

# 2011 SRA: First Draft

RMA

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# Foundations for the New SRA

- Authorization and guidance from 2008 Farm Bill.
- Recommendations from the industry.
- Various outside studies, i.e. Milliman
- Guidance from oversight bodies, i.e. GAO and OIG
- Extensive internal analyses and discussion.

# Negotiation Objectives

- Align Administrative and Operating (A&O) subsidy to insurance companies to actual delivery costs;
- Ensure continued producer access to these important risk management tools;
- Provide a reasonable rate of return to insurance companies;
- Protect producers from higher costs while equalizing reinsurance performance across States to more effectively reach under-served producers, commodities and areas;
- Simplify provisions to make the SRA more understandable and transparent; and
- Enhance program integrity.

# Overview of Changes

- Significant changes in financial terms structures:
  - Reinsurance gain/loss sharing
  - A&O subsidy
- Significant reorganization:
  - Regulatory terms moved to Appendix I
  - Categorized exhibits to Appendix II
- Appendix IV changes:
  - Provide AIPs more flexibility in achieving training and quality control.
  - Have AIPs be more accountable.
- Incorporated AIP suggestions, Amendments #1 and #2, guidance from MGR bulletins and procedures, clarified terms.

# SRA Changes: Preamble and Section I

- Preamble: Annual Agreement
- Farm Bill changes:
  - Annual settlement
  - Familial relationship, relative, immediate family
  - Rebate
- Financial terms restructuring:
  - Adjusted net book premium
  - Reference price
  - State Group 1, ... 4
- Other changes:
  - CAT LAE
  - Cooperative Association, Trade Association
  - PII, Protected Information
  - PIC
  - PASS instead of DAS

# SRA Changes: Section II

- Reinsurability of eligible crop insurance contract.
- Rebating
- Loss Adjuster training (Amendment #2)
- Strengthen notification requirements and amending of Plan of Ops.
- Large Claims requirements (to Appendix I)
- Reinsurance gain/loss restructuring.

# SRA Changes: Section III

- A&O restructuring
- Admin Fee debt management

# SRA Changes: Section IV

- Moved to Appendix I
  - Compliance with State law
  - Controlled Business
  - Oversight and Cut-through
  - Supervision, Rehabilitation, and Liquidation
  - Mediation, Arbitration, Litigation, and Assistance
  - Sanctioned Persons
  - Member Delegate

# SRA Changes: Section IV (cont.)

- Data collection (strengthened)
- Reports
  - Date clarification
  - Penalty for late acreage reporting
- Operations
  - Strengthened Plan of Ops requirements
  - Flexibility in event can't approve July 1
- Compliance and Corrective Action
  - Changed liquidating damages
- Certification: Sign SRA Annually

# Appendix I Changes

- Moved regulatory requirements from SRA
- II. Drug Free (rewritten for clarity)
- III. Anti-lobbying (rewritten to conform to law changes and specify penalties)
- Large Claims (modified to conform to RMA guidance)
- Conflict of Interest (added guidance from MGR 05-019, added disclosure requirements from Appendix IV, added COI reporting guidance from Info Memos, etc.)
- Controlled Business (Amendment #1)
- Training Requirements (including Amendment #2)

# Appendix II Changes

- Restructured and reformatted
- Added PIC agreement disclosure
- Financial statements
  - Incorporated RMA annual Plan of Ops guidance
  - Agent Comp, LAE, Expense, audited for prior year
  - Removed Exhibit 18
- Insurance Operations
  - Added: Number of agents, agencies, and loss adjusters
  - Added: IT hardware and software description
- Business Plan (changes in reinsurance terms, state designation)
- Risk Assessment and Contingency Plan (incorporated RMA annual Plan of Ops guidance)

# Appendix IV Changes

- Definitions
  - Added “Agent of Record” and “Satisfactory Work Performance”
  - Significantly strengthened “inspection”
  - Removed “field inspection” and “file review”
- Quality Control Plan (clarified from RMA guidance)
- Training
  - TPEP requirement, tied to needs and performance issues.
  - Curriculum (similar to current)
- Quality Control
  - Internal Controls system
  - Provided for Electronic records reporting of QC reviews
- Specified Reviews and Their Requirements:
  - Data Mining, Individual Policy, Operational reviews.

