for Appendix IV purposes so that it is very clear as to which is applicable under the various reviews or inspections. There may be a better means but for the sake of clarity and space, specific current plan codes that fit the criteria have been identified for now in lieu of listing all of the applicable individual policies. Plan codes listed above are for RA, CRC, IP and IIP and will likely change due to the CCIP Policy.</p>   |
| <p><b>Material</b></p>                   | <p>Definition</p> | <p>“<b>Material</b>” means an act or omission that, as determined by FCIC/RMA, would: 1) cause FCIC/RMA to assume a significant additional risk it would not otherwise have assumed but for the act or omission; 2) cause the amount paid by or to FCIC/RMA to significantly differ from the amount that would otherwise be paid or owed but for the act or omission; 3) likely preclude or make it substantially more difficult to carry out the requirements of the Agreement and procedures; or 4) create a program vulnerability that could cause a payment to be made that would be significantly different than would otherwise be made if the act or omission had not occurred.</p> |
|  | <p>Procedure</p>  | <p>For all purposes of SRA section IV.H., the following rebuttable presumptions shall apply in determining whether an error resulting in payment of an incorrect indemnity or charging an incorrect premium with respect to an individual crop insurance contract is significant:</p> <ul style="list-style-type: none"> <li>(a) an error of 15% or less is presumed not to be material; and</li> <li>(b) an error of 25% or greater is presumed to be material, but no error equal to or less than \$1,000.00 ever shall be deemed to be material regardless of the percentage of indemnity or premium which it may constitute.</li> </ul>  |
| <p><b>Misrepresentation</b></p>          | <p>Definition</p> | <p>“<b>Misrepresentation</b>” means knowingly misstating or omitting material facts that are relied upon by the person to whom the statement is made to obtain money, goods or benefits of another to which the accused is not entitled.</p>   |
|  | <p>Procedure</p>  | <p><b><i>[Additional discussion is needed.]</i></b></p>  |
|  | <p>Discussion</p> | <p>Misrepresentation is currently undefined within the SRA. Waste and abuse need to be defined, reported and addressed separately from fraud and misrepresentation. Fraud needs to be defined separately from misrepresentation.</p>   |

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| <b>Non-Yield Based Plan of Insurance</b> | Definition | “ <b>Non-Yield Based Plan of Insurance</b> ” means those plans of insurance that do not require a production history data base but may require verification of an insured’s current crop year actual production, inventory or revenue in order to determine any indemnity and includes Plans 40, 43, 46, 50, 51, 61, 63.   |
|  | Discussion | Policy types or plans need to be defined for Appendix IV purposes so that it is very clear as to which is applicable under the various reviews or inspections. There may be a better means but for the sake of clarity and space, specific current plan codes that fit the criteria have been identified for now in lieu of listing all of the applicable individual policies.   |
| <b>Pre-Harvest Inspection</b>            | Definition | “ <b>Pre-Harvest Inspection</b> ” means a visit to the policyholder’s farming operation prior to harvest of the insured crop.  |
|  | Procedure  | When a Pre-Harvest Inspection is performed, it will be for the purpose of conducting appraisals of the insured crop to determine yield potential prior harvest.  |
| <b>Program Error Rate</b>                | Definition | “ <b>Program Error Rate</b> ” is determined by FCIC/RMA as a result of their National Operation Reviews of Approved Insurance Providers and is based on a comparison of premium and indemnity before and after the review.   |
|  | Discussion | The program error rate should be based on the results of FCIC/RMA’s National Operation Reviews and not on information obtained from the Appendix III Type 57 record. The Appendix III Type 57 record should be used to report quality control activity.  |
| <b>Rebate</b>                            | Definition | “ <b>Rebate</b> ” means to pay, allow, give or offer to pay, allow or give, directly or indirectly, either as an inducement to procure insurance or after insurance has been procured, any benefit (including money, goods or services for which payment is usually made [except any service provided to fulfill an obligation of the Company under this Agreement]), discount, abatement, credit, or reduction of the premium named in the insurance policy and any other valuable consideration or inducement not specified in the policy. |
|  | Discussion | Recommended definition is from PM-08-029 SRA Amendment No. 1.  |

