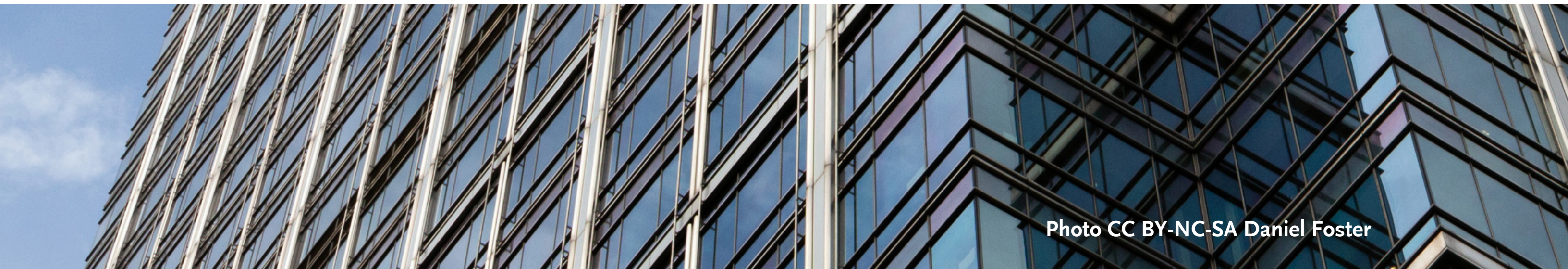
Crop Insurance — How a Safety Net Became a Farm Policy Disaster

A Land Stewardship Project Special Report

White Paper 1

Crop Insurance — The Corporate Connection



Main points

- There is significant disconnect between the massive profits crop insurance corporations enjoy and the risks they take on.
- There is little systematic accountability to make certain an insurance company's administrative costs match the amount of tax money it receives for administrative reimbursement.
- Profit margins for crop insurance companies far exceed what is considered a reasonable rate of return for crop insurers.

Introduction

Federal crop insurance is the single largest agricultural program, measured by funding, delivered by the Farm Bill. This program cost $58.7 billion between 2003 and 2012,[1] and is projected to cost $90 billion over the next ten years.[2]

There's big money in crop insurance, which is why major corporations such as Wells Fargo, John Deere and Archer Daniels Midland are involved in this industry. These corporations receive reimbursements for administrative costs and ensure themselves large profits by off-loading the riskiest policies to the federal government. They also benefit from an artificially created market, initiated and maintained by huge public subsidies that decrease the cost of insurance premiums for farmers. This subsidy has radically expanded the number of farmers and acres enrolled in crop insurance, thus guaranteeing a huge and expanding clientele for these private corporations.

Between 2003 and 2012, the federal government spent $42.1 billion in premium subsidies, $12.5 billion in administrative reimbursements and $4.1 billion on underwriting losses and additional costs — a tax funded total of $58.7 billion.[3] These public dollars are going to already wealthy corporations — top ranked insurer Wells Fargo had $1.4 trillion in assets in 2013, while second-ranked insurer Ace reported $2.7 billion net income in 2012.[4]

"Crop Insurance — The Corporate Connection" is the first of three white papers authored by the Land Stewardship Project (LSP). In this paper, we take a look at the money taken in by the crop insurers themselves, how the system works, and who takes on risk and who doesn't.

1 USDA Risk Management Agency (RMA). Fiscal year of government cost of federal crop insurance. Accessed 11/12/14, www.rma.usda.gov/aboutrma/budget/fycost2003-2012.pdf

2 Environmental Working Group. EWG Farm Subsidy Database, Homepage. Acessed 11/12/14, www.farm.ewg.org

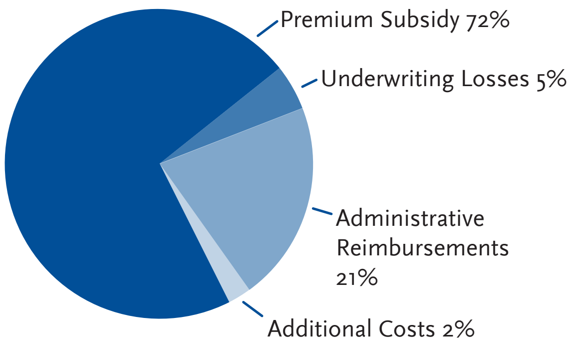
3 USDA Risk Management Agency (RMA). Fiscal year of government cost of federal crop insurance. Accessed 11/12/14, www.rma.usda.gov/aboutrma/budget/fycost2003-12.pdf

