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CROP INSURANCE

Federal Program Has Been Unable to Meet Objectives of 1980 Act

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Mr. Chairman and Members of the Subcommittee:

We are pleased to be here today to discuss the performance of the federal crop insurance program, administered by the U.S. Department of Agriculture's (USDA) Federal Crop Insurance Corporation (FCIC). In 1980 the Congress substantially revised the program to expand the availability of crop insurance; develop actuarially sound premiums; utilize private insurance companies to sell, service, and bear risk on crop insurance policies; and abolish government-funded disaster payments.

Our testimony focuses on the extent to which the program has met the objectives of the 1980 act and is based on extensive work conducted since 1980. Appendix I lists reports and testimonies on FCIC's achievement of 1980 program goals, other problems related to FCIC's financial and management performance, and issues related to disaster assistance. We are also continuing to examine the crop insurance program. A forthcoming report to the Chairman, Senate Committee on Agriculture, Nutrition, and Forestry, addresses additional issues concerning actuarial soundness. A subsequent review for that Committee will analyze agriculture risk-protection options available to the Congress.

In summary, FCIC's performance since the 1980 revision has been mixed. FCIC expanded the program, subsidized farmer premiums, and utilized private insurance companies to sell policies and administer claims. However, these measures, and actions FCIC has taken to improve the program, have not been sufficient to meet all of the 1980 act's objectives. Specifically:

- FCIC has rapidly expanded the program. However, this expansion was done without developing actuarially sound premiums. From 1981 to 1990, FCIC increased the number of county crop programs available to farmers by over 250 percent.[1] Because premiums were not actuarially sound, losses exceeded premium income by over $2.3 billion for this period.

- Since 1980, FCIC has utilized private insurance companies to deliver the majority of crop insurance policies. However, FCIC bore most of the risk on those policies. Consequently, while FCIC had underwriting losses of $2.3 billion over the 1981-90 period, reinsured companies had underwriting gains in 7 of those 10 years, contributing to a net underwriting profit of $101 million.

- FCIC does not sufficiently control how private insurance companies service crop insurance policies, particularly

[1]FCIC offers county crop programs for specific crops in individual counties.

claims adjustments. For example, we found that a sample of 134 claims from the 1984 and 1985 crop years had an overpayment rate of 31 percent. FCIC has since improved its oversight of claims adjustments, but in 1992 USDA identified overpayment of FCIC claims as a continuing high-risk area.

-- Other forms of agricultural disaster assistance continued to expand during the 1980s. Of the $25 billion in costs that USDA incurred between 1980 and 1990 for crop insurance, emergency loans, and direct payments, only 24 percent, or $6 billion, was spent on crop insurance; $19 billion, or 76 percent, was spent on other assistance.[2]

BACKGROUND

FCIC insures individual crop yields against losses from unavoidable production risks. Participating farmers can elect yield-guarantee coverage of 50, 65, or 75 percent of their 10-year actual production history yield, if these data are available. Participants also select a commodity price level--from 30 to 100 percent of the crop's expected market price. Claim payments are calculated by multiplying the number of bushels that fall below the guaranteed yield level by the selected commodity price level. Premiums depend on the type of crop insured, location of the farm, and historical yield level, as well as the coverage and price levels selected.

The vast majority of crop insurance policies are sold to farmers through private insurance companies that are reinsured by FCIC. These reinsured companies sell and service policies and adjust claims. FCIC establishes premiums, program policies, and reinsurance terms that are governed by a standard reinsurance agreement that is revised annually and compensates reinsured companies for administrative costs associated with selling and servicing crop insurance policies--33 percent in 1992.

