FEDERAL CROP INSURANCE PROGRAM

PROFITABILITY AND EFFECTIVENESS ANALYSIS

2008 UPDATE

Prepared on behalf of National Crop Insurance Services, Inc.

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INTRODUCTION

Grant Thornton LLP was engaged by National Crop Insurance Services, Inc. ("NCIS") to update the "Federal Crop Insurance Program Profitability and Effectiveness Analysis 2007 Update" with 2007 results.[1] The analysis benchmarks the Multi-Peril Crop Insurance ("MPCI") program against the Property & Casualty ("P&C") insurance industry[2], as did previous studies prepared in 2004 by Deloitte & Touche LLP ("Deloitte") and in 1997 and 1999 by PricewaterhouseCoopers ("PwC").

The primary U.S. crop insurance program is a public-private partnership between the Federal government and private industry. The insurance format, known as MPCI, has been offered to U.S. farmers since the 1930s through the Federal government. Since 1981, the program has operated as a public-private partnership between members of NCIS, as direct insurers or their managing general agents, and the Federal Crop Insurance Corporation ("FCIC"), as their principal reinsurer. The basic terms of this relationship are set forth in a Standard Reinsurance Agreement ("SRA") signed by FCIC and each individual direct insurer. FCIC, a federal government agency, is managed by the Risk Management Agency ("RMA"), an agency within the U.S. Department of Agriculture ("USDA"). In crop year 2007, the MPCI program provided coverage on 272 million acres of eligible acreage of major U.S. crops, insured liability of $67.4 billion, generated total premiums of $6.6 billion (of which $3.8 billion were premium subsidies) and distributed $3.5 billion in indemnity payments.[3]

MPCI companies write a particular class of P&C insurance. Therefore, comparisons of the MPCI program to the P&C industry in the areas of profitability and expenses are informative. However, while the profitability profiles of the P&C insurance and MPCI program are similar, they have distinct differences as detailed in the following table.[4]

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1 This report was prepared for NCIS to be used by its members solely in evaluating aggregated, historical data. The report does not express a view with regard to the results for any individual member of NCIS. This update primarily addresses the MPCI and P&C information for 2007. However, previous years data was amended if more current information for any year was available from Best's Aggregates & Averages Property & Casualty ("Best's A&A") or RMA.

2 This report uses aggregate historical data on both the MPCI program and the P&C industry. MPCI data used in this report were taken from public sources (USDA/RMA) and from a survey by NCIS of its member companies. Data on the P&C industry were obtained from the industry publication Best's A&A. Data utilized from previous versions of Best's A&A have been updated with data from the 2008 edition where possible. Data were also obtained from the 2004 analysis prepared by Deloitte and from the 1997 and 1999 analyses prepared by PwC.

3 http://www3.rma.usda.gov/apps/sob/current_week/sobrpt2005-2008.pdf as of 10-20-2008.

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

	P&C Insurance	MPCI Program
Premium	Expense loaded – meaning administrative expenses are included in the premium charged.	Not expense loaded – expenses partially reimbursed to companies through A&O Reimbursements.
Premium Rates	Set by company, approved by State regulators. Rates will differ by company due to risk and administrative loads.	Set by RMA – the same rates apply to all companies.
Premium Payments	Upfront at time of sale. Held by company to generate investment income.	At harvest with companies turning over to RMA within 30 days. Minimal to no investment income. Credit risk to company of nonpayment by policyholders.
Underwriting	Ability to underwrite risks. Can choose whether or not to accept risks and to modify rates and coverage to amend participant risk profile.	No ability to underwrite risks. Must take all eligible participants regardless of risk profile.
Reinsurance	Private	Mixture of private and federal
Administrative Expenses	Set by company and approved by State regulators as part of the Premium rate.	Set by statute and RMA[5] – A&O Reimbursements may or may not cover actual expenses incurred.

Therefore, a comparison of the P&C industry to the MPCI program is only valid as long as the major differences in the two lines are recognized, understood, and adjusted for appropriately. Our analysis takes the appropriate adjustments into consideration to the extent possible from the information sources utilized.

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

KEY FINDINGS

The key findings of our analysis can be summarized as follows:[6]

- **The MPCI program is not as profitable as the P&C industry and writing MPCI coverage entails greater risk.**
  - MPCI's ratio of Pretax Net Income as a percentage of Adjusted Retained Premium averaged 14.7% for the period 1992-2007. P&C's ratio of Pretax Net Income as a percentage of Adjusted Net Earned Premium averaged 18.6%. Furthermore, the volatility of MPCI's historical earnings was 12.7% compared to only 9.9% for the P&C industry. Therefore, in general, the MPCI industry is less profitable than the P&C industry, and its return more variable, indicating that the returns are riskier. (Please refer to the Profitability Analysis section of this report).
- **MPCI Expense-Premium ratios are significantly below those of the P&C industry.**
  - MPCI's average ratio of Total Expenses was only 28.1% of Gross Premiums for the period 1992-2007, compared to P&C's ratio of 60.2% of Adjusted Direct Premiums Written for the period 1992-2007. (Please refer to the Effectiveness Analysis section of this report.)
- **Under the current SRA, A&O Reimbursements continue to be below actual MPCI expenses incurred by private insurers.**
  - For 2006, MPCI companies incurred Total Expenses equal to 24.6% of Gross Premiums while the A&O Reimbursements only totaled 20.3% of Gross Premiums, resulting in an approximate 4.3% ($201.2 million) shortfall.
  - For 2007, MPCI companies incurred Total Expenses equal to 23.9% of Gross Premiums while A&O Reimbursements only totaled 20.4% of Gross Premiums, resulting in an approximate 3.6% ($233.5 million) shortfall.

These general findings are consistent with the findings of the 1997 and 1999 PwC reports, the 2004 Deloitte report and the 2007 Grant Thornton update. All studies consistently show that the MPCI program compares unfavorably to the P&C industry in the area of profitability and compares favorably to the P&C industry in the area of expense management. The remainder of this report provides a detailed discussion of the analysis supporting each of these key findings.

6 Profitability ratios for the MPCI program for the 2007 and 2008 Updates include an adjustment to retained premium for Quota Share for the years 2005-2007.

PROFITABILITY ANALYSIS

Profitability is measured as a function of Pretax Net Income for both the P&C industry and the MPCI program. For the P&C industry, we measured Pretax Net Income as the sum of Net Underwriting Income(Loss), Net Investment Income and Realized Capital Gain(Loss). For the MPCI program, we measured Pretax Net Income as the sum of Net Underwriting Gain(Loss) and Net Expense Gain(Loss). Underwriting Gains are defined in the SRA as "the amount by which the Company's share of retained net book premium exceeds its retained ultimate net losses".[7] However, Underwriting Gains do not represent pure profit to the MPCI companies. As stated by RMA Administrator Eldon Gould, *"It would be a mistake to consider them [Underwriting Gains(Losses)] pure profit or absolute loss for the reinsured companies. Underwriting Gains serve a number of functions – they cover partial delivery expenses for some companies, they are used to build reserves to meet the required policyholder surplus and they provide a return on equity."*[8] Therefore, the Net Expense Gain(Loss) must be included in the calculation of MPCI Pretax Net Income to arrive at a profitability measure.

