United States General Accounting Office

GAO

Report to Congressional Requesters

June 2004

CROP INSURANCE

USDA Needs to Improve Oversight of Insurance Companies and Develop a Policy to Address Any Future Insolvencies

GAO-04-517

June 2004

CROP INSURANCE

USDA Needs to Improve Oversight of Insurance Companies and Develop a Policy to Address Any Future Insolvencies

GAO Accountability • Integrity • Reliability

Highlights

Highlights of GAO-04-517, a report to congressional requesters

Why GAO Did This Study

U.S. Department of Agriculture's (USDA) Risk Management Agency (RMA) administers the federal crop insurance program in partnership with insurance companies who share in the risk of loss or gain. In 2002, American Growers Insurance Company (American Growers), at the time, the largest participant in the program, was placed under regulatory control by the state of Nebraska. To ensure that policyholders were protected and that farmers' claims were paid, RMA agreed to fund the dissolution of American Growers. To date, RMA has spent about $40 million.

GAO was asked to determine (1) what factors led to the failure of American Growers, (2) whether RMA procedures were adequate to monitor companies' financial condition, and (3) how effectively and efficiently RMA handled the dissolution of American Growers.

What GAO Recommends

GAO recommends that RMA (1) develop written policies to improve reviews of companies' financial condition, (2) develop written agreements with states to improve coordination on the oversight of companies and (3) develop a policy clarifying RMA's authority as it relates to federal and state actions and responsibilities when a state regulator takes control of a company.

In commenting on this report, RMA agreed with our recommendations and has begun implementing them.

www.gao.gov/cgi-bin/getrpt?GAO-04-517.

To view the full product, including the scope and methodology, click on the link above. For more information, contact Lawrence J. Dyckman at (202) 512-3851 or dyckmanl@gao.gov.

What GAO Found

The failure of American Growers was caused by the cumulative effect of company decisions that reduced the company's surplus, making it vulnerable to collapse when widespread drought in 2002 erased anticipated profits. The company's decisions were part of an overall strategy to increase the scope and size of American Growers' crop insurance business. However, when anticipated profits did not cover the company's high operating expenses and dropped its surplus below statutory minimums, Nebraska's Department of Insurance (NDOI) declared the company to be in a hazardous financial condition prompting the state commissioner to take control of the company.

In 2002, RMA's oversight was inadequate to evaluate the overall financial condition of companies selling federal crop insurance. Although RMA reviewed companies' plans for selling crop insurance and analyzed selected financial data, oversight procedures generally focused on financial data 6 to 18 months old and were insufficient to assess the overall financial health of the company. Additionally, RMA did not routinely share information or otherwise coordinate with state regulators on the financial condition of companies participating in the crop insurance program. For example, NDOI had identified financial and management weaknesses at American Growers. Since American Growers' failure, RMA has acted to strengthen its oversight procedures by requiring additional information on companies' planned financial operations. It is also working to improve its coordination with state insurance regulators. However, as we completed our review, neither of these initiatives had been included in written agency policies.

When American Growers failed, RMA effectively protected the company's policyholders, but lacked a policy to ensure it handled the insolvency efficiently. RMA has spent over $40 million, working with the state of Nebraska, to protect policyholders by ensuring that policies were transferred to other companies and that farmers' claims were paid. NDOI accommodated RMA's interests by allowing RMA to fund the operation of the company long enough to pay farmers' claims. Prior to American Growers' failure, RMA did not have an agreement with the NDOI commissioner defining state and federal financial roles and responsibilities. If the NDOI commissioner had decided to liquidate the company, RMA may have incurred more costs and had less flexibility in protecting policyholders.

Contents

Figure

Abbreviations

CRC Plus	Crop Revenue Coverage Plus
FCIC	Federal Crop Insurance Corporation
IRIS	Insurance Regulatory Information System
NAIC	National Association of Insurance Commissioners
NDOI	Nebraska Department of Insurance
RMA	Risk Management Agency
SRA	Standard Reinsurance Agreement
USDA	U.S. Department of Agriculture

GAO
Accountability * Integrity * Reliability

United States General Accounting Office
Washington, D.C. 20548

June 1, 2004

The Honorable Bob Goodlatte
Chairman, Committee on Agriculture
House of Representatives

The Honorable Charles W. Stenholm
Ranking Minority Member, Committee on Agriculture
House of Representatives

The Honorable Jerry Moran
Chairman, Subcommittee on General
Farm Commodities and Risk Management
Committee on Agriculture
House of Representatives

The Honorable Collin C. Peterson
Ranking Minority Member, Subcommittee
on General Farm Commodities and Risk Management
Committee on Agriculture
House of Representatives

Federal crop insurance is part of an overall safety net of federal programs for American farmers.[1] Federal crop insurance provides protection for participating farmers against the financial losses caused by droughts, floods, or other natural disasters and against the risk of crop price fluctuations. Participation in the program is voluntary; however, participation is encouraged through federal premium subsidies. In 2003, the program provided nearly $40 billion in risk protection for over 200 million acres of farmland at a cost of over $3 billion to the federal government. The U.S. Department of Agriculture's (USDA) Risk Management Agency (RMA) has overall responsibility for the crop insurance program. RMA manages the contracts with the companies that sell and service crop insurance, oversees the development of new insurance products for farmers, and monitors compliance with program provisions by both farmers and insurance companies. RMA also acts as the ultimate guarantor for policy losses, in the event companies are unable to fulfill their obligations under

[1]Other safety net programs include price support programs such as counter cyclical payments and marketing assistance loans, and disaster assistance for farmers who experience extreme losses due to a natural disaster.

the federal crop insurance program. RMA administers the program in partnership with private insurance companies that share a percentage of the risk of loss or gain associated with each insurance policy written. In addition, RMA pays companies an expense reimbursement—a percentage of premiums on policies sold—for the administrative costs of selling and servicing federal crop insurance policies. Companies sell crop insurance to farmers through agents, who are paid a commission by the companies on the policies they sell.[2]

American Growers Insurance Company (American Growers) failed in 2002; at that time, it was the largest participant in the federal crop insurance program, accounting for about 20 percent of the premiums written in 2002. American Growers experienced a 50 percent decline in its surplus over a 9-month period, from January through September 2002.[3] This decline in the company's surplus prompted the Nebraska Department of Insurance (NDOI), the regulator for the state in which American Growers was chartered, to take control of the company, due to its hazardous financial condition. On November 22, 2002, NDOI issued a state order of supervision. Under the order of supervision, American Growers could not sell any new insurance policies or conduct other nonroutine business without the approval of the supervisor appointed by NDOI. Rather than immediately liquidating the company, NDOI decided with RMA to place the company in rehabilitation—the process where the regulator, in this case NDOI, takes control of the management of the company—and to operate the company to settle remaining claims and transfer existing policies to other companies. On December 20, 2002, NDOI obtained a court order that placed American Growers into rehabilitation under the auspices of NDOI. Under rehabilitation, NDOI appointed a rehabilitator who took control of American Growers to oversee the orderly termination of the company's business and to allow for an orderly transfer of policies to other companies. To ensure continued service to farmers who purchased crop insurance through American Growers, RMA chose to pay costs associated with managing the company while American Growers finished collecting and processing premiums and settling claims. To date, RMA's funding of

[2]While most companies pay their agents a commission to sell and service crop insurance policies, some companies pay agents a salary. American Growers paid its agents a commission.

[3]Surplus is defined as the amount by which an insurance company's assets exceed its liabilities, as reported in its annual statement. Companies can use surplus funds to pay policy losses.

American Growers' operations has cost taxpayers over $40 million to pay agent commissions, staff salaries, and other operating expenses.

You asked us to determine (1) what key factors led to the failure of American Growers, (2) whether RMA procedures were adequate for monitoring crop insurance companies' financial condition, and (3) how effectively and efficiently RMA handled the dissolution of American Growers. In addition, you asked us to determine the factors that led to RMA determinations that affected a proposed sale of American Growers' assets to Rain and Hail LLC (Rain and Hail); and RMA's decision to guarantee that all American Growers' agent commissions be paid. Information related to Rain and Hail's proposal is provided in appendix VII. Information on RMA's decision to pay agent commissions is provided in appendix VIII. To determine the key factors that led to the failure of American Growers, we examined company documents and financial statements, reviewed RMA and NDOI files, conducted interviews with employees and company personnel, and obtained statistical analyses of the crop insurance program from RMA's data mining center.[4] We compared American Growers' financial information with that of other companies in the crop insurance program. We also spoke with crop insurance companies to gain an industry perspective on the failure of American Growers and RMA's actions. To evaluate RMA's procedures for monitoring companies, we reviewed RMA's regulations and methods, interviewed RMA staff, and reviewed documentation to verify that monitoring procedures were followed. To determine the effectiveness of RMA's handling of the dissolution of American Growers, we examined RMA's decision-making process, reviewed financial and other documents, and interviewed RMA and American Growers' staff, National Association of Insurance Commissioners (NAIC)[5] officials, and industry groups. We also contacted state insurance commissioners where crop insurance companies are chartered to discuss oversight issues and coordination with RMA. We performed our work between July 2003 and May 2004, in accordance with

[4]RMA contracts with the Center for Agribusiness Excellence at Tarleton State University to provide data warehousing and data mining services for agricultural data, including analyses of crop insurance sales and claims data.

[5]NAIC is a nonregulatory organization composed of the heads of the insurance departments of the 50 states, the District of Columbia, and the four U.S. territories. The organization encourages uniformity and cooperation among the various states and territories as they individually regulate the insurance industry.

generally accepted government auditing standards. Appendix I contains more detailed information on our scope and methodology.

Results in Brief

American Growers failed because of the cumulative effect of a number of business decisions by the company. First, in 1999, the company developed and sold a new supplemental insurance product that was not guaranteed by RMA. The new insurance provided supplemental revenue protection for rice, a crop with which American Growers had limited revenue protection experience. Claims and litigation associated with the sale of this new product resulted in significant losses to the company's surplus. Second, the company incurred above average operating expenses in an effort to increase market share. From 2000 to 2002, American Growers paid agent commissions that averaged 12 percent higher than other companies participating in the program. The company also paid expenses not directly related to the sale and service of federally funded crop insurance, such as trips to resort locations. These expenses, among others, created operating costs that were 11 percent greater than the average operating costs of other companies selling crop insurance, and these expenses exceeded the reimbursement RMA provides companies. Third, in 2001, American Growers attempted to increase its market share by purchasing policies and assets from another company, but it failed to achieve the level of efficient operations necessary to make this decision profitable. The cumulative effects of failed growth strategies and high operating costs weakened the financial condition of the company and reduced its surplus, setting the stage for its eventual financial failure. Finally, in 2002, the company projected underwriting gains—the amount by which the company's share of retained premium exceeds its retained losses—in excess of its 10-year average—and was relying on these anticipated profits to cover the company's high operating expenses. When such profits did not materialize, as the result of a widespread drought in 2002, American Growers' surplus dropped significantly, leading NDOI to declare the company to be in a hazardous financial condition, and prompting NDOI to take control of the company.

