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REPORT TO THE CONGRESS

Reduction In Federal Expenditures Possible Through Commodity Credit Corporation's Assumption Of Insured Warehousing Risks

Department of Agriculture

BY THE COMPTROLLER GENERAL OF THE UNITED STATES

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JAN. 10, 1975

COMPTROLLER GENERAL OF THE UNITED STATES
WASHINGTON, D.C. 20548

B-114824

To the President of the Senate and the
Speaker of the House of Representatives

This is our report pointing out that a reduction in Federal expenditures is possible through Commodity Credit Corporation's assumption of insured warehousing risks.

Our review was made pursuant to the Budget and Accounting Act, 1921 (31 U.S.C. 53), and the Accounting and Auditing Act of 1950 (31 U.S.C. 67).

Copies of this report are being sent to the Director, Office of Management and Budget, and to the Secretary of Agriculture.

Elmer B. Staats

Comptroller General
of the United States

Contents

ABBREVIATIONS

AMS	Agricultural Marketing Service
ASCS	Agricultural Stabilization and Conservation Service
CCC	Commodity Credit Corporation
GAO	General Accounting Office

COMPTROLLER GENERAL'S
REPORT TO THE CONGRESS

REDUCTION IN FEDERAL EXPENDITURES POSSIBLE THROUGH COMMODITY CREDIT CORPORATION'S ASSUMPTION OF INSURED WAREHOUSING RISKS
Department of Agriculture

D I G E S T

WHY THE REVIEW WAS MADE

Some time ago, GAO identified risks for which the Government was paying commercial insurance but which could possibly be assumed by the Government at a saving. Two of these pertained to insurance protection involving the Commodity Credit Corporation in the Department of Agriculture.

GAO made this review to (1) develop information on the cost and related benefits to the Corporation of commercial insurance protection on losses and shortages of stored grain and (2) ascertain whether it was practicable for the Corporation to assume these risks rather than pay for such protection. (See p. 1.)

FINDINGS AND CONCLUSIONS

The storage charges which the Corporation pays on grain under its price-support programs are set under a contract--the Uniform Grain Storage Agreement--with commercial warehouses. The storage rate includes a factor for insurance against loss by fire and other hazards. The Department has announced that in July 1975 it will change from a uniform storage rate to rates based on offers by individual warehousemen. The Corporation pays storage charges on

--its grain stored in commercial warehouses and

--farmer-owned grain stored in warehouses or on farms, which is serving as collateral for price-support loans extended beyond initial maturity dates.

The Corporation also carries a blanket insurance policy for protection against shortages of warehouse-stored grain which it owns or which is serving as collateral for price-support loans.

During the 5 years ended June 30, 1972--the most recent period for which data on both grain storage and insurance costs were available or could be estimated--the Corporation incurred $22.6 million in insurance costs in connection with the storage of grain under its price-support programs. (See p. 6.)

If the Corporation had assumed its own insurable risks, it would have saved about $17.1 million--$7.7 million on warehouse-stored grain, $8.2 million on farm-stored grain serving as collateral for extended loans, and $1.2 million on insurance against warehouse shortages. (See p. 6.)

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Warehouse-stored grain

During the 5 years ended June 30, 1972, the Corporation incurred an estimated $11.5 million in insurance costs. These were included in storage charges paid to grain warehousemen. Its collections on insured losses amounted to $3.8 million and involved 113 cases. Therefore, the Corporation would have saved $7.7 million had it assumed the risks on warehouse-stored grain. (See p. 7.)

The Corporation's assumption of the hazard risks on warehouse-stored grain for which it pays storage charges would present no procedural problem. (See p. 13.)

Additional Corporation administrative expenses would be relatively minor. (See p. 14.)

State requirements that warehousemen carry insurance could be made inapplicable to the Corporation's operations through provisions in warehouse storage contracts that no insurance be obtained on grain for which the Corporation pays storage charges. (See p. 15.)

Farmers would be protected on extended-loan grain to the extent of loan amounts although warehousemen could carry insurance for additional protection in accordance with State licensing requirements, business practice, or the farmers' requests. (See p. 15.)

Insurance company officers, although acknowledging the desirability of reducing Federal expenditures, told GAO that their premium income would be reduced if the Corporation's requirement for hazard insurance was eliminated. They also said that they would have to continue inspecting warehouses for potential hazards and that it might be necessary to adjust the premiums for insuring non-Corporation grain to make up the reduction in revenue. (See p. 16.)

An officer of a grain warehouse association told GAO that the Corporation's assumption of hazard risk would be workable and would present no particular problem. At a second association, officers said that there might be procedural problems and a legal problem involving State laws that require warehousemen to carry insurance on all stored grain. The two associations represented warehouses accounting for about 90 percent of the storage capacity under the Uniform Grain Storage Agreement. (See p. 17.)

Farm-stored, extended-loan grain

When the Corporation pays farmers storage on farm-stored grain serving as collateral for price-support loans extended beyond initial maturity dates, it pays them at the same rate that it pays commercial warehousemen. The rate includes a factor for insurance which warehousemen are required to carry.

The farmers, however, are not required to insure the grain and the Corporation sustains any hazard losses. Consequently, the Corporation does not benefit from payment of this insurance factor.

GAO estimated that the Corporation's storage payments to farmers during the 5 years ended June 30, 1972, included $8.2 million for the insurance factor without the Corporation's deriving any benefit. During the same time, the Corporation sustained hazard losses totaling about $800,000. Although the Corporation currently is not extending loans or paying storage charges on farm-stored grain because of the high demand for U.S. agricultural commodities, its authority to do so continues.

If the Corporation reinstitutes loan extensions and continues its policy of paying storage to farmers at the same rate that it pays commercial warehousemen, eliminating the hazard insurance factor from storage charges paid on warehouse-stored grain would also eliminate the insurance factor from storage payments on farm-stored, extended-loan grain. (See p. 21.)

Warehouse shortages

The Corporation would have saved an estimated $1.2 million during the 5 years if it had not carried blanket insurance on warehouse shortages. This saving is the difference between $2.9 million in premiums paid by the Corporation and $1.7 million in losses and expenses which it would have incurred if it had not had the insurance.

The Corporation's premiums for shortage insurance are, in effect, payments primarily for a collection service because the insurers recover a considerable part of their payments to it from warehousemen's sureties. (See p. 22.)

Conclusions

The purpose of insurance protection is to share risk of loss with others by paying into a fund, administered by an insurer, from which payments are made to cover participants' losses. Premiums paid must be sufficient, in the long run, to cover not only participants' losses but also expenses and to provide a profit to the insurer.

Grain in which the Corporation has had an insurable interest has been stored at thousands of locations. Large losses have been infrequent.

It is apparent that a party, which has large financial resources, which is financially able to absorb maximum probable losses and which has risks spread so widely that the statistical probability of losses exceeding premium costs over a reasonable period of time is minimal, generally will find it less costly to assume the risk of loss than to pay for insurance. The Corporation meets these criteria.

As a large Federal operation, the Corporation has ample resources to absorb insurable losses. Its activities are financed largely by borrowings under a statutory authorization of $14.5 billion. Its operating losses, several billion dollars annually, are reimbursable through congressional appropriations. It is difficult to conceive of an organization better prepared to assume its own risks.

At June 30, 1974, the Corporation's investment in grain inventories and loans amounted to $250 million compared with $1 billion at June 30, 1973, and $2.5 billion at June 30, 1972. The quantity of grain on which it was incurring hazard insurance costs at June 30, 1974, was at a low level because of strong market demand.

At that date the Corporation's warehouse-stored grain inventory totaled about 95 million bushels and the quantity of grain serving as collateral for loans that had been extended beyond the initial maturity date was nil. In contrast, during the 5 years ended June 30, 1972, the Corporation's warehouse-stored inventory and the quantity of grain serving as collateral for extended loans averaged about 1.4 billion bushels.

Because grain stocks in which the Corporation has an insurable interest are at a low level, its assumption of its insurable risks would have only minimal impact on insurance companies' premium incomes at this time. Consequently, this is a good time for the Corporation to assume its insurable risks and attain a position to economize should grain price-support operations again reach a substantial level. (See p. 29.)