# Implications of Changes

- All changes meet one or more RMA negotiation objectives.
- Significant benefits to all stakeholders
  - Producers:
    - Ensure that tools will continue to be provided.
    - Incentives for AIPs to reach under-served producers.
  - Taxpayers:
    - Ensure responsible expenditures of government delivery costs.
  - AIPs:
    - More stable and predictable returns, better protection against “blow outs”, lower commercial reinsurance costs.
    - Opportunities to grow in underserved areas.
    - Confidence that they can earn a reasonable rate of return in the long run.
  - RMA:
    - Clearer and more flexible monitoring and regulatory tools.

# Next Steps

- Comments on SRA First Draft due to RMA by:

January 15, 2010

- Preparation of SRA Second Draft by February.

**QUESTIONS ?**

# 2011 SRA Financial Terms

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- Risk-Sharing
- A&O

# 2011 SRA Risk-Sharing Terms

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- Eliminate sub funds
  - Simplification
  - Revenue accounts for most premium

## Proportion of Gross Premium by Sub-Fund

(in Commercial and Developmental Funds)

	2000	2009
Other	48%	18%
CAT	14%	4%
<b>Revenue</b>	<b>38%</b>	<b>78%</b>
Total	100%	100%

# 2011 SRA Risk-Sharing Terms

- Eliminate Developmental Fund
  - Simplification
  - In 2009, Developmental Fund accounted for 9% of gross premium
- Minimum retention for Commercial Fund lowered to from 50% to 35%
  - Allow for reduced retention in place of using Developmental Fund

# 2011 SRA Risk-Sharing Terms

- Replace Assigned Risk Fund with a national-level Residual Fund
  - Gains/losses apportioned to AIP's according to share of total premium
    - Industry as a whole retains all premium
  - Gain shares the same as current Assigned Risk Fund
  - Cession limit of 75% in all states
    - Current cession limit for Assigned Risk Fund varies by state from 25% to 75%

# 2011 SRA Risk-Sharing Terms

- Replace Assigned Risk Fund with a national-level Residual Fund
  - Simplification
  - Equalize exposure to high risk business (rebalancing)

# 2011 SRA Risk-Sharing Terms

- Revise gain shares
  - Equalize expected returns across states (rebalancing)
  - Reasonable rate of return
  - Stabilize returns
    - Reduce exposure to extreme events (gain or loss)