In 2002, when American Growers was experiencing financial difficulties, RMA's oversight was inadequate to evaluate the overall financial condition of the companies participating in the program. One of RMA's primary responsibilities is to ensure a sound system of federal crop insurance, in part, by monitoring insurance companies' compliance with provisions of the federal crop insurance program. However, we found that although RMA reviewed companies' operation plans and analyzed certain financial data,

oversight procedures were insufficient to assess the overall financial health of a company. RMA oversight procedures focused on historical financial information—from the prior 6 to 18 months—and whether a company had the financial resources to pay claims on policies based on past surplus, not on whether the company would be able to cover its operating expenses in the upcoming year. In the case of American Growers, RMA was unaware that the company was projecting profits on crop insurance policies sold in excess of historic averages to pay for its operating expenses, or that failure to achieve these profits could result in the financial failure of the company. Additionally, RMA did not routinely share information or otherwise coordinate with state regulators on the financial condition of companies participating in the crop insurance program. NDOI had identified financial and management weaknesses at American Growers and had considered planning an on-site examination of the company to determine the extent of those weaknesses; but NDOI was unable to disclose this information because RMA had not signed an agreement that would allow NDOI officials to share such confidential business information with RMA. Since the failure of American Growers, RMA has taken steps to improve its financial oversight of companies participating in the crop insurance program. However, at the time of our review, RMA had not developed written policies to formalize its oversight procedures. Additionally, RMA was working with state regulators to increase RMA-state coordination and was working with NAIC on draft language for confidentiality agreements that would allow state regulatory agencies to share sensitive business information with RMA.

RMA effectively protected farmers insured by American Growers, but it lacked a policy to efficiently address insurance provider insolvencies. Once the company failed, RMA worked with NDOI to protect policyholders by ensuring that policies were transferred to other companies participating in the federal crop insurance program and ensuring that claims were paid. To date, all American Growers' policies have been transferred, and nearly all of the claims have been paid. However, servicing the company's crop insurance policies cost RMA over $40 million for such things as agent commissions, employee severance packages, and staff salaries. RMA would like to recoup some of these costs if American Growers' assets are sold, but whether this will occur is unknown. Finally, while RMA was able to effectively cooperate with NDOI to dissolve American Growers, RMA has no written policy or information sharing agreements to guide its coordination with states for ensuring the most effective and efficient resolution of any future insolvencies in the federal crop insurance program. As the failure of American Growers demonstrates, without written

agreements RMA is vulnerable to state insurance regulators' actions when a company fails.

To address these issues, we are recommending that the Secretary of Agriculture direct RMA to (1) formalize actions under way to improve the financial and operational reviews used to monitor the financial condition of companies, (2) improve coordination with state insurance regulators regarding the financial oversight of companies, and (3) develop a written policy clarifying RMA's and states' authority and responsibility when a state regulator decides to place a company under supervision or to liquidate a company.

We provided USDA with a draft of this report for its review and comment. We received written comments from the Administrator of USDA's Risk Management Agency. RMA agreed with our recommendations and stated that it is (1) formalizing the improvements in oversight that we recommended in the new Standard Reinsurance Agreement (SRA) and (2) developing written agreements with state insurance regulators and the NAIC to improve data sharing and oversight and to clarify RMA's authority, as it relates to federal/state actions when a state takes action against a crop insurance company. Our detailed response to RMA's written comments are presented with RMA's written comments in appendix IX.

Background

Farming is an inherently risky enterprise. In conducting their operations, farmers are exposed to both production and price risks. Crop insurance is one method farmers have of protecting themselves against these risks. Over the years, the federal government has played an active role in helping to mitigate the effects of these risks on farm income by promoting the use of crop insurance.

Federal crop insurance began on an experimental basis in 1938, after private insurance companies were unable to establish a financially viable crop insurance business. The federal crop insurance program is designed to protect farmers from financial losses caused by events such as droughts, floods, hurricanes, and other natural disasters as well as losses resulting from a drop in crop prices. The Federal Crop Insurance Corporation (FCIC), an agency within USDA, was created to administer the federal crop insurance program. Originally, crop insurance was offered to farmers directly through FCIC. However, in 1980, Congress enacted legislation that expanded the program and, for the first time, directed that crop insurance—to the maximum extent possible—be offered through private

insurance companies, which would sell, service, and share in the risk of federal crop insurance policies. In 1996, Congress created an independent office called RMA to supervise FCIC operations and to administer and oversee the federal crop insurance program.

Federal crop insurance offers farmers various types of insurance coverage to protect against crop loss and revenue loss. Multiperil crop insurance is designed to minimize risk against crop losses due to nature—such as hail, drought, and insects—and to help protect farmers against loss of production below a predetermined yield, which is calculated using the farmer's actual production history. Buy-up insurance, the predominant form of coverage, provides protection at different levels, ranging from 50 to 85 percent of production. Catastrophic insurance provides farmers with protection against extreme crop losses. Revenue insurance, a newer crop insurance product, provides protection against losses in revenue associated with low crop market prices in addition to protecting against crop loss. RMA, through FCIC, pays a portion of farmers' premiums for multiperil and revenue insurance, and it pays the total premium for catastrophic insurance. However, farmers still must pay an administrative fee for catastrophic insurance.[6] RMA determines the amount of premium for each type of insurance policy by crop. RMA, through FCIC, contracts with private insurance companies who then sell these policies to farmers. Companies sell crop insurance to farmers through agents. An agent, a person licensed by the state in which the agent does business to sell crop insurance, is employed by or contracts with a company to sell and service eligible crop insurance policies. While most companies pay their agents a commission to sell and service crop insurance policies, some companies pay agents a salary. American Growers paid its agents a commission.

RMA establishes the terms and conditions to be used by private insurance companies selling and servicing crop insurance policies to farmers through a contract made with the companies called the SRA. The SRA is a cooperative financial assistance agreement between RMA, through FCIC, and the private crop insurance companies to deliver federal crop insurance under the authority of the Federal Crop Insurance Act.[7] Under the SRA, FCIC reinsures or subsidizes a portion of the losses and pays the insurance companies an administrative fee or expense reimbursement—a

[6]Farmers with limited resources may have this fee waived.

[7]7 U.S.C. 1501 (et seq.).

preestablished percentage of premiums—to reimburse the companies for the administrative and operating expenses of selling and servicing crop insurance policies, including the expenses associated with adjusting claims.[8] While the reimbursement rate is set at a level to cover the companies' costs of selling and servicing crop insurance policies, the companies have no obligation to spend their payment on expenses related to crop insurance, and they may spend more than they receive from FCIC. The current reimbursement rates, set by statute, are based on recommendations in our 1997 report[9] of the costs associated with selling and servicing crop insurance policies. However, RMA does not have a process for regularly reviewing and updating these rates. RMA is currently conducting a limited review of companies' expenses to validate the costs of selling and servicing federally reinsured crop insurance policies.

RMA, through FCIC, is the reinsurer for a portion of all policies covered by the federal crop insurance program. Reinsurance is sometimes referred to as insurance for insurance companies. It is a method of dividing the risk among several insurance companies through cooperative arrangements that specify ways in which the companies will share risks. Reinsurance serves to limit liability on specific risks, increase the volume of insurance policies that may be written, and help companies stabilize their business in the face of wide market swings in the insurance industry. As the reinsurer, RMA shares the risks associated with crop insurance policies with companies that sell federal crop insurance. However, if a crop insurance company is unable to fulfill its obligations to any federal crop insurance policyholder, RMA, as the ultimate guarantor for losses, assumes all obligations for unpaid losses on these policies. Reinsurance is also available through private reinsurance companies. Crop insurance companies must maintain certain surplus levels to issue crop insurance policies. However, they may increase their capacity to write policies and may further reduce their risk of losses by purchasing reinsurance from private reinsurance companies on the risk not already covered by FCIC.

American Growers was originally established in 1946 as Old Homestead Hail Insurance Company. The company went through several

[8]Since 1999, the administrative and operating expenses reimbursement cannot exceed 24.5 percent of the companies' net book premium.

[9]U.S. General Accounting Office, *Crop Insurance: Opportunities Exist to Reduce Government Costs for Private-Sector Delivery*, GAO/RCED-97-70 (Washington, D.C.: Apr. 17, 1997).

reorganizations and name changes between 1946 and 1989. In 1989, the company became American Growers Insurance Company, operating as a subsidiary of the Redland Group, an Iowa-based insurance holding company. Acceptance Insurance Companies Inc.,[10] (Acceptance)—a publicly owned holding company that sold specialty property and casualty insurance—acquired American Growers in 1993.

As a wholly owned subsidiary of Acceptance, American Growers was primarily responsible for selling and servicing federal crop insurance policies and shared the same general management as the parent organization. Another wholly owned subsidiary of Acceptance, American Agrisurance Inc., served as the marketing arm for American Growers.

Company Decisions Contributed to American Growers' Failure

American Growers' failure was the result of a series of company decisions that reduced the company's surplus, making it vulnerable to collapse when widespread drought erased anticipated profits in 2002. The company's decisions were part of an overall management strategy to increase the scope and size of American Growers' crop insurance business. The company's surplus declined due to losses and other costs from mistakes made when introducing a new crop insurance product, decisions to pay higher than average agent commissions, and the purchase of a competitor's business. Additionally, the company's operating expenses were about 1 1/3 times its reimbursement from RMA. In other words, American Growers was spending $130 for every $100 it was receiving from RMA to pay for selling and servicing crop insurance. American Growers planned to use profits from policy premiums to pay for the expenses not covered by RMA's reimbursement. When these gains did not materialize due to widespread drought, the company's surplus dropped below statutory minimums, prompting NDOI to take control of the company.

First, the company introduced a new crop insurance product, but mistakes associated with the sale of this product resulted in significant losses in the company's surplus. In 1997, the company chose to market a new crop insurance product, Crop Revenue Coverage Plus (CRC Plus), which was a

[10]Acceptance was incorporated in Ohio as National Fast Food Corp in 1968, reincorporated in Delaware in 1969 and thereafter operated under the names NFF Corp (1971 to 1973); Orange-co, Inc., (1987-1992); Stoneridge Resources, Inc., (1987 to 1992); and renamed Acceptance in 1992. American Growers and Acceptance were domiciled in Nebraska. However, their principal offices were located in Council Bluffs, Iowa.

supplement to federal crop insurance, but which was not reinsured by RMA. In 1999, American Growers expanded the sale of this product into rice, a crop with which it had little experience. When the company realized it had mis-priced the product for rice and withdrew the product, farmers who had planned on using CRC Plus sued the company. Financial losses, legal settlements, and other costs related to CRC Plus caused significant losses in the company's financial surplus. Appendix II provides further details on the losses associated with CRC Plus.

Second, American Growers chose to spend more than RMA reimbursed it for selling and servicing crop insurance, in part, because the company chose to pay above-average agent commissions in order to attract more agents to sell for the company. As part of its effort to expand operations, the company in 2000 to 2002, paid agent commissions about 12 percent higher, on average, than those offered by other crop insurance companies. In addition to paying agent commission rates above the average of other companies in the industry, American Growers offered agent sales incentives, such as trips to resort locations, and funded other expenses not required to sell and service federal crop insurance. These expenses, among others, created operating costs that were 11 percent greater than the average operating costs of other companies selling crop insurance, and these expenses exceeded the reimbursement RMA provided companies. Appendix III provides additional details of the high operating costs associated with agent commissions and other expenses.