FCIC EXPANDED PROGRAM WITHOUT ESTABLISHING ACTUARIALLY SOUND RATES

From 1981 to 1990, FCIC increased the number of county crop programs from 5,969 to 21,354, but largely did not develop appropriate premiums for these new programs before they were in place. Appendix III illustrates the program's expansion. The most dramatic expansion occurred during crop year 1982, when the number of county crop programs ballooned from 5,969 to 14,498--an increase of more than 140 percent. However, program expansion proceeded in the absence of actuarial soundness. To be actuarially sound, FCIC

[2]App. II summarizes other findings on FCIC problems that impede program performance.

must charge premiums that, over time, are sufficient to cover indemnities. We have reported several times since 1981 that FCIC did not develop premiums that were consistent with the level of risk involved. Without actuarially sound premiums, FCIC experienced underwriting losses that exceeded premiums by $2.3 billion between 1981 and 1990.

Appendix IV illustrates the effect of program expansion on FCIC's loss ratio--the ratio of premiums collected to indemnities paid. A loss ratio of less than or equal to 1 means that premiums are sufficient to cover losses. Before 1980, when the program offered limited coverage, the loss ratio was often below 1. However, since rapid expansion began in 1981, the ratio has generally increased and has never been below 1, reflecting FCIC's difficulty in setting actuarially sound premiums in an expanded program.

In 1984 we recommended that USDA moderate further program expansion until FCIC's actuarial division could establish actuarially sound rates. In addition, in 1990 FCIC's compliance division made several recommendations regarding program expansion, including establishing appropriate rates. Despite FCIC's actions to improve actuarial soundness, indemnities continue to exceed premiums on a yearly basis.

REINSURED COMPANIES' RISK SHARING IS LOW

Because the crop insurance program continued to lose money, reinsured companies did not have an incentive to bear a substantial portion of risk on the policies they delivered during the 1980s. The risk-sharing provisions of the standard reinsurance agreement allowed the reinsured companies to transfer most of the risk to FCIC. As early as 1984, when reinsured companies delivered an estimated 50 percent of crop insurance, we recommended that USDA moderate further expansion of the reinsurance program until it could be evaluated to ensure cost effectiveness for both FCIC and the reinsured companies. However, FCIC continued to increase the portion of crop insurance delivered by reinsured companies--approximately 88 percent of the premium value in 1992 (as of October).

Because they had only limited risk sharing, reinsured companies either earned underwriting gains in years when FCIC had underwriting losses or experienced very limited losses. More specifically, FCIC experienced net underwriting losses each year from 1981 to 1990, losing over $2.3 billion above the federal government's premium subsidy and compensation to reinsured companies. Yet the reinsured companies had underwriting gains in 7 of those 10 years, contributing to an overall net underwriting gain of about $101 million. In 1988, the worst drought year, reinsured companies lost about $8 million, while the federal government lost about $616 million. (App. V compares the total program losses and reinsured companies' gains from 1981 to 1990).

In the 1992 standard reinsurance agreement, FCIC increased the amount of risk borne by reinsured companies, but the amount of risk retained by companies remains limited compared with FCIC's risk. The 1992 agreement requires companies to retain a higher proportion of risk on the policies they write, reduces the level of protection offered through FCIC reinsurance, and requires companies to risk more losses to earn gains. However, we estimated that FCIC would still bear almost 75 percent of the total risk of loss in a worst-case scenario under the 1992 agreement.

In 1992 we reported that companies cannot be expected to assume increasing portions of risk as long as the program is not actuarially sound. Therefore, substantially increasing reinsured companies' risk sharing solely through Standard Reinsurance Agreement revisions is highly unlikely.

FCIC HAS INSUFFICIENT CONTROLS OVER REINSURED COMPANIES' CLAIMS ADJUSTMENT

Because reinsured companies do not bear a substantial amount of risk, they may have less incentive to accurately adjust losses. We have demonstrated that reinsured companies' claims adjustments resulted in millions of dollars in overpayments by FCIC. For instance, as we reported in 1987, we reviewed a sample of 134 claims covering three crops in five states from the 1984 and 1985 crop years and found overpayments of nearly $3 million--an overpayment rate of 31 percent. We believed this sample to be indicative of a nationwide problem and, focusing on claims for crop loss because of drought on irrigated farms, estimated that overpayments of about $18 million may have occurred between 1984 and 1986 on these claims. We also found problems with claims adjusted by FCIC, but these problems were of a much smaller magnitude.

