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Industry Calls for Long Term Analysis in Judging Crop Insurance Market Performance

OVERLAND PARK, KANSAS...USDA's Risk Management Agency (RMA) released late last Friday an update of their disputed Milliman study of returns to private crop insurers participating in the Federal Crop Insurance Program. While the report focuses on 2009 earnings, which indeed represent the second highest ever, it is more reflective of record-high crop yields than indicative of the future profitability of the crop insurance industry.

RMA understands too well that conclusions can't be drawn from data representing such a narrow timeframe. A long-term view is essential when analyzing a program based on a private insurance model, where any year's returns can vary due to weather or fluctuating crop prices. In fact, when discussing the rating of crop insurance policies in a recent interview, USDA's Risk Management Agency Administrator William Murphy indicated that a short timeframe is inappropriate when making crop risk-based policy decisions, adding that the analytical horizon had to extend back to the middle 1970's to ensure the policies were correct.

Corn and soybeans account for two-thirds of crop insurance business. In 2009 these crops each had record-highs in total production. But looking back to as recent as 2008, which was not a disaster year but featured corn and soybean yields close to trend values, RMA reports the rate of return on equity at 12.9%, less than half RMA's estimate for 2009. If the country had growing conditions in 2009 closer to the severe flood conditions of 1993 or the severe drought conditions of 1988, and crop yields were dramatically below trend values and the return on equity in the crop insurance industry would have been sharply negative with companies losing billions of dollars.

Beyond the obvious concern with using one year of data to judge the financial performance of the industry, RMA's analytical methods used to estimate rates of return on equity have been challenged by the crop insurance industry and are not a reasonable basis for estimating expected returns to the industry. In fact, Milliman itself cautions, "against drawing any strong conclusions on the adequacy or excessiveness of the historical returns." This is particularly relevant in this case, as their analysis also fails to take into account the \$6.4 billion in funds that Congress already cut from the crop insurance program in the 2008 farm bill.

An independent analysis by the firm Grant Thornton compared the profitability of the crop insurance industry to that of the property and casualty industry, an appropriate benchmark for judging financial performance. Over a 17-year period (1992-2008), Grant Thornton found that the Federal Crop Insurance Program is significantly less profitable than the property and casualty industry while having consistently lower expense-to-premium ratios. And while there have been good years, and even very good years like 2009, the public-private crop insurance partnership leverages this period to invest capital and build its reserves so that the program can cover future expected losses.

The Federal Crop Insurance Program is a successful public-private partnership that has become the primary stabilizing force in U.S. farm policy and a key element of the farm policy safety net. And one of the main reasons it has thrived is due to the mandated reserves that invest returns from good years to protect farmers during difficult years. In fact, the companies in the Federal Crop Insurance program are required to hold reserves about twice the amount currently held by the property and casualty insurance sector.

The program has grown from roughly 84 million acres in 1993 to the record year of 265 million acres in 2009. This growth in the size and importance of the program has happened in large measure due to the private delivery system that allows the agents to offer tailored coverage to meet producer's needs. Crop insurance is essential to making farmers credit worthy and otherwise able to secure loans from banks to operate and modernize their operations. The program has grown also in part because farmers know its value and they can afford to pay the premiums.

The crop insurance industry hopes RMA and others in the policy community will take the proper, longer term view of industry performance. Such a balanced perspective is essential not only to the health and sustainability of the private crop insurers but also to the public-private crop insurance partnership, the foundation of the U.S. farm program safety net today.