Third, the company purchased the crop business of a competitor, which increased its expenses. In 2001, American Growers attempted to expand its share of the crop insurance market by purchasing assets from another company, including that company's book of crop insurance business. Because American Growers was unable to achieve the operational efficiencies it had anticipated, this acquisition resulted in additional operating costs and expenses that were higher than the reimbursement that RMA provided companies to cover the sale and service of crop insurance. Appendix IV provides additional details on the operating expenses incurred from the purchase of a competitor's crop insurance business.

Finally, the company relied on large underwriting gains to pay for its expenses, rather than RMA's reimbursement. When these gains did not materialize due to widespread drought in 2002, the company's surplus dropped to a level that prompted NDOI to take control of the company. In its 2002 operating budget, American Growers projected profits in excess of its 10-year average and relied on these anticipated profits to cover the

company's operating expenses and to further its growth. The company's profit projections were based, in part, on retaining a higher percentage of the risk for the policies it sold than in past years. By retaining a higher percentage of the risk on the policies, American Growers could increase its profits if claims were low. Conversely, the company increased its exposure to loss if claims were high. However, profits did not materialize as the result of widespread drought, which caused overall federal crop insurance program losses to increase from $3 billion in 2001 to $4 billion in 2002. When American Growers' expenses and losses dropped the company's surplus below statutory minimums, NDOI declared the company to be in a hazardous financial condition and took control of the company—first placing the company under supervision in November 2002 and then in rehabilitation in December 2002. Appendix V provides additional details on the decline in American Growers' surplus.

RMA Financial Oversight Was Inadequate to Identify American Growers' Financial Weaknesses

At the time of American Growers' failure, RMA's financial oversight processes were inadequate to identify the full extent of financial weaknesses of insurance companies participating in the federal crop insurance program. RMA's actual oversight procedures focused primarily on whether a company had sufficient surplus to pay claims based on its past performance, rather than the overall financial health and outlook of the company. In addition, RMA did not generally share information or coordinate with state regulators on the financial condition of companies participating in the federal crop insurance program. Although RMA reviewed companies' operational plans and selected financial data, such as annual financial statements, in the case of American Growers, RMA was unaware that the company was projecting underwriting gains in excess of historic averages to pay for its operating expenses. The company's failure to achieve these gains resulted in a substantial reduction in its surplus and its subsequent financial failure. In the case of American Growers, RMA and NDOI did not begin cooperating on overseeing the company until it had been placed into supervision in November 2002.

RMA's Procedures Were Inadequate to Evaluate Companies' Overall Financial Condition

In 2002, when American Growers failed, data provided to RMA by the companies participating in the federal crop insurance program provided an overall picture of company operations and complied with RMA's regulations. However, the information provided was typically 6 to 18 months old; and, according to an RMA official, the agency's oversight focused primarily on whether a company had financial resources to pay

claims on crop insurance policies and not on the overall financial health of the company.[11] RMA's approach to financial oversight stemmed, in part, from the fact that the companies participating in the program are private and are licensed and regulated by state insurance departments. State insurance departments are responsible for monitoring the overall financial condition of companies chartered and licensed to operate in their state. In addition, some of the companies selling crop insurance are affiliated with holding companies or other related companies, which RMA does not review for financial soundness. Since American Growers' failure, RMA has begun requiring federal crop insurance companies to provide additional financial data to help the agency determine if companies are adequately financed to perform their obligations under their SRAs.

One of RMA's primary responsibilities is to ensure the integrity and stability of the crop insurance program, in part, by monitoring insurance companies' compliance with program criteria such as submitting statutory statements required by state regulators and meeting certain financial ratios, as defined in federal regulations. To ensure that the companies participating in the federal crop insurance program sell and service insurance policies in a sound and prudent manner, the Federal Crop Insurance Act[12] requires crop insurance companies to bear a sufficient share of any potential policy loss. Title 7, Code of Federal Regulations, chapter IV, contains the general regulations applicable to administering the federal crop insurance program. The SRA between RMA and participating crop insurance companies establishes the terms and conditions under which RMA will provide subsidy and reinsurance on crop insurance policies sold or reinsured by insurance companies. These terms and conditions state, in part, that companies must provide RMA with accurate and detailed data, including their (1) annual plan of operation, (2) financial statements filed with the applicable state insurance regulator, and (3) any other information determined necessary for RMA to evaluate the financial condition of the company.

[11]RMA also reviewed other company information, such as its stock price and private reinsurance agreements.

[12]7 U.S.C. 1501 (et seq).

When approving a company to participate in the crop insurance program, RMA analyzes it according to 16 financial ratios set forth in RMA regulations.[13] Combined, these 16 ratios are intended to provide RMA a reasonable set of parameters for measuring insurance companies' financial health, albeit generally from a historical perspective.[14] The 16 financial ratios include such things as (1) change in net writings, (2) 2-year overall operating ratio,[15] (3) change in surplus, and (4) liabilities to liquid assets. Ten of the 16 ratios specifically refer to changes related to companies' surplus—the uncommitted funds used to cover policy claims. When a company fails more than 4 of the 16 financial ratios, RMA requires the company to submit an explanation for the deviation and its plans to correct the situation.[16] If the explanation appears reasonable, RMA approves the company to sell and service crop insurance for the next crop year.

In August 2001, RMA notified American Growers that the company had 6 ratios, based on its December 2000 financial statement, that fell outside acceptable ranges, including its 2-year overall operating ratio, change in surplus, and 2-year change in surplus. Table 1 shows the 6 ratio requirements and American Growers' ratio for each of the 6 ratios it failed.

[13]The 16 ratios include 11 ratios developed by the NAIC, 3 ratios used by A.M. Best Company, and 2 ratios specifically calculated by RMA for the federal crop insurance program. NAIC maintains the Insurance Regulatory Information System (IRIS) to assist state insurance departments in identifying significant changes in the operations of an insurance company, such as changes in its product mix, large reinsurance transactions, or certain changes in operations. Among other things, IRIS is intended to assist state regulators in establishing priorities for scheduling on-site examinations of insurance companies and to clarify the scope and focus of each examination. A.M. Best Company provides ratings used to assess insurance companies' financial strength.

[14]The financial information provided by the company is based on its prior year's activities.

[15]The 2-year operating ratio measures the profitability of a company and is a principal determinant of a company's financial stability and solvency.

[16]According to 7 C.F.R. 400.172, the company may submit a financial management plan acceptable to RMA to eliminate each deficiency indicated by the ratios, or an acceptable explanation as to why a failed ratio does not accurately represent the company's operations, or have a binding agreement with a reinsurance company that qualifies the company to assume financial responsibility in the event the reinsurance company fails to meet its obligations under RMA's reinsured policies.

Table 1: Comparison of Ratio Requirements and American Growers' 6 Failed Ratios for December 2000

Ratio	Ratio requirement (percent)	American Growers' ratio (percent)
Two-year overall operating ratio	< 100	122
Investment yield	4.5 to 10	13
Change in surplus	-10 to +50	-22
Combined ratio after policyholders' dividends	< 115	145
Two year change in surplus	> -10	-18
Return on surplus	> -5	-40

Source: GAO analysis of RMA data.

According to an RMA memorandum dated October 2001, American Growers reported that most of its unacceptable ratios were due primarily to underwriting losses related to its multiperil crop insurance that produced unfavorable results due to drought conditions in 2000, particularly in Nebraska and Iowa, and the impact of the federally subsidized reimbursement not covering the company's expenses. Additionally, American Growers cited the cost of the class-action lawsuit relating to its CRC Plus product as a contributing factor. Finally, American Growers explained that the expansion of its crop operations through the purchase of a competitor's crop insurance business was expected to provide efficiencies that would reduce expenses and help improve the company's profitability in the future.

Based on American Growers' explanations, RMA determined that the company's 2002 SRA should be approved. RMA did not believe that the adverse developments that American Growers had experienced were significant enough to move the company close to insolvency. RMA's decision was partially based on anticipated improvements in overall performance resulting from American Growers' acquisition of another company's assets and the potential for achieving greater economies of scale.

Furthermore, while American Growers failed more than 4 of the 16 financial ratios, it was not the only company with such results. Of the 18 companies participating in the federal crop insurance program in 2002, other companies had a higher number of failed ratios than American Growers, though most had fewer. Specifically, of the other 17 companies, 3

companies had 7 or more failed ratios, 1 had 6—the same number as American Growers, and 13 companies had 4 or fewer failed ratios.

In March 2002, American Growers had 5 ratios, based on its December 2001 financial statement, that fell outside acceptable ranges, including change in net writings, 2-year overall operating ratio, and liabilities to liquid assets. Table 2 shows the 5 ratio requirements and American Growers' ratio for each of the 5 ratios it failed.

Table 2: Comparison of Ratio Requirements and American Growers' 5 Failed Ratios for December 2001

Ratio	Ratio requirement (percent)	American Growers' ratio (percent)
Change in net writings	-33 to +33	51
Two-year overall operating ratio	<100	105
Investment yield	4.5 to 10	15
Liabilities to liquid assets	<105	117
Quick liquidity	>20	9

Source: GAO analysis of RMA data.

American Growers cited its acquisition of its competitor's crop insurance business, the adverse development of its CRC Plus settlement, and the delay in its reinsurance payments due from RMA as the primary reasons for failing these ratios. Based on the company's explanation of why it had failed the 5 ratios, in June 2002—5 months before American Growers' financial failure—RMA determined that American Growers met the standards for approval to sell and service crop insurance policies for 2003.

In 2002, as in 2001, although American Growers failed to meet more than 4 ratios, as required by the SRA, its performance was not unlike some other companies. Of the 19 companies participating in the crop insurance program in 2003, 2 companies had 8 or more failed ratios, 2 had 5—the same number as American Growers, and 14 companies had 4 or fewer failed ratios.

Although RMA routinely reviewed the financial documents required under the SRA, we found the agency's financial oversight procedures inadequate to fully assess American Growers' financial condition. RMA reviewed the company's surplus and reinsurance arrangements and approved the

company to write policies for the 2003 crop year, based on this analysis. However, RMA was unaware that American Growers was projecting profits in excess of historic averages to pay for its operating expenses and that its failure to achieve these profits would mean that the company's surplus would be inadequate to absorb resulting operating losses and could result in the financial failure of the company.

One reason RMA was unable to identify deficiencies in American Growers' finances was because, following the agency's emphasis on companies' compliance with program criteria, RMA only reviewed a company's historical financial information and its ability to pay claims on the basis of the company's past surplus and its private reinsurance agreements. For example, RMA's decision to approve companies to participate in the federal crop insurance program for 2002 (July 2001 – June 2002) was based on the company's financial information as of December 31, 2000. Further, while RMA required companies to submit an operation plan showing projected policy sales, RMA did not require a company to provide operating budget projections for the upcoming year. As a result, RMA's approval decisions were generally based on a company's past financial performance rather than a forward-looking perspective of a company's financial health.[17]

Without knowing the details of a company's projected operating budget including its acquisition plans and the financial conditions of affiliated, parent, or subsidiary companies, RMA did not have a complete picture of the company's financial condition. Thus, RMA was unable to adequately identify or take action to lessen any risks that may have been developing in companies with deteriorating profits, as was the case in American Growers. We believe that this lack of information impaired RMA's decision-making process; therefore, the agency was forced to make decisions based on incomplete, narrowly focused, and dated information.

