



Crop Insurance Research Bureau, Inc.

201 Massachusetts Ave, NE, Suite C5 • Washington, DC 20002
(202) 544-0067 • FAX (202) 330-5255 • www.cropinsurance.org

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Comments on the Second Draft of the Standard Reinsurance Agreement

We very much appreciate the ongoing willingness of the Risk Management Agency (“RMA”) to listen to the views of the crop insurance industry regarding the 2011 Standard Reinsurance Agreement (“SRA”) negotiation process. We realize that you have many competing demands and a wide range of interested parties, so we commend you and your staff for actively reaching out to the industry.

As you know, the Crop Insurance Research Bureau (“CIRB”) is a national trade association representing crop insurance companies, reinsurance companies, and other organizations who lend support to the crop insurance industry nationwide. CIRB members write policies in nearly every state and provide billions of dollars in multiple-peril crop insurance protection. Given its strong connection to the reinsurance industry, CIRB has engaged with that community in particular during this process.

Therefore, while specific companies may wish to share with you their own analyses, we hope to address in this letter several general themes expressed primarily by the reinsurance community. In our recent teleconference with you on the second draft of the 2011 SRA, we agreed that CIRB would work with its reinsurance members to develop comments and work to set another meeting time with RMA. Our hope is this letter will reflect several consensus points raised during our discussions in preparation for a follow up meeting.

From a broad perspective, we believe, and we think that RMA agrees, that the public-private partnership employed in the delivery of federally reinsured crop insurance has been a tremendous success. We also believe that the availability of commercial reinsurance is an important part of this partnership. To that end, RMA has recognized the important role that commercial reinsurers play in the program.

From the perspective of the approved insurance providers (AIPs) represented by CIRB, commercial reinsurance provides an invaluable benefit to the crop insurance program by enhancing the capacity of AIPs. Without this benefit, less well capitalized AIPs could be forced to sharply reduce the volume of business they insure in order to maintain adequate levels of capitalization relative to premium. We are concerned that changes to the SRA that adversely affect the ability of AIPs to issue policies would jeopardize the goal of ensuring uniform availability of coverage for all eligible producers.

The possible reduction in available commercial reinsurance could have direct consequences for AIPs. By reducing the number of policies it issues, an AIP could lose the necessary ability to benefit from economies of scale, which could result in the insurer’s fixed expenses being so large

in relation to its premium that it would be unable to earn a profit net of its expenses and be compelled to withdraw from the program.

Additionally, commercial reinsurance is important to the marketplace as it enhances competition, thereby reducing the risk to the government that could arise if only a few insurers were able and willing to deliver the program. For example, commercial reinsurance makes it possible for new companies to enter a market. Insurers are often reluctant to enter new markets, particularly one as unique as crop insurance, unless they have financial and analytic support from commercial reinsurers. Not only does commercial reinsurance make it possible for new entrants to write a larger book of business than they might otherwise be willing to write, but also it makes it possible for the insurer to gain experience in a new market without risking a large portion of its own capital. Further, it is the commercial reinsurers that assist the AIPs in satisfying Federal Regulations, which require AIPs to have sufficient capacity to absorb two years of a 500 percent gross loss ratio, at a minimum.

With this in mind, our concern is that the second draft of the 2011 SRA goes in a direction that may well jeopardize the overall structure and delivery of the program. In its current form, the proposed SRA makes it more costly for AIPs to participate in the program, thereby conflicting with the Congressional intent of encouraging private sector participation.

The reinsurance industry believes that the guiding principle of these discussions should be one of managing risks. We find, however, that the RMA views the process as one of managing expense. These approaches are substantially different and, while RMA has worked to strike a balance, we remain concerned that combining these two principles will make it very difficult to arrive at an outcome that satisfies either the government or the industry.