FCIC established a compliance division in 1986 to, among other things, provide oversight for reinsured company claims adjustments. We subsequently found that, although the compliance division's efforts improved reinsured companies' claims adjustments, it was still a material weakness in the program. In 1992, USDA's Office of Inspector General identified overpayment of FCIC claims as a continuing high-risk area. Targeting 16 claims of at least $90,000 that were adjusted by either reinsured companies or FCIC for crop years 1989 and 1990, the Inspector General found overpayments totaling $1.5 million.

CROP INSURANCE HAS NOT ELIMINATED OTHER FORMS OF DISASTER ASSISTANCE

Despite the 1980 revisions to make crop insurance the preeminent means of providing agricultural disaster assistance, direct disaster payments to farmers and emergency loans expanded throughout the 1980s. Of the $25 billion in costs that USDA incurred between 1980 and 1990 for all three programs, $19 billion, or 76 percent, was for forms of disaster assistance other than crop insurance. (App. VI illustrates the relative costs for all three programs from 1980 to 1990).

In 1980 the House Committee on Agriculture envisioned that crop insurance participation would reach 50 percent of eligible acres and abolish government-funded disaster payments. However, despite federal subsidies, crop insurance participation has never reached that level. The highest participation rate--40 percent--was achieved only in 1989 and 1990, when participation was mandatory for farmers who had received disaster payments during the previous year to be eligible for future payments. After the requirement was lifted, however, participation immediately fell back to 33 percent. In 1988 we reported that participation varies considerably among states and that a variety of factors can influence participation, including crop diversification, the condition of the farm economy, and insurance agent problems. FCIC is currently reviewing its methods for measuring participation, including what factors influence a farmer's participation decision and how these factors can be accounted for when measuring participation.

While we have cited problems with the crop insurance program over the past 12 years, we have also noted deficiencies with other forms of disaster assistance. In 1989 we found that crop insurance was more equitable and efficient than disaster payments and emergency loans, although none of the programs was ideal. In 1991 we found that USDA's Agricultural Stabilization and Conservation Service lacked assurance that the $1.3 billion in disaster payments it made to producers of nonprogram crops were accurate and free from fraud, waste and abuse.

In summary, Mr. Chairman, the federal crop insurance program has not achieved many of the objectives of the 1980 act. While FCIC has significantly expanded the program, it has done so at a price--underwriting losses of more than $2.3 billion between 1981 to 1990. FCIC has also involved private industry in the operation of the program, but, again, at a price--the industry has assumed very little of the risk: It earned underwriting gains of $101 million, while FCIC lost $2.3 billion. Further, insufficient oversight over reinsured companies has led to claims adjustment practices that have resulted in millions of dollars in overpayments. Finally, a major objective of the legislation--to make crop insurance the preeminent means of providing agricultural disaster assistance--has not been achieved. Other forms of agricultural disaster assistance represented 76 percent of all assistance from 1980 to 1990.

A number of alternatives and variations to the current program have been proposed over the past several years. In the final analysis, any method of agricultural disaster assistance that the Congress chooses will involve tradeoffs between the desire to protect farmers from hardship and the cost of providing this protection. We are currently evaluating alternative forms of assistance for the Senate Committee on Agriculture, Nutrition, and Forestry.

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Mr. Chairman, this concludes my formal statement. We would be happy to respond to any questions you or other Members of the Subcommittee may have.