Subsequent to the financial failure of American Growers, RMA took several steps to improve its oversight and analysis of the financial condition of companies currently participating in the federal crop insurance program. For example, in 2003, RMA started requesting more comprehensive budget and cash flow information from participating companies, which provides

[17]Forward-looking information generally reflects a company's current best estimate regarding its future operations. RMA requested forward-looking financial data in 2003, to use in deciding whether to grant approval to participating companies to sell and service crop insurance policies in the 2004 crop year.

the agency a more forward-looking perspective of the companies' financial health. Specifically, RMA will require insurance companies to provide their estimated underwriting gains or losses for the coming year; copies of all risk-based capital reports;[18] and a signed statement identifying any potential threats to the company's ability to meet its obligations for current and future reinsurance years, along with the possible financial ramification of such obligations. In addition, RMA is revising the SRA in its efforts to address some of the shortcomings of the current SRA. Although RMA officials said the agency plans to continue requesting more comprehensive information from crop insurance companies and had developed a financial analysis plan, as we concluded our review, the agency did not have formal written policies and procedures in place incorporating these changes.

In a November 2003 memorandum to RMA's administrator, USDA's Office of Inspector General provided general comments and suggestions for RMA's consideration in its renegotiation of the current SRA. Some of the suggestions to improve the SRA included requiring companies to provide (1) "revenue and expense forecast budget data for the forthcoming year as a part of the plan of operations approval process, including agents' commission rates and salary and other compensation for top company officials," (2) "information relating to any planned acquisition of other crop insurance companies," and (3) "the financial roles that will be played by parent/subsidiary companies in the crop insurance operations."

RMA Did Not Coordinate Oversight with State Insurance Regulators

RMA did not routinely coordinate with state regulators regarding the financial condition of companies participating in the federal crop insurance program. RMA's contact with state regulators was ad hoc and primarily limited to episodes during the introduction of new crop products or company acquisitions. RMA did not discuss the financial status of companies with regulators, but it would have been prevented from doing so

[18]In 1993, NAIC instituted formal regulatory risk-based capital requirements. NAIC's risk-based capital system uses a formula that establishes the minimum amount of capital and surplus necessary for an insurance company to support its overall business operations. That amount is compared to the company's actual statutory capital to determine whether a company is technically solvent. The NAIC's risk-based capital system limits the amount of risk a company can take on by requiring higher amounts of capital for bearing higher amounts of risk. Failure to maintain minimum capital and surplus adequate to support the company's particular risks, including the risks associated with its underwriting and investment activities, may subject it to regulatory action by its state insurance commissioner.

because it lacked an agreement with state insurance regulators regarding the sharing of confidential financial and examination records.

Companies selling and servicing crop insurance under the federal crop insurance program are subject to the regulations of the state where the company is chartered as well as federal regulations. According to NAIC, a state regulators' primary responsibilities are to protect the public interest; promote competitive markets; facilitate the fair and equitable treatment of insurance consumers; promote the reliability, solvency, and financial solidity of insurance institutions; and enforce state regulation of insurance. State regulators, among other things, require companies to file periodic information regarding their financial condition, including the adequacy of their surplus to cover claim losses, and the solvency of the company.

Prior to the failure of American Growers, RMA did not routinely coordinate with state regulators regarding companies' financial condition. Also, RMA did not have a written policy or information-sharing agreements that would allow state insurance regulators to share sensitive financial information about crop insurance companies with the agency. According to several state regulators, RMA did not routinely share information or otherwise coordinate with state regulators to determine the financial health of a company. According to another state regulator, RMA and the state have talked when a company was introducing a new crop insurance product; however, the regulator could not remember sharing information with RMA about the financial operations of companies participating in the federal crop insurance program. Furthermore, the state regulators with whom we spoke said that any policy promoting coordination would be of limited value unless the states and RMA established a written agreement allowing the state regulators to share confidential business information with RMA.

RMA's lack of an agreement for sharing information with NDOI prevented the state from disclosing sensitive business information on American Growers. NDOI officials identified financial and management weaknesses directly or indirectly affecting American Growers during its periodic reviews as early as 2000. Beginning in 2001, and continuing through August 2002, NDOI was internally discussing the possibility of conducting a targeted examination of Acceptance, including its subsidiary—American Growers. However, in September 2002, due to other priorities and resource constraints, NDOI decided to postpone an on-site examination of the company until 2003. RMA called the state insurance regulator in May 2002, and again in September 2002, asking whether there were any special inquiries or actions pending by the state regarding American Growers and

whether American Growers was listed on the state's list of companies at risk. NDOI acknowledged to RMA that it had asked American Growers to provide additional information regarding its first quarterly submission for 2002; however, NDOI explained that this was not unusual because a number of other companies also had outstanding inquiries. NDOI explained that most of its information is considered public and could be furnished to RMA if requested. However, NDOI's work products, including its list of companies most at risk, company examination reports, and associated work papers were considered confidential. As a result, NDOI required that a confidentiality agreement be signed before they could share the information. On September 20, 2002, NDOI began drafting a confidentiality agreement so it could share information about American Growers with RMA. However, this agreement was not completed before American Growers' failure.

Since the failure of American Growers, RMA has begun working with NAIC on draft language for confidentiality agreements that would allow state regulatory agencies to share confidential business information with RMA. However, at the conclusion of our review, no written confidentiality agreements had been formalized.

RMA Effectively Protected American Growers' Policyholders but Lacked a Policy to Efficiently Address Insolvencies

RMA worked with NDOI to effectively manage the failure of American Growers by ensuring that policyholder claims were paid and crop insurance coverage was not disrupted. However, servicing the company's crop insurance policies cost RMA more than $40 million for such things as paying agent commissions and staff salaries. Further, RMA lacked a written policy that clearly defined its relationship to state actions in handling company insolvencies. While NDOI accommodated RMA's interests by not immediately liquidating American Growers' assets so that policyholders could be served, without a written agreement in place, other actions such as liquidation could have limited RMA's flexibility to protect policyholders and maintain stability in the federal crop insurance program.

RMA Effectively Protected American Growers' Policyholders

RMA effectively protected American Growers' policyholders after the company's failure by ensuring that farmers' claims were paid and that their crop insurance coverage was not disrupted. After NDOI obtained an order of supervision, NDOI and RMA signed a memorandum of understanding that specified that American Growers, under NDOI appointed management, would pay claims and service policies with American Growers' funds. RMA

signed an amendment to American Growers' 1998 SRA and agreed to reimburse the company for continued expenses associated with paying or servicing crop insurance claims when American Growers' available cash accounts—about $35 million—dropped to $10 million or below. RMA began day-to-day oversight of American Growers in conjunction with NDOI at the company's Council Bluffs, Iowa, offices on January 6, 2003. The purpose of the oversight was, among other things, to ensure the timely payment of claims, the timely collection of premiums, the efficient transfer of 2003 business to other insurance companies, and the review and approval of the company's employee retention plan and payments to creditors.

RMA worked with NDOI to keep American Growers in rehabilitation rather than liquidate the company because RMA was concerned that if NDOI chose to liquidate the company RMA may not have a mechanism to expeditiously pay claims and transfer American Growers' policies to other insurance providers. Continuity of coverage is critical to policyholders because they must provide proof of insurance coverage in order to secure loans and obtain credit to plant the next year's crops. Policyholders may become ineligible for crop insurance for 1 year if their coverage is terminated. RMA was concerned that if American Growers was liquidated, policyholders would not be paid for their losses and their coverage would lapse, making them ineligible for continued crop insurance coverage. While the SRA provides that RMA could take control of American Growers' crop insurance policies, it did not have an effective way to service these policies.

On December 18, 2002, RMA issued procedures for transferring existing policies written under American Growers to other insurance providers approved under the federal crop insurance program. Under these procedures, American Growers was to notify its agents that all of its policies must be placed with another insurance provider. The agents had the primary responsibility to transfer the policies. By April 2003, RMA transferred or assigned a total of 349,185 policies—all which were eligible—to other companies in the federal crop insurance program reflecting about $576.4 million in premiums.[19] Any American Growers' policy that was not transferred voluntarily to a new insurance provider was assigned by RMA on a random basis to a provider that was currently writing insurance in the applicable state. Less than 8 percent of the policies had to be assigned to other insurance providers because the policy or agent

[19]An additional 30,231 American Growers' policies were not transferred because the policyholder had not been planting, the farmer was deceased, or other reasons.

had not acted on them, or because paperwork errors interfered with their transfer. For the fall and spring crop seasons combined, agents or policyholders transferred about 323,000 policies, and RMA assigned about 26,500 policies.

RMA worked in conjunction with NDOI and remaining American Growers' staff to ensure that 52,681 claims totaling about $410 million were paid.[20] About $400 million of these claims were paid by March 2003. The claims that were filed resulted from policyholder losses from the 1999 through 2003 crop seasons—primarily the 2002 crop season. A month-by-month presentation of this information is presented in appendix VI.

Servicing American Growers' Policies Cost RMA More Than $40 Million

The cost of servicing American Growers' crop insurance policies, which included the administrative and operating costs of paying claims and transferring policies, totaled about $40.5 million as of March 2004 (see table 3). These costs included agent commissions, office space leases and rental equipment, payroll for remaining American Growers' staff, severance pay, and other expenses.[21] Six former American Growers' employees remained on-site to respond to information requests associated with paid claims and transferred policies, to process remaining claims, and to produce end-of-year financial statements.

[20]As of February 2004, 19 claims remained unsettled due to litigation, problem claims, and other reasons.

[21]RMA will incur additional costs for staff that are employed until all claims are paid.

Table 3: RMA Costs Incurred in the Dissolution of American Growers as of March 2004

Type of costs	Amount
Payroll, payroll taxes, benefits	$8.4
Agent commissions	7.6
Space leases including costs to break leases, rental, equipment maintenance, and other	6.8
Severance	6.4
Premiums to reinsurers	4.3
Claims overpayments[a]	3.6
Health insurance	2.1
Other[b]	1.3
Total	**$40.5**

Source: GAO analysis of RMA data.

[a]Payments to farmers that, after adjustment, were determined to be overpayments. RMA is in the process of trying to collect these claims.

[b]Other costs include 401k benefit costs, and profit-share bonuses, among others costs.

RMA would like to recoup some of these costs by (1) obtaining revenues that could be derived from the liquidation of American Growers' assets by NDOI, if that should occur, and (2) requesting that NDOI provide RMA with any portion of the company's cash reserves—totaling about $7 million as of February 2004—that may remain before the company is liquidated. However, according to NDOI, RMA's standing as a creditor in the case of liquidation is unclear, and RMA does not know to what extent, if any, it can recoup its costs from these financial sources.