4 Lynch, David J. "Safety Net for Crops Means $14 Billion Tab for Taxpayers," Bloomberg News, 9/18/2013. www.bloomberg.com/news/2013-09-10/crop-insurers-14-billion-some-see-as-money-laundering.html

Corporations & their involvement with federally subsidized crop insurance

While the federal government sets the terms for crop insurance, private corporations sell and administer the insurance products offered to farmers and reap the financial gains that result. Crop insurance is offered through insurance corporations that are approved by the USDA. In 2014, 19 corporations were designated as approved insurers and include subsidiaries of many large banks and agribusinesses, including Rural Community Insurance Services (a subsidiary of Wells Fargo), John Deere Insurance Company, American Farm Bureau Insurance Services, and Archer Daniels Midland Crop Risk Services.[5]

Federal Spending on Crop Insurance 2003 – 2013[6]



Crop insurance differs from other insurance products in that the government requires it to be available to any farmer who applies and is raising crops for which insurance is available. Whereas a company might deny someone home or vehicle insurance due to a high liability risk, it cannot turn a farmer down for that reason. In theory, this increases risk for the insurance corporations, since their product cannot be sold exclusively to cherry-picked, low-risk clients. As a result, the federal government reimburses corporations for their administration costs and allows crop insurance corporations to off-load their riskiest policies onto the taxpayer, thereby creating a portfolio that is calculated to result in significant profits for the corporation.

Insurance corporations also benefit from the heavy federal government subsidies for producers' insurance premiums. In 2012, the federal government paid 62 percent of premiums, $7.1 billion worth.[7] This is by far the most expensive aspect of the program, costing the taxpayer a total of $42 billion from 2003 to 2012.[8] While farmers benefit from lower cost insurance, this subsidy creates a much larger benefit for insurance corporations by artificially expanding the market for their products, with the market boost coming from the pockets of the American taxpayer.

While it is true that crop insurance is a risky business, these government incentives have gone far beyond their original intention and now virtually guarantee a large annual profit for the 19 designated corporations, which include some of the largest banks and agribusinesses in the country.

5 USDA Risk Management Agency (RMA), Crop Insurance Providers List for 2015. Accessed 11/12/14, www3.rma.usda.gov/tools/agents/companies/indexCI.cfm

6 USDA Risk Management Agency (RMA), Fiscal year of government cost of federal crop insurance. Accessed 11/12/14, www.rma.usda.gov/aboutrma/budget/fycost2003-12.pdf

7 US Government Accountability Office (GAO), Crop Insurance Considerations in Reducing Federal Premium Subsidies. August 2014. www.gao.gov/assets/670/665267.pdf

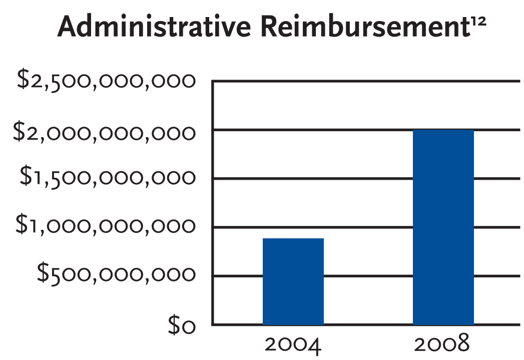
8 USDA Risk Management Agency (RMA), Fiscal year of government cost of federal crop insurance. Accessed 11/12/14, www.rma.usda.gov/aboutrma/budget/fycost2003-12.pdf

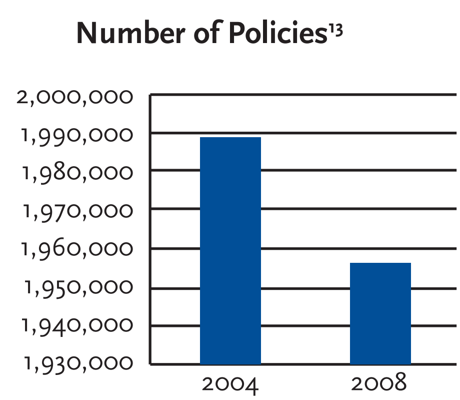
Administrative & operating costs

Crop insurance corporations also get tax-funded reimbursements to help cover the administrative and operating costs of servicing insurance policies. Between 2003 and 2012, the federal government reimbursed insurance corporations $12.5 billion for their administrative and operation costs.[9]