RELATED GAO PRODUCTS

Crop Insurance: Program Has Not Fostered Significant Risk Sharing by Insurance Companies (GAO/RCED-92-25, Jan. 13, 1992)

Crop Insurance: Inaccurate FCIC Price Forecasts Increase Program Costs (GAO/PEMD-92-4, Dec. 13, 1991)

Crop Insurance: FCIC's Internal Controls on Safflower Coverage Must Be Improved (GAO/PEMD-91-27, July 15, 1991)

Disaster Assistance: Problems in Administering Payments for Nonprogram Crops (GAO/RCED-91-137, June 28, 1991)

Financial Audit: Federal Crop Insurance Corporation's Financial Statements for 1989 and 1988 (GAO/AFMD-90-107, Sept. 28, 1990)

Analysis of Crop Insurance Proposals H.R. 4360 and H.R. 4592 (GAO/T-RCED-90-76, May 1, 1990)

Financial Audit: Federal Crop Insurance Corporation's Fiscal Year 1988 Financial Statements (GAO/AFMD-90-43, Apr. 18, 1990)

1990 Farm Bill: Opportunities for Change (GAO/RCED-90-142, Apr. 10, 1990)

Crop Insurance: Private Company Loss Adjustment Improving, but Overpayments Still High (GAO/RCED-90-32, Nov. 7, 1989)

Disaster Assistance: Crop Insurance Can Provide Assistance More Effectively Than Other Programs (GAO/RCED-89-211, Sept. 20, 1989)

Roles, Cost, and Criteria for Assessing Agriculture Disaster Assistance Programs Between 1980 and 1988 (GAO/T-RCED-89-63, Sept. 20, 1989)

Crop Insurance: FCIC Should Strengthen Actual Production History Program Controls (GAO/RCED-89-19, Dec. 15, 1988)

Crop Insurance: FCIC Needs to Improve Its Oversight of Reinsured Companies (GAO/RCED-89-10, Oct. 19, 1988)

Crop Insurance: Program Has Merit, but FCIC Should Study Ways to Increase Participation (GAO/RCED-88-211BR, Aug. 15, 1988)

Crop Insurance: Participation in and Costs Associated With the Federal Program (GAO/RCED-88-171BR, July 6, 1988)

Crop Insurance: Conflict-of-Interest Problems Involving an FCIC Official (GAO/RCED-88-24, Dec. 18, 1987)

Crop Insurance: Overpayment of Claims by Private Companies Costs the Government Millions (GAO/RCED-88-7, Nov. 20, 1987)

Crop Insurance: Federal Crop Insurance Corporation Needs to Improve Decision-Making (GAO/RCED-87-77, July 23, 1987)

Financial Audit: Federal Crop Insurance Corporation's Financial Statements for 1986 and 1985 (GAO/AFMD-87-36, June 12, 1987)

Results of GAO's Review of the Department of Agriculture's Federal Crop Insurance Program (GAO/T-RCED-87-18, Apr. 29, 1987)

Preliminary Results of GAO's Review of the Department of Agriculture's Federal Crop Insurance Program (Sept. 23, 1986, Testimony)

Financial Audit: Federal Crop Insurance Corporation's Financial Statements for 1985 and 1984 (GAO/AFMD-86-58, Sept. 19, 1986)

Farm Payments and Loans: Consistency Needed in USDA Crop Yield Estimates (GAO/RCED-86-118, May 29, 1986)

Examination of the Federal Crop Insurance Corporation's Financial Statements For the Year Ended September 30, 1984 (GAO/AFMD-85-54, Sept. 30, 1985)

Information on the Federal Crop Insurance Corporation's 1986 Standard Reinsurance Agreement (GAO/RCED-85-155, July 26, 1985)

The Federal Crop Insurance Corporation's Efforts to Provide Monthly Reports to the Senate Committee on Appropriations (GAO/RCED-84-169, July 13, 1984)

More Attention Needed in Key Areas of the Expanded Crop Insurance Program (GAO/RCED-84-65, Mar. 14, 1984)