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| <b>Tolerance</b>    | Definition | <b>“Tolerance”</b> Means the degree of equitable relief granted for a discrepancy or inadvertent error.   |
|                     | Procedure  | <p>A monetary tolerance will be allowed for any amount equal to or less than \$1000 on a county crop contract basis for an individual crop year. The dollar amount used when determining whether the amount is within tolerance is the amount determined after netting any premium discrepancy against any payment discrepancy.</p> <p>An APH yield tolerance will be allowed for the actual yield within a database certified for an individual crop year. The APH yield tolerance amount will be dependent on the crop (i.e. 2%-5%).</p> <p><i>[Percent by crop needs additional discussion. Recommendation is to retain tolerance by crop similar to the current crop category listing under section 14 of the CIH. However, this listing needs to be updated.]</i></p>  |
|                     | Discussion | <p>Current CIH Section 14 lists Category D (dollar plan crops), E, F (E and F were the tobaccos now included as category B), and G (Nursery) crops as zero tolerance.</p> <p>The following Category "B" and "C" crops have a two (2) percent tolerance: Almonds, Apples, Blueberries, Processing Beans, Citrus (Arizona-California), Cranberries, Dry Beans (bush varieties for garden seed), Figs, Forage Production, Grapes, Macadamia Nuts, Millet, Onions, Peaches, Pears, Peas (except for Contract Seed Peas), Pecan Revenue, Plums, Potatoes (Northern and Southern), Prunes, Sugar Beets, Sugarcane, Stonefruit, Processing Sweet Corn, Table Grapes, Texas Citrus Fruit, Guaranteed Production and Quota Tobacco, Tomatoes (Processing and Fresh Market Guaranteed Production Plan) and Walnuts.</p> <p>The following Category B crops have a 5% tolerance: Barley, Canola/Rapeseed, Corn, Cotton, ELS Cotton, Flax, Grain Sorghum, Oats, Peanuts, Popcorn, Rice, Rye, Safflower, Soybeans, Sunflower Seed, and Wheat.</p> |
| <b>Verification</b> | Definition | <b>“Verification”</b> means the determination of whether information submitted is true and accurate through independent means in accordance with Appendix IV procedures. With respect to certifications, asking the provider of the information whether the information is true and accurate does not constitute verification. Information from independent third parties or independent documentation must be obtained.  |
|                     | Discussion | Appendix IV needs to be all inclusive as the sole source for quality control requirements and procedures. Current Appendix IV definition revised accordingly.   |

|                                      |            |  |
|--------------------------------------|------------|--|
| <b>Waste</b>                         | Definition | <b>“Waste”</b> means the occurrence of unnecessary or excessive costs as a result of inefficient or ineffective regulations, procedures, systems, or controls.   |
|                                      | Procedure  | <b><i>[Additional discussion is needed.]</i></b>   |
|                                      | Discussion | Waste is currently undefined within the SRA. The recommended definition is similar to the one currently located in the 4-RM. Waste and abuse need to be defined, reported and addressed separately from fraud and misrepresentation.   |
| <b>Yield Based Plan of Insurance</b> | Definition | <b>“Yield Based Plan of Insurance”</b> means those plans of insurance that require an actual production history data base and includes Plans 10, 25, 41, 42, 44, 45, 47, 55, 84, 86, 90, 92, and 96.   |
|                                      | Discussion | Policy types or plans need to be defined for Appendix IV purposes so that it is very clear as to which is applicable under the various reviews or inspections. There may be a better means but for the sake of clarity and space, specific current plan codes that fit the criteria have been identified in lieu of listing all of the individual policies. Plan codes listed above for RA, CRC, IP and IIP and will likely change due to the CCIP Policy. |