Furthermore, the function that Underwriting Gains serve in building required policyholder surplus in the MPCI program is substantial. As part of RMA's financial integrity requirements, the insurance companies must maintain, at a minimum, adequate policyholder surplus to pay losses resulting from two consecutive years of a 500 percent loss ratio (losses equal to 500% of premiums).[9]

The policyholder surplus requirements are generally more stringent than those of state regulators for the P&C industry. As MPCI program premiums increase, the required policyholder surplus increases. The policyholder surplus requirement has implications for the amount of underwriting gains that would need to be retained in order to build the reserves to the required minimum level. It could also affect the amount of commercial reinsurance that MPCI insurers would need to purchase to maintain the required capitalization standard. In either case, this would reduce the available income that would otherwise be paid out to shareholders and reduce the financial incentive for new participants to enter the program. As Mr. Gould testified in June 2007, "*To put this requirement in perspective, the highest loss ratio the program has experienced was 2.39(239%) in 1988. The recent underwriting gains provide the surplus needed to cushion and plan for catastrophic weather events and years like 1988 and 1993. This is important as the companies today retain risk on almost 80 percent of the premiums written, with much of the retained premium in the riskiest Commercial Fund."*[10]

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

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

9 Ibid.

10 Ibid.

Exhibit 1 provides the data required to calculate Pretax Net Income for the MPCI program while **Exhibit 2** provides data required to calculate Pretax Net Income for the P&C industry. **Exhibit 3** compares the MPCI and P&C Pretax Net Income figures.

In addition to the comparison of MPCI and P&C Pretax Net Income, we also analyzed MPCI and P&C returns and the risk associated with those returns in the form of their standard deviation.[11] To measure returns for the MPCI program, we divided Pretax Net Income by Retained Premiums.[12] To measure P&C returns, we divided Pretax Net Income by Net Earned Premiums[13] minus Total Expenses ("Adj. NEP"). Premium data for MPCI and P&C lines do not have the same base. P&C premiums are expense loaded, while MPCI premiums are not. Expenses for MPCI policies are intended to be reimbursed through the A&O Reimbursement. The removal of the expense loading from the P&C premiums ensures that comparisons of P&C and MPCI returns are developed on consistent bases, with denominators of each ratio representing the expected indemnities under each program.

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

Exhibits 1 and 2 provide weighted average returns and the standard deviation of those returns for the MPCI program and the P&C industry, respectively. The MPCI program has a lower average return of 14.7% compared to 18.6% for the P&C industry. Further, risk as measured by the standard deviation is greater for the MPCI program (12.7% versus 9.9% for the P&C industry). Financial theory tells us that in general, investors will require higher expected returns when risks are greater. Therefore, when allocating their capital between the investment alternatives of the MPCI business or the P&C industry, a rational investor would be expected to choose to invest in the P&C industry, as over the long-term it has provided greater profits or returns with less variability or risk than the MPCI program.

The greater risk of the MPCI program is inherent in its structure. As previously detailed, the P&C industry has greater control over its ratemaking and underwriting activities.[14] Insurers can respond to underwriting losses by increasing their rates in subsequent years and/or

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11 Standard deviation is a standard statistical measure of spread in a distribution of values. It is computed by taking the square root of the expected value of the square of the difference between actual returns and expected returns.

12 2005, 2006 and 2007 adjusted for Quota Share.

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

14 Please refer to chart on page 2.

limiting coverage. In comparison, MPCI companies must adhere to ratemaking decisions of and policy provisions established by FCIC/RMA, regardless of underwriting loss experience.

Our overall findings are consistent with the general findings of the previous Deloitte and PwC reports and the 2007 Grant Thornton Update. Historically, the MPCI industry has had no overall economic advantage over the P&C industry. The results of the current and previous studies are presented below. Please note that the Grant Thornton, Deloitte, and PwC results are not directly comparable due to differences in methodologies used and the time periods covered. The focus is on the overall results of the various studies.

Profitability		P&C Industry			MPCI Industry		
Report	Period	Metric	Wtd. Avg.	Std. Dev.	Metric	Wtd. Avg.	Std. Dev
Grant Thornton 2008 Update	1992-2007	Pretax Net Income/Adj. NEP	18.6%	9.9%	Pretax Net Income/ Retained Premium[15]	14.7%	12.7%
Grant Thornton 2007 Update	1992-2006	Pretax Net Income/Adj. NEP[16]	17.4%	9.5%	Pretax Net Income/ Retained Premium[17]	12.5%	12.4%
Deloitte 2004	1992-2002	Pretax Net Income/Adj. DEP	12.7%	8.9%	Pretax Net Income/ Retained Premium	7.9%	12.9%
PwC 1999	1988-1997/8	Pretax Net Income/Surplus	16.6%	7.6%	Pretax Net Income/ Surplus[18]	15.8%	10.1%
PwC 1997	1988-1995	Pretax Net Income/Surplus	14.1%	7.3%	Pretax Net Income/ Surplus	11.7%	10.4%

As detailed in the above table, for each time period, the P&C industry has reported more profitability, with less variability in results. In general, this indicates that the participants in

15 2005, 2006 and 2007 MPCI adjusted for Quota Share.

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

17 2005 and 2006 MPCI adjusted for Quota Share.

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

the overall P&C industry have the ability to generate greater returns with less risk, and therefore hold an advantage over the MPCI program.

EFFECTIVENESS ANALYSIS

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

We have defined the MPCI Expense ratio as Total Expenses divided by Gross Premiums while the P&C Expense ratio is defined as Total Expenses divided by Direct Premiums Written net of Expenses ("Adjusted DPW").[19] As previously stated, expenses are removed from P&C premiums to put those premiums on a consistent base with MPCI premiums, which are not expense loaded. Total Expenses include Loss Adjustment Expense, Commissions and Other Expenses incurred while selling and servicing business.[20] Total premiums for a line of business such as MPCI or P&C will be impacted by the price of each policy –- which is established by RMA for MPCI policies on an annual basis –- and the number and type of policies sold.

Exhibit 4 shows the Total Expense to Gross Premium ratio for the MPCI program has declined significantly over time. Since 1993, MPCI Total Expense ratios have never been above 34.2%, and since 1998, they have not exceeded 29.5%. **Exhibit 4** also shows that the Total Expense ratio for the MPCI program is well below the Total Expense ratio observed for the P&C industry. The major categories of expense used in our analysis are Commissions, Loss Adjustment Expense, and Other Expenses, which include salaries of company employees, IT support and overhead expenses. **Exhibit 5** provides a breakdown of the components of the Total Expense ratio; the three additional ratios presented are Loss Adjustment Expense/Premium, Commission/Premium and Other Expense/Premium. Overall, the MPCI program has lower expense ratios in all three categories.

