

**STATEMENT OF ROBERT PARKERSON,
PRESIDENT, NATIONAL CROP INSURANCE SERVICES,
BEFORE THE U.S. HOUSE OF REPRESENTATIVES,
COMMITTEE ON AGRICULTURE,
SUBCOMMITTEE ON GENERAL FARM COMMODITIES
AND RISK MANAGEMENT**

July 22, 2010

Mr. Chairman, Mr. Ranking Member and other Members of the Subcommittee, thank you for inviting the National Crop Insurance Services to appear at today's hearing to discuss the Standard Reinsurance Agreement (SRA) and its implications for the future of the crop insurance industry. I will briefly describe the role of NCIS and the approved insurance providers (the companies) in the negotiations of the 2011 SRA, identify some key issues of agreement and controversy, and conclude with an assessment of why the new SRA, combined with other factors, raise serious concerns for the crop insurance industry as it moves ahead, striving to provide the best in risk management service to America's agricultural producers.

The Function of NCIS in the Crop Insurance Industry

NCIS is a not-for-profit trade association whose members include every crop insurance company that participates in the Federal crop insurance program. NCIS and its predecessor organizations have provided members support in their crop insurance businesses since 1915. NCIS has worked actively with the Risk Management Agency (RMA) as an approved contractor and with the Board of the Federal Crop Insurance Corporation (FCIC) as an expert reviewer.

NCIS is also a licensed advisory organization and statistical agent for private Crop-Hail insurance in forty-nine of the fifty states, and it assists the crop insurance industry in meeting the regulatory requirements of these states. This is accomplished by filing the appropriate policy forms and statistical information with state insurance departments. Further, NCIS serves as a liaison with individual state insurance departments through active participation with the National Association of Insurance Commissioners (NAIC).

In 2009, NCIS member companies wrote nearly \$9 billion in Federal multiple peril crop insurance and related revenue products premium and \$620 million in private Crop-Hail insurance products premium. The potential liability between both programs was approximately \$105 billion. NCIS member companies service policies that encompass all farmers participating in the federal and private programs, including limited resource and socially disadvantaged farmers. In partnership with the Federal government, our participating member companies comprise the safety net that equitably provides the preeminent risk management program to America's farmers.

Role of NCIS and the Companies in the SRA Negotiations

NCIS began preparations for the new SRA early in 2008 by engaging company leaders on the future of the industry. By early 2009, after being advised by the administration that the 2005 SRA was unlikely to be renewed for the 2011 reinsurance year, NCIS and all 16 companies that deliver the Federal crop insurance program to America's farmers met and initiated a specific plan for negotiating the new SRA. NCIS organized five working groups, chaired by and consisting of representatives from all 16 crop insurance companies. The working groups addressed five subject areas: financial provisions, the Plan of Operations, information technology and data, quality standards and controls and education and training. The working groups met beginning last spring, reviewing the performance of the 2005 SRA and developing recommendations for the 2011 SRA.

In September 2009, RMA notified Congress that the 2005 SRA would not be renewed. In October 2009, in response to RMA's request for SRA proposals from the industry, NCIS submitted formal recommendations for the 2011 SRA on behalf of its member companies and reflecting the efforts of the working groups. Since December 2009 when RMA released the first SRA draft until mid-July 2010, when the 2011 SRA went into effect, NCIS and the companies held frequent meetings with RMA and provided substantial written comments to RMA on the first and second drafts. NCIS also organized a technical, legal review of the final SRA conducted by NCIS and company attorneys. Throughout the process, NCIS was very aware of antitrust issues and worked closely with USDA's Office of General Counsel, RMA leadership, industry leadership and third party legal counsel to ensure the negotiations were conducted properly. On behalf of the industry, we thank Members of Congress for including language in the 2008 Farm Bill that ensured the companies could confer with one another and with RMA in developing the new SRA.

NCIS and its member companies organized and carried out their activities with the primary objective of negotiating transparently and in good faith. Among our objectives was a new agreement that ensures effective service to producers, safeguards taxpayers' interests, and provides an opportunity for the insurance companies to earn a reasonable return relative to other lines of insurance, accounting for their relative risks. Unfortunately, the final agreement may put all these objectives at risk.