| <b>SRA Working Group Membership</b>   |                   |                      |                     |
|---------------------------------------|-------------------|----------------------|---------------------|
| <b>Working Group</b>                  | <b>Name</b>       | <b>Company</b>       |                     |
| <b>Risk Sharing and A/O workgroup</b> | Laura Arnold      | AgriServe            |                     |
|                                       | Gene Grimsley     | AgroNational         |                     |
|                                       | David Graves      | AACI                 |                     |
|                                       | Jim Aldeman       | AFBIS                |                     |
|                                       | Sam Scheef        | ARMtech              |                     |
|                                       | Mike Torrey       | CIRB                 |                     |
|                                       | Bill Nissen       | COUNTRY Mutual       |                     |
|                                       | Rod Clark         | Diversified Crop     |                     |
|                                       | Steve Rutledge    | Farmers Mutual Hail  |                     |
|                                       | Mike Kelley       | Great American       |                     |
|                                       | Mark Hagen        | Guy Carpenter        |                     |
|                                       | Wade Shuler       | Heartland            |                     |
|                                       | Steve Ginie       | Hudson Ins.          |                     |
|                                       | Bill Fischer      | James River Ins.     |                     |
|                                       | Mark Raymie       | John Deere           |                     |
|                                       | <i>Vice Chair</i> | Jim Korin            | NAU Country         |
|                                       | <i>Chairman</i>   | Mike Connealy        | ProAg               |
|                                       |                   | Stephen Frerichs     | Rain & Hail         |
|                                       |                   | Kevin Berg           | RCIS                |
|                                       |                   | Joe Kaiser           | Western Ag/Crop 1   |
| <b>Appendix III Data Collection</b>   | Sam Bright        | AgriServe            |                     |
|                                       | Tim Green         | AFBIS                |                     |
|                                       | <i>Vice Chair</i> | Jay Rushing          | ARMtech             |
|                                       |                   | Lindsey Rinkenberger | COUNTRY Mutual      |
|                                       |                   | Barb Whalen          | Diversified Crop    |
|                                       |                   | Larry Casey          | Farmers Mutual Hail |
|                                       |                   | Laura Young          | Great American      |
|                                       |                   | Craig Hoover         | Hudson Ins.         |
|                                       |                   | Brian Donoho         | John Deere          |
|                                       |                   | Rollin Grefsrud      | NAU Country         |
|                                       |                   | Robert Gideon        | ProAg               |
|                                       |                   | Randy Thomas         | Rain & Hail         |
|                                       | <i>Chairman</i>   | Jim Nelson           | RCIS                |

| <b>SRA Working Group Membership</b>           |                                    |                      |
|---|------------------------------------|----------------------|
| <b>Working Group</b>                          | <b>Working Group</b>               | <b>Working Group</b> |
| <b>Appendix IV Compliance/Quality Control</b> | Geoff Redman                       | AgriServe            |
|   | Mary Sellers                       | AgroNational         |
|   | Don Nelson                         | AFBIS                |
|   | Ware Brown                         | ARMtech              |
|   | Kurt Henke                         | CIRB                 |
|   | Roger Ninness                      | COUNTRY Mutual       |
|   | Linda Williams                     | Diversified Crop     |
|   | <i>Vice Chair</i> Cindi Anderson   | Farmers Mutual Hail  |
|   | Chris Fisher                       | Great American       |
|   | Trent Nauholz                      | Heartland            |
|   | Jennifer Umscheid                  | Hudson Ins.          |
|   | Cheryl Critelli                    | John Deere           |
|   | Mark Mossman                       | NAU Country          |
|   | Bob Dow                            | ProAg                |
| <i>Chairman</i> Bob Haney                     | Rain & Hail                        |                      |
|   | Teri Steppel                       | RCIS                 |
| <b>Training &amp; Education requirements</b>  | Kevin Knapple                      | AgriServe            |
|   | <i>Chairman</i> Richard Stinson    | AFBIS/Nodak          |
|   | Christie Bracey                    | ARMtech              |
|   | Bob Dewey                          | COUNTRY Mutual       |
|   | Bryant Tjeerdsma                   | Farmers Mutual Hail  |
|   | Bob Twomey                         | Great American       |
|   | Travis Gellatly                    | Heartland            |
|   | <i>Vice Chair</i> Garneda Petersen | Hudson Ins.          |
|   | John Sheeley                       | John Deere           |
|   | Elliot Konschak                    | NAU Country          |
|   | Missy Waters                       | ProAg                |
|   | Scott Arnold                       | Rain & Hail          |
|   | Lisa Haag                          | RCIS                 |
|   |                                    |                      |
| <b>Plan of Operations</b>                     | David Johnson                      | AgriServe            |
|   | <i>Vice Chairman</i> Tom Watson    | AgroNational         |
|   | John Bednarik                      | AFBIS                |
|   | Mike Jones                         | ARMtech              |
|   | Bill Nissen                        | COUNTRY Mutual       |
|   | Russell Slade                      | Diversified Crop     |
|   | Darin Roggenburg                   | Farmers Mutual Hail  |
|   | <i>Chairman</i> Dennis Strickland  | Great American       |
|   | Jim Eastburn                       | Heartland            |
|   | Kent Petersen                      | Hudson Ins.          |
|   | Annette Roth                       | John Deere           |
|   | Kendall Jones                      | ProAg                |
|   | Tom Witthoft                       | Rain & Hail          |
|   | Marlene Merten                     | RCIS                 |