# 2011 SRA Risk-Sharing Terms

## Current SRA Gain/Loss Shares

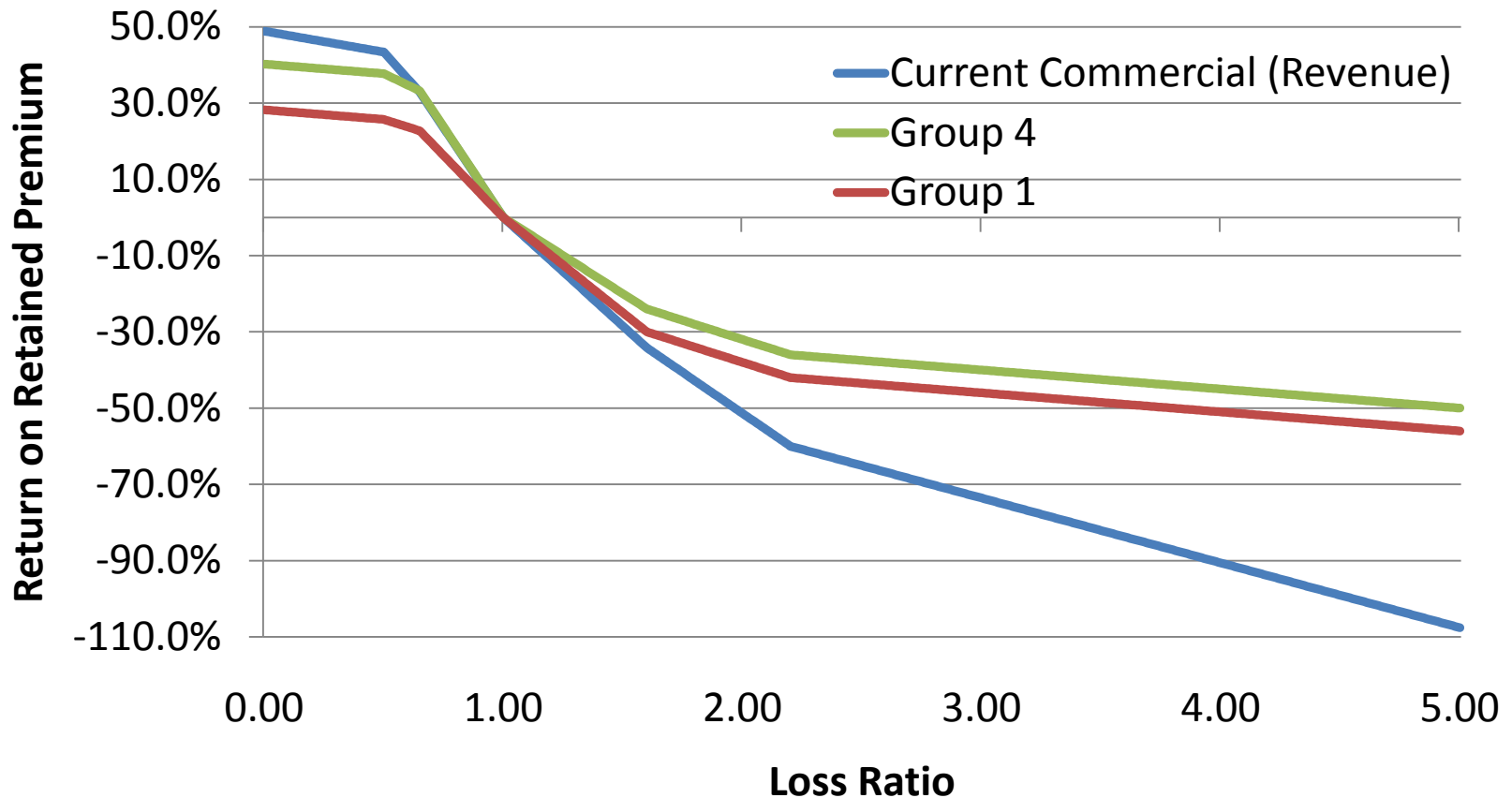
Loss Ratio		0.00 to 0.50	0.50 to 0.65	0.65 to 1.00	1.00 to 1.60	1.60 to 2.20	2.20 to 5.00
Com Fund	CAT	0.08	0.50	0.75	0.50	0.40	0.17
	Revenue	0.11	0.70	0.94	0.57	0.43	0.17
	Other	0.11	0.70	0.94	0.50	0.40	0.17

## 2011 SRA Gain/Loss Shares

Loss Ratio		0.00 to 0.50	0.50 to 0.65	0.65 to 1.00	1.00 to 1.60	1.60 to 2.20	2.20 to 5.00
Com Fund	Group 1	0.05	0.20	0.65	0.50	0.20	0.05
	Group 2	0.05	0.20	0.75	0.50	0.20	0.05
	Group 3	0.05	0.30	0.85	0.50	0.20	0.05
	Group 4	0.05	0.30	0.95	0.40	0.20	0.05

# 2011 SRA Risk-Sharing Terms

## Current v. 2011 Commercial Fund



# 2011 SRA Risk-Sharing Terms

- State groups based on
  - Expected returns
  - Underserved
- Group 1: IA, IL, IN, MN, NE
- Group 2: CA
- Group 3: OH, KY, TN, OR, WA
- Group 4: The rest

# 2011 SRA Risk-Sharing Terms

- Increase Net Book Quota Share from 5% to 10%
  - If gain, a portion distributed back to AIP's according to pre-determined criteria
  - Focus on underserved producers, areas, crops

# 2011 SRA A&O Terms

# 2011 SRA A&O Terms

- ❖ Fixed reference price established for 7 major insurable commodities and be used to for purposes of calculating A&O payments when market prices exceed reference prices
  - Reference prices based on 1999-2008 average of NASS season-average prices, with loan rate as a floor
  - SRA would accommodate statutory change to allow use of reference prices when market prices fall below reference prices
  
- ❖ Rationale: Amount of A&O subsidy should reflect underlying cost of delivery and not be tied to high prices of recent years

# Reference Price Comparison

<b>Commodity</b>	<b>USDA Baseline Price*</b>	<b>Reference Price</b>	<b>2000-2004 Average Price</b>
Wheat	\$5.40	\$3.92	\$3.15
Corn	\$3.72	\$2.56	\$2.12
Grain Sorghum	\$3.32	\$2.43	\$2.06
Barley	\$3.92	\$2.93	\$2.47
Upland Cotton	\$0.61	\$0.52	\$0.46
Rice	\$0.1092	\$0.0830	\$0.0595
Soybeans	\$8.70	\$6.36	\$5.51
*Average for 2011-2015			

