

CROP INSURANCE FACT SHEET

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The Crop Insurance Debate in the House Version of the 2007 Farm Bill

Roderick M. Rejesus, *Assistant Professor and Extension Specialist*

The U.S. House of Representatives passed its version of the 2007 Farm Bill on July 29, 2007. One of the more important (and controversial) crop insurance-related issues that came out of the Bill is: (1) the proposed 2.9 percentage points reduction in the Administrative and Operating (A&O) Expense reimbursement to crop insurance companies (See Section 11001.d.1 of the bill), and (2) the increase to 12.5% of the “net book quota share” of the government.

A unique aspect of the federal crop insurance program is the role of private insurance companies in program delivery and risk sharing. The relationship between the U.S. government and these private insurance companies is governed by the Standard Reinsurance Agreement (SRA). In accordance with the 1980 Federal Crop Insurance Act and through the SRA, A&O reimbursements were given to the companies to essentially cover the costs of delivering crop insurance (i.e. payment of agent commissions, loss adjustment, etc.). A&O reimbursement is like a sales commission – for each dollar of premium the company brings in they retain a certain percentage. For the 2006 crop year, the average reimbursement was 20.7% of net premiums (Gould, 2007). This percentage has steadily decreased over time (for example, in 2000, the rate was 25.7%). Nevertheless, with net premiums of \$4.6 Billion in 2006, the companies received approximately \$958 Million in A&O reimbursements. In 2000, the companies only received \$642 Million in A&O reimbursements (based on approximately \$2.5 Billion in net premiums that year).

The “net book quota share” is a provision in the 2005 SRA where each private crop insurance company is required to cede to the government 5% of its cumulative underwriting gain or loss. This means that once all other provisions of the SRA are applied and the company calculates its net gain or loss, this

final amount is reduced by 5%, with the government receiving the difference (Vedenov, et al., 2006).

The proposals in the House version of the farm bill will therefore effectively reduce A&O reimbursements by 2.9 percentage points (from an average of 20.7% in 2006 to 17.8% in 2009) and increase the “net book quota share” by 7.5 percentage points (from 5% to 12.5%).

Understandably, the private crop insurance companies do not support these proposals and have argued that they will not be able to effectively deliver crop insurance to the country’s producers with these amendments (Graves, 2007). In their view, the A&O cuts and the increased “net book quota share” will reduce the number of agents and would then make it difficult for farmers to obtain crop insurance and the associated service. High loss states may also not be serviced by the private companies given these proposals that adversely affect their bottomline.

In contrast, the government is looking to reduce their program delivery costs through the A&O cut and “net book quota share” increase. The government argues that the current SRA already allows the companies to cede the riskier policies to the government and retain the gains/losses from the less risky policies. Hence, the view is that companies have benefited from the program over the years (Babcock, 2007) and these House proposals will allow for a better

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risk sharing balance and provide the government some program savings.

The 2007 Farm Bill is now in the hands of the Senate and it may take several more months before a resolution to this debate will materialize. We have to wait and see.

References:

Babcock, B.A. (2007). Statement of Bruce A. Babcock (Iowa State University) before the House Committee on Oversight and Government Reform (May 3, 2007)

Gould, E. (2007). Statement of Eldon Gould (RMA Administrator) before the House Committee on General Farm Commodities and Risk Management (June 7, 2007)

Graves, D. (2007). "House Farm Bill Amendment will Devastate the Crop Insurance Program. Farmers will Lose Coverage." Memorandum to AACI Members (August 2, 2007) (See: <http://www.myagritrust.com/Form/cro/Urgent%20Grassroots%20Appeal.pdf>)

Vedenov, D.V., M.J. Miranda, R. Dismukes, and J.W. Glauber. (2006). "Portfolio Allocation and Alternative Structures of the Standard Reinsurance Agreement." *J. of Ag. and Resource Econ.* Vol 31(2): 57-73.

FOR MORE INFORMATION:

Title X of the 2007 Farm Bill as Passed by the House (See: <http://thomas.loc.gov/cgi-bin/query/D?c110:3:./temp/~c110oxizWF::>)

The Title X Farm Bill Fact Sheet (See: <http://agriculture.house.gov/inside/2007FarmBill.html>)

The June 7, 2007 and May 1, 2007 hearings and testimony of various experts in front of the House Agriculture Subcommittee on General Farm Commodities and Risk Management (See: <http://agriculture.house.gov/hearings/statements.html>)

The May 3, 2007 hearing and testimony of various experts in front of the House Oversight and Government Reform Committee (See: <http://oversight.house.gov/story.asp?ID=1288>)