RECOMMENDATIONS

The Secretary of Agriculture should have the Corporation

--eliminate hazard insurance coverage on grain for which it pays storage charges and

--obtain commensurate reductions in storage rates.

An opportune time to make these revisions effective would be in July 1975 when the Department of Agriculture changes the storage rates from a uniform storage rate to rates based on offers by individual warehousemen.

The Secretary also should have the Corporation terminate the blanket insurance coverage for warehouse shortages at the earliest opportunity and assume the risks and the responsibility for collecting from warehousemen and their sureties. (See p. 30.)

AGENCY ACTIONS AND UNRESOLVED ISSUES

The Department agreed with the facts on hazard risks.

However, it did not say whether it concurred in GAO's recommendation that the Corporation eliminate hazard insurance coverage on grain for which it pays storage charges and obtain commensurate reductions in the storage rates. The Department said that, to assist it in deciding what to do, it would seek the views and comments of the grain warehouse industry.

The Department said that, in the event programs for farm-stored, extended-loan grain are reinstituted, it would evaluate the storage rates on the grain in relation to GAO's recommendation.

The Department said that, on the basis of commodities subject to insurance coverage and potential losses of $42.4 million upon loadout of the Corporation's inventory, it had been decided that it was in the Corporation's best interests to continue the shortage insurance through November 30, 1975, at an annual premium reduced from $576,250 to $250,000. GAO noted, however, that in the year ended August 31, 1974, during which Corporation-owned grain having a market value of about $700 million was shipped from warehouses, only a minor part of nearly $1.2 million in shortage claims reported to the insurer originated upon loadout; most of it originated during warehouse examinations.

The Department said that, before September 1975, the Corporation would again examine the relationship of its inventory position to the cost of the blanket coverage and, if conditions so dictate, intended to assume its own risk against warehouse shortages. (See p. 32.)

MATTERS FOR CONSIDERATION BY THE CONGRESS

Although this report contains no recommendations requiring legislative action by the Congress, the information presented on how the Corporation can effect savings by assuming warehousing risks, rather than incurring insurance costs that greatly exceed benefits, may be of interest.

CHAPTER 1

INTRODUCTION

The Federal Government has generally followed a policy of assuming its own risks rather than paying for commercial insurance protection. This policy is based on the fact that the wide diversification of Government property and the magnitude of Government operations accomplish the objective of insurance protection--lessening the impact of individual losses by distributing the burden over extensive property interests.

The Commodity Credit Corporation (CCC), a wholly owned Government entity within the Department of Agriculture, however, procures insurance directly, or pays for insurance indirectly, in connection with the storage of grain, beans, and rice under its price-support programs.

In a June 14, 1972, report to the Congress (B-168106), on applying the Government's policy on self-insurance (risk assumption), we stated that there appeared to be a potential for savings if CCC adopted a policy of risk assumption on these commodities. Two risks were identified--hazard losses and shortages.

We made this followup review to (1) develop information on the cost and related benefits to CCC of commercial insurance protection on losses and shortages of stored grain and (2) ascertain whether it was practicable for CCC to assume these risks rather than pay for such protection. We did not cover beans and rice in this review because insurance costs on these commodities were relatively minor.

GRAIN PRICE-SUPPORT PROGRAMS

To support the price of grain, the Department's Agricultural Stabilization and Conservation Service (ASCS), which administers CCC's price-support programs, makes CCC loans to farmers on grain serving as collateral. The grain may be stored either in CCC-approved commercial grain elevators (warehouses) or on farms. CCC loans become available at harvesttime and mature in the following spring or summer, depending on the commodity and the area. During the initial loan period, farmers are responsible for the storage of collateral grain and for storage charges.

Upon maturity of a loan, the farmer may repay it or forfeit the collateral without further obligation, or CCC may extend the loan. If the farmer forfeits warehouse-stored collateral, CCC retains the farmer's warehouse receipt and takes title to the grain. If farm-stored collateral is forfeited, the farmer delivers the grain to a CCC-approved warehouse from which CCC obtains a warehouse receipt evidencing its ownership. CCC pays the storage charges on grain it owns. The grain is stored commingled with that of other owners.

PROTECTION AGAINST HAZARD LOSSES

CCC stores its grain in commercial warehouses under a contract--the Uniform Grain Storage Agreement--that specifies storage rates, storage conditions, and shipping requirements. The Department has announced that in July 1975 it will change from a uniform storage rate to rates based on offers by individual warehousemen.

The agreement requires warehousemen to carry hazard insurance (fire, lightning, explosion, windstorm, cyclone, and tornado) on all stored grain at full market value. The coverage includes CCC-owned grain and farmer-owned grain serving as collateral for price-support loans.

On grain serving as collateral, the farmer pays the storage charge for the initial loan period. CCC pays the storage charge for grain it owns and for grain serving as collateral on a loan extended beyond the initial maturity date whether the farmer ultimately redeems the grain or forfeits it to CCC to cancel the loan obligation.

On farm-stored grain under extended loans, CCC pays the farmers for storage at the same rate it pays on warehouse-stored grain. That rate includes an insurance factor. The farmers, however, are not required to insure such grain and CCC sustains any hazard losses.

CCC's policy of paying storage charges on extended-loan grain originated in 1949 to encourage farmers to retain ownership of their farm-stored grain. The storage payments were to increase farmers' income. If CCC were to acquire the grain, it would be moved to commercial warehouses with storage payments to warehousemen rather than farmers.

PROTECTION AGAINST WAREHOUSE SHORTAGES

In addition to the hazard insurance factor included in the storage charges it pays, CCC has paid directly for a blanket insurance policy since July 1, 1963, for protection against shortages of warehouse-stored grain which it owns or which is serving as collateral for price-support loans. Before that time, CCC required each warehouseman to furnish a bond in favor of CCC.

The current policy, which became effective December 1, 1972, covers 5 years. It provides annual coverage of $250,000 for each warehouse and a maximum of $5 million for all warehouses. The annual premium for the first 2 years was $576,250. Because of a declining quantity of commodities covered by the policy (see p. 5), CCC in October 1974 negotiated a premium rate of $250,000 for the third year, beginning December 1, 1974.

GRAIN WAREHOUSES

Total storage capacity of warehouses under the Uniform Grain Storage Agreement has ranged from about 4.5 billion to 4.9 billion bushels of grain since 1965. The maximum use of such capacity for CCC inventories and price-support collateral totaled about 1.7 billion bushels, or about 36 percent of capacity, in 1965 when the capacity was 4.7 billion bushels.

On September 30, 1973, 7,429 warehouses nationwide with a storage capacity of about 4.9 billion bushels were under the Uniform Agreement. The following table indicates their locations.

State	Numbers of warehouses	Capacity (million bushels)
Kansas	981	780
Iowa	904	424
Illinois	801	499
Nebraska	716	453
North Dakota	614	144
Minnesota	590	311
Texas	471	656
South Dakota	354	82
Montana	250	47
Oklahoma	233	178
Missouri	213	154
Washington	165	154
Indiana	157	106
Ohio	152	123
Michigan	124	38
Idaho	111	43
Colorado	108	56
Arkansas	90	134
Other (23 States)	395	473
Total	7,429	4,855

Of these warehouses, 5,700 were licensed under State warehousing laws or regulations; 1,400 were licensed under the United States Warehouse Act (7 U.S.C. 241); and the remaining 300 operated without any licensing regulations. The U.S. Warehouse Act and many States' laws and regulations require licensed warehouses to furnish surety bonds for the protection of grain depositors.

CCC'S INVESTMENT IN GRAIN INVENTORIES AND PRICE-SUPPORT LOANS

CCC's investment in grain inventories and price-support loans at June 30, 1973, totaled $1 billion (1.1 billion bushels, mainly corn) compared with $2.5 billion (2.4 billion bushels) a year earlier.