RMA Lacked a Written Policy to Efficiently Address Insurance Provider Insolvencies

At the time of American Growers' failure, RMA did not have a written policy defining its financial roles and responsibilities in relationship to state actions in the event of an insurance provider insolvency. While the SRA provides that RMA may take control of the policies of an insolvent insurance company to maintain service to policyholders and ensure the integrity of the federal crop insurance program, state regulators' decisions may constrain RMA's ability to efficiently protect policyholders. In the case of American Growers, an RMA official reported that NDOI made it clear that it had no choice, given the weakened financial condition of the company, but to liquidate American Growers unless RMA funded the

company until all the policies had been serviced. If the state had liquidated the company, it would have sold all the company's property and assets, creditors may have initiated legal actions over the existing assets (including premiums owed by policyholders), and there was the possibility of a freeze on the payment of any claims. Furthermore, liquidation would have left RMA with a number of crop policies to service, with no way of servicing them.

RMA decided that the best course of action was to reach an agreement with NDOI to stave off liquidation by reimbursing NDOI for all costs associated with the servicing of policies until all 2002 policies had been serviced and until all producers had found new insurance providers for the 2003 crop year. Fortunately, NDOI accommodated RMA's interests by allowing RMA to fund the operation of the company long enough to pay farmers' claims and transfer policies. However, other actions available to the state could have increased RMA's costs or limited RMA's flexibility in protecting policyholders.

When an insurance provider becomes insolvent, the SRA provides that RMA will gain control of its federally funded crop insurance policies and any premiums associated with those policies. However, as the case of American Growers demonstrates, RMA is not prepared to assume such responsibility. RMA was concerned, among other things, that it lacked sufficient staff and other capabilities, such as data management systems, to effectively service policyholders. RMA could have employed a contractor to service policyholders, but doing so could have been costly and may not have resulted in the timely payment of claims. Furthermore, according to RMA, they were unable to identify a company to contract with to service the policies and related claims. Thus, according to RMA, while RMA has the authority in the event of insolvency to service policyholders by taking control of companies' policies, it is unprepared to act on this authority. RMA is further dependent on state regulators to make decisions that will allow the agency to act in the most efficient manner to protect policyholders and maintain stability in the federal crop insurance program.

Prior to American Growers' insolvency, RMA had not reached an agreement with NDOI that addressed RMA's interests in the case of insolvency including the state's financial responsibilities. RMA argues that while it does not have a written policy to address insolvencies, it does have flexibility to assess the situation when it occurs and use the most efficient way to ensure that policyholders do not face a service disruption. While the lack of a written policy and agreements may allow greater flexibility, the

absence of specific framework may also result in state regulator decisions detrimental to RMA and the federal crop insurance program. A policy describing state and RMA authorities and responsibilities when a state decides to act against an insolvent company would provide RMA some assurance that the federal government's interests are protected.

Conclusions

The failure of American Growers, at the time, the largest participant in the federal crop insurance program was caused by the cumulative effect of company decisions over several years, and triggered by a drought that forced the company to severely deplete its surplus to cover operating expenses. Reviewing the causes underlying American Growers' failure and RMA's actions provides a valuable opportunity to identify shortcomings in the financial oversight of companies participating in the federal crop insurance program and reforms necessary to strengthen RMA's oversight and RMA's ability to respond to an insurance provider insolvency.

The failure of American Growers demonstrates that companies relying on anticipated underwriting gains to cover operational expenses may face financial difficulties similar to American Growers. More specifically, it suggests that companies must find ways to achieve operating efficiencies so that their expenses do not exceed the administrative and operational expense reimbursement provided by RMA to cover expenses for the sale and service of federal crop insurance policies. Further, the failure of American Growers highlights the need to improve RMA's financial oversight of companies participating in the federal crop insurance program. Clearly, RMA's oversight procedures at the time of the failure were inadequate to ensure that companies met applicable financial requirements for participation in the program. Specifically, the failure of American Growers highlights the need for improved financial and operational reviews, and improved coordination with state insurance regulators. If adequate financial oversight procedures had been in place prior to the failure of American Growers, the company's weakened financial condition may have been detected in time to allow for corrective actions and thereby reduced costs to taxpayers. While RMA has conducted additional oversight of companies and has initiated greater contact with state regulators after the failure of American Growers, RMA has not formalized these procedures.

RMA responded to the failure of American Growers in an effective manner that ensured continued coverage for farmers and stability in the crop insurance program. Further, RMA demonstrated that the federal crop

insurance program functioned as intended by ensuring that policyholders were protected. However, the failure of American Growers highlights the need for RMA to consider developing written policies to ensure that it takes the most effective and efficient actions in the event of future insolvencies in the federal crop insurance program. As demonstrated by the failure of American Growers, RMA is vulnerable to state insurance regulators' actions when a company fails. State regulators are vested with the authority to determine what supervisory action to take in response to the financial failure of an insurance company. While NDOI accommodated RMA's interests by allowing RMA to fund the operation of the company long enough to pay farmers' claims, other actions available to the state, including liquidation, could have increased RMA's costs or limited RMA's flexibility in protecting policyholders. Better coordination with state regulators, regarding respective authorities and responsibilities in the event of future insurance provider insolvencies, is necessary to ensure that RMA's interests are protected.

Recommendations

To improve RMA's financial oversight of companies participating in the federal crop insurance program and its ability to effectively address future insolvencies, we recommend that the Secretary of Agriculture direct RMA to take the following three actions:

(1) Develop written policies to improve financial and operational reviews used to monitor the financial condition of companies to include analyses of projected expenses, projected underwriting gains, relevant financial operations of holding companies, and financial data on planned acquisitions.

(2) Develop written agreements with state insurance regulators to improve coordination and cooperation in overseeing the financial condition of companies selling crop insurance, including the sharing of examination results and supporting work papers.

(3) Develop a written policy clarifying RMA's authority as it relates to federal/state actions and responsibilities when a state regulator decides to place a company under supervision or rehabilitation, or to liquidate the company.

Agency Comments and Our Evaluation

We provided USDA with a draft of this report for its review and comment. We received written comments from the Administrator of USDA's RMA. RMA agreed with our recommendations and stated that it is (1) formalizing the improvements in oversight that we recommended in the new SRA, (2) developing written agreements with state insurance regulators and the National Association of Insurance Commissioners (NAIC) to improve data sharing and oversight, and (3) clarifying RMA's authority as it relates to federal/state actions when a state takes action against a crop insurance company in its draft SRA and in discussions with state regulators and the NAIC.

When completed, RMA's initiatives to implement the recommendations in this report will improve its ability to evaluate companies overall financial health and to earlier detect weaknesses in companies' financial condition. However, to the extent that RMA cannot obtain enhanced disclosure and accountability through proposed changes to the SRA, it should implement our recommendation by modifying its regulations or other written policies. Finally, RMA's increased cooperation and coordination with state insurance regulators will likely strengthen oversight by both federal and state regulators and facilitate problem resolution should a company fail in the future.

RMA also provided technical corrections, which we have incorporated into the report as appropriate. RMA's written comments are presented in appendix IX.

As arranged with your office, unless you publicly announce its contents earlier, we plan no further distribution of the report until 30 days from its issue date. At that time we will send copies of this report to appropriate

congressional committees; the Secretary of Agriculture; the Director, Office of Management and Budget; and other interested parties. In addition, this report will be available at no charge on GAO's Web site at http://www.gao.gov.

Lawrence J. Dyckman
Director, Natural Resources
and Environment

Scope and Methodology

At the request of the Chairman and Ranking Minority Member of the House Committee on Agriculture and the Chairman and Ranking Minority member of the House Subcommittee on General Farm Commodities and Risk Management, we reviewed USDA's actions regarding American Growers Insurance Company (American Growers) and their impact on the federal crop insurance program. Specifically, we agreed to-determine (1) what key factors led to the failure of American Growers, (2) whether Risk Management Agency (RMA) procedures were adequate for monitoring crop insurance companies' financial condition, and (3) how effectively and efficientlyRMA handled the dissolution of American Growers. In addition, we were asked to determine what factors led to RMA determinations affecting a proposed sale of American Growers' assets to Rain and Hail LLC (Rain and Hail) and RMA's decision to guarantee that all American Growers' agent commissions be paid. Information related to the Rain and Hail proposal is provided in appendix VII. Information on USDA's decisions to guarantee agent commissions is provided in appendix VIII.

To determine the key factors leading to the failure of American Growers, we analyzed company documents and financial statements, including annual and quarterly statements for 1999 through 2002. We compared American Growers' expense data with expense data for other companies participating in the program. For this analysis, we computed the average expense ratios of companies participating in the crop insurance program, excluding the expense data from American Growers. Due to the timing of American Growers' failure, it did not submit an expense report to RMA for 2002. To capture the extent of the financial problems that American Growers experienced in 2002 in comparison with other companies, we worked closely with staff who remained at American Growers while it was in rehabilitation to create an expense report for 2002. We also interviewed American Growers' management; the Nebraska Department of Insurance (NDOI) appointed rehabilitator for American Growers and other key staff; industry groups, such as the National Association of Insurance Commissioners (NAIC); and representatives from other crop insurance companies, including key Rain and Hail personnel, to gain an industry perspective on the failure of American Growers' and RMA's actions. We also contacted the National Association of Crop Insurance Agents; however, they did not grant our requests for an interview. To adjust for the general effects of inflation over time, we used the chain-weighted gross domestic product price index to express dollar amounts in inflation-adjusted 2003 dollars.

To evaluate RMA's oversight procedures we interviewed RMA staff in Washington, D.C. and Kansas City, Missouri, offices. We reviewed the guidance that RMA uses to monitor companies' compliance with the federal crop insurance program, including relevant laws; the Code of Federal Regulations, title 7, part 400; and agency guidance, including RMA's Crop Insurance Handbook for 2002 and the current Standard Reinsurance Agreement (SRA), to verify that monitoring procedures were met. We also reviewed RMA's files relating to the oversight of American Growers and approval of its SRA.

To determine the effectiveness of RMA's dissolution of American Growers, we examined RMA's decision-making process and the costs associated with running American Growers' operations after its failure to ensure that federal crop insurance policies were serviced. We reviewed American Growers' financial statements and other documents. We used semistructured interviews to obtain the views of the Nebraska state commissioner; American Growers' management; representatives from other crop insurance companies, including key Rain and Hail personnel; RMA staff; NAIC officials; and, industry groups on the failure of American Growers and on issues related to RMA's handling of the dissolution. Specifically, we obtained our information from the officials by asking 10 structured questions in a uniform order within an interview that included additional unstructured, probing follow-up questions that were interjected at the discretion of the interviewer. We also used structured interviews to obtain the views of insurance commissioners on the failure of American Growers and on issues related to sharing confidential business information with RMA. In this case, we asked an additional three structured questions and followed up with additional unstructured questions as needed. We selected insurance commissioners in 10 states where there was at least one 2004 SRA holder, according to RMA data. These states were Connecticut, Indiana, Illinois, Iowa, Kansas, Minnesota, New York, Ohio, Pennsylvania, and Texas. We met with RMA officials in February 2004 to discuss our findings and tentative recommendations.

We conducted our review from July 2003 through May 2004 in accordance with generally accepted government auditing standards.

