Federal Crop Insurance Program

Profitability and Effectiveness Analysis

2016 Update for Reinsurance Year 2015

EXECUTIVE SUMMARY

Federal Crop Insurance Program: Profitability and Effectiveness Analysis, 2016 Update

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Each year since 2007 the national accounting firm Grant Thornton LLP has prepared an analysis for National Crop Insurance Services (NCIS) reporting the financial performance of the crop insurance companies participating in the Federal Crop Insurance Program, commonly known as the Multiple Peril Crop Insurance program (MPCI). The Grant Thornton reports are derived from governmental and company information and summarize the experience of the program from the early 1990's to the present. The reports also include comparisons to the overall financial performance of the Property and Casualty (P&C) insurance industry.

Factors Affecting the Profitability of the MPCI Program

The MPCI program differs from more standard P&C programs in a variety of ways, two of which are especially relevant to this discussion. First, the obligations and financial terms for the companies participating in the MPCI program are delineated in the Standard Reinsurance Agreement (SRA) between the US Department of Agriculture's Risk Management Agency (RMA) and each individual company. Second, unlike traditional P&C insurance, crop insurance premium rates are determined by RMA rather than the insurance companies themselves.

There have been two changes to the program in recent years that have the potential to reduce profitability for participating insurers:

- In 2011, revisions to the SRA resulted in reduced A&O reimbursements and underwriting gains to insurers
- In 2012, RMA revised the methodology it uses to establish premium rates. This change resulted in lower premium rates for corn and soybeans in many states

Recent Performance of the MPCI Program

The following table utilizes two separate metrics to depict the financial performance of the MPCI program. Each demonstrates that industry profitability has been lower in recent years relative to what it had been under the two previous (1998 and 2005) SRAs (annual results are available in the exhibit on page 5). First illustrated is Net Underwriting Gain or Loss over a period from 1998 to 2010 and, separately, from 2011 to 2015. Net Underwriting Gain represents the premium remaining after 1) insured farmers are reimbursed for any loss on their farms and 2) RMA takes its share of any gains or losses.

The second metric is Pretax Net Income, which is simply Net Underwriting Gains reduced by the industry's net cost for delivering the program. Delivery costs include loss adjustment, company operating expenses such as salaries and rent, and agent compensation. The delivery costs incurred by the industry are only partially reimbursed by RMA in the form of Administrative and Operating Expense payments (A&O). The resulting deficit is absorbed by participating companies.[1] As illustrated in the table below as well as in the exhibit on page 5, the unreimbursed expenses (A&O Expense Deficit) significantly reduce the industry's profitability. The A&O Expense Deficit equaled roughly 25% of the industry's Net Underwriting Gains during the 1998 and 2005 SRAs, but represented nearly 85% of the industry's Net Underwriting Gains so far under the 2011 SRA.

Rates of Return As percent of Retained Premium			
SRA	Time Period	Net Underwriting Gain or Loss	Pretax Net Income
1998 and 2005	1998 through 2010	22.8%	16.9%
2011	2011 through 2015	9.1%	1.4%

Despite the decline in industry profitability in recent years, the crop insurance industry has continued to expand service to an increasing portion of the agricultural economy, with program participation rates (defined as the ratio of net insured acres to total planted acres) increasing from 81% in 2010 to 93% by 2015.

Comparison to the Property & Casualty Insurance Industry

While results can vary from year to year, the crop insurance program historically has been less profitable and its financial performance more variable than the P&C industry as a whole. Less favorable returns may encourage crop insurers to exit the industry and render it more difficult for companies to attract capital needed for development and implementation of innovative approaches to improve the delivery of the program.

The findings from the most recent Grant Thornton analysis include:

- The crop insurance simple average return from 1998 to present of 10.6% was below the 18.1% return for the P&C industry, where returns are measured in relation to the risk portion of the premium

[1] We were advised by NCIS that the expense deficit has been exacerbated by the necessity for the industry to implement various provisions mandated by the 2014 Farm Bill. Among others, the Farm Bill provisions included new farmer conservation compliance requirements and eligibility benefits to new farmers. In addition, a myriad of new policies have been introduced, including revised Whole Farm Revenue coverage, new supplemental coverages and expansion of coverage options for existing policies.