Except for 32 million bushels stored in CCC-owned grain bins, CCC's June 30, 1973, grain inventory--388 million bushels costing $408 million--was stored in commercial warehouses to which CCC was paying storage charges. The collateral for CCC's $635 million investment in grain price-support loans at that date aggregated 669 million bushels of grain, of which 640 million bushels, or 96 percent, were stored on farms; the remainder was stored in commercial warehouses. Of the $635 million investment, $368 million represented loans that CCC had extended beyond their original maturity dates.

At June 30, 1973, CCC was paying farmers storage on 399 million bushels of farm-stored grain serving as collateral for extended loans. By August 1973, CCC was no longer paying storage on such grain because, to make additional stocks of grain available to meet the strong market demand, CCC had not extended the loans.

At June 30, 1974, CCC's investment in inventories and loans amounted to $250 million. The sharp reduction in investment was attributable to CCC's selling its inventories and farmers' redeeming their grain to meet increased demand, both domestic and foreign, for U.S. agricultural commodities. At that date, CCC's warehouse-stored grain inventory totaled about 95 million bushels and the quantity of grain serving as collateral for loans that had been extended beyond the initial maturity date was nil. Most of the inventory was committed for disposition.

CHAPTER 2

REDUCTION IN FEDERAL EXPENDITURES POSSIBLE THROUGH CCC'S ASSUMPTION OF INSURED WAREHOUSING RISKS

During the 5 years ended June 30, 1972--the most recent period for which data on both grain storage and insurance costs were available or could be estimated--CCC directly through purchase of the blanket insurance policy and indirectly through storage payments incurred insurance costs of $22.6 million in connection with the storage of grain under its price-support programs. We estimated that, of this amount, about $17.1 million would have been saved if CCC had assumed its own insurable risks.

The following table summarizes these estimated costs and savings.

	Insurance cost	Cost if CCC carried no insurance	Saving
	(millions)		
Hazard insurance factor included in CCC storage rate:			
Warehouse-stored grain	$11.5	$3.8	$7.7
Farm-stored grain under extended loans	8.2	-	8.2
	19.7	3.8	15.9
Insurance on warehouse shortages	2.9	1.7	1.2
Total	$22.6	$5.5	$17.1

During the 5 years CCC paid storage charges on an average of about 1.4 billion bushels of grain. This compared with charges on an average of about 2 billion bushels for the 5 years ended June 30, 1967.

The costs and savings in each of the foregoing categories and the practicability of CCC's assuming risks rather than paying for insurance are discussed in the sections that follow.

HAZARD INSURANCE ON GRAIN STORED IN COMMERCIAL WAREHOUSES

During the 5 years ended June 30, 1972, CCC incurred an estimated $11.5 million in insurance costs which were included in the storage charges paid to grain warehousemen. The insurance protection was against loss on warehouse-stored stocks which CCC owned or which were serving as collateral on price-support loans that CCC had extended beyond the initial maturity dates.

CCC's collections on insured losses during this period amounted to $3.8 million, or 33 cents per dollar of premium. CCC studies covering 5 other fiscal years, 1957-59 and 1962 and 1963, showed collection ratios in those years of about 28 cents per dollar of premium. If CCC had assumed the risks during the 5 years we reviewed, it would have saved $7.7 million. Additional funds would have been saved on damaged grain salvaged for use as animal feed, to the extent that the value of such grain exceeded the cost of screening and other salvage operations. (See p. 11.)

Cost of insurance protection

Our estimate that CCC incurred about $11.5 million in insurance costs during the 5 years through storage payments to commercial warehousemen is based on CCC records and cost studies by the Department's Economic Research Service. CCC records showed that it paid storage charges during the 5 years on an average of 805 million bushels of grain as shown in the following table.

Fiscal year	CCC owned	Extended loan collateral	Total
	(million bushels)		
1972	790	36	826
1971	821	175	996
1970	786	315	1,101
1969	493	205	698
1968	395	11	406
Total	3,285	742	4,027
Average	657	148	805

According to the Economic Research Service's cost studies, the average annual insurance cost included in the storage charge ranged from a little less than 1/5 of a cent a bushel (.178 cents) to a little more than 1/3 of a cent a bushel (.347 cents) during the 5 years. By applying the average annual cost to the respective average quantity for which CCC paid storage charges, we estimated that CCC paid $11.5 million for insurance for the 5-year period, or a weighted average annual cost of .285 cents a bushel.

The cost studies were based on a statistical sampling of grain warehouses selected according to size, location, and function in the marketing system. All the warehouses were approved under CCC's Uniform Grain Storage Agreement.

Collections on insured losses

During the 5-year period, CCC collected about $3.8 million--averaging $755,000 a year--on insured losses involving 113 cases. The individual collections for the market value of grain lost or damaged ranged from $29 to $376,000 and average about $33,400.

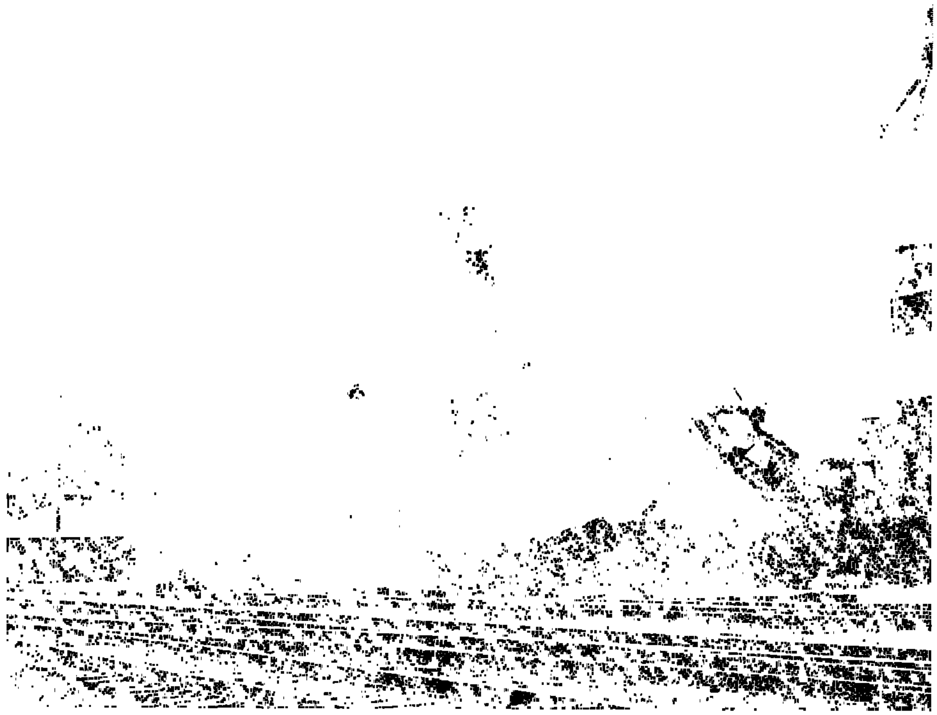
Range of collections	Number of cases	Amount of collections	Average
$ 29 to $ 5,000	19	$ 48,000	$ 2,500
$ 5,001 to $ 10,000	21	153,000	7,300
$ 10,001 to $ 50,000	55	1,370,000	24,900
$ 50,001 to $100,000	9	658,000	73,100
$100,001 to $376,000	9	1,548,000	172,000
Total	113	$3,777,000	33,400

Of the $3.8 million collected, most--$2.8 million--resulted from fire cases; the largest loss--$376,000 in Texas--was attributed to hurricane damage. About half the fire cases were in North Dakota and Minnesota.