# 2011 SRA A&O Terms

- ❖ In 2004/05, RMA and companies negotiated a new SRA effective for reinsurance year 2005
- ❖ Total A&O subsidy was projected to average slightly over \$700 million annually from 2005-2010 under 2005 SRA, for average A&O subsidy amount per policy of almost \$600.
- ❖ Under 2011 SRA, A&O subsidy for 2011-2015 is projected to average about \$1.1 billion annually, or about \$940 per policy
  - Greater than amounts envisioned under 2005 SRA and any increases in costs that have occurred in interim

# A&O Calculations

	<b>Current SRA</b>	<b>2011 SRA</b>
APH	150	150
Coverage Level	75%	75%
Acres	100	100
Price Election	\$4.00	\$2.56
Liability	\$45,000	\$28,800
Premium Rate	10%	10%
Premium	\$4,500	\$2,880
A&O Subsidy Rate	21.9%	21.9%
A&O Subsidy	\$985.50	\$630.72

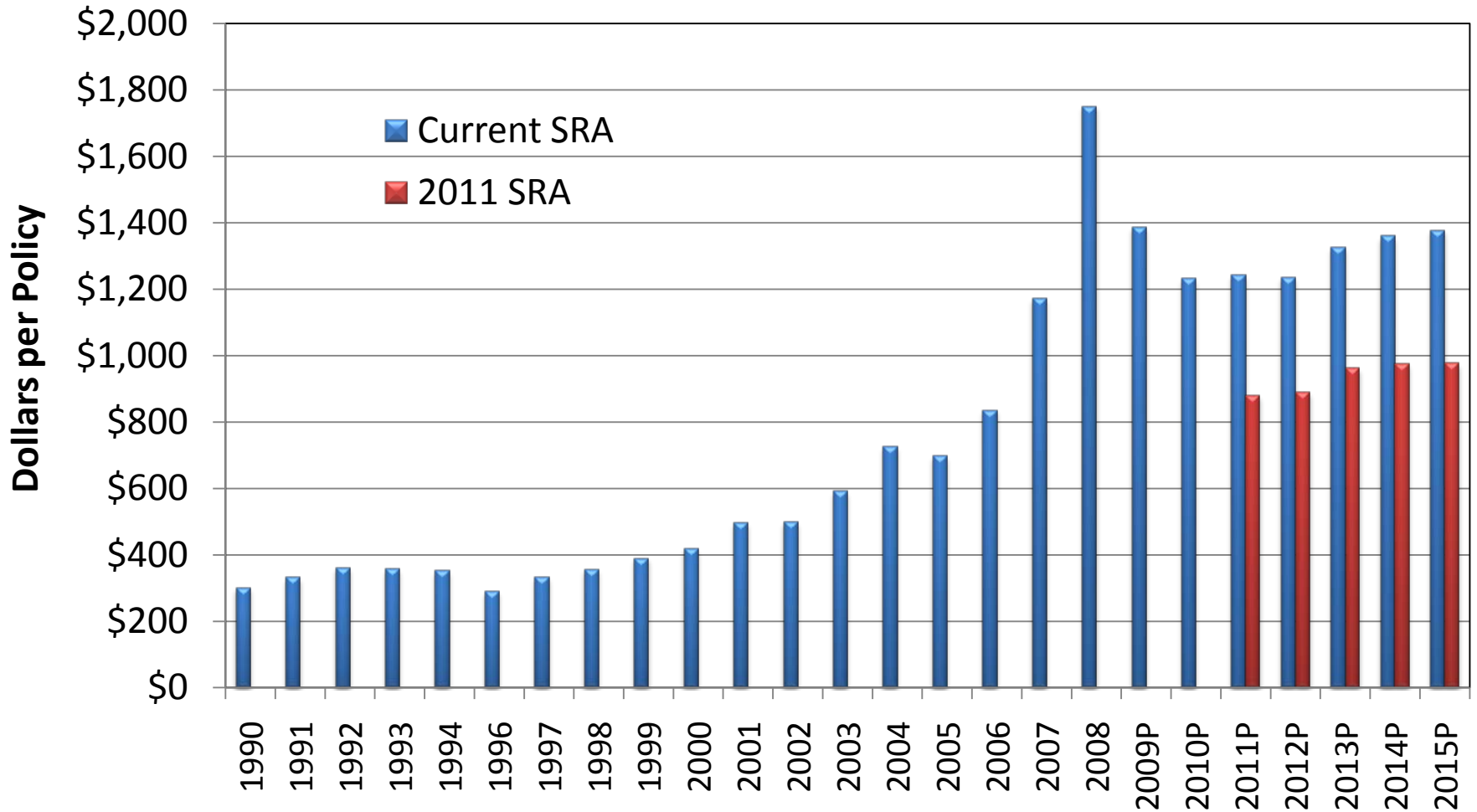
# A&O Subsidy Rates

- ❖ A&O subsidy rates fixed at levels mandated by 2008 Farm Bill
  - SRA would accommodate statutory changes to eliminate subsidy rate differences among coverage levels
- ❖ Rationale: Eliminating coverage level differentials would offer greater simplicity