- Over the same period, the returns for crop insurance were more volatile, indicating that crop insurance is riskier than traditional P&C business[2]
- Returns for the crop insurance industry since 2011 have been lower and more volatile than results under the 1998 and 2005 SRAs

Notwithstanding MPCI's gains in the cost effectiveness of product delivery and the fact that crop insurers have been more efficient than the P&C industry in the area of expense management,[3] the crop insurance industry continues to trail the P&C business more generally in the two reported measures of financial performance. As described in the previous discussion, A&O payments fail to cover the full cost of delivering the program. The Grant Thornton analysis indicates a $792.5 million shortfall in delivery expense reimbursements in 2014 and a deficit of $777.2 million in 2015. These costs are shouldered directly by crop insurers.

Summary

Historically, the profitability of the crop insurance industry has been less than that of the P&C industry as a whole, despite the greater risk crop insurers incur for participating in the program. Returns for the crop insurance industry in recent years have been lower than they were prior to the 2011 rewrite of the SRA and the introduction of RMA's new ratemaking methodology in 2012. And in spite of the efficiency of private industry in delivering the program to America's farmers and ranchers, A&O reimbursements for delivery costs continue to not cover A&O costs.

[2] The long-term volatility of MPCI's historical earnings was 12.6% compared to just 9.6% for the P&C industry.

[3] Measured as the ratio of total expenses to the risk portion of the premium (i.e., the expected indemnity payments), MPCI delivery costs from 1998 to the present averaged 23.8% as compared to 60.4% for the P&C industry. Furthermore, the crop insurance industry is becoming increasingly efficient, with its expense ratio falling from 29.5% in 1998 to 23.3% in 2015. The comparable P&C ratios have been consistently much higher than MPCI, with no improvement in efficiency over time. In addition, MPCI's delivery costs were better than comparable statistics for Homeowners Multiple Peril and Private Passenger Automobile Physical Damage lines, which also are primarily sold to individuals rather than to businesses.

Industrywide Rate of Return

($ in millions)

Industrywide Results under the 1998 and 2005 SRAs

	Federal Crop Insurance Program						P&C Insurance
		Net Underwriting Gain			Pretax Net Income		Pretax Net Income
Year	Retained Premium	$	As % of Retained Premium	A&O Expense Deficit	$	As % of Retained Premium	As % of Adjusted Net Earned Premium
1998	1,591.7	279.2	17.5%	-109.7	169.5	10.6%	24.8%
1999	1,836.9	271.8	14.8%	-113.5	158.3	8.6%	17.0%
2000	1,894.2	281.8	14.9%	-140.1	141.7	7.5%	15.3%
2001	2,373.0	345.9	14.6%	-179.9	166.0	7.0%	-3.1%
2002	2,295.0	-47.4	-2.1%	-200.3	-247.7	-10.8%	5.3%
2003	2,607.1	378.4	14.5%	-164.8	213.6	8.2%	17.3%
2004	3,145.2	692.0	22.0%	-134.0	558.0	17.7%	20.2%
2005	2,892.9	916.4	31.7%	-160.9	755.5	26.1%	22.0%
2006	3,501.9	842.4	24.1%	-201.2	641.2	18.3%	33.9%
2007	4,898.7	1,597.4	32.6%	-233.5	1,363.9	27.8%	31.5%
2008	7,743.8	1,105.1	14.3%	-160.8	944.3	12.2%	4.2%
2009	6,626.6	2,226.4	33.6%	-476.1	1,750.3	26.4%	16.7%
2010	6,052.6	1,914.3	31.6%	-525.3	1,389.0	22.9%	19.1%
1998-2010	47,459.6	10,803.7	22.8%	-2,800.1	8,003.6	16.9%	17.8%

Industrywide Results under the 2011 SRA

	Federal Crop Insurance Program						P&C Insurance
		Net Underwriting Gain			Pretax Net Income		Pretax Net Income
Year	Retained Premium	$	As % of Retained Premium	A&O Expense Deficit	$	As % of Retained Premium	As % of Adjusted Net Earned Premium
2011	9,531.4	1,693.5	17.8%	-561.9	1,131.6	11.9%	9.2%
2012	8,639.8	-1,316.2	-15.2%	-430.6	-1,746.8	-20.2%	17.0%
2013	9,230.9	639.5	6.9%	-701.8	-62.3	-0.7%	27.9%
2014	7,925.7	1,045.4	13.2%	-792.5	252.9	3.2%	25.6%
2015	7,384.4	1,814.5	24.6%	-777.2	1,037.3	14.0%	22.5%
2011-2015	42,712.2	3,876.7	9.1%	-3,264.0	612.7	1.4%	20.7%

	Crop Insurance	P&C Insurance
1998-2015 Simple Average Rate of Return (Pretax Net Income %)	10.6%	18.1%
1998-2015 Simple Standard Deviation	12.6%	9.6%