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Premium Reduction Plans for Crop Insurance

The Risk Management Agency (RMA) allows insurance companies to offer Premium Reduction Plans (PRPs) on 2006 crop insurance policies. Under a PRP, a crop insurance company can offer premium reductions if administrative and operating expenses are low and RMA approves the premium reduction. The amount, if any, of premium reductions will not be known until after 2006. Reductions may not be paid until 2008.

Background

Background on insurance premiums and subsidies will aid in understanding PRPs. The RMA sets premiums offered by all crop insurance companies. In setting premiums, RMA first determines “total” premiums for insurance policies. The goal in setting total premiums is to obtain a loss ratio of 1.08. A loss ratio equals indemnity payments on insurance policies divided by total premiums. Given a 1.08 loss ratio, indemnity payments should equal 1.08 times total premiums over time.

Total premiums are reduced by risk subsidies to determine farmer-paid premiums. Risk subsidies are set in the Agricultural Risk Protection Act of 2000, Federal legislation setting many details of the Federal crop insurance program. Subsidy rates vary by coverage level and by insurance type. Farm-level insurances, for example, have subsidy rates varying from 67% for 50% coverage levels down to 38% for 85% coverage levels (see Table 1).

Table 1. Risk Subsidies as a Percent of Total Premium.

Coverage Level	Farm-Level Products ¹	Group Products ²
CAT	100%	
50%	67%	
55%	64%	
60%	64%	
65%	59%	
70%	59%	64%
75%	55%	64%
80%	48%	59%
85%	38%	59%
90%		55%

¹ Products include Actual Production History (APH), Crop Revenue Coverage (CRC), Income Protection (IP), and Revenue Assurance (RA).

² Products include Group Risk Plan (GRP) and Group Risk Income Plan (GRIP).

Source: Risk Management Agency

Total premiums do not cover the costs of selling and delivering crop insurance policies that are incurred by crop insurance companies. The Federal government covers these costs by providing crop insurance companies with administrative and operating (A&O) subsidies that are set by the 2005 Standard Reinsurance Agreement, a contract between the Federal government and crop insurance companies detailing risk sharing provisions on crop insurance policies. Subsidies depend on insurance product and range from 24.2% down to 18.1% of net book premium (see Table 2). Net book premiums equal total premiums minus some adjustments for administrative items. In practice, net book premiums are usually close to total premiums. For 2006, estimates are that A&O subsidies will be 21.6% of total premium.

Table 2. 2006 Administrative and Operating Subsidies as a Percent of Net Book Premium.

Coverage Level	Other Products ¹	Farm-Level Products ²	Group Products ³
75% or less	24.2%	20.8%	22.4%
80%	21.7%	18.7%	20.1%
85%	21.0%	18.1%	19.4%
90%			19.4%

¹ Products include Actual Production History (APH).

² Products include Crop Revenue Coverage (CRC), Income Protection (IP), and Revenue Assurance (RA).

³ Products include Group Risk Plan (GRP) and Group Risk Income Plan (GRIP).

Source: Standard Reinsurance Agreement of 2005.

Subsidies are illustrated for an Actual Production History (APH) policy in Champaign County, Illinois for a farm having a 150 bu. APH yield. In 2006, the RMA set the total premium for the APH product for the 75% coverage level at \$7.09 per acre. The risk subsidy for the 75% coverage level is 55%. Hence the farmer-paid premium is \$3.19 per acre ($\$7.09 \times (1 - .55 \text{ risk subsidy})$). The A&O subsidy rate on 75% coverage level yield insurance is 24.2 percent, meaning that the maximum A&O subsidy is \$1.72 per acre ($\$7.09 \text{ total premium} \times .242$). Hence, farmers pay \$3.19 for the policy and the Federal government provides risk subsidy of \$3.90 per acre ($\$7.09 \text{ total premium} - \$3.09 \text{ farmer-paid premium}$) and A&O subsidies of \$1.72. The total risk and A&O subsidy is \$5.62 per acre.

Procedure for Determining Premium Reductions

PRPs relate to A&O subsidies. (The \$1.72 per acre in the above APH example.) If crop insurance companies can show that their total A&O costs are less A&O subsidies, they can petition RMA to share some of the A&O profits with policy holders.