The Negotiations: Substantive Issues but a Predetermined Outcome

The first draft of the SRA released in December 2009 set an ominous tone for the negotiations. The first draft was a significant overreach by the administration. The administration proposed an unprecedented and potentially very damaging reduction of \$8.4 billion over 10 years in program funding. They proposed an inflexible formula for calculating administrative and operating (A&O) expense payments to the companies that would have used a proxy measure of premiums based on fixed "reference prices." These reference prices were sharply below policy prices and would never change. The first draft replaced the Assigned Risk Fund with a "Residual Fund" that would have enabled companies writing bad business to shift their risks to other companies. The first draft's reinsurance terms created separate gain and loss provisions for four different groups of states; groupings that had little apparent rationalization.

The reinsurance terms sharply reduced potential gains while also reducing potential losses, in effect shifting risk to taxpayers and crowding out private reinsurance. Moreover, the administration proposed increasing the net book quota share—its tax on underwriting gains—from 5% to 10%. Crop insurance companies are in the business of taking on and managing risks, but the administration wanted to take over risks and the potential for gains as well, moving away from the Federal Crop Insurance Act's reliance on private industry and exposing the taxpayer to greater losses in bad years.

I will not belabor the industry's position at the beginning of the process, beyond saying that the administration's first-draft overreach was so great that subsequent concessions by them would still leave the companies at a serious disadvantage. Clearly, the 2011 SRA was a budget-driven process that took full advantage of the companies' short-term inability to exit the program. Congress authorized a negotiation in the 2008 Farm Bill presumably with the idea that it be open and balanced. But, the administration had a budget cutting target and simply staked out an extreme position to the right of it, knowing full well that, in the end, the companies had no choice but to accept the final outcome.

In the second and third drafts of the 2011 SRA, the gap between the administration's proposals and the companies' proposals narrowed. The reference price concept was thrown out, the Residual Fund concept was dropped, the number of state groups for reinsurance terms was reduced from four to two (the first group includes the Corn Belt states of Iowa, Illinois, Indiana, Minnesota, and Nebraska and the second comprises all other states), and the reinsurance terms were improved for the companies. There were a number of concepts that companies and the administration could agree upon. Both sides wanted to address the concern that A&O payments could unnecessarily shoot up when there are market price spikes, such as occurred in 2008. Both sides agreed that reinsurance gain and loss provisions should be made more profitable for the lowest return states and reduced for the highest return states. This "rebalancing" of returns would help companies cover costs and hopefully earn a small underwriting profit in the low return states.

Unfortunately, the final 2011 SRA fails to achieve a fair balance among these shared concepts. The final draft has been signed by the 16 companies, but that hardly means the companies think things are satisfactory. Here are a few of the glaring issues with the 2011 SRA:

- The size of the overall funding cut remains unsupported and represents a decided risk to the companies. The administration premised its budget-cutting objective on two RMA-funded studies (contracted to Milliman, Inc.) on the companies' rate of return on equity. The flaws in this approach are legion. First, the administration never provided an explanation of how the Milliman results were utilized to determine the final gain and loss provisions for reinsurance. Second, the Milliman studies are rebuttable on numerous grounds. Milliman estimated the equity of crop insurance firms using a model that did not take account actual firm equity and crop insurance regulatory requirements for equity, thus producing unverifiable estimates of industry equity; they failed to consider reinsurance and actual A&O costs; and they did not include a long enough period of time to adequately account for the potential for catastrophic loss. The administration repeatedly defended its proposals in public based on the returns to companies since 2006,

a period that included an unusually rare spike in crop prices and the two lowest loss ratio years in the history of the program dating to 1981. Arguing for steep budget cuts based on unusual circumstances clearly is not a sound actuarial basis for determining expected future returns and establishing sound policy. The administration appears to be betting that the program's good performance in recent years will continue. The insurance companies have to go along for the ride, but they may have no seat belt on.