Penalties and Financial Losses Associated with Marketing CRC Plus for Rice Reduced American Growers' Surplus

As part of an overall strategy to increase the company's market share of the crop insurance industry, in 1997, American Growers developed and marketed a crop insurance product—Crop Revenue Coverage Plus (CRC Plus)—that was a supplement to federally reinsured crop insurance, but it was not subsidized or reinsured by the federal government. The product was a supplement to Crop Revenue Coverage (CRC), an insurance product that protected farmers against crop loss and low crop prices in the event of a low price, a low yield, or any combination of the two. CRC Plus allowed farmers to obtain supplemental coverage for their crops, in essence providing a higher level of coverage in the event of losses. American Growers initially marketed CRC Plus in only two states and covered grain, corn, sorghum, and soybean crops. In 1999, when the company extended CRC Plus to rice, a crop with which American Growers had limited actuarial experience, the company mistakenly priced the product too low. It then promoted the product heavily and did not adequately anticipate the demand for the product.

When it priced CRC Plus for rice, American Growers made a mathematical error—caused by the misplacement of a decimal point—that resulted in the insurance being sold for a lower price than it should have been. The low price for the policy, coupled with uncertainty in the market price of rice that year, resulted in a greater demand for the product than the company had anticipated. When American Growers realized that the demand for the product and associated losses would be greater than the company's surplus could handle, especially considering its low price, American Growers announced it would no longer accept applications at the price originally listed, effectively withdrawing the product from the market. However, farmers had already made decisions about what crop insurance they would purchase, based upon their belief that they could obtain the new product offered by American Growers. The withdrawal of the product was untimely and made it difficult for some farmers to find adequate insurance. As a result, Congress acted to extend the filing deadline for other types of federally reinsured crop insurance so that farmers adversely affected by American Growers' actions could obtain adequate insurance for their crops.

Finally, some farmers sued American Growers, while RMA and six states examined American Growers' actions. The litigation by farmers and regulatory actions resulted in more than $13 million in fines and settlements levied against American Growers in addition to losses of $6 million. The fines, costs from litigation, and increased service costs resulting from the new insurance product reduced American Growers'

surplus. As a result, American Growers' surplus dropped from $76 million in 1998, to $60 million in 2000, a 21 percent decline over 2 years. This decline in American Growers' surplus occurred at the same time the company increased the amount of insurance premium it wrote, from $271 million in 1998 to $307 million in 2000, an increase of 13 percent. To lessen the impact of losses associated with the CRC Plus policies, American Growers accepted a $20 million loan in the form of a surplus note[1] from an affiliate company to strengthen its surplus. American Growers also acquired commercial reinsurance coverage to pay for losses related to CRC Plus. This reinsurance coverage committed the company to future payments of more than $60 million through 2006.

[1]Surplus notes are a form of debt that insurers can issue. Because the loan was provided as a surplus note, it was recorded as surplus instead of as a liability; and, as such, NDOI would have had to approve any repayment of this surplus note.

Agent Commissions and Other Expenses Created High Operating Costs

American Growers' reported that operating expenses were higher than the average reported expenses of other companies participating in the federal crop insurance program, primarily due to American Growers' efforts to attract agents by paying them higher than average commissions and other actions designed to expand its business. From 2000 to 2002, average commissions for American Growers' agents were 12 percent higher than commissions for agents working for other companies. American Growers paid commissions that averaged about $17 for each $100 premium it sold while other companies' agent commissions averaged $15 for each $100 of premium.[1]

Agents are companies' principal representatives to farmers. Farmers purchase crop insurance through agents who can write premium for any company selling crop insurance. Farmers generally develop relationships with specific agents and rely on agents for advice and service. Successful agents write more policies and may write policies with lower loss ratios. Agents typically receive as a commission a percentage of every dollar of premium in crop insurance sold to farmers. Some agents choose to write policies for certain companies based on commissions paid them by the company and on how well the company services the agents' clients. Higher commission rates are not the only factor attracting an agent to a company, but rates do play an important role. In an effort to increase its market share by recruiting more agents to sell crop insurance, American Growers paid higher agent commissions than other companies participating in the program.

American Growers also funded some expenses not directly related to the sale and service of federally funded crop insurance, such as trips to resort locations. These expenses, among others, created operating costs that were greater than the average operating expenses of other companies in the industry. Overall, American Growers' expenses, as a percentage of premium sold, were about 11 percent higher than the average expenses of the other companies. In other words, American Growers had expenses of about $30 for every $100 of premium it sold while other companies had expenses of about $27 for every $100 of premium sold. Salaries at American Growers averaged 15 percent higher than at other companies. In addition, American Growers spent twice the rate as other companies on advertising; and American Growers' expenses for equipment, including computer equipment, was twice that of other companies. In addition to the fact that

[1]Not all agents receive the same commission rate.

American Growers' expenses, as a percent of premium sold, were higher than those of other companies, American Growers' expenses were also higher than the amount of RMA's reimbursement to the company.

RMA provides companies a reimbursement to cover their expenses related to the sale and service of crop insurance. This reimbursement is a preestablished percentage of premiums to reimburse companies for the expenses associated with selling and servicing federal crop insurance. The reimbursement rate is set at a level to cover the companies' costs to sell and service crop insurance policies. These costs include agent commissions, staff and office expenses required to process policies and claims, and loss adjusting expenses. In 1998, Congress reduced the amount of reimbursement from a cap of 27 cents per dollar of premium a company sells to 24.5 cents per dollar of premium. This reduction occurred after our 1997 report[2] revealed that companies were basing their request for higher reimbursement rates on numerous expenses that were not directly related to the sale and service of crop insurance, such as trips to resorts, noncompete clauses associated with company mergers, and company profit-sharing arrangements. Under the current reimbursement arrangement, companies have no obligation to spend their payment on expenses related to crop insurance; they may spend the payment in any way they choose. We found that American Growers spent more than its reimbursement by paying above average-rates for agent commissions, marketing efforts, and other items not directly related to the sale and service of federal crop policies, such as tickets to sporting events and trips to resorts for agents.[3]

[2]U.S. General Accounting Office *Crop Insurance: Opportunities Exist to Reduce Government Costs for Private-Sector Delivery,* GAO/RCED-97-70 (Washington, D.C.: Apr. 17, 1997).

[3]In 2003, seven companies reported expenses in excess of RMA's reimbursement for selling and servicing federal crop insurance. RMA is currently reviewing company expenditures to determine if expenses reported are accurate.

Purchase of Competitor's Crop Insurance Business Created Additional Expenses

On June 6, 2001, Acceptance Insurance Companies Inc., (Acceptance) and its subsidiaries, including American Growers, acquired the crop insurance business of IGF Insurance Company (IGF) from Symons International Group, Inc. Acceptance and its subsidiaries raised funds for this purchase by selling most of its noncrop insurance subsidiaries between September 1999 and July 2001, as part of a larger business strategy to focus on and expand American Growers' crop insurance business.

American Growers, through its parent corporation Acceptance, acquired most of IGF's book of crop insurance policies, in addition to obtaining leased office space, company cars, and related staff to service these policies. A senior manager at American Growers said that the company's strategy was to achieve operational efficiencies by combining the operations of the two companies. However, he said that this goal was not achieved as quickly as the company had planned. For example, American Growers had planned on combining the companies' two computer systems; but it was unable to successfully do so, requiring it to keep two staffs of information technology specialists.

After the acquisition, American Growers grew from the company with the third largest volume of premium sold to being the largest. However, this growth also came with higher costs. American Growers' expenses increased 63 percent, from 2000 to 2001, the years before and after the purchase of IGF. In 2000, American Growers had about $117 million in expenses, but its expenses increased to $191 million in 2001. While the amount of premium American Growers wrote increased, from about $291 million in 2000 to $450 million in 2001, a 54 percent increase, the amount of surplus the company kept only increased from $57 million in 2000 to $75 million in 2001, a 31 percent increase. In 2002, American Growers wrote nearly $632 million in premiums, but without adding to the $75 million reserve.

American Growers' Surplus Was Inadequate to Cover Expenses When Underwriting Gains Did Not Materialize

American Growers' high expenses led them to spend more than RMA was reimbursing it for the sale and service of crop insurance. In 2001, for every $100 RMA provided American Growers to sell and service crop insurance, the company was spending $130. To pay for its expenses in excess of RMA's reimbursement, American Growers planned on making underwriting profits from the sale of crop insurance. When setting its budget for 2002, American Growers predicted it would receive an 18 percent underwriting gain from policies it serviced under the federally reinsured crop program. However, American Growers' 10-year history of underwriting gains in the program was only 16 percent.[1]

American Growers based its 2002 budget on achieving over $86 million in underwriting gains that year. The company's profit projections were based, in part, on retaining a higher percentage of the risk for the policies it sold than in past years. By retaining a higher percentage of the risk on policies, American Growers could increase its profits if claims were low. Conversely, the company increased its exposure to loss if claims were high.

However, widespread drought impacted the company's ability to achieve these gains. In June 2002, more than one-third of the contiguous U.S. was in severe to extreme drought. Total losses for the crop insurance program increased 33 percent from 2001. In 2001, total losses to the program were over $3 billion. In 2002, total losses increased to over $4 billion. For the category of policies for which American Growers retained a higher level of risk, the loss ratio in 2002 was about 40 percent higher than in 2001, resulting in the payment of $114 in claims for every $100 it received in premiums for those policies.

When the underwriting gains American Growers had predicted did not materialize, losses and expenses depleted the company's surplus. As a result, NDOI, which regulates insurance companies domiciled in that state, declared that the company was operating in a hazardous financial condition and placed the company in supervision, and later rehabilitation. On November 22, 2002,[2] NDOI took steps to protect American Growers'

[1]As an example of the effect of a higher projected return, on a retained premium base of $480 million, 18 percent is $86 million and 16 percent is $76 million, a difference of $10 million.

[2]On this same date, RMA notified American Growers that its SRA was suspended and the company was to cease and desist from selling any new insurance policies.

policyholders by issuing a state order of supervision.[3] NDOI ordered the supervision because the company's surplus declined from about $75 million for the year ending December 31, 2001, to about $11 million as of September 2002. According to the order, the decline in American Growers' surplus—in excess of 50 percent within a 9-month period—rendered the company financially hazardous to the public and its policyholders. Under the order of supervision, American Growers could not sell any new insurance policies or conduct business beyond those that are routine in the day-to-day operations of its business, without the approval of the supervisor appointed by NDOI.

On December 20, 2002, NDOI obtained a court order that placed American Growers into rehabilitation under the auspices of NDOI.[4] Under rehabilitation, NDOI appointed a rehabilitator who took control of American Growers to oversee the orderly termination of the company's business and to allow for an orderly transfer of policies to other companies. The NDOI-appointed rehabilitator assumed the responsibilities of the board of directors and officers and took control of the day-to-day management of the company.

[3]The Insurers Supervision, Rehabilitation, Liquidation Act, *Neb. Rev. Stat.* 44-4809(2)(a)(i).

[4]NDOI did not invoke its option to liquidate the company, which entails closing the company, selling off all of its assets, and distributing proceeds to creditors in order of legal precedence.

RMA Paid Policyholders' Claims after American Growers' Failure

RMA worked in conjunction with NDOI and remaining American Growers' staff to ensure that claims were paid (see table 4).[1] The claims that were filed resulted from policyholder losses from the 1999 through 2003 crop seasons—primarily the 2002 crop season.