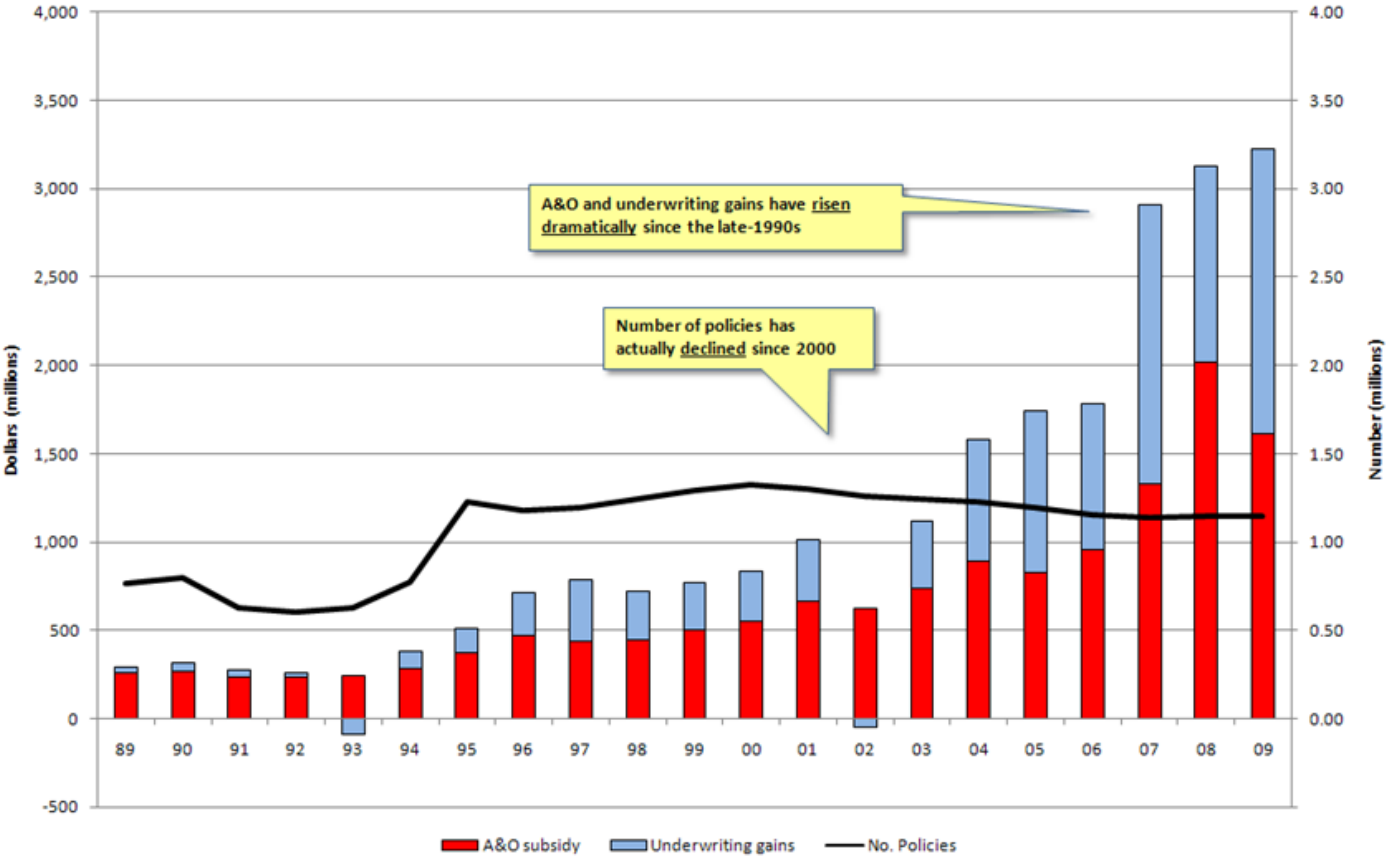
# A&O Subsidy Rates

Plan of Insurance	Current SRA				2011 SRA
	Coverage Level				
	CAT	≤75%	80%	85%	All BUP
Revenue	6.0%	18.5%	16.4%	15.8%	18.5%
Area	6.0%	12.0%	12.0%	12.0%	12.0%
Other	6.0%	21.9%	19.4%	18.7%	21.9%

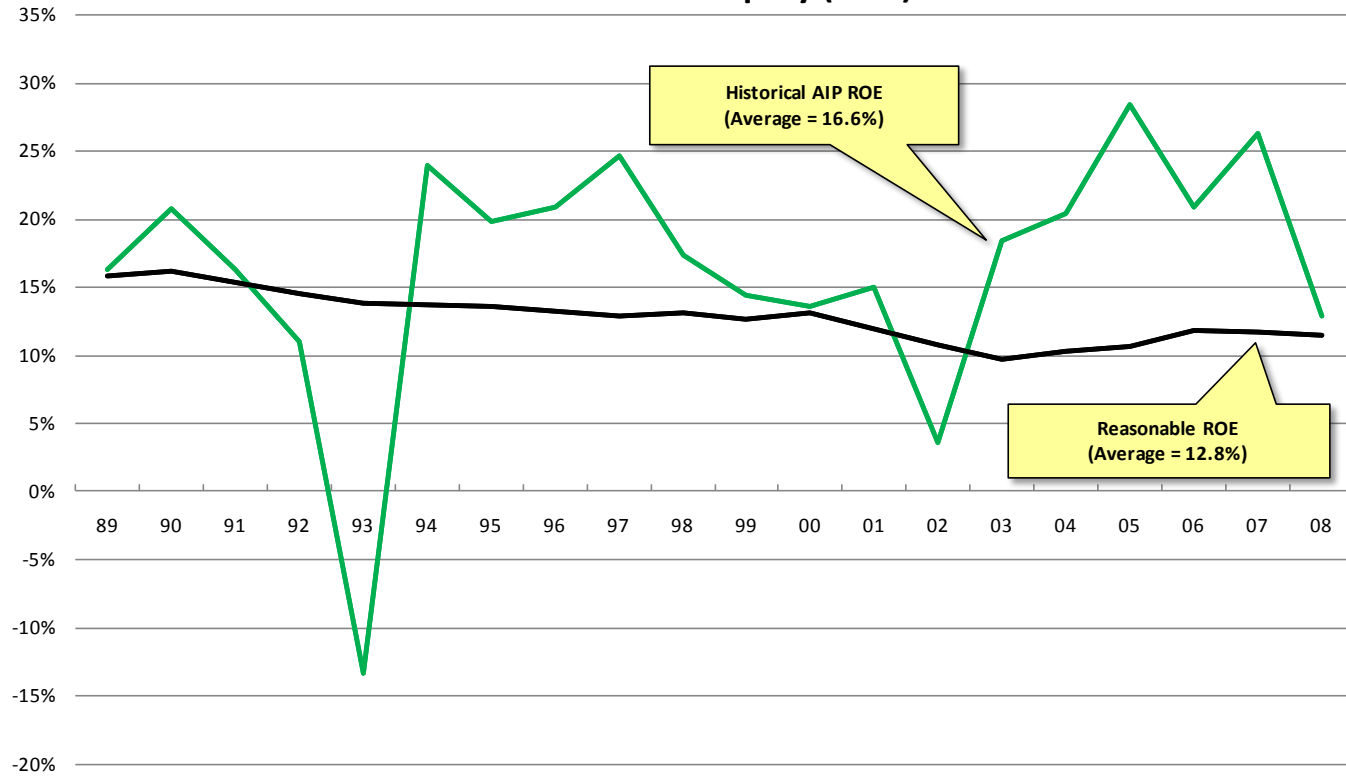
# A&O per Policy



### AIP Revenue from FCIC



## Rate of Return on Equity (ROE)



Source: Milliman Inc., *Historical Rate of Return Analysis*, 2009  
2008 Historical AIP ROE revised by RMA to reflect most recent data.

Reasonable Rate of Return Measures