- The A&O cap used by the administration in the final SRA is preferable to the use of fixed reference prices; however, RMA's change in approach does not mask the reality that the A&O cuts remain large coming on top of the A&O funding reductions of the 2008 Farm Bill. RMA's own assessment shows A&O cuts of \$220 million per year during 2011-2015. These A&O cuts are being imposed oblivious to the payment delays that will occur in 2012. As a result of a 2008 Farm Bill budget mechanism, companies will have to wait up to 9 months to receive payments from RMA to fund their businesses. Operating costs must be paid and companies will have to borrow in difficult credit markets to meet payrolls. Moreover the new A&O reductions were determined before RMA has completed its study of agent costs of delivery. RMA agreed with recent GAO findings that a study of agent business costs was necessary to fully understand total delivery expenses and to judge the appropriate level of delivery payments to companies and agents. In this case, there were insufficient facts to influence a predetermined budget cut.
- The 2011 SRA implements soft and hard caps on the companies' compensation of agents. These caps were not proposed by NCIS in its initial recommendations to RMA last October and were not proposed in any comments submitted to RMA on the SRA drafts. The soft cap, which restricts agent compensation to 80% of the A&O a company receives in a state, first appeared in the second draft SRA. However, the hard cap, which restricts agent compensation plus profit sharing to 100% of the A&O a company receives in a state, was presented in the final SRA—without the opportunity to comment by the companies. These A&O provisions are fraught with competitive issues and administrative problems.
 - A major problem is that RMA will not know the overall limit on A&O payments until the year is over. Companies must pay their agents for their work before the year is over. How will companies know what 80% of their A&O payments are when they won't know what their total payments will be until the year is over?
 - Another critical issue is the definition of compensation. NCIS has agreed to work with RMA to define agent compensation in a clear way so that companies will be able to implement the caps without being out of compliance. It is obvious at this point that the caps on agent compensation could easily be violated quite unintentionally by companies that are assiduously trying to stay within the caps. Penalties for noncompliance may be severe. We recommend that Congress keep abreast of this issue and help ensure that RMA shows forbearance for unintentional violations.
 - Finally, many of our member companies have raised concerns over the impact of the caps on agents. They fear that agents may shift from one company to another

to chase the prospect of better profit sharing. They fear that the compensation caps could lead to consolidation and reduced service, especially for smaller farm operations that have lower premium volume. We recommend that Congress monitor closely the structural changes that may take place among agents and companies as a result of the change in A&O payments and agent commission caps.

- The final gain/loss provisions and A&O reductions combined are expected to reduce returns well below historical levels in the Corn Belt states. In addition, the changes in prospective net returns in other states do not reflect their loss experiences. The administration rejected the industry's recommendation that higher return states that were not put into Group 1 (Corn Belt) be given less favorable reinsurance terms than the underserved states. Preliminary NCIS analysis indicates that had the 2011 SRA been in effect for 2009, the Group 1 states would have had a combined reduction in A&O payments and underwriting gains of nearly 25%. The remaining states, while seeing an increase in underwriting gains, would still have faced a collective decline of around 6% in A&O payments and underwriting gains combined. It is unclear how such a decline in returns is going to increase incentives for companies to operate and improve service in low return states, as the administration claims.

In addition to the problems just identified with the key financial terms of the 2011 SRA, the SRA imposes a range of administrative requirements on the companies. Many people do not realize that the SRA encompasses hundreds of pages of IT, data reporting (such as common land units and FSA data reconciliation), training and quality control requirements (such as large claim reviews). These regulatory burdens continue to escalate. For example, the Crop Insurance Handbook for the 2011 SRA, which specifies the requirements to write crop insurance, is now 834 pages long, compared with 525 for the 2005 SRA. Appendix III of the 2011 SRA, which specifies information and reporting requirements, is 826 pages, compared with 205 pages for the 2005 SRA. In addition to these SRA requirements, FCIC continues to approve new products and revise and expand existing products, all of which demand increased servicing by the companies. For example, between 2000 and 2009, there have been 37 introductions of new crop or insurance plans.

The 2011 SRA: A Yellow Flag that Augurs for Policy Caution over the Next Several Years

As the industry looks ahead, we can find little security in the developments of the past two years and the economic prospects before us. Congress and others need to know that the combination of the \$6.4 billion in 2008 Farm Bill reductions, the \$6 billion in SRA reductions, the delay in payments to companies in 2012 and the increase in workload and investments needed to adequately deliver this program and meet its regulatory requirements are going to strain this industry, even with normal weather over the next several years. The companies must do more and are going to get paid less, and get paid less frequently, to do it.