Review of the Federal Crop Insurance Corporation's Financial Statements for the Year Ended September 30, 1981 (GAO/AFMD-83-74, July 22, 1983)

The Department of Agriculture's Federal Crop Insurance Corporation (May 26, 1983, Testimony)

Information on the Federal Crop Insurance Corporation's 1983 Standard Reinsurance Agreement (GAO/RCED-83-114, Mar. 9, 1983)

Information on the Federal Crop Insurance Program (GAO/RCED-83-117, Mar. 8, 1983)

Concerns About the Actuarial Soundness of the Federal Crop Insurance Program (Letter dated Aug. 10, 1982)

General Accounting Office Reviews of Department of Agriculture Activities (Apr. 1, 1982, Testimony)

Analysis of Certain Operations of the Federal Crop Insurance Corporation (CED-81-148, July 30, 1981)

Information on Personnel and Travel at the Federal Crop Insurance Corporation (FPCD-81-22, Dec. 23, 1980)

Federal Disaster Assistance: What Should the Policy Be? (PAD-80-39, June 16, 1980)

Additional GAO Findings

In addition to issues previously presented, GAO has reported on other issues related to the Federal Crop Insurance Corporation's (FCIC) financial and management performance. The following highlights some of these major findings.

In 1991 we found that inaccurate FCIC price forecasts for corn, soybeans, and wheat increased losses. Although U.S. Department of Agriculture (USDA) considers World Agricultural Outlook Board (WAOB) price forecasts to be official, FCIC uses its own forecasts. For crop years 1983 to 1989, the program would have cost $194 million less had WAOB forecasts been used in place of the actual forecasts used for establishing price elections for corn, wheat, and soybeans. We therefore recommended that the Manager of FCIC, to the extent possible, use available WAOB crop price forecasts because they have been shown to be more accurate. USDA, in its official comments on our report, agreed with our findings and recommendations pertaining to price forecasts.

In 1991 we reported on a specific example of program expansion into a new area before actuarially sound rates and coverages were established. In 1990, FCIC insured producers of nonirrigated safflowers in three California counties that had experienced four straight years of drought. Losses from these policies in 1990--which FCIC preliminarily estimated to be as much as $14.8 million--were greater than safflower losses in all other states combined since the inception of the safflower program in 1987. We recommended that the Manager of FCIC promptly evaluate FCIC compliance division's recommendations concerning program development and expansion and fully implement those controls that were needed, as well as any other internal controls necessary to ensure that new and revised county crop programs are implemented in an actuarially sound manner.

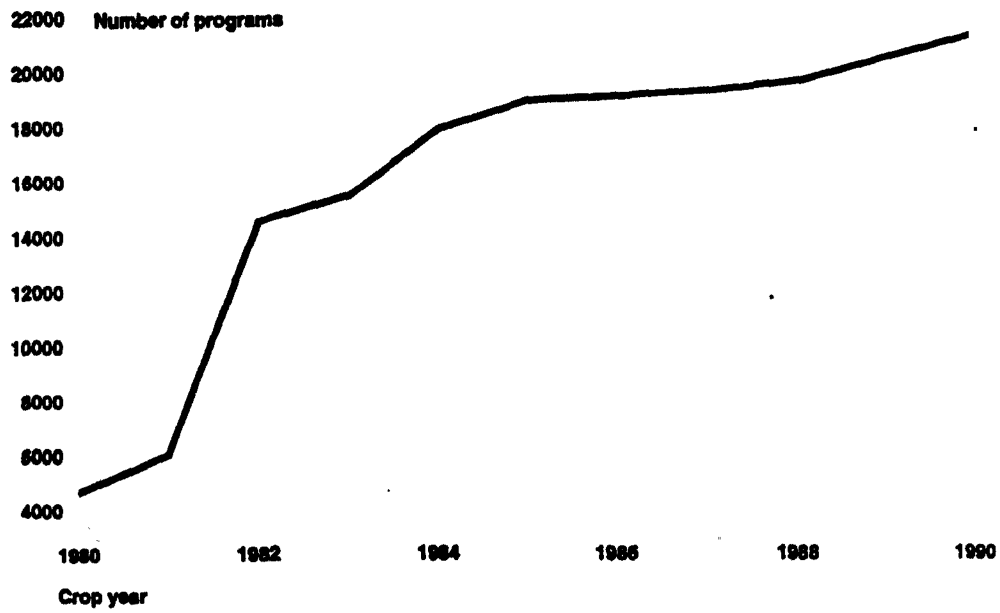
We also found that FCIC does not have adequate procedures to determine that production guarantees are accurate. In 1987 FCIC determined that producers' actual production histories, used to establish insurance coverage for individual farmers, were inaccurate as much as 37 percent of the time. We made several recommendations directed at FCIC's obtaining assurance that reinsured companies were making loss adjustments on the basis of reliable APH data. At the end of 1992, FCIC was studying these recommendations but had not taken any actions.