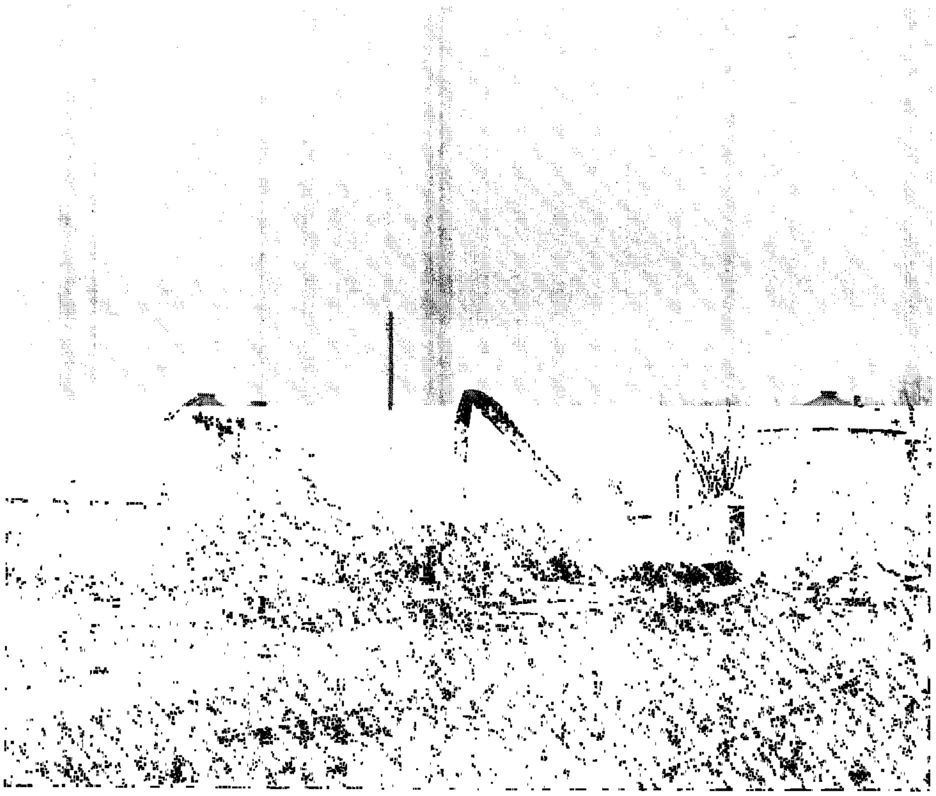
	Fire (including explosion)		Hurricane, tornado, and windstorm		Total	
	Cases	Amount	Cases	Amount	Cases	Amount
Texas	6	$ 186,000	7	$777,000	13	$ 963,000
North Dakota	32	777,000	-	-	32	777,000
Minnesota	19	682,000	-	-	19	682,000
Iowa	2	185,000	4	181,000	6	366,000
Illinois	7	319,000	-	-	7	319,000
Other (13 States)	35	668,000	1	2,000	36	670,000
Total	101	$2,817,000	12	$960,000	113	$3,777,000

Department operating personnel told us that warehouses occasionally experienced minor losses in which CCC did not become involved because the warehousemen considered the losses to involve only their grain. The personnel had no data on the frequency of such losses but said they believed them to be insignificant.

The following photographs illustrate fire damage at two different warehouses. According to the insurance company representative who furnished the photographs included in this report, the structures were of corrugated metal outside with interior wood frames.



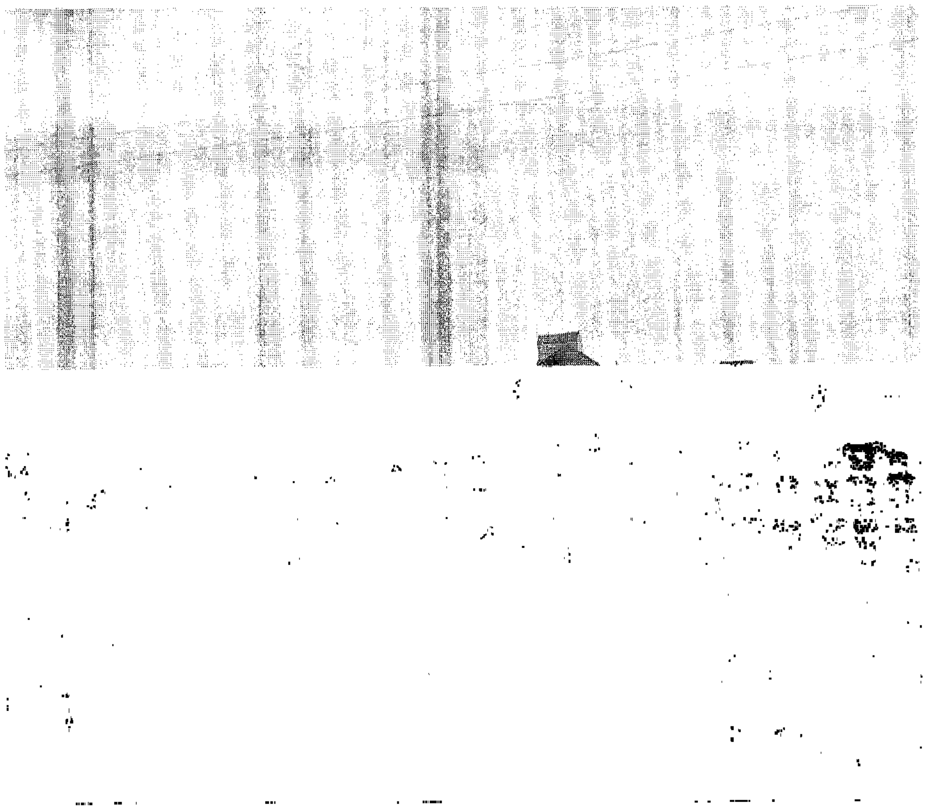
GRAIN WAREHOUSE FIRE



GRAIN WAREHOUSE AFTER FIRE

In settling hazard losses, insurance companies pay for damaged grain on the basis of its market value. Such grain becomes the property of the insurance company. The grain may, if salvaged, retain some value as animal feed. To the extent that the value of the salvaged grain exceeds the cost of salvaging it, the insurance company can offset its loss payments. The following photographs show grain-salvage operations.

SALVAGED GRAIN BEING SCREENED AND AUGURED UPWARD TO FORM A CONE



SALVAGED GRAIN AFTER IT HAS BEEN ROUGH-SCREENED AND CONED

Elimination of insurance requirement
presents no procedural problem

Eliminating insurance for warehouse-stored grain on which CCC pays storage charges presents no procedural problem. Normally under an insurance policy, the warehouseman periodically reports usually at the end of each month, the market value of all stored grain, including CCC-owned grain and extended-loan collateral, to the insurance company.

If CCC should eliminate the insurance requirement--with a corresponding reduction in the storage rate--the warehouseman would have to know the quantity of each type of grain on which he is collecting storage from CCC so that he could reduce the valuation to be reported to the insurance company. For grain that a farmer delivers to CCC at a warehouse upon loan maturity, the warehouseman issues a receipt to CCC; thus, the warehouseman knows that this grain belongs to CCC.

The warehouseman, however, would not readily know the status of warehouse receipts originally issued to farmers and subsequently deposited as collateral by the farmers with the ASCS county office for price-support loans. Upon loan maturity, the receipt may be (1) redeemed by the farmer through repayment of the loan, (2) acquired by CCC through forfeiture of the loan collateral, or (3) retained by CCC as collateral for an extended loan. Informing the warehouseman of the status of such receipts would be no problem for CCC.

Shortly before loans mature, the ASCS accounting office sends ASCS county offices lists, by individual warehouse, of loans and related warehouse receipts. Each county office designates whether the individual loans are being repaid or extended or whether the collateral is being forfeited to CCC. The list is then returned to the accounting office for recording. This procedure could be expanded to provide a copy of the county office response to the warehouseman, who would then be able to reduce the valuation of grain reported to the insurance company by the market value of grain on which CCC was assuming responsibility for storage charges.

Warehousemen told us they sometimes called an ASCS county office to obtain information about the ownership of certain receipts issued to farmers and used as loan collateral because they were interested in offering to buy the grain from farmers who had redeemed the receipts. Normally, warehousemen do not learn of all the grain on which CCC is paying storage until they get a quarterly storage invoice from CCC.

If CCC were to eliminate the insurance requirement, the warehouse storage contract would have to provide for distribution of losses, if any, between insured grain and noninsured grain because grain is stored commingled. A distribution could be accomplished among the grain owners on a pro rata basis. The Uniform Grain Storage Agreement provides that flood losses, for example, be distributed on such a basis because warehousemen are not required to carry flood insurance.