The 2011 SRA outcome raises several issues relevant to future actions by Congress. First, the Federal crop insurance program, the safety net for American farmers and ranchers, has now contributed greatly towards deficit reduction. We believe we have done so for this industry as

well as for production agriculture in general. We ask that this Committee work to ensure that these funding cuts receive appropriate recognition and prevent further cuts for production agriculture, such as in the 2012 Farm Bill.

Second, while the industry would hope to be able to move forward with no further financial shocks, we emphasize that, unlike private property casualty companies, crop insurance companies do not set premium rates and cannot compete using rate changes. Nor are the companies able to adjust rates to recoup losses in previous years. Premium rate changes can have major impacts on industry profitability, and the companies are handicapped by not knowing what will happen with respect to premium rates. Historically, the companies have not been part of the rate setting process.

Third, Congress should assess the concept of a periodically negotiated SRA. The companies have little leverage to conduct such a negotiation as an equal partner with RMA. RMA conducted the negotiations in a mutually respectful fashion but with far less than full transparency. Requests for key data and analyses were not satisfied. Even today, as we testify, we do not have the details of the baseline USDA used to score the 2011 SRA. In the final SRA draft, which was not negotiable, RMA introduced major new concepts that had not received public or industry comment. These concepts included the hard cap on agent commissions and the requirement that companies forgo legal recourse in the event that the administration has acted illegally with its A&O provisions. Finally, should multi-billion dollar changes in legislated programs be made through unilateral discretionary actions?

The crop insurance companies are committed to the public-private partnership. We are committed to the efficient functioning of competition and markets. We believe the private sector, not the government, is the best way to provide the individual risk management information and tools that are indispensable for farmers today. We believe that is the way farmers want the program to operate. We believe this program can be expanded and improved to provide even better protection for farmers and ranchers. We ask that Congress pay careful attention to the impacts of the 2008 Farm Bill and the 2011 SRA and work with the crop insurance industry to strengthen this valued program.

Thank you Mr. Chairman, that completes my statement.

Committee on Agriculture
U.S. House of Representatives
Information Required From Non-governmental Witnesses

House rules require non-governmental witnesses to provide their resume or biographical sketch prior to testifying. If you do not have a resume or biographical sketch available, please complete this form.

1. Name: Robert W. Parkerson
2. Business Address: 8900 Indian Creek Parkway, Suite 600
Overland Park, KS 66210
3. Business Phone Number: (913) 685-2767
4. Organization you represent: National Crop Insurance Services, Inc.
5. Please list any occupational, employment, or work-related experience you have which add to your qualification to provide testimony before the Committee:
17 Years as President of NCIS
35 Years background in agricultural insurance
Served as officer of several trade association boards
6. Please list any special training, education, or professional experience you have which add to your qualifications to provide testimony before the Committee:
University of Kentucky
7. If you are appearing on behalf of an organization, please list the capacity in which you are representing that organization, including any offices or elected positions you hold:
President of NCIS (National Crop Insurance Services)

PLEASE ATTACH THIS FORM OR YOUR BIOGRAPHY TO EACH COPY OF TESTIMONY.

A World Of Information

National Crop Insurance Services

**ROBERT W. PARKERSON
NATIONAL CROP INSURANCE SERVICES, INC.**

Robert W. Parkerson is President of National Crop Insurance Services, Inc., a position he has held since April 1, 1993. He has an extensive background in agricultural insurance, and served as Vice President and President of several insurance trade associations prior to assuming his current duties. He has served as advisor and as a member of the board of directors on various ag business organizations and civic foundations.

With over thirty years of experience in insurance (property, casualty and life) Mr. Parkerson has been placed in a leadership role within the agricultural insurance industry. He oversees all crop-hail activities with state regulators on behalf of the private crop-hail industry. Under Mr. Parkerson's guidance, NCIS has also taken on a key role as liaison with the Risk Management Agency and the Federal Crop Insurance Corporation on behalf of its member companies.

Mr. Parkerson is an alumnus of the University of Kentucky and served in the United States Air Force Strategic Air Command. He spent several years in advertising/marketing agencies prior to his work in the insurance industry, where he held many positions, from agent to Vice President of Marketing, for a multi-line insurance company.

Committee on Agriculture
U.S. House of Representatives
Required Witness Disclosure Form

House Rules* require nongovernmental witnesses to disclose the amount and source of Federal grants received since October 1, 2007.