Table 4: Claims Paid to Policyholders After American Growers' Failure

Dollars in millions

	Claims		Cumulative Claims	
Year	Number of claims	Amount	Number of claims	Amount
2002				
November	10,383	$ 65.3	10,383	$65.3
December	16,531	140.9	26,914	206.2
2003				
January	11,815	110.5	38,729	316.7
February	6,515	67.0	45,244	383.7
March	2,032	20.2	47,276	403.9
April	4,286	4.9	51,562	408.8
May	468	4.2	52,030	413.0
June	176	2.0	52,206	415.0
July[a]	172	(4.4)	52,378	410.6
August	124	.2	52,502	410.8
September[a]	44	(2.4)	52,546	408.4
October	74	.2	52,620	408.6
November	49	.8	52,669	409.4
December	12	.5	52,681	409.9
Total	**52,681**	**$409.9**	**52,681**	**$409.9**

Source: GAO analysis of RMA data.

Notes: This table reflects both claims and adjustments to claims that reduced the amount of claims—the amount of claims are net claims.

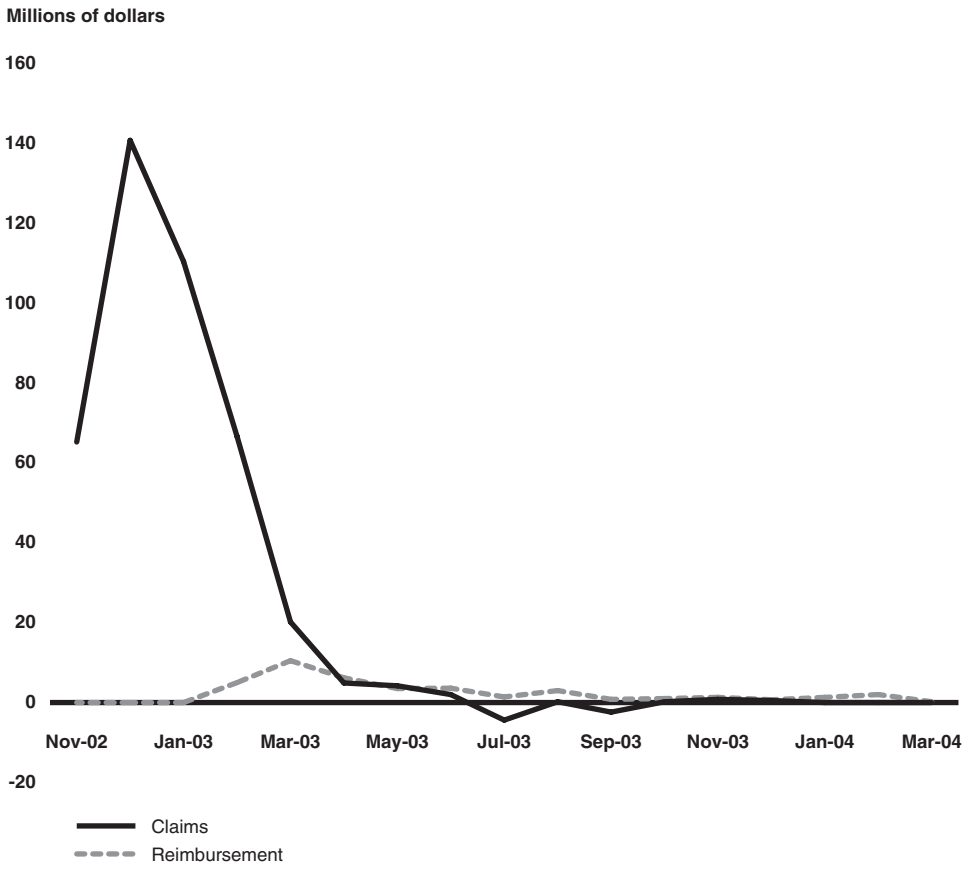
Dollar totals do not add up due to rounding.

[a]The amount of claims shown for July 2003 and September 2003 are negative claims due to adjustments.

[1]As of February 2004, 19 claims remain unsettled due to litigation, problem claims, and other reasons.

After NDOI took control of American Growers, the company had about $35 million in cash. These funds were used, in part, to pay American Growers' staff and support staff operating under the auspices of NDOI to pay policyholder claims. When American Growers' cash reserves were reduced to $10 million, RMA reimbursed NDOI for additional costs of $40.5 million to operate the company. When RMA began reimbursing NDOI in February 2003, the vast majority of policyholder claims had been paid (see Fig. 1). About $317 million, or 77 percent, of the approximately $410 million in claims were paid by the end of January 2003.

Figure 1: American Growers' Policyholders Claims Paid vs. RMA Reimbursements



Source: GAO analysis of RMA data.

According to an RMA official, while the costs of reimbursing American Growers' operations may appear excessive, relative to the amount of claims paid, the claims that had been paid before February 2003, were those that could be expeditiously handled. The claims that remained to be paid—beginning in February 2003—were those that required follow-up to determine the accuracy of reported information, were difficult to process due to missing information, or had other problems. Additionally, although claims had been paid and policies transferred, staff were still needed to process the transfer of policy-related paperwork to other companies and resolve lingering issues, such as claims with missing information.

Rain and Hail's Proposal to Purchase Selected Assets of American Growers

Prior to NDOI's declaration of its hazardous financial condition, American Growers was working to strengthen its financial condition by selling its insurance business to another insurance provider. In September 2002, as losses associated with that year's extensive drought began to materialize, American Growers realized that the company's operating expenses and crop losses were outpacing its income and surplus and advised NDOI and RMA accordingly. To improve its financial condition, American Growers attempted to sell its crop insurance business to another insurance company. On November 18, 2002, American Growers' parent company, Acceptance, signed a nonbinding letter of intent setting forth preliminary terms for the company to sell portions of its crop insurance business to Rain and Hail LLC (Rain and Hail) for over $20 million pending regulatory approval.

Rain and Hail asked RMA for authority to transfer American Growers' policies without having to cancel each policy and rewrite them under its own name—a concession that would have facilitated the bulk transfer of the policies. In the past, RMA had allowed this type of transfer only if the acquiring company agreed to (1) accept all the policies previously underwritten by the company being purchased and (2) assume all past liability for those policies. According to RMA, Rain and Hail did not want to assume any past liabilities for the policies and wanted to retain the right to select agents and policyholders with whom it wished to contract. According to RMA, Rain and Hail's intention was to not accept past liabilities regarding disputed claims, compliance issues, litigation or regulatory issues associated with American Growers' policies and ultimately to acquire only about one-third of American Growers' business.

In a letter dated November 25, 2002, RMA rejected Rain and Hail's request for exemptions from RMA rules regarding the bulk transfer of policies. The agency was concerned that waiving the existing rules regarding potential liabilities and future policy placement would not protect the interests of policyholders and taxpayers or the integrity of the federal crop insurance program. RMA was concerned that if it approved the sale of American Growers' policies to Rain and Hail, it could have left a significant number of policyholders without insurance. It also may have left a disproportionate number of poor performing policies for other insurance providers to assume. Since reinsured companies are required to accept all policyholders that apply for insurance regardless of their loss history, RMA was concerned that its decision would be unfair to other insurance providers and that any future denial of similar exemptions to other companies would

be challenged as arbitrary and capricious. As a result, RMA informed Rain and Hail that it could not grant the exemptions it requested.[1]

Accordingly, Rain and Hail announced that it was withdrawing its offer to purchase American Growers' business. When we discussed this issue with Rain and Hail, it concurred that its company was unwilling to accept the past liabilities associated with American Growers' policies, but denied it was not willing to accept all of American Growers' policyholders. Senior managers at Rain and Hail said their company was unwilling to accept the past liabilities associated with American Growers' policies because they did not have adequate time to assess the extent of any such liabilities and the financial implications for Rain and Hail. However, these managers said that Rain and Hail was willing to accept any farmer who wanted a policy from the company, but they stated that the company wanted to retain the right to select which agents it would use to sell and service crop insurance policies.

Whether the sale of American Growers' policies to Rain and Hail could have saved taxpayers all or some of the costs of the dissolution if the proposed sale had been completed is unclear. A Rain and Hail representative stated that the sale would have provided a cash infusion that could have prevented the failure of American Growers. An Acceptance representative stated that the sale might have allowed American Growers to pay remaining claims without having to come under control of NDOI. However, depending on the details, even with the cash infusion from the sale of assets to Rain and Hail, the company may still have been found to be in a financially hazardous condition.

[1]According to RMA, nothing in its refusal to approve Rain and Hail's requested exemption constituted a disapproval of the sale. RMA has stated that it did not have the authority to approve or disapprove the sale provided that all SRA requirements were met.

RMA's Decision to Pay American Growers' Agent Commissions

After consultation with NDOI, RMA agreed to pay American Growers' agent commissions in full, despite the fact that they were paid higher than industry averages.[1] RMA believed several factors, any one of which could have resulted in the disruption of policyholders' coverage, warranted paying agent commissions in full. First, RMA agreed to pay agent commissions in full, in part, because NDOI's position was that as long as American Growers was under the rehabilitation order instead of in liquidation, the company's contracts were valid, enforceable legal obligations that had to be paid. Second, RMA was concerned that some agents may have refused to continue to service policyholders if they knew they would not get paid for their work, and RMA needed agents' cooperation in ensuring the timely collection of premiums and transfer of policies to other crop insurance companies. Third, RMA was concerned that some agents, particularly small agents, could go out of business if not paid their commissions and would therefore be unable to service claims or transfer policies. Finally, RMA was concerned that some agents may have deducted their commissions from policyholder premiums, which could have made it more difficult for RMA to determine which policyholders had paid the premiums on their policies.

While RMA could have potentially achieved cost savings of about $800,000 by not paying some of American Growers' agents' commissions—the portion of their $7.6 million in commissions that exceeded industry averages—agents' response to such a decision could have also disrupted service to policyholders and caused RMA to incur additional costs.

Industry opinion varied on whether RMA should have paid agent commissions in full. According to the former chief executive officer of American Growers, high commissions paid to agents contributed to American Growers' and other companies' financial troubles. One company executive expressed concerns that RMA's actions might make it more difficult for companies that are holding the line on agent commissions to continue to hold commissions at a reasonable level. Another representative was concerned that agents were going to work for the company that paid the highest commissions, regardless of the company's financial health,

[1]After consultation with NDOI, RMA agreed to pay agent commissions in full, both parties agreed that they were not obligated to pay about $6 million in bonuses, based on agent performance, that agents believed they were due under existing contracts with American Growers. RMA did, however, pay about $429,000 in bonuses to agents with an affiliated company because a review of the contract showed that American Growers had a binding obligation with the company to make these payments.

because RMA had shown that agents would receive their commission regardless of the company's status. However, one crop insurance company representative was concerned about the consequences of not paying agent commissions, particularly since the agents were not directly responsible for the company's failure. Representatives also stated that RMA was correct in paying agent commissions to ensure agent cooperation, to not drive smaller agents into bankruptcy, and to maintain the integrity of the federal crop insurance program.

Finally, RMA's actions in paying full agent commissions could have implications for the future of the federal crop insurance program, but it is unclear how future company and agent practices may be affected by RMA's decisions. RMA's actions could suggest that it might provide similar financial support in the event of future insolvencies, regardless of company and agent practices. For example, RMA's actions could have set a precedent for high agent commissions, a key factor in the failure of American Growers, which could, in turn, be a factor in other insolvencies. However, RMA has stated that it plans to consider each new situation on a case-by-case basis and that agents and companies should not expect the same treatment as in the case of American Growers. RMA said that a managing general agent had recently gone out of business and that RMA had not stepped in to provide relief to agents.[2]

[2]A managing general agent is a company that acts on behalf of the insurance company in selling and servicing policies.