In 1990 we reported that FCIC did not have effective internal controls over the processing and payment of $61 million in reinsured companies' administrative costs. FCIC had not established internal accounting control procedures to ensure that all transactions sent to USDA's National Finance Center in New

Orleans were accurately processed and recorded. We also found that the compensation rates may not be accurate. Because compensation rates are computed as a percentage of total premiums sold, large premium increases translate into higher compensation expenses. In 1984, we concluded that, although the costs to sell a policy undoubtedly increased because of both inflation and the increased number of options available to farmers under the expanded program, such costs probably did not increase at the same rate as the premiums. We recommended that FCIC consider adjusting the method of compensation to more accurately reflect actual costs. However, FCIC has continued to compensate reinsured companies on a percentage of total premiums.

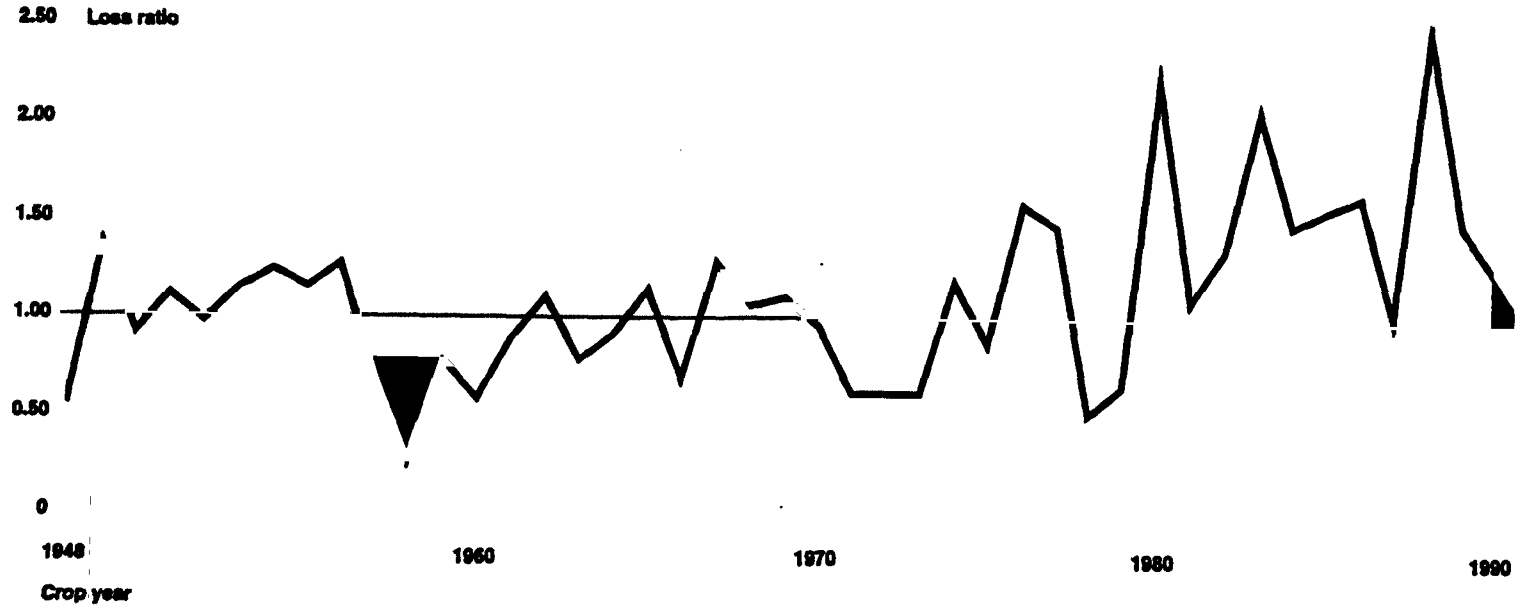
 APPENDIX III

Expansion of County Crop Programs, 1980-90



APPENDIX IV

FCIC Loss Ratio, Crop Years 1948-90



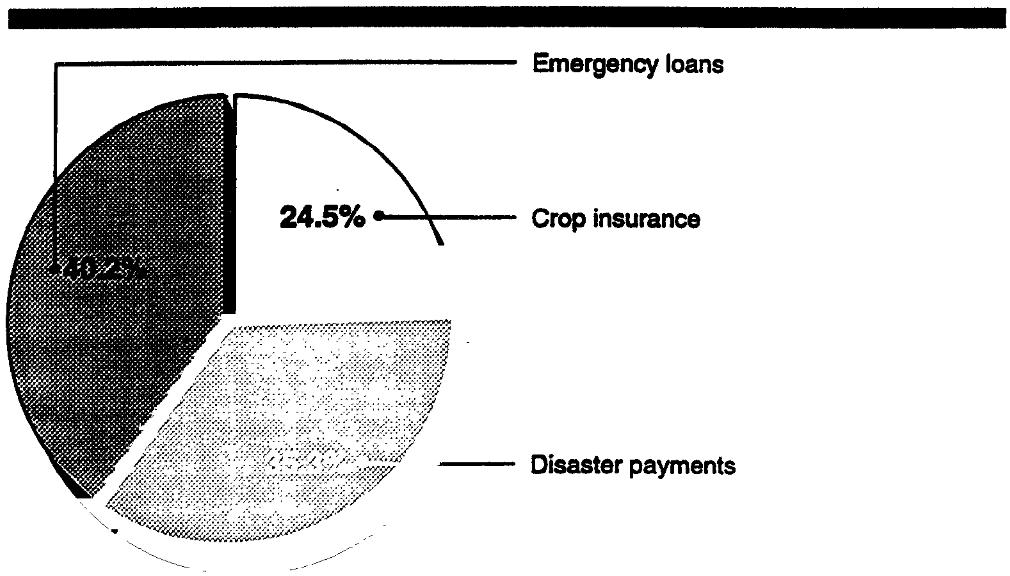
Total Program and Reinsured Companies' Financial Performance, 1981-90

Dollars in Millions

Program year	Total Program Gain or (loss)	Reinsured Companies Gain or (loss)
1981	($28.9)	$0.3
1982	(129.5)	2.6
1983	(296.3)	(2.4)
1984	(207.1)	(0.4)
1985	(242.7)	3.3
1986	(234.5)	8.0
1987	(2.5)	16.7
1988	**(616.1)**	**(8.0)**
1989	(395.0)	28.4
1990	(163.8)	52.9
Total	($2,316.4)	$101.4

Note: Excludes funds the government spends for premium subsidies and compensating reinsured companies for administrative expenses.

Cost of Disaster Assistance, 1980-90



Note: Total costs were $25 billion.

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