Additional CCC expenses in assuming hazard risk would be relatively minor

CCC would not incur any major additional administrative expenses by eliminating insurance protection because the basic change would involve omitting the cost of insurance from the storage rate. Only a nominal expense would be incurred to inform warehousemen, upon maturity of price-support loans, on the status of warehouse receipts.

CCC might have to share with insurance companies expenses for administering salvage and settlement operations. Expense data on adjusting insured-grain losses, provided confidentially by a company that specializes in adjusting insurance losses, indicated that CCC's share of expenses for such operations would be relatively minor.

A large hazard loss would not necessarily involve additional administrative expenses because, in such instances, current procedures could still be followed. Under these procedures, warehouse examiners of the Department's Agricultural Marketing Service (AMS) make a special examination in large hazard loss cases to protect CCC's interest in grain it owns or grain serving as loan collateral. The examiners also verify that the quantity and quality of remaining undamaged grain conforms with the warehouseman's unliquidated storage obligations.

State requirements for insurance not a deterrent to CCC's assuming hazard risk

Eliminating insurance for warehouse-stored grain on which CCC pays storage charges presents no legal problem. Some trade officials questioned whether eliminating such protection would be in conflict with State laws and regulations requiring warehousemen to carry insurance on all stored grain.

Although practically all the major grain-producing States require warehousemen to insure stored grain as a condition of eligibility for receiving a State warehouse license, the Commodity Credit Corporation Charter Act (15 U.S.C. 714b(g)) specifies that:

> "State and local regulatory laws or rules shall not be applicable with respect to contracts or agreements of the Corporation or the parties thereto to the extent that such contracts or agreements provide that such laws or rules are inconsistent with such contracts or agreements."

State insurance requirements, therefore, could be made inapplicable through provisions in warehouse storage contracts that no insurance be obtained on grain for which CCC pays storage charges.

Farmers' interest in extended-loan grain would be protected at loan amounts

In its comments on this report (see app. I), the Department said that farmers are now protected against hazard losses on warehouse-stored grain they own and suggested a clarification as to what protection farmers would have if CCC eliminated insurance on farmer-owned grain serving as collateral for extended loans. Warehousemen operating under the Uniform Grain Storage Agreement are required to carry hazard insurance at full market value on all stored grain, including farmer-owned, extended-loan grain on which CCC pays storage charges.

If farmer-owned, extended-loan grain in a warehouse was destroyed without insurance protection, the farmers would sustain monetary losses to the extent that market value exceeded loan amounts. Farmers decide when to redeem their grain collateral and, without insurance, would be taking a risk for such losses. The farmers' losses, however, would be the same as if the grain collateral were stored without insurance protection on the farm. (See p. 21.) In either situation, the farmers' obligations to CCC would be canceled and CCC would write off the price-support loans as a loss, having fulfilled its responsibility of supporting the price for farmers at the loan level.

The farmers could still be protected against hazard losses which exceed loan amounts, however, to the extent that warehousemen carry insurance at full market value in accordance with State licensing requirements, business practice, or the farmers' requests.

Views of insurance trade on CCC's assuming hazard risk

We interviewed officers of several companies that insured warehouse-stored grain. Activities of these companies were broadly diversified, covering a variety of insurable risks, including marine losses, auto liability, and workmen's compensation. The officers told us that, for grain warehouses, their companies generally underwrote the grain stocks, the warehouse structures, and other insurable risks.

Of the $658 million in premiums these companies earned in calendar year 1972, $158 million pertained to the hazard categories in which insurance on warehouse-stored grain was included. For individual insurance companies, the amounts ranged from about $3 million to $114 million. No information was readily available on the amount of premiums on grain stocks.

The officers generally acknowledged the desirability of reducing Federal expenditures but said that, if CCC's insurance requirement was eliminated, their premium income would be reduced. They explained that they would have to continue their loss-prevention inspections; consequently, it might be necessary to adjust the premiums for insuring non-CCC grain to make up for the reduction in revenue.

They told us that their loss-prevention inspections were made at least annually, depending on such potential hazards as whether the warehouse was constructed of concrete or wood. The inspectors were to emphasize detection of electrical and other deficiencies considered conducive to fires or explosions.

Officials of insurance associations told us that the insurance industry emphasized loss-prevention and that, if CCC eliminated insurance coverage, it would be getting the benefit of insurance industry inspections without cost.

We noted, however, that AMS employees, in addition to visiting warehouses when significant losses occur, periodically visit warehouses to verify the quantity and quality of the grain in relation to storage obligations. They also examine into the adequacy of storage and housekeeping conditions and make visual inspections for fire hazards. On the average AMS examines the warehouses about twice a year.

Views of warehousing trade on CCC's assuming hazard risk

We interviewed officers of two grain warehouse associations which, according to one officer, represented warehouses accounting for about 90 percent of the storage capacity under the Uniform Grain Storage Agreement.

An officer of one association said that CCC's assumption of hazard risk would be workable and would present no particular problems. At the second association, officers said that there might be procedural problems and a legal problem involving State laws that require warehousemen to carry insurance on all stored grain. As discussed on pages 13 and 15, however, CCC's assumption of hazard risk would be procedurally and legally feasible.

Department's prior consideration of CCC's assuming hazard risk

On January 10, 1964, the Department announced that CCC would assume the risk of loss from fire, windstorm, and other causes then covered by hazard insurance on commodities, owned by the Government or pledged as collateral for price-support loans, which were stored in commercial warehouses. The announcement stated that (1) the wide distribution of CCC's commodity holdings would accomplish the same spreading of risks which individuals obtain from insurance and (2) assuming the risks was in line with our views regarding insurance on Government property. The change was to take effect July 1, 1964, on grain and August 1, 1964, on cotton and other commodities.

In justifying the change in the policy on grain, the Department stated that:

- --Information compiled for fiscal years 1962 and 1963 showed that, for every dollar paid to commercial warehousemen for insurance on grain (apparently CCC-owned), only 27 cents was paid to CCC as a result of insured losses.

- --The estimated average annual gross savings from assuming the risk of losses on CCC-owned grain during fiscal years 1962 and 1963 would have been about $4.5 million, without considering the administrative, investigative, and other overhead costs that CCC would have incurred or the income that might have been realized from salvage of damaged grain.

During hearings on March 10, 1964, before the House Subcommittee on Department of Agriculture and Related Agencies Appropriations, Department officials were questioned extensively about the risk-assumption policy announced on January 10. Questions on the policy, however, were directed to CCC's assuming risks on warehouse-stored loan-collateral commodities.[1] Farmers were incurring the insurance costs on warehouse-stored grain as part of their storage cost. CCC, however, deducted the storage amount from the loans for settlement upon maturity of the loans. CCC, upon taking possession of the grain and canceling the farmers' loan obligations at maturity, paid the warehousemen for storing the grain during the loan period.

The Subcommittee Chairman urged Department officials to hold a hearing on its proposed policy change to determine whether money would be saved and American agriculture would be favorably served. A Department official promised that the Chairman's recommendation would be considered respectfully and expeditiously. The hearing apparently was never held because CCC reversed its risk-assumption policy on March 24--14 days later.

1

The questions referred to initial loan periods. Extended loans based on warehouse-stored grain--on which CCC paid storage, including a factor for insurance--did not begin until the 1967 crop.

In a letter to ASCS's Deputy Administrator, Commodity Operations, dated March 16, 1964, ASCS's Director, Inventory Management Division, stated that, because of adverse public reaction to the January 10 announcement of CCC's risk-assumption policy and the many complexities involved, CCC's policy on risk-assumption should be reappraised. He recommended that insurance be continued on loan collateral and be dropped on CCC-owned commodities.

In the March 24 announcement reversing the policy of January 10, the Department stated that CCC would continue to require commercial warehousemen to carry hazard insurance on CCC-owned grain and on grain and other commodities pledged as collateral for price-support loans.