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

20 Commission expense is the part of an insurance premium paid by the insurer to an agent or broker for his services in procuring and servicing insurance. Loss adjustment expenses are expenses incurred to investigate and compute losses.

The decline in MPCI Expense-Premium ratios presented in **Exhibits 4 and 5** is consistent with improved cost effectiveness of the industry as program participation has grown.[21] This decline has occurred even under stringent governmental requirements for insurers to provide service to all eligible producers regardless of the cost. Because of this requirement, private companies are precluded from taking many actions that other types of insurers use to contain costs and enhance economic viability. As a result, MPCI companies are required to offer coverage to growers with poor insurance experience, small acreage or other characteristics that may make them impossible or difficult to serve profitably. While this requirement may significantly increase overall program costs, it does support the social goal of making crop insurance available to all eligible farmers.

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

A&O REIMBURSEMENT SHORTFALL

As shown in **Exhibit 1**, column (1), the available data on MPCI companies' Net Expense Gain(Loss) from the listed sources indicate that the amount of the MPCI expenses has exceeded A&O Reimbursements every year since 1997. Renegotiations of the SRA and the passage of the Agricultural Research, Extension and Education Reform Act of 1998 have significantly reduced A&O Reimbursements over time. Since 1998, the A&O Reimbursements have fallen short of MPCI incurred expenses by more than $100 million annually. In 2002, 2006 and 2007 the unreimbursed amounts exceeded $200 million. **Exhibit 7** compares the historical level of expenses incurred in delivering crop insurance by the MPCI companies to the historical level of A&O Reimbursements. It indicates that although the MPCI companies have reduced expenses over time through efficiencies, the A&O Reimbursements have regularly fallen short of covering the expenses incurred. The inadequacy of the A&O Reimbursements is absorbed by the MPCI companies through a reduction in their profits.

CONSIDERATION OF COMMENTS ON 2007 UPDATE

Following the completion of the Grant Thornton 2007 Update, representatives from NCIS and Grant Thornton met with interested parties to solicit their comments. The comments

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21 Program participation rates (defined as the ratio of net insured acres to total eligible acres) have increased dramatically in the past two decades. In 1980, the participation rate was less than 10%. By 1990, participation rates had increased to around 40%, where they hovered in the early 1990s. In 1995, participation rates jumped to over 80%. The jump in participation rates from 1994 to 1995 is coincident with the Federal Crop Insurance Reform Act of 1994, which made enrollment in the crop insurance program a precondition for participating in many of USDA's benefit support programs. Though participation rates decreased after 1995, they were above 80% in 2001 and 2002.

are noted and discussed in **Exhibit 8.** In general, although some comments raised appropriate issues for consideration, the net effect of all comments does not change the fundamental findings in the Grant Thornton 2007 Update or this report – crop insurance is less profitable than and, at the same time, riskier than the P&C industry.

EFFECT OF THE 2008 FARM BILL

The recently passed Food, Conservation, and Energy Act of 2008 ("2008 Farm Bill") further diminishes the profitability of MPCI companies by reducing the amount of A&O Reimbursement and delaying payment by FCIC of both A&O Reimbursement and Underwriting Gains as noted below:

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

- Reduces the maximum rate of reimbursement for "expenses incurred by the approved insurance provider or agent for loss adjustment" from 7.0%[22] to 6.0% of "the premium for catastrophic risk protection that is used to define loss ratio."

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

- Effective beginning with the 2012 reinsurance year, delays the reimbursement of allowable A&O costs to October of the following reinsurance year. Reimbursements covering the 2012 reinsurance year ending June 30, 2012 will not be paid until October 2012.
- Effective beginning with the 2009 reinsurance year starting July 1, 2008, reduces the rate of reimbursement of allowable A&O costs (currently 24.2%) by 2.3 percentage points. Only half of the reduction will apply "to the total premium written in a State in which the State loss ratio is greater than 1.2." If this reduction is applied retroactively to actual results for reinsurance years 2005 through 2007, the result is as follows:

Year	Original Shortfall (000,000)	Reduction in A&O Reimbursements (000,000)	Revised Shortfall (000,000)
2005	$160.9	$87.0	$248.0
2006	$201.2	$95.7	$296.9
2007	$233.5	$145.6	$379.1

22 The 2008 Farm bill states the reduction is from 8% to 6%; however, the current SRA indicates that the current reimbursement rate is 7%.

- Effective beginning with the 2009 reinsurance year, reduces the reimbursement rate for area policies and plans of insurance to 12.0% of the gross (net book) premium.

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

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

SUMMARY AND CONCLUSIONS

This report analyzes the profitability and effectiveness of the MPCI program. Specifically, it presents Pretax Net Income, risk and return profiles for the MPCI and P&C industries. It also compares expense ratios for these two lines of business and examines historical subsidies for A&O Reimbursements and their shortfall to actual expenses incurred by the MPCI companies.

The results of this analysis continue to indicate that the MPCI program does not possess risk-return advantages relative to the P&C industry. The P&C industry has had an annual net loss in only one year in its history, 2001 (largely due to the extraordinary losses related to September 11). In contrast, the MPCI program as a whole lost money in two years between 1992 and 2007 alone (1993 and 2002). MPCI expense ratios continue to be substantially below those of the P&C industry, and total A&O Reimbursements have fallen short of MPCI companies' total expenses for all years since 1997. The results of this analysis may be updated and augmented as additional data and information become available.

Exhibit 1

Profitability of the MPCI Program
(in millions)

Calendar Year	Net Expense Gain/(Loss) [a]	Net Underwriting Gain/(Loss) [b]	Pretax Net Income	Pretax Net Income after Quota Share	Retained Premium [c]	Retained Premium Adjusted for Quota Share	Pretax Net Income after Quota Share / Retained Premium	Pretax Net Income after Quota Share / Adjusted Retained Premium
Formula	(1)	(2)	(3) = (1) + (2)	(4)	(5)	(6)	(4)/(5)	(4)/(6)
1992	$ 5.4	$ 21.8	$ 27.2	$ 27.2	$ 465.6	$ 465.6	5.8%	5.8%
1993	2.6	(83.3)	(80.7)	(80.7)	434.5	434.5	-18.6%	-18.6%
1994	(4.1)	103.3	99.2	99.2	534.5	534.5	18.6%	18.6%
1995	20.3	131.7	152.1	152.1	768.5	768.5	19.8%	19.8%
1996	1.3	247.5	248.8	248.8	1,155.1	1,155.1	21.5%	21.5%
1997	(60.5)	352.1	291.6	291.6	1,263.1	1,263.1	23.1%	23.1%
1998	(109.7)	279.2	169.6	169.6	1,591.7	1,591.7	10.7%	10.7%
1999	(113.5)	271.8	158.2	158.2	1,836.9	1,836.9	8.6%	8.6%
2000	(140.1)	281.8	141.8	141.8	1,894.2	1,894.2	7.5%	7.5%
2001	(179.9)	345.9	166.0	166.0	2,373.0	2,373.0	7.0%	7.0%
2002	(200.3)	(47.4)	(247.7)	(247.7)	2,295.0	2,295.0	-10.8%	-10.8%
2003	(164.8)	378.4	213.6	213.6	2,607.1	2,607.1	8.2%	8.2%
2004	(134.0)	692.0	558.0	558.0	3,145.2	3,145.2	17.7%	17.7%
2005	(160.9)	964.6	803.6	755.4	3,045.1	2,892.9	24.8%	26.1%
2006	(201.2)	886.7	685.5	641.2	3,686.2	3,501.9	17.4%	18.3%
2007	(233.5)	1,681.4	1,447.9	1,363.8	5,156.5	4,898.7	26.4%	27.8%
Totals	$ (1,672.9)	$ 6,507.4	$ 4,834.5	$ 4,658.0	$ 32,252.3	$ 31,657.9		
1992-2007	**Weighted Average**						14.4%	14.7%
	Standard Deviation						12.4%	12.7%