We focus our comments on the risk and exposure management elements of the Standard Reinsurance Agreement. This recognizes in particular the key role of commercial reinsurers over the past 30 years in supporting this public-private partnership as well as their technical professional expertise. As it pertains to the second draft of the 2011 SRA, we believe that the following points regarding risk are important to a thoughtful, transparent discussion:

YIELD AND PRICE RISK vs. UNDERWRITING GAIN AND LOSS

- Catastrophic losses (similar to TRIA or National Flood type risks) in assessing savings from the gain/loss formula are ignored in any analysis carried out by RMA that we have seen to date.
- In calculating potential savings to be made from the gain/loss formula and risk sharing partnership, RMA has apparently ignored the seven years since 1970 that claims have exceeded premiums. These occurred in 1974 (c.17.5% of total values at risk), 1976 (c.13% of values), 1980 (c.12.5%), 1983 (c.14.5%), 1988 (c.22%), 1993 (c.16%), and 2002 (c.14%).
- The above large loss and catastrophe loss years may approximate RMA's own loss cost figures. However, only one of those years, 2002, reflects the experience of revenue insurance policies, which did not exist in any of the loss years prior to 2002. Revenue insurance represents approximately 80%+ of the liabilities at risk under the program. Also, this re-stated experience

does not include an appropriate allowance for crop market commodity price volatility. We see this as a very significant additional exposure that has not been appropriately recognized by RMA in its analysis of past and potential future program experience.

- Given today's uncertain market and climatic environment, should a 1988 or similar event occur today, commercial reinsurers' estimates of underwriting loss to the industry averages 45% or greater, with a variance of 35% to over 65% loss dependent upon underlying spread of risk exposures.
- RMA has excluded any allowance for these losses in either their annualized expected savings, or in their increased risk retention.
- Key drought exposed regions in the Midwest will now be increasingly reinsured by the U.S. taxpayer. These states also face the biggest threat from volatile financial markets. The RMA now proposes that these risks increasingly be borne by the U.S. taxpayer.
- By focusing on five "excess" profit states, RMA ignores the key fact that it is these states that face the greatest potential for both catastrophe production loss and financial price risk.
- RMA largely appears to be ignoring the program benefits already delivered in the other 45 eligible states, instead focusing on cuts to the major corn and soybean producing states.
- It is not less exposure to catastrophe loss that the commercial insurance and reinsurance market seeks; rather, a fair and equitable recognition of the true costs incurred in managing these risks. The second draft of the 2011 SRA proposes that these risks be largely ignored and be borne by the U.S. taxpayer.

The reinsurance community also believes strongly that a fair and realistic assessment of the "numbers" is essential to the SRA discussion. Most conversations regarding the SRA thus far have addressed the different financial assumptions made by RMA and the industry. The success of the program is too important for us to simply "agree to disagree" on the basic understanding of assumptions made by RMA in these discussions. We acknowledge and agree that RMA has an obligation to do what is best for America's taxpayers. However, we do believe it is important to have an open, fact-based discussion in order to achieve an outcome that is best for all parties involved. As it pertains to returns, we believe the following points are important to consider:

RATE OF RETURN (ROR)

- CIRB reinsurance members are experts in operating in an environment where ROR is a primary objective of their business. As such, they are well versed in calculating and measuring ROR.
- The Milliman report has been the key document that the RMA has used to measure a "fair" return for the insurance companies that share in the risk, operate, manage and service the FCIC crop insurance program.

□ RMA repeatedly asserts that Milliman clearly demonstrates the “excess” reward that companies have received. However, to date, it is impossible to evaluate Milliman ROR calculations as the underlying assumptions have not been provided. With transparency in mind, CIRB respectfully asks RMA to make available Milliman underlying assumptions. Without a common perspective on basic assumptions, we fear the results may be misguided and jeopardize the program’s future.

□ It is possible to state clearly that the consensus opinion of the reinsurers who we represent is that the ROR's RMA has used are overly optimistic and greatly inflated. Little or no allowance for key production loss years or highly volatile financial risk has been made.

□ The recent series of extremely benign crop seasons by definition will be offset by extremely adverse years. These have not been “weighted” into RMA's assessment.

□ Importantly, there is no comparable ROR target demonstrated by the RMA as a result of the proposed implementation of the second draft. This has to be the basis of any successful agreement and implementation of a new SRA.

We trust our comments are helpful to you in understanding the concern of CIRB reinsurance members as it relates to the 2011 SRA. We again note that some of these discussions may be best left to individual companies. Nonetheless, we stand ready to answer any questions you may have regarding these points.