Name: Robert Wayne Parkerson
Address: 8900 Indian Creek Parkway, Suite 600
Overland Park, KS 66210
Telephone: (913) 685-2767

Organization you represent (if any): National Crop Insurance Services

1. Please list any federal grants or contracts (including subgrants and subcontracts) you have received since October 1, 2007, as well as the source and the amount of each grant or contract. House Rules do NOT require disclosure of federal payments to individuals, such as Social Security or Medicare benefits, farm program payments, or assistance to agricultural producers:

Source: See Attached Amount:

Source: Amount:

2. If you are appearing on behalf of an organization, please list any federal grants or contracts (including subgrants and subcontracts) the organization has received since October 1, 2007, as well as the source and the amount of each grant or contract:

Source: N/A Amount:

Source: Amount:

Please check here if this form is NOT applicable to you:

Signature: Robert W. Parkerson

* Rule XI, clause 2(g)(4) of the U.S. House of Representatives provides: *Each committee shall, to the greatest extent practicable, require witnesses who appear before it to submit in advance written statements of proposed testimony and to limit their initial presentations to the committee to brief summaries thereof. In the case of a witness appearing in a nongovernmental capacity, a written statement of proposed testimony shall include a curriculum vitae and a disclosure of the amount and source (by agency and program) of each Federal grant (or subgrant thereof) or contract (or subcontract thereof) received during the current fiscal year or either of the two previous fiscal years by the witness or by any entity represented by the witness.*

PLEASE ATTACH DISCLOSURE FORM TO EACH COPY OF TESTIMONY.

National Crop Insurance Services

8900 Indian Creek Parkway, Suite 600 Overland Park, KS 66210

Expert Review Blanket Purchase Agreement Contracts Since October 1, 2007

| | |
|--|---------------------|
| USDA Risk Management Agency - ARH Cherry Pilot Crop Insurance Program Expert Review (Jan 2008) | \$33,769.20 |
| USDA Risk Management Agency - Named Peril Weather Ins Pilot Expert Review (Oct 2008) | \$35,457.60 |
| USDA Risk Management Agency - Quarantine Endorsement Expert Review (Dec 2008) | \$23,638.40 |
| USDA Risk Management Agency - Vegetation Index - PRF - Max Indemnity Factor Expert Review (May 2009) | \$7,091.52 |
| USDA Risk Management Agency - APH Sesame Pilot Crop Insurance Program Expert Review (Sep 2009) | \$23,638.40 |
| Total Expert Review Blanket Purchase Agreement Contracts | \$123,595.12 |

Commodity Partnerships for Risk Management Education Since October 1, 2007

| | |
|--|---------------------|
| USDA/RMA - Cost Control: Risk Management Planning Strategies for Northern Plains Livestock Producers | 95,464 |
| USDA/RMA - Insuring Pasture, Rangeland, Forage, and Vegetative Resources for Livestock and Biomass Use | 94,642 |
| USDA/RMA - Risk Management for the Environmental Horticulture Industry in the Valdosta Region | 91,150 |
| USDA/RMA - Risk Management for the Environmental Horticulture Industry in the Jackson Region | 92,050 |
| USDA/RMA - Risk Management for the Environmental Horticulture Industry in the Oklahoma City Region | 86,500 |
| Total Commodity Partnerships for Risk Management Education | \$459,806.00 |

Crop Insurance Education in Targeted States Cooperative Agreements Since October 1, 2007

| | |
|---|---------------------|
| USDA/RMA - Crop Insurance and Risk Management Education in Rhode Island (October 2007) | 157,000 |
| USDA/RMA - Sub-Contract - Crop Insurance and Risk Management Education in Rhode Island (October 2009) | \$37,500.00 |
| Total Crop Insurance Education in Targeted States Coop. Agreements Since October 1, 2007 | \$194,500.00 |

Risk Management and Community Outreach Program Subaward Agreements

| | |
|---|--------------------|
| USDA/RMA-Risk Mgmt. and Comm. Outreach Program for Limited Resource & Underserved Farmers (Oct. 2009) | \$10,000.00 |
| Total Risk Management and Community Outreach Program Subaward Agreements | \$10,000.00 |