Sources:

[a] Expenses:
1992-1998: PwC 1999 Update Exhibit 4 and Deloitte 2004 Report Exhibit 5.1
1999-2007: Surveys of NCIS member companies

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

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

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

Exhibit 2

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

Calendar Year	Net Underwriting Gain/(Loss) [a]	Net Investment Income [a]	Realized Capital Gain/(Loss) [b]	Pretax Net Income	Net Earned Premium [c]	Total Expenses [d]	Adjusted Net Earned Premium	Pretax Net Income / NEP	Pretax Net Income / Adjusted NEP
Formula	(1)	(2)	(3)	(4) = (1)+(2)+(3)	(5)	(6)	(7) = (5) - (6)	(4) / (5)	(4) / (7)
1992	$ (36,260)	$ 33,734	$ 9,874	7,348	$ 225,778	$ 92,288	$ 133,490	3.3%	5.5%
1993	(18,094)	32,645	10,153	24,704	235,514	94,910	140,604	10.5%	17.6%
1994	(22,083)	33,687	1,620	13,224	244,230	98,557	145,673	5.4%	9.1%
1995	(17,375)	36,834	5,997	25,456	254,048	104,074	149,974	10.0%	17.0%
1996	(17,162)	37,962	9,249	30,049	266,552	106,147	160,405	11.3%	18.7%
1997	(6,030)	41,499	11,068	46,537	275,801	110,275	165,526	16.9%	28.1%
1998	(17,669)	41,097	17,506	40,934	280,335	115,450	164,885	14.6%	24.8%
1999	(24,750)	40,071	13,034	28,355	285,501	118,804	166,697	9.9%	17.0%
2000	(32,143)	42,650	16,484	26,991	298,233	121,790	176,443	9.1%	15.3%
2001	(52,692)	39,849	6,978	(5,865)	317,596	129,303	188,293	-1.8%	-3.1%
2002	(32,347)	41,099	2,824	11,576	358,551	142,043	216,508	3.2%	5.3%
2003	(5,230)	41,147	6,519	42,436	399,127	153,895	245,232	10.6%	17.3%
2004	1,692	41,776	9,191	52,659	423,578	162,798	260,780	12.4%	20.2%
2005	(5,574)	51,872	12,120	58,418	428,656	167,873	260,783	13.6%	22.4%
2006	34,303	54,814	3,584	92,701	442,605	171,604	271,001	20.9%	34.2%
2007	18,807	57,533	9,032	85,372	444,152	173,712	270,440	19.2%	31.6%
Totals	$ (232,607)	$ 668,269	$ 145,233	$ 580,895	$ 5,180,257	$ 2,063,524	$ 3,116,733		

1992-2007	**Weighted Average**	11.2%	18.6%
	Standard Deviation	6.0%	9.9%

Sources:

[a] 1992-2002: Best's Aggregates & Averages 2007, Industry Operating Results, p. 407, includes State Funds
2003-2007: Best's Aggregates & Averages 2008 (advance copy), Industry Operating Results, p. 407, includes State Funds

[b] 1992-1996: PriceWaterhouseCoopers 1999 Update, Exhibit 1 (used in Deloitte 2004 report Exhibit 2)
1997-2000: Best's Aggregates & Averages 2002, QAR p. 106
2001: Best's Aggregates & Averages 2006, QAR, p. 89
2002-2005: Best's Aggregates & Averages 2007, QAR, p. 91
2006-2007: Best's Aggregates & Averages 2008 (advance copy), QAR, p. 91

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

[d] 1992-1995: Deloitte 2004 Report, Exhibit 2
1996: calculated from ratios in Best's Aggregates & Averages 2006, Cumulative By Line Underwriting Experience - Industry, Net Premiums, p. 407

1997 & 2000-2001: calculated from ratios in Best's Aggregates & Averages 2007, Cumulative By Line Underwriting Experience - Industry, Net Premiums, p. 417
1998-1999 & 2002-2007: calculated from ratios in Best's Aggregates & Averages 2008 (advance copy), Cumulative By Line Underwriting Experience - Industry, Net Premiums, p. 417

Exhibit 3 Comparison of Pretax Net Income

Figure 1: MPCI Pretax Net Income 1992-2007

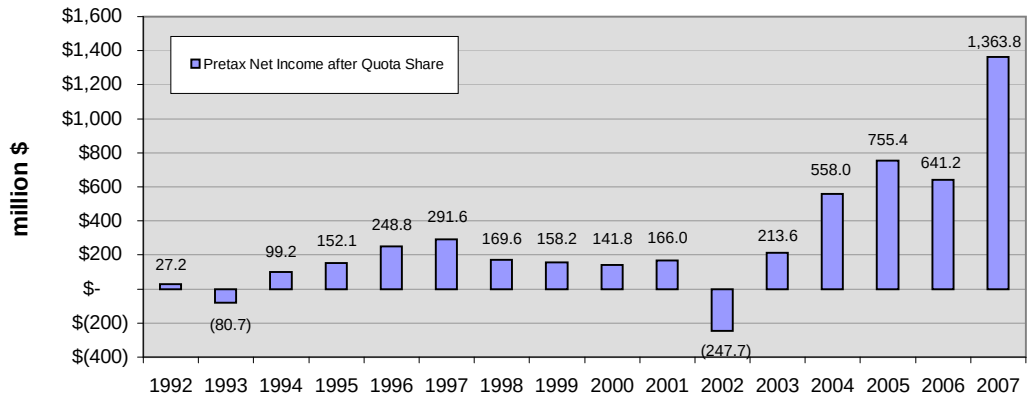
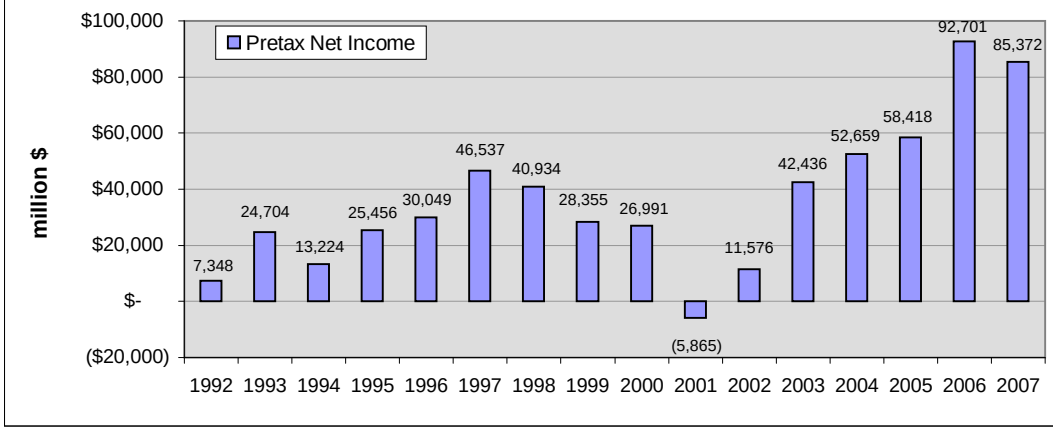