The official document which reversed the risk-assumption policy (Docket CZ 153, revision 2, approved by CCC's Board of Directors on March 26, 1964) justified the action on the basis that

--a risk-assumption policy would be impracticable in administering farm price-support programs;

--a reappraisal of the storage programs had disclosed substantial complexities, particularly as applicable to warehousemen and the long-established practices prevailing in the industry on insurance;

--warehousemen and insurance firms and brokers had made strong and convincing representations that the policy was an infringement upon a long and well-established trade custom; and

--State legislatures and State warehousing authorities had protested that CCC's plan to eliminate insurance on stored commodities would create a serious conflict with State laws and regulations, particularly in grain-producing States, most of which required warehousemen to carry insurance as a condition to receiving a State license. (The Department's General Counsel had ruled on December 20, 1963, that, pursuant to section 4(g) of the Commodity Credit Corporation Charter Act, such State laws would not be applicable to CCC operations so long as the storage contracts with warehousemen stated that no insurance would be provided.)

During this period we received two inquiries from Members of Congress regarding the Department's proposed risk assumption. In response to those inquiries (B-151876, April 24, 1964), the Comptroller General stated, in part:

"As previously pointed out, exceptions have been made to the Government's policy as self-insurer of its property. Inasmuch as we view that policy as equally applicable to commodities held as security on price-support loans, the standards for exception to such policy apply as well. Those standards for exception are repeated here as follows:

"(1) Where the economy sought by self-insurance is defeated.

"(2) Where sound business practice indicates that a savings can be effected.

"(3) Where services or benefits not otherwise available can be obtained by purchasing insurance.

"It is apparent from the findings made by the Department of Agriculture that neither of the first two reasons for exception apply in this consideration. We are not aware of any basis for applying the third reason for exception in this matter.

"Consequently, we believe that the Department of Agriculture's decision as stated in the press release of January 10, 1964, that the Commodity Credit Corporation would assume its own risks on Government-owned commodities and commodities held by it as security on price-support loans, was in accord with the Government's policy * * *."

INSURANCE FACTOR IN STORAGE RATE ON FARM-STORED GRAIN UNDER EXTENDED LOANS

When CCC pays farmers storage on farm-stored grain under extended loans, it pays them at the same rate that it pays commercial warehousemen. The rate includes a factor for insurance although the farmers are not required to insure the grain and CCC sustains any hazard losses. Consequently CCC does not benefit from payment of this insurance factor. Although CCC currently is not extending loans or paying storage on farm-stored grain (see p. 5), its authority to do so continues.

During the 5 years ended June 30, 1972, CCC paid an estimated $8.2 million to farmers for the insurance factor, without deriving any benefit. The estimate is based on the average annual cost of insurance on grain stored in commercial warehouses applied to the respective average annual quantity of grain stored on farms and serving as collateral for extended price-support loans. An average of 583 million bushels of grain serving as collateral for extended loans was stored on farms.

Fiscal year	Million bushels
1972	528
1971	709
1970	770
1969	569
1968	338
Total	2,914
Average	583

On the basis of CCC records, we estimated that CCC sustained hazard losses totaling about $800,000 during the 5-year period on farm-stored, extended-loan grain.

By August 1973 CCC was no longer paying storage on such grain because, to make additional stocks of grain available to meet the strong market demand, it did not extend the loans. If CCC reinstitutes loan extensions and continues its policy of paying storage to farmers at the same rate that it pays commercial warehousemen, eliminating the hazard insurance factor from storage charges paid on warehouse-stored grain would also eliminate the insurance factor from storage payments on farm-stored, extended-loan grain.

INSURANCE AGAINST WAREHOUSE SHORTAGES

In addition to paying for the hazard insurance factor included in storage charges, CCC pays for protection against shortages of grain stored in commercial warehouses--including CCC-owned grain and grain serving as collateral for price-support loans. CCC's premiums for shortage insurance are, in effect, payments primarily for a collection service because the insurers recover a considerable part of their payments to CCC from warehousemen's sureties.

We estimated that CCC would have saved $1.2 million during the 5 years ended June 30, 1972, if it had not carried such protection. This saving is the difference between CCC's premium costs of $2.9 million and an estimated $1.7 million in losses and expenses which CCC would have incurred if it had not carried such insurance but had assumed the risk of shortage losses and the responsibility for collecting directly from warehousemen's sureties.

To protect itself against warehouse shortages of grain before July 1963, CCC required each warehouseman storing grain under price-support programs to furnish a bond in favor of CCC. In 1962 a Department task force evaluated CCC policies and procedures on warehouse bonding and recommended a substantial increase in individual bond amounts. Instead, CCC purchased a blanket insurance policy effective July 1, 1963, covering all of its warehouse-stored grain and terminated the requirement for individual bonds. CCC reduced the storage rate paid to warehousemen to offset its cost for the blanket insurance.

According to CCC's records, it decided against increasing the individual bond amounts because of the increased premiums that warehousemen would have had to pay and the possibility that warehousemen with small operations might have had difficulty qualifying for increased amounts. CCC cited several reasons favoring blanket insurance, including

--considerably less potential for losses to CCC and

--a substantial reduction in the number of cases involving costly and troublesome litigation.

During the 9-1/2 years from July 1, 1963, to December 1, 1972, CCC's premiums for the blanket insurance totaled $5,486,000, or a $580,000 average a year.

The current policy, which became effective December 1, 1972, covers 5 years and provides annual coverage up to $5 million with a maximum of $250,000 for each warehouse. The annual premium for the first 2 years was $576,250, or a total of $1,152,500. During that period, the policy provided that CCC could terminate the policy through a 30-day written notice.

In October 1974 CCC negotiated a reduced premium of $250,000 for the third year, beginning December 1, 1974, because of declining agricultural stocks covered by the policy. The termination clause was changed from the 30-day notice to a notice of 90 days before the policy's anniversary date.

The policy provides that "CCC shall make reasonable efforts, by offset or otherwise short of litigation, to collect amounts due from the warehouseman." When a substantial warehouse shortage is revealed, generally through an AMS warehouse examination, CCC notifies the blanket insurer of the potential claim.

If the shortage turns out to be of a routine operational nature, such as weight shrinkage, CCC permits the warehouseman to absorb the shortage in his own stocks and CCC withdraws its notice of potential claim. If a shortage is not satisfactorily resolved, CCC files a claim against the blanket insurer which must pay the claim within 60 days. After paying CCC, the blanket insurer usually has recourse against a surety--another insurance company--because in most instances the warehouses are covered by surety bonds. Because of this recourse aspect, CCC in effect pays the blanket insurer primarily for a collection service.

About 96 percent of the 7,400 grain warehouses under CCC contract are under bonding requirements of State or U.S. Warehouse Act regulations for the protection of their depositors, including CCC. According to CCC records, the amount of protection provided by such surety bonds in 1972 was $731 million, as shown in the following table.

State	Protection provided by bonds
	(millions)
Texas	$115
Iowa	91
Nebraska	80
Kansas	78
Minnesota	74
Illinois	70
South Dakota	68
North Dakota	41
Other	114
Total	$731

Our estimate of CCC's savings, had it not carried shortage insurance, is derived from the following analysis.

Premiums paid by CCC, 7-1-63 to 12-1-72			$5,486,000
Losses and expenses:			
Blanket insurers' uncollectible claims against warehousemen, net of recoveries from sureties, 7-1-63 to 12-1-72 (note a)		$2,008,000	
Expenses if CCC had not carried insurance:			
Interest expenses that CCC would have incurred because of delayed collections	$669,000		
Additional administrative and legal expenses	568,000	1,237,000	3,245,000
Estimated saving for 9-1/2 years			$2,241,000
Pro rata saving for 5 years			$1,190,000

[a] Recovery data shown as net amount to avoid disclosure of confidential data.

The estimated loss during the 9-1/2 years of $2,008,000 on uncollectible claims after recovery from sureties is based on the blanket insurers' experience for the first 6-1/2 of the 9-1/2 years of coverage. We assumed that the insurers would have experienced similar losses for the remaining 3 years. Although CCC may not necessarily have recovered as much as the insurers if it had not carried the insurance, the estimated saving is sufficiently large to allow for a smaller recovery and still yield substantial savings.