RMA requires a two step procedure for determining premium reductions. First, crop insurance companies had to request the opportunity to offer PRPs. The following companies, with there managing general agents in parentheses, are eligible to offer premium reductions in Illinois in 2006 (see <http://www.rma.usda.gov/news/2005/08/831prp.html>):

ACE Property and Casualty Insurance Company (Rain and Hall L.L.C.)
Farmers Alliance Mutual Insurance Company (Farmers Alliance Mutual Insurance Company)
Occidental Fire & Casualty Company of North Carolina (Crop1 Insurance Direct)
Rural Community Insurance Company (Rural Community Insurance Service)
Stonington Insurance Company (Agro National L.L.C.)
Westfield Insurance Company (John Deere Risk Protection, Inc.)
XL Reinsurance America, Inc. (Heartland Crop Insurance, Inc.)

Second, RMA must approve the PRPs submitted by the companies. Companies must provide RMA with statements audited by Certified Public Accountants showing A&O costs. Companies must also submit a dollar amount that they wish to distribute as part of PRPs. RMA will approve or disapprove each company's PRPs.

Premium reductions, if any, will be received by farmers well after the 2006 crop year. Because A&O expenses include costs related to loss adjustments and paying claims, insurance companies are not likely to be able to submit PRPs to RMA until well into 2007. It is likely that 2006 premium reductions will not be received until 2008.

Letter from Crop Insurance Agents

Crop insurance policy holders may receive a letter from their crop insurance agents that state they write policies for some companies that have been approved for payment reductions. An example text of this letter was contained in a manager's bulletin sent by RMA (MGR-05-023 at <http://www.rma.usda.gov/news/managers/2005/PDF/mgr-05-023.pdf>):

"I write for [insert names of all approved insurance providers that the agent represents] that [has/have] been determined by the Risk Management Agency to be eligible to offer a premium reduction plan for the 2006 reinsurance year in [state name]. Premium discounts are not available for crops insured at the catastrophic (CAT) level of coverage or for ineligible producers. The past payments of premium discounts are not a guarantee that future payments will be made or an indication of the amount of future premium discounts."

If a crop insurance agent will not have to send out a letter about PRPs if that agent does not write for a company that is eligible to offer a premium reduction plan.

Some crop insurance agents write crop insurance policies through multiple crop insurance companies. In these cases, a farmer's policy may not be eligible for a premium reduction even though the above letter is received.

Premium Reduction Plans Will Not Exist in 2007

Section 793 of the Federal agricultural appropriations bill for the 2006 fiscal year prohibits funds appropriated by the bill to be used for paying salaries or other expenses to implement PRPs for the 2007 reinsurance year. As a result, RMA announced that PRPs will not exist in 2007.

The Agricultural Risk Protection Act of 2000 mandated that RMA develop pilot programs for reducing crop insurance premiums. This caused RMA to pursue PRPs. The PRP plan implemented for the 2006 crop years caused a wide range of concerns including 1) farmers would not know what premium reductions are at crop insurance sign-up and this may cause confusion, 2) PRPs may result in reductions in service to farmers and training for crop insurance personnel, 3) paper work to comply with PRPs by crop insurance companies could be onerous, 4) companies with limited clientele may have advantages over full service companies in offering PRPs, 5) PRPs could reduce crop insurance company profits, thereby reducing the number of companies providing crop insurance, 6) limited resource farmers may not be well served by PRPs. These concerns likely caused political pressures, resulting in the U.S. Congress not allowing funds to be used to implement PRPs in 2007.

Summary

Purchasers of crop insurance could receive premium reductions for policies related to the 2006 crop. The size these premium reductions are not known and will not be known till after the 2006 crop year. Crop insurance companies approved to offer PRPs do not have to offer PRPs for 2006. The amount of PRPs is difficult to estimate. Even if offered, it is my estimation that most PRPs would be less than 10% of farmer paid premium. Unless Congressional action is taken, PRPs will not exist in 2007. Concerns have resulted in political pressure that calls into question the long-term futures of PRPs.

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