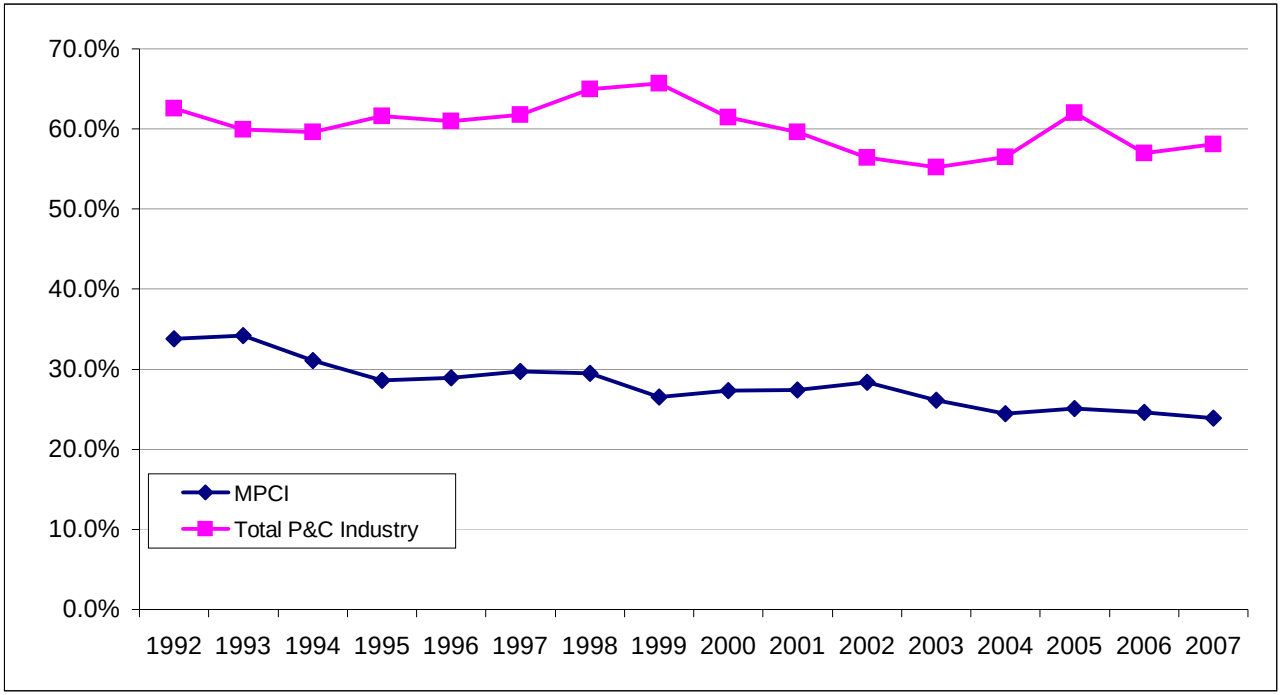
Figure 2: P&C Pretax Net Income 1992-2007



Sources: See Exhibits 1 and 2 for sources

Exhibit 4

Total Expense to Premium Ratio
MPCI vs. Property & Casualty



Sources:

MPCI 1992-1998: PwC 1999 Update Exhibit 4 and Deloitte 2004 Report Exhibit 5.1
1999-2007: Surveys of NCIS member companies, excluding disallowed expenses

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

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

5.1: MPCI

Year	Loss Adjustment Expense / Gross Premium	Commission / Gross Premium	Other Expense / Gross Premium	Total Expense / Gross Premium	A&O Reimbursement / Gross Premium	A&O Reimbursement Excess / (Shortfall)
1992	4.2%	16.0%	13.6%	33.8%	34.6%	0.8%
1993	5.4%	16.8%	12.0%	34.2%	34.6%	0.4%
1994	3.9%	17.0%	10.3%	31.1%	30.7%	-0.4%
1995	3.9%	14.9%	9.8%	28.6%	30.2%	1.6%
1996	3.6%	15.9%	9.4%	28.9%	29.0%	0.1%
1997	3.4%	15.6%	10.6%	29.7%	26.1%	-3.6%
1998	3.7%	16.6%	9.2%	29.5%	23.7%	-5.8%
1999	3.1%	15.5%	8.0%	26.6%	21.6%	-4.9%
2000	3.5%	15.9%	7.9%	27.3%	21.8%	-5.5%
2001	3.7%	15.7%	8.1%	27.4%	21.4%	-6.0%
2002	4.2%	15.8%	8.4%	28.4%	21.5%	-6.9%
2003	3.3%	15.9%	6.9%	26.2%	21.4%	-4.8%
2004	2.8%	15.6%	6.0%	24.4%	21.2%	-3.2%
2005	3.3%	15.2%	6.6%	25.1%	21.0%	-4.1%
2006	2.9%	15.6%	6.2%	24.6%	20.3%	-4.3%
2007	2.3%	17.0%	4.6%	23.9%	20.4%	-3.6%
Averages 1992-2007	3.6%	15.9%	8.6%	28.1%	25.0%	-3.1%

Sources:

Expenses:
1992-1998: PwC 1999 Update Exhibit 4 and Deloitte 2004 Report Exhibit 5.1
1999-2007: Surveys of NCIS member companies

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

5.2: Total P&C Industry

Year	Loss Adjustment Expense / Adjusted DPW [a]	Commission / Adjusted DPW [a]	Other Expense / Adjusted DPW [a]	Total Expense / Adjusted DPW [a]
1992	21.7%	18.1%	22.8%	62.6%
1993	20.0%	17.1%	22.7%	59.9%
1994	20.1%	17.3%	22.3%	59.6%
1995	20.8%	17.6%	23.1%	61.6%
1996	20.1%	18.2%	22.7%	60.9%
1997	19.5%	18.8%	23.5%	61.8%
1998	21.2%	19.1%	24.6%	64.9%
1999	20.9%	19.4%	25.3%	65.7%
2000	19.3%	18.6%	23.6%	61.5%
2001	19.7%	18.2%	21.7%	59.6%
2002	18.6%	17.4%	20.5%	56.4%
2003	18.0%	17.2%	20.0%	55.3%
2004	18.8%	17.8%	19.9%	56.5%
2005	22.8%	18.1%	21.1%	62.0%
2006	17.9%	17.7%	21.3%	56.9%
2007	17.6%	18.0%	22.4%	58.1%
Averages 1992-2007	19.8%	18.0%	22.3%	60.2%