As the blanket insurance policies specified, CCC generally collected on its claims within 60 days. According to ASCS personnel, CCC experienced long delays in collecting from sureties before 1963 when the blanket policy was first used. Our sampling of pre-1963 claims indicated that it took 26 months, on the average, to collect from individual sureties. For our analysis, therefore, we estimated that, if CCC had not used a blanket policy, it would have incurred interest expenses of $669,000 by not having use of the money for about 2 years. CCC records of pre-1963 cases indicated that it encountered difficulties at times in collecting from sureties.

State laws indicate that sureties are obligated to honor legitimate and substantiated claims. Insurance company (surety) representatives acknowledged that claims should be processed promptly and fairly but said that questions of fact or law may at times necessitate judicial review. Insurance experts in the academic and regulatory fields confirmed this but said that, in recent years, State insurance commissions have become more active in stimulating prompt and fair settlement of claims through closer supervision and monitoring.

Our computation of the amount of additional administrative and legal expenses of $568,000 for the 9-1/2 years was based on the assumption, after discussions with Department officials, that the Department would have needed four additional persons, including two attorneys, to provide such services in connection with recoveries from warehousemen or their sureties. We included only a nominal allowance for legal involvement by the Department of Justice because Department of Agriculture attorneys, we were told, would have done the basic legal work. Our estimate is conservative because it was based on a higher level of activity than the current level. In October 1973 the Department's Office of the General Counsel advised CCC that, if the blanket insurance policy was terminated, additional staff would not be needed in view of the low levels of grain then in CCC's inventory and serving as loan collateral.

We did not include in our computation an interest saving on CCC funds paid for premiums because the estimated amount that could have been saved would have been largely offset by the amount of interest CCC could have earned on funds collected from the blanket insurers.

The Department (see app. I) said that we did not consider the saving realized during the 9-1/2 years through reductions in the storage rates that more than offset its premium cost. Although such saving may have been realized, this factor is not pertinent to whether CCC should assume shortage risks and thereby avoid premium payments. Such saving should have been realized also if there had been no blanket policy and CCC had assumed the risks.

The Department said also that we did not indicate the percentage of recoveries by the blanket insurance companies and that, by using the companies' experience, we may be overestimating the amount of recoveries that CCC might have experienced. The Department suggested that it would be more appropriate to use CCC's recovery experience covering fiscal years 1948 through 1963.

As Department personnel acknowledged during discussions with us, the blanket insurers' recovery percentages are confidential; therefore we are not disclosing them. As to use of CCC's recovery experience before July 1963, our computation of the estimated saving, as noted on page 25, is conservatively based on a sample of pre-1963 claims which showed an average lapse of 26 months before CCC collected from sureties. We believe that such a long lapse would not apply today in view of the insurance experts' statements that, in recent years, State insurance commissions have become more active in stimulating prompt claim settlement.

The Department said that, during the period of almost 2 years beginning December 1, 1972, $1,039,000 in claims were collected by CCC from the blanket insurer, $500,000 in additional claims were submitted for payment, and $1,839,000 in potential claims remained. The Department did not indicate, however, how much the blanket insurer had recovered or could expect to recover from the warehousemen's sureties nor did it mention that CCC paid $1,152,500 in premiums during this period. Any comparison of costs and benefits of the blanket insurance policy must, of course, include these factors because CCC's premium payments are, in effect, primarily for a collection service.

RISKS ASSUMED BY OTHER LARGE ENTITIES

A research study[1] of insurance in industry showed that a number of large and well-established manufacturing, wholesaling, retailing, and other businesses had assumed fire and other risks either wholly or in part through large deductibles. The assets of most of the enterprises that retained fire risks ranged from $50 million to about $750 million. By comparison, CCC's assets during the 5 years covered by our review averaged $6.4 billion, of which $3.7 billion was the investment in price-support loans and inventories. At June 30, 1974, CCC's assets totaled $6 billion and the investment in loans and inventories amounted to $560 million. With such financial resources, it seems reasonable for CCC to assume its insurable risks.

1 Corporate Self-Insurance and Risk Retention Plans, Robert C. Goshay, Ph. D.; published for the S. S. Huebner Foundation for Insurance Education, University of Pennsylvania, by Richard D. Irwin, Inc., Homewood, Ill., 1964.

CHAPTER 3

CONCLUSIONS, RECOMMENDATIONS, AND DEPARTMENT COMMENTS

CONCLUSIONS

The purpose of insurance protection is to share risk of loss with others by paying into a fund, administered by an insurer, from which payments are made to cover the participants' losses. Premiums paid into the fund must be sufficient, in the long run, to cover not only participants' losses but also the selling, administrative, and other expenses and to provide a profit to the insurer.

Grain in which CCC has had an insurable interest has been stored at thousands of locations throughout the Nation and large losses have been infrequent. It is apparent that a party, which has large financial resources, which is able to absorb maximum probable losses, and which has risks spread so widely that the statistical probability of losses exceeding premium costs over a reasonable period of time is minimal, generally will find it less costly to assume the risk of loss than to pay for insurance. CCC meets these criteria.

As a large Federal operation, CCC has ample resources to absorb insurable losses. Its activities are financed largely by borrowings under a statutory authorization of $14.5 billion, and its operating losses--normally several billion dollars annually--are reimbursable through congressional appropriations.

It is difficult to conceive of an organization better prepared to assume its own risks than a U.S. Government entity. Yet, in connection with the storage of grain under price-support programs, CCC incurred insurance costs of about $22.6 million during the 5 years ended June 30, 1972, of which about $17.1 million would have been saved if it had assumed its own insurable risks.

Over the 5 years, CCC collected only 33 cents per dollar of premium for insurance protection against hazards on warehouse-stored grain. On farm-stored, extended-loan grain, CCC does not derive a benefit from payment for the insurance factor because it absorbs any hazard losses. For the blanket insurance protection against warehouse shortages, CCC, in effect, pays primarily for a collection service because the blanket insurer recovers from sureties a considerable part of the payments to CCC.

As we have demonstrated, CCC could accomplish worthwhile savings on grain price-support operations by assuming the risks and sustaining losses as they occur. As indicated on page 5, the quantity of grain on which CCC was directly and indirectly incurring insurance costs at June 30, 1974, was at a low level and mostly committed for disposition. Consequently, this would be a good time for CCC to adopt a policy of assuming its insurable risks because the impact on insurance companies' premium incomes would be minimal. In adopting such a policy, CCC would attain a position to economize should grain price-support operations again reach a substantial level.

RECOMMENDATIONS

We recommend that the Secretary of Agriculture have CCC (1) eliminate hazard insurance coverage on grain for which it pays storage charges and (2) obtain commensurate reductions in storage rates. We believe that an opportune time to make these revisions effective would be July 1975 when the Department changes from a uniform storage rate to rates based on offers by individual warehousemen. If CCC continues its policy of paying storage to owners of farm-stored grain at the warehouse-stored rate, this reduction would have the additional effect of eliminating the insurance factor from storage payments on farm-stored, extended-loan grain.

We recommend also that the Secretary have CCC terminate the blanket insurance coverage for warehouse shortages at the earliest opportunity and assume the risks and the responsibility for collecting from warehousemen and their sureties.

DEPARTMENT COMMENTS

Hazard insurance

In a letter dated November 8, 1974, (see app. I), the Department agreed with the facts on hazard risks. However, it did not say whether it concurred in our recommendation that CCC eliminate hazard insurance coverage on grain for which it pays storage charges and obtain commensurate reductions in the storage rates. The Department said that, to assist it in deciding what to do, it would seek the views and comments of the grain warehouse industry. Department officials said this would be done during negotiations in connection with conversion to the offer rate basis. The Department agreed that, if CCC converts to assuming its own risks, such conversion should coincide with the introduction of the offer rate basis in July 1975.

The Department said that, in the event programs for farm-stored, extended-loan grain are reinstituted, it would evaluate the storage rates on such grain in relation to our recommendation.