Comments from RMA

Note: GAO comments supplementing those in the report text appear at the end of this appendix.

USDA

APR 2 8 2004

United States Department of Agriculture

Risk Management Agency

1400 Independence Avenue, SW
Stop 0801
Washington, DC
20250-0801

TO: Lawrence J. Dyckman
Director, Natural Resources and Environment
General Accounting Office

FROM: Ross J. Davidson, Jr.
Administrator

SUBJECT: Risk Management Agency: USDA Needs to Improve Oversight of Insurance Companies and Develop a Policy to Address any Future Insolvencies, Audit Number GAO-04-517

Thank you for providing the United States Department of Agriculture (USDA) and the Risk Management Agency (RMA) with your draft report, "USDA Needs to Improve Oversight of Insurance Companies and Develop a Policy to Address any Future Insolvencies." I would like to offer the following comments for your consideration, and ask that a copy of this response be included in your final report.

General Comments

The Risk Management Agency (RMA) would like to recognize the GAO for the professional manner in which this audit was conducted. RMA was actively involved in the run-off of American Growers policies at the time of the audit, and the GAO auditors were cognizant of the workload and flexible in their requests for audit assistance from the RMA staff who were assigned to the American Growers activity.

While RMA understands that GAO does not recognize actions until they are concluded, many of the problems encountered with American Growers have been recognized and are being addressed through the current Standard Reinsurance Agreement (SRA) negotiations. The proposed changes to the SRA will formalize a system of enhanced insurance company disclosures and accountabilities consistent with the Agency's current authority and will help RMA to more efficiently and effectively deal with insolvencies and clarify the roles and responsibilities of the companies and RMA in the event of another catastrophic failure. The proposed SRA also contains provisions that will provide RMA with information that should help to highlight future problems and provide RMA additional time to preempt situations similar to the American Growers failure. RMA will report the changes made to the SRA once the negotiations have been completed.

General (Technical) Comments

In reading the draft, we noted a few general items in addition to the responses to the specific recommendations that could be clarified to assist both the casual reader of this report as well as anyone familiar with insurance industry practices and the Federal crop insurance program specifically.

RMA The Risk Management Agency Administers And Oversees All Programs Authorized Under The Federal Crop Insurance Corporation

An Equal Opportunity Employer

See comment 1.

RMA would suggest that where the report discusses the State of Nebraska's takeover of the company the draft be modified to reflect that the State's first action was to place the company under supervision for some time before they moved into rehabilitation. This is an important point, because the State has different authorities depending on whether a company is under supervision, rehabilitation or liquidation. For example, while a company is under supervision, the State has less authority to abrogate existing contracts. This impacted RMA's flexibility in working with the State and the company in the weeks and months following the first action of the State.

See comment 2.

The report may also give the reader the impression that all agents who sell crop insurance receive commissions. While this was true in the case of American Growers, some companies employ captive agents who receive salaries rather than commissions and some use a combination of salaried and contracted agents. For clarity, the statements referring to the industry as a whole should either be modified or changed to reference American Growers only. The same is also true relative to loss adjusters in that companies may employ or contract their loss adjusters or use a combination of both salaried or contracted adjusters in order to ensure service to their policyholders.

GAO Recommendation 1

Develop written policies to improve financial and operational reviews used to monitor the financial condition of companies to include analyses of projected expenses, projected underwriting gains, relevant financial operation of holding companies, and financial data on planned acquisitions.

USDA Response

See comment 3.

As stated above, much of the improvement in monitoring the companies is intended to be achieved through the enhanced disclosures and accountabilities incorporated in the draft SRA. However, in the interim, for the 2004 reinsurance year, RMA requested additional financial documentation from the companies to be included with their Plan of Operations to help ensure the program integrity and stability of the crop insurance program. At that time, a financial analysis template (FAT) was developed to convert financial data into meaningful ratios, charts, graphs, and reports that more accurately depict the existing and future financial strength of the company. This was used for the 2004 SRA approval process and will again be used for the 2005 SRA approval process when companies will again be required to provide additional financial documentation with their Plan of Operations. RMA is using a modification of the FAT to assist in a quarterly financial analysis of each SRA holder and managing general agent (MGA) to determine both of their financial strengths. In addition, written procedures are in place for the yearly approval of SRA holders and applicants and their MGAs to ensure they all have the financial and operational ability to fulfill their obligations under the SRA.

See comment 4.

On-site financial and operational reviews are conducted on each company at least once in a three-year period. A review plan that contains tasks, objectives, and items to be reviewed is in place. To improve our monitoring of the companies, the plan is reviewed periodically and modified as RMA's needs change or issues are identified.

The additional financial information received for the 2004 and 2005 Plans of Operations review and approval, including projected expenses, underwriting gains, etc., needs to be provided as a matter of course in the annual Plan of Operation review and approval process. This additional information disclosure requirement has been added to Appendix III of the draft 2005 SRA to formalize the process.

GAO Recommendation 2

Develop written agreements with state insurance regulators to improve coordination and cooperation in overseeing the financial condition of companies selling crop insurance, including the sharing of examination results and supporting work papers.

USDA Response

RMA is currently developing two agreements. One standard agreement will be executed with each individual state to obtain and share information on a confidential basis regarding a crop insurance company's financial and market conduct performance. This would include any state examination information and documentation obtained by the state as well as RMA sharing its financial analysis information and documentation with the state. This agreement will form the foundation of a "collaborative effort" between RMA and state insurance regulators in the review, examination and regulation of crop insurance companies.

The second agreement will be executed with the National Association of Insurance Commissioners (NAIC) for the purposes of accessing regulatory data reported to the NAIC by each individual state. The NAIC databases contain insurance company financial information and analysis results as well as regulatory data regarding crop insurance agents, loss adjusters, etc.

GAO Recommendation 3

Develop a written policy clarifying RMA's authority as it relates to federal/state actions and responsibilities when a state regulator decides to place a company under supervision or rehabilitation, or to liquidate the company.

USDA Response

RMA has utilized the existing agreement with the State of Nebraska in the supervision of American Growers Insurance Company and "lessons learned" documented during this process to draft changes to the SRA. One change specifies that RMA must be promptly notified by the company of any regulatory action to be taken against a crop insurance company if such action would affect the company's ability to perform its obligations under the SRA and the state must obtain RMA's approval before such action may be taken. The draft SRA also sets forth RMA's requirements and processes to ensure that the interests of Federal crop insurance policyholders and taxpayers are protected in the event the company is unable to fulfill its obligations under the SRA by requiring RMA approval of actions taken a company or service provider, the orderly transfer of policies to other companies to

ensure uninterrupted service; preserving the ability to use the company's systems, records and equipment to run out the business; ensuring receipt of all funds in the possession of the company or owed to the company related to the Federal crop insurance policies; and preserving the highest priority in liquidation. In addition, RMA will work with the states and the NAIC to outline the respective roles, duties and responsibilities in this collaborative relationship between the states and RMA in the supervision, rehabilitation or liquidation process. RMA may employ the SRA, Federal regulation, memoranda of understanding or other appropriate means as needed to ensure maximum effectiveness of these changes.

Thank you for the opportunity to comment on this report. If you have any questions, please contact Michael Hand, Deputy Administrator for Compliance, at (202) 720-0642.

The following are GAO's comments on the Risk Management Agency's letter dated April 28, 2004.

GAO Comments

1. Per RMA's suggestion, we have provided additional details in this report noting that NDOI placed American Growers under supervision on November 22, 2002, and later placed the company under rehabilitation on December 20, 2002. RMA suggests that the state's initial action impacted its flexibility in working with the state and the company. As we note in our conclusions, better coordination with state regulators regarding respective authorities and responsibilities in the event of future insurance provider insolvencies is necessary to ensure that RMA's interests are protected.

2. We revised the report to note that some agents are paid a salary rather than receiving commissions on the premiums from policies sold. American Growers' agents received commissions, as do most agents who sell and service crop insurance.

3. At the time of our review, we noted written procedures based on regulations for the yearly review and approval of SRA holders and applicants. However, as noted in this report, these procedures were insufficient to assess the overall financial health of a company. To the extent that the final SRA does not fully address oversight weaknesses identified in our report, RMA should take action to modify its regulations or other written policies.

4. RMA on-site financial and operational reviews do not appear to focus on the overall financial health of a company, but rather on internal controls. However, as a minimum, RMA should coordinate these reviews with state regulators who periodically review company operations.

GAO Contacts and Staff Acknowledgments

GAO Contacts

Lawrence J. Dyckman (202) 512-9692
Ronald E. Maxon, Jr. (214) 777-5659

Acknowledgments

In addition to the individuals named above, David W. Bennett, John W. Delicath, Tyra DiPalma-Vigil, Jean McSween, and Bruce Skud made key contributions to this report.

GAO's Mission

The General Accounting Office, the audit, evaluation and investigative arm of Congress, exists to support Congress in meeting its constitutional responsibilities and to help improve the performance and accountability of the federal government for the American people. GAO examines the use of public funds; evaluates federal programs and policies; and provides analyses, recommendations, and other assistance to help Congress make informed oversight, policy, and funding decisions. GAO's commitment to good government is reflected in its core values of accountability, integrity, and reliability.

Obtaining Copies of GAO Reports and Testimony

The fastest and easiest way to obtain copies of GAO documents at no cost is through the Internet. GAO's Web site (www.gao.gov) contains abstracts and full-text files of current reports and testimony and an expanding archive of older products. The Web site features a search engine to help you locate documents using key words and phrases. You can print these documents in their entirety, including charts and other graphics.

Each day, GAO issues a list of newly released reports, testimony, and correspondence. GAO posts this list, known as "Today's Reports," on its Web site daily. The list contains links to the full-text document files. To have GAO e-mail this list to you every afternoon, go to www.gao.gov and select "Subscribe to e-mail alerts" under the "Order GAO Products" heading.

Order by Mail or Phone

The first copy of each printed report is free. Additional copies are $2 each. A check or money order should be made out to the Superintendent of Documents. GAO also accepts VISA and Mastercard. Orders for 100 or more copies mailed to a single address are discounted 25 percent. Orders should be sent to:

U.S. General Accounting Office
441 G Street NW, Room LM
Washington, D.C. 20548

To order by Phone: Voice: (202) 512-6000
TDD: (202) 512-2537
Fax: (202) 512-6061

To Report Fraud, Waste, and Abuse in Federal Programs

Contact:

Web site: www.gao.gov/fraudnet/fraudnet.htm
E-mail: fraudnet@gao.gov
Automated answering system: (800) 424-5454 or (202) 512-7470

Public Affairs

Jeff Nelligan, Managing Director, NelliganJ@gao.gov (202) 512-4800
U.S. General Accounting Office, 441 G Street NW, Room 7149
Washington, D.C. 20548

United States
General Accounting Office
Washington, D.C. 20548-0001

Official Business
Penalty for Private Use $300

Address Service Requested

Presorted Standard
Postage & Fees Paid
GAO
Permit No. GI00