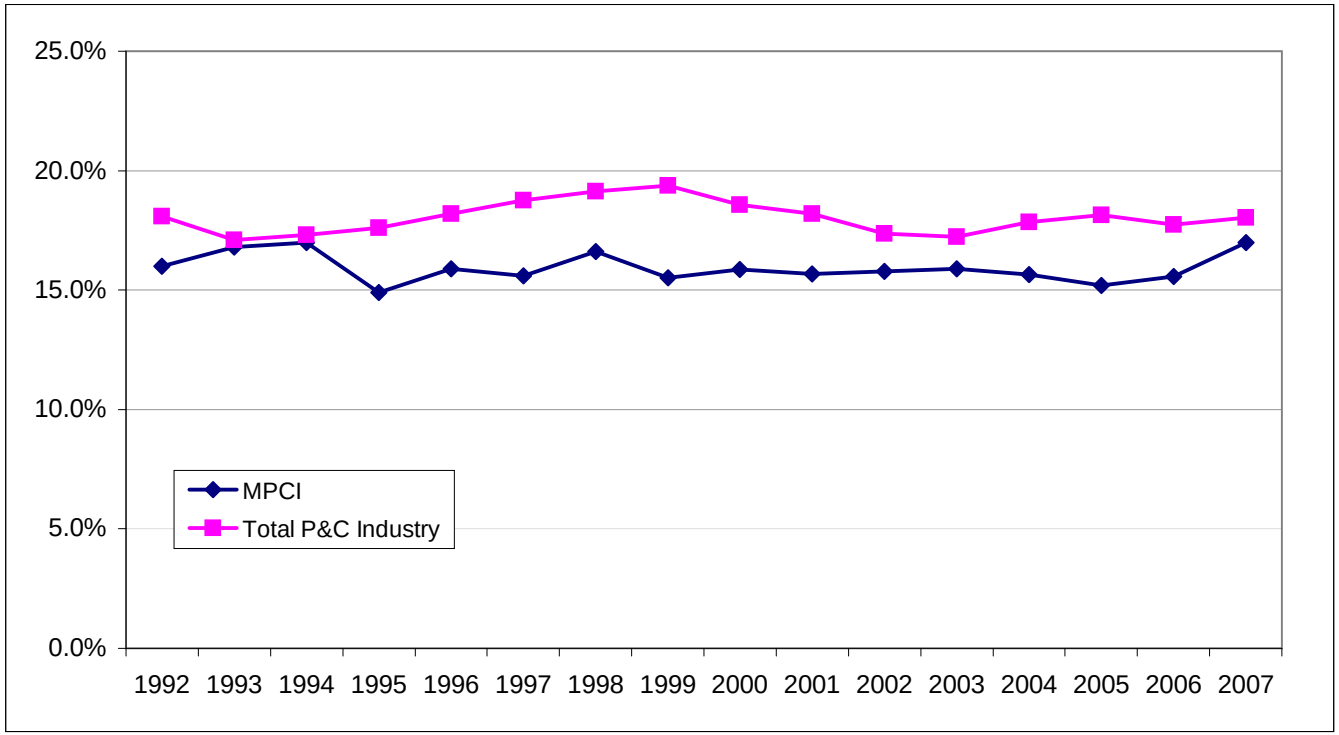
Sources:
1992-1995: PwC 1999 Update Exhibit 4 and Deloitte 2004 Report Exhibit 5.2
1996: A.M. Best's Aggregates & Averages 2006, expense ratios converted to adjusted Direct Premiums Written
1997 & 2000: A.M. Best's Aggregates & Averages 2007, expense ratios converted to adjusted Direct Premiums Written

1998-1999 & 2001-2007: A.M. Best's Aggregates & Averages 2008 (advance copy), expense ratios converted to adjusted Direct Premiums Written