Shortage insurance

In a letter to CCC dated August 24, 1973, we suggested that it terminate its blanket insurance policy and eliminate premiums because warehouse-stored grain stocks in which CCC had an interest were declining sharply. We recognized that, at that time, CCC still owned a large quantity of grain which, although largely committed for disposition, had yet to be transferred to recipients or sold and that shortages could be disclosed upon loadout of the grain from warehouses. We said, however, that it appeared CCC did not have to wait until all its grain was removed from warehouses before terminating the policy because the warehouses were usually covered to some extent by surety bonds required by States or by the U.S. Warehouse Act.

In replies dated October 19, 1973, and February 4, 1974, CCC said that it was continuing the blanket insurance policy pending disposition of a majority of the stocks in warehouses because loadouts always revealed some operational losses that warehousemen could not pay. CCC said it would decide after July 1974 whether to continue the blanket policy.

In its November 1974 comments, the Department said that it had been decided that it was in CCC's best interests to continue the blanket insurance policy through November 30, 1975, at a reduced premium of $250,000 on the basis of

--the quantity of warehouse-stored inventory and loan collateral subject to insurance coverage (114.2 million bushels as of September 30, 1974, at an acquisition cost or loan value of $110 million) and

--the potential losses of $42.4 million during the 1974-75 premium year upon loadout of its inventory.

The Department said that, before September 1975, the Corporation would again examine the relationship of its inventory position to the cost of the blanket coverage and, if conditions so dictate, intended to assume its own risk against warehouse shortages.

The Department's comments and CCC's responses to our letter of August 24, 1973, expressed concern about potential shortage losses upon loadout of grain from warehouses. In the year after our letter, during which CCC-owned grain having a market value of about $700 million was shipped from warehouses, CCC notified the insurer of potential claims totaling nearly $1.2 million. According to CCC records, however, all the larger shortage claims originated not upon grain loadouts, but during warehouse examinations. The amount of loadout claims was minor.

CHAPTER 4

SCOPE OF REVIEW

Our review was directed primarily to (1) developing information on the cost and related benefits to CCC of insurance protection, (2) ascertaining whether it was practicable for CCC to dispense with insurance protection, and (3) exploring the extent to which other large entities had assumed their own risks when premiums for insurance exceeded probable losses.

We reviewed data on CCC's grain price-support programs, losses protected by insurance, insurance practices pertaining to grain stocks, and CCC's corporate powers.

Our review was made primarily at ASCS's national office in Washington, D.C., and its commodity office in Prairie Village, Kansas. We also visited grain warehouses, insurance companies, and the regulatory divisions--insurance and warehousing--of Iowa and Minnesota. We interviewed ASCS officials, warehouse managers, insurance officials, representatives of insurance and grain warehouse associations, and insurance experts in the regulatory and academic fields.

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UNITED STATES DEPARTMENT OF AGRICULTURE
COMMODITY CREDIT CORPORATION
WASHINGTON, D. C. 20250

NOV 8 1974

Mr. Henry Eschwege
Director, Resources and Economic
Development Division
United States General Accounting Office

Dear Mr. Eschwege:

This is in reply to your letter of October 7, 1974, transmitting a draft report to Congress entitled, "The Reduction in Federal Expenditures Possible Through CCC's Assumption of Insured Warehousing Risk" (B-114824).

We have reviewed the aforementioned draft report and have the following comments.

Hazard Insurance on Grain for Which CCC Pays Storage Charges

We agree with the facts as presented in the subject draft report as they relate to hazard insurance and agree that in the event that CCC determines to convert to self-insurance such conversion should coincide with the introduction of the offer rate basis in July 1975. To assist us in arriving at a decision we will, after the subject report has been published, request members of the grain warehouse industry to furnish us views and comments regarding your recommendation that CCC assume the risk of hazard losses on grain stored under the grain storage agreement.

With regard to the elimination of hazard insurance on extended warehouse loan grain, the subject draft is not clear as to CCC's obligation regarding such grain stored in commercial warehouses and what the producers protection would be in the event of a hazard loss. Hazard insurance as presently required provides producers protection at the full market value.

There are presently no farm-stored extended loan grain programs in effect. However, in the event that such programs are reinstituted, storage rates paid to producers for farm-stored grain will be evaluated in relation to your recommendation.

Insurance Against Warehouse Shortages

In reply to a letter from your office concerning the blanket insurance policy, the Acting Executive Vice President, CCC, stated in a letter dated February 4, 1974, that it was our determination that the blanket coverage shall be continued in its present form until the movement of committed CCC inventory has been substantially completed. As stated in the letter we have again reviewed our position on the continuation of the blanket coverage preparatory to the payment of the annual premium for the period December 1, 1974, through November 30, 1975.

As of September 30, 1974, the warehouse inventory and loans subject to insurance coverage was 114,200,000 bushels at an acquisition cost or loan value of $110,054,000. Of the $81,297,000 representing CCC-owned warehouse inventory, $42,416,000 or 52 percent was committed to other than reserve required by legislation, but undelivered, representing potential losses when loadout occurs.

Prior to receipt of the subject draft report, and in view of the reduction in the quantity of commodities covered by the insurance, we discussed with the insurer the amount of the forthcoming annual premium. As a result of the discussions the insurer proposed to reduce the premium from $576,250 to $250,000.

On the basis of the quantity of existing warehouse-stored inventory and loans and the potential loadout during the 1974-1975 premium year, it was decided that it was in the best interests of CCC to continue the policy through November 30, 1975, at the reduced premium. Prior to September 1975, we will again examine the relationship of the inventory position to the cost of the blanket insurance coverage and, if conditions so dictate, it is our intention to become a self-insurer against warehouse shortages.

In addition to the above we have the following comments regarding certain statements and assumptions included in the report.

[22]

Page 34 of the draft report contains the statement that CCC reduced the storage rate to offset the cost of the blanket insurance policy. However, the report does not give consideration to the savings realized by the reduction in storage rates over the 9.5-year period. It would appear that the reduction in storage rates more than offsets the cost of premium during that period.[27]

[26]

On page 37, the assumption concerning losses is based on the first 6.5 years of coverage and projected for the 9.5 years the policy had been in effect through November 30, 1972. The 2-year period December 1, 1972, to present, which was excluded from the computation of estimated losses, was a period of declining inventories and heavy loadouts which resulted in losses larger than those experienced during the previous 9.5 years. During this 2-year period, approximately $1,039,000 in claims were paid, proof of claims totaling over $500,000 were submitted for payment, and potential claims of $1,839,000 are yet to be considered. We believe that a valid estimate of losses should take this 2-year period into account.

[25]

On pages 36 and 37 of the draft report the estimate of CCC savings is based in part on recoveries by the blanket insurance companies but does not indicate the percentage of recovery to losses. Our records reflect that during a period from fiscal years 1948 through 1963, prior to the blanket insurance coverage when warehousemen were required to carry individual bonds, $11,823,000 was recovered by CCC in settlement of 177 claims totaling $17,911,000 filed under the Uniform Grain, Rice and Bean Storage Agreements. This resulted in a total recovery of 66 percent. Of the total amount of claims settled, $10,340,000 or 87 percent was recovered from warehouses and $1,483,000 or 13 percent was recovered from sureties. In light of your statement on page 37 that CCC may not have necessarily recovered as much as the insurer, we believe that CCC's historical rate of recovery should be reflected in the computation of savings rather than the higher rate experienced by the insurer.

[26]

Page 38 contains the following passages: "...sureties are obligated to honor legitimate and substantiated claims," "...claims should be processed promptly and fairly," and "Insurance experts...confirmed... that State insurance commissions encourage prompt and fair settlement of claims." The report concludes on page 37 however, that prior to the blanket insurance coverage, "CCC required 26 months on the average to collect from individual sureties." These statements appear to be inconsistent. Furthermore, as pointed out above only 13 percent of the recoveries made by CCC were from sureties. [26]

Sincerely,

Kenneth E. Frick

Executive Vice President

GAO note: The numbers in brackets refer to pages in this report.

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