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

Exhibit 6

Commission Expense to Premium Ratio
MPCI vs. Property & Casualty

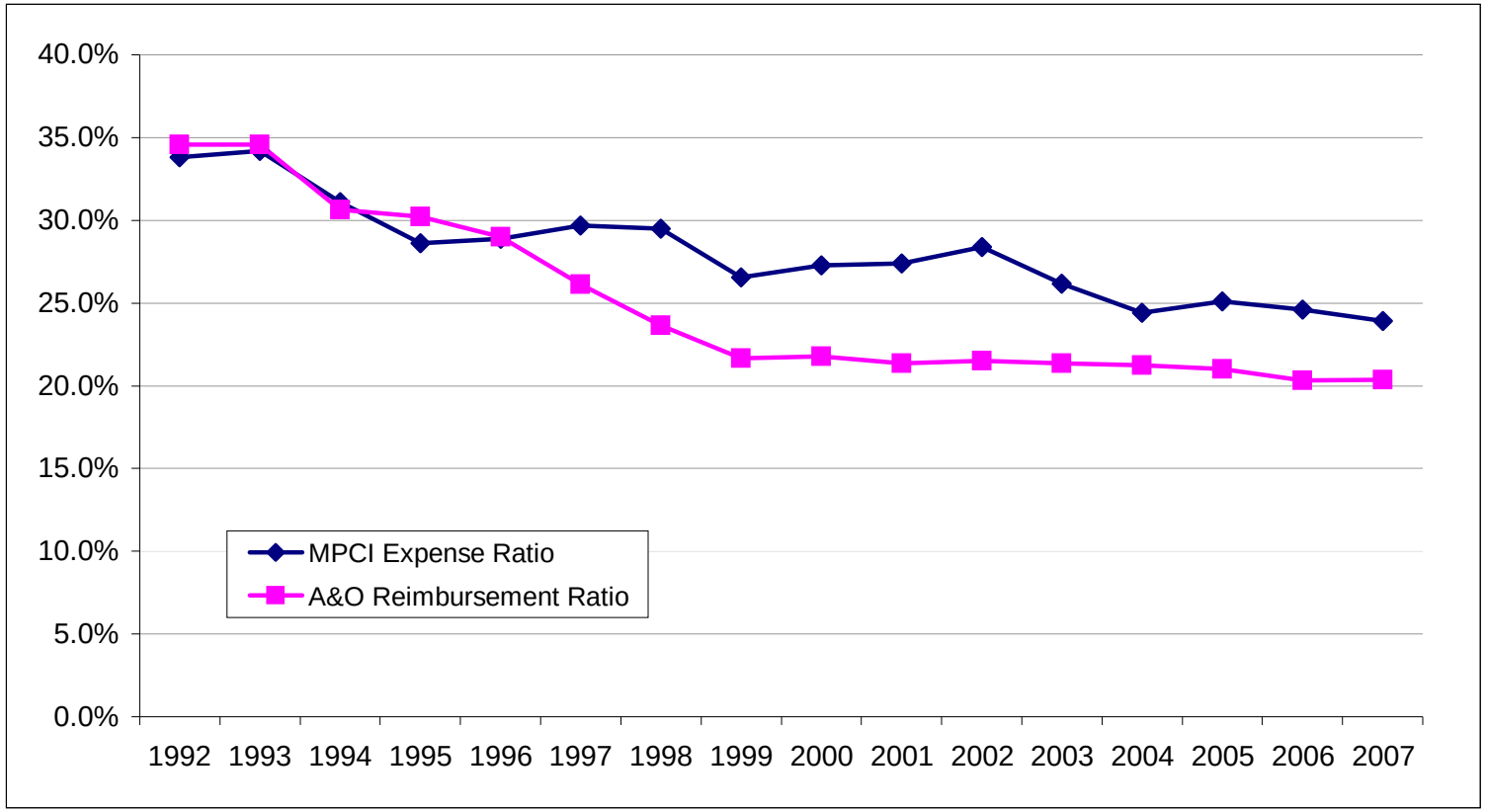


Sources:

MPCI 1992-1998: PwC 1999 Update Exhibit 4 and Deloitte 2004 Report Exhibit 5.1
1999-2007: Surveys of NCIS member companies

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

Exhibit 7 Comparison of A&O Reimbursement to Gross Premium with Ratio of Total Expense to Gross Premium



Sources: **Expenses:**

1992-1998: PwC 1999 Update Exhibit 4 and Deloitte 2004 Report Exhibit 5.1
1999-2007: Surveys of NCIS member companies, excluding disallowed expenses

A&O Reimbursement:

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

CONSIDERATION OF COMMENTS ON 2007 UPDATE

In response to the 2007 Update, interested parties raised various issues that they believed could be relevant in the analysis of the MPCI program and its comparison to the P&C industry. Although the MPCI companies do not necessarily agree that all issues raised are in fact relevant, the following discussion reflects their responses to those issues.

In general, the results described in the 2008 Update demonstrate that the MPCI industry is able to deliver the program to policyholders on a much more cost effective basis than the P&C industry. However, in conducting a more detailed analysis of the differences between the two industries, it should be noted that the MPCI and P&C industries have different sources of income and expense, different regulatory requirements and different pricing mechanisms. Their operations, while similar, are not identical. For instance, as noted previously, premiums charged by MPCI companies are determined by federal agencies, not by market forces, and MPCI companies cannot deny coverage on an individual applicant basis based on risk. The differences in operations prevent a pure and exacting comparison of the two industries using the publicly available sources of information relied upon for this analysis.

Costs for underwriting standards, rate setting and some marketing efforts are borne by RMA, not the MPCI industry

For P&C companies, the costs of developing rates and underwriting standards are borne by the companies, either using their own resources or by purchasing the data from statistical agencies such as ISO and NCCI (shown as Boards, Bureaus and Associations expense in A.M. Best). For the MPCI industry, RMA provides most of the underwriting standards and rate setting services, and conducts certain marketing efforts.

One measure of the value of the functions performed by RMA can be obtained based on the amount spent by the P&C industry in support of its statistical agencies and for advertising. For calendar year 2007, A.M. Best data indicate that Boards, Bureaus and Associations expense for the P&C industry was 0.26% of net premiums earned.[1] Furthermore, A.M. Best data for the same period indicates that advertising expenses represent 0.90% of net premiums earned.[2] These represent individual company expenses to maintain their competitive position whereas RMA marketing efforts are primarily for the purpose of disseminating information to producers. The cost of educating P&C policyholders on the benefits and availability of coverage would likely be considerably less than the 0.90%. Given this caveat, the value of the functions similar to those performed by RMA on behalf of the MPCI program should be considerably less than 1.2% of the net premiums of the P&C industry.

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1 2008 Best's Aggregates & Averages, Underwriting Expenses Incurred to Net Premiums Written, p. 676 translated into percent of net premiums earned based on Cumulative by Line Net Underwriting Experience – Industry.

2 Ibid.

From a financial statement perspective, deducting the Boards, Bureaus and Associations and advertising costs from the P&C industry expenses or adding RMA's budget to MPCI expenses to attempt to improve the comparability of the two industries would increase the amount by which the P&C industry's profitability exceeds that of the MPCI program, further supporting the findings of this analysis. For illustrative purposes, if we were to subtract the amount of RMA's yearly budget from MPCI pretax net income, the resulting profitability ratio declines from 14.7% to 12.6%, falling further behind the P&C industry's 18.6% ratio.[3]

The effect of commercial reinsurance and ceding commissions

The effect of commercial reinsurance and ceding commissions on the profitability of the MPCI program is a matter of some dispute. Reinsurance can be a difficult issue, and there is as of yet no consensus on the proper treatment of reinsurance on ratemaking within the whole of the insurance industry.

In general, commercial reinsurance and related ceding commissions are not associated with policy delivery and, therefore should be excluded from the discussion of profitability or expense comparisons between the two industries. From the insurance company's perspective, the purpose of reinsurance is to spread risk, not to earn a profit. However, the purpose of reinsurance from the reinsurer's perspective is to generate a profit. Over the long-run, this means that reinsurance is a cost to the primary insurer rather than a source of profit. Despite this, the profitability of the program should be evaluated based on it own experience, not taking into consideration commercial reinsurance or other factors external to the program. This is consistent with RMA's treatment of reinsurance as a disallowed item for company expense reporting.

The MPCI industry obtains a financial benefit from the existence of a government provided reinsurance structure that is not available to the P&C industry

Companies participating in the MPCI program operate under severe underwriting and rating restrictions not applicable to P&C insurers. Participation in the program requires that companies provide insurance to all eligible producers. In addition, companies are not permitted to establish rates independently or to recoup their losses through rate increases or surcharges on individual policies. These types of restrictions endanger the financial solvency of insurers and would normally lead to the withdrawal of capacity from the market. To address these issues, the SRA reinsurance structure has been designed to ensure the ability of the private market to function effectively by allowing undesirable or uninsurable risks to be transferred to the Government. The SRA reinsurance structure represents the role the Federal Government chose to adopt to ensure universal availability of coverage and socially

3 Reflects reduction in MPCI Pretax Net Income by the amount of RMA's Administrative and Operating Expenses for the years 2003 through 2007.

equitable rating of producers who might otherwise have been unable to obtain insurance protection.

Certain MPCI expenses are not directly tied to the cost of the MPCI program and should not be used to calculate profitability

From an accounting perspective, the most appropriate basis for evaluating the cost of policy delivery is to compare the expenses involved in generating revenue to the amount of revenue being generated. It has been suggested that disallowed expenses are not directly tied to the cost of delivering the MPCI program and should not be taken into account when calculating profitability. If disallowed expenses are removed from the MPCI program profitability analysis, the profitability ratio increases from 14.7% to 15.6%, which remains below the P&C industry's ratio, and the variability of those returns increases from 12.7% to 13.0%.

However, some expenses disallowed by RMA are related to the cost of delivery. One such expense is "fronting fees." Fronting fees are payments made by MPCI insurers not licensed in a particular state(s) to a fronting company with the appropriate state licensing. The MPCI insurer writes policies in the name of the fronting company in that state(s), but reinsures 100% of the policies so that there is no financial impact on the fronting company. For this service, the MPCI insurer pays a fee, often approximately 2% of the premium written. In the absence of this arrangement the MPCI company would not be legally permitted to issue insurance policies in that state. The effect of treating fronting fees as a disallowed expense has the potential of restricting the number of new entrants into the program by limiting the ability of smaller companies to effectively diversify their risk portfolios across states.

Another example of a disallowed expense that is related to the cost of policy delivery is bonuses paid to employees of MPCI companies. Salaries of MPCI employees are allowable expenses. If an MPCI company chooses to compensate their employees on a salary and bonus basis rather than on a straight salary basis, the bonus is a disallowed expense. However, the effort expended by the employee in delivering service to the policy holder is the same. Bonuses are a standard method for compensating and providing incentives to employees throughout the economy and should be treated as a legitimate business expense to the extent they are reasonable.

RMA shows an expense ratio lower than that shown in the 2007 Update

For this and previous analyses prepared by Grant Thornton, Deloitte and PwC, MPCI expenses were calculated by scaling up survey responses from MPCI companies based on the gross premiums reported by RMA. Survey responses provided for separate reporting of allowed and disallowed expenses. Grant Thornton's analysis includes both allowed and disallowed expenses in the calculations of profitability and expense ratios. This may result in a higher expense ratio than in reports prepared by RMA.

If the analysis is amended to eliminate disallowed expenses from expense ratio calculations, the MPCI expense ratio falls slightly but still results in a shortfall of 2.7% from A&O Reimbursements. That is, A&O reimbursements have been insufficient to cover even the industry's allowable expenses. Therefore, the overall conclusion of the original analysis does not change.

Premium taxes are paid by P&C companies but not by MPCI companies

P&C companies pay a state premium tax on policies that MPCI companies do not. This is a clear difference between the two programs. However, since P&C companies set their premiums to cover expenses as well as expected losses, it is reasonable to assume that the cost of the premium tax is passed on to policyholders. Therefore, the impact of this tax on the profitability of P&C companies as compared to MPCI companies is likely nil.

From an expense perspective, for calendar year 2007, A.M. Best data indicates that State and Local Taxes, Licenses and Fees for the P&C industry, which includes premium taxes, were 2.3% of net premiums earned.[4] If premium taxes were applicable to the MPCI industry, the expense ratio gap between the two industries would be reduced marginally. However, this would result in a significant decrease in the profitability of the MPCI program that would need to be recouped through an increase in A&O reimbursements. Therefore, it does not appear that this difference in the two industries would impact the overall conclusion of this analysis.

MPCI companies have opportunities for increased profits from A&O Reimbursements in times of high crop prices

A&O Reimbursements to MPCI companies are a flat percentage of gross premiums. MPCI premiums are based, in part, on crop prices. As crop prices increase, the premiums charged for crop insurance increase and the dollar value of A&O Reimbursement to MPCI companies increases. This factor is accounted for in the Profitability and Effectiveness analyses. However, it should be noted that the opposite is true as well. When crop prices fall, MPCI premiums fall and the dollar value of A&O Reimbursement falls.

As with many types of property coverage, the establishment of insurance underwriting and operating measures such as premium, liability, and expense for the Federal Crop Insurance program are a function of the value of the insurable assets. As the insured asset fluctuates in value and/or price, the program's premium, liability, and expense will also fluctuate. This contributes to the high degree of variability in annual experience and is an important factor in our decision to focus on the long-term profitability of the program. To focus on short-

4 2008 Best's Aggregates & Averages, Underwriting Expenses Incurred to Net Premiums Written, p. 677 translated into percentage of Net Premiums Earned based on Cumulative by Line Net Underwriting Experience – Industry.

term profitability or to narrowly define profitability in terms of short-term commodity price fluctuations is a flawed approach to evaluating the performance of the program. Commodity price levels do not account for other factors impacting profitability, namely, actual expenses of doing business including such items as employee salaries, transportation, employee medical benefits, etc. The proper focus of the analysis of the Federal Crop Insurance program should be on its long-term profitability.

From a short-term perspective, high prices have a significant adverse effect on companies by magnifying their underwriting risk. High prices increase the insured value of the crop, creating the potential for much larger indemnities. The probability of large losses is also magnified due to the higher potential for prices to collapse to levels closer to their long-term norms. In addition, the short-term increase in A&O reimbursements in 2008 arising from recent commodity price increases has been offset by permanent reductions to reimbursement rates in the recent Farm Bill. With the rapid decline in commodity prices in recent months, future A&O reimbursements may be even less adequate to compensate company expenses than in previous years. In summary, focusing on short-term commodity price variation as a measure of profitability is fatally flawed.

The Quota Share adjustment should be applied to retained premiums as well as pretax net income

In order to address this issue, the MPCI retained premiums for 2005 through 2007 have been adjusted in this analysis by the 5% Quota Share. This adjustment does not change the overall conclusions.

One argument made is that the Quota Share adjustment has no impact on participating companies' profitability because the same percentage reduction applies to the underwriting gain/loss (numerator) and retained premiums (denominator). This rationale relies on presenting information in a way that appears reasonable on its surface, but only if evaluating the profitability ratio. However, the real measure of profitability is the actual underwriting gain/loss (in dollars), not its ratio to retained premiums. On this basis, the 5% Quota Share adjustment clearly has an adverse impact on the industry.

A more meaningful interpretation of the Quota Share arrangement is that it should be considered a direct tax on each company's net underwriting income. The 5% Quota Share provision has exactly the same effect on a company's net underwriting income as a 5% tax. Based on this interpretation, it is undeniable that companies are harmed by increases in the Quota Share percentage.

Any A&O shortfall should be deducted from retained premiums to fully simulate the adjustment for P&C expense loading

It was suggested that the adjustment for P&C expense loading did not go far enough and equates P&C expenses with A&O Reimbursements not A&O expenses. The purpose of the profitability analysis is to compare net income to premium on a consistent basis. The premium of the P&C companies contains a component to cover expected indemnities (risk premium) and a component to cover expenses (expense load). The analysis assumes that P&C companies set the expense load to equal delivery expenses. Thus, these terms cancel out in the numerator of the profitability ratio, and there is no contribution to, or subtraction from net income for MPCI companies, because actual expenses exceed the A&O reimbursement. The appropriate evaluation then is to compare the respective and consistent measures of net income to a common measure of retained premium. The common and consistent measure used in this analysis is retained risk premium, which requires P&C expenses (assumed to be equal to the expense load) to be subtracted from the P&C total premium. If the A&O shortfall were to be subtracted from the MPCI companies retained premium, as suggested, the resulting difference would be a number that is smaller than the actual retained risk premium and would no longer be comparable to the P&C risk premium. The suggested adjustment would distort the profitability ratios and is inappropriate.