These reimbursements are calculated based on a percentage of the value of the premiums. The cost of one particular type of policy, revenue insurance, can be particularly high since this type of protection is based on the market value of the insured crops. If the price of a crop falls below what the policy was locked in at when purchased by the farmer, revenue protection kicks in and makes up for a certain percentage of this loss. Revenue insurance is now the most popular insurance product, accounting for 63 percent of policies and 85 percent of claims in 2013.[10] Since the insured amount of revenue rises and falls due to commodity prices, premiums follow that trend, with administrative reimbursements following suit.

However, the reality is that whether corn is selling for $6 per bushel or $2.50 per bushel, administering a policy should cost the insurance company the same amount. But when commodity prices are high, as they were from 2008 to 2013, taxpayers end up paying more for administrative reimbursements, even when the workload for the insurance companies decreases.[11]





It has become clear there is little accountability on the part of the insurance companies when it comes to getting paid for servicing policies. As the bar graphs at the right show, in 2008 33,000 fewer crop insurance policies were sold than in 2004, yet administrative reimbursements were $1.2 billion higher. As the U.S. Government Accountability Office described in 2009, the reimbursements are detached from "reasonable business expenses," generating a "kind of windfall" for many insurance companies.[14]

In an effort to address this detachment, the USDA's 2010 crop insurance guidelines established an annual cap of $1.3 billion in adminis-

9 USDA Risk Management Agency (RMA), Fiscal year of government cost of federal crop insurance. Accessed 11/12/14, www.rma.usda.gov/aboutrma/budget/fycost2003-12.pdf

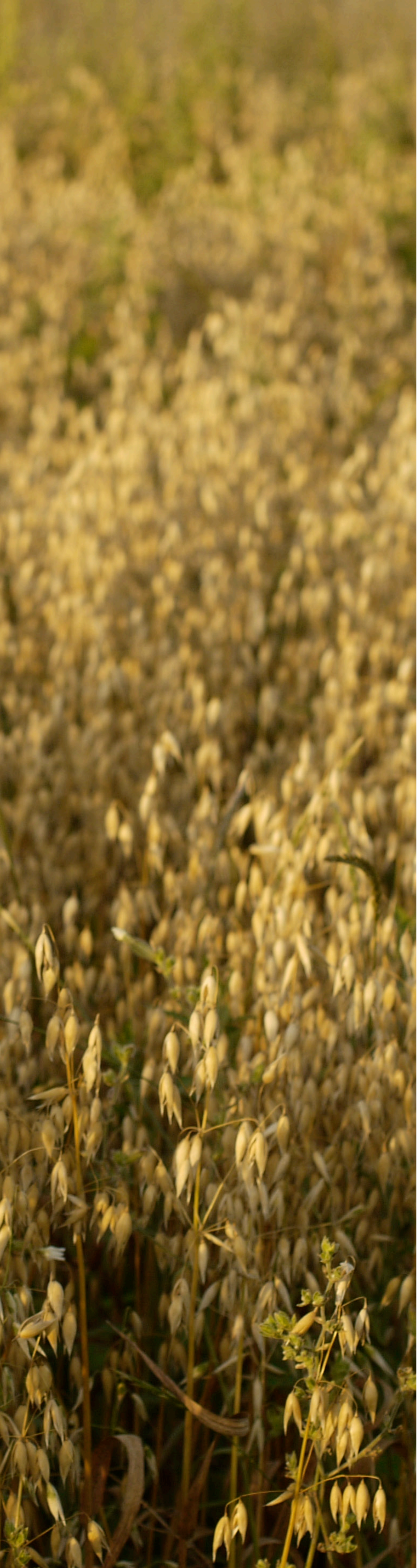
10 Federal Crop Insurance Corporations, Statistics for 2013 by Product. Accessed 11/12/14, www3.rma.usda.gov/apps/sob/current_week/insplan2013.pdf

11 USDA Risk Management Agency (RMA), Fiscal year of government cost of federal crop insurance. Accessed 11/12/14, www.rma.usda.gov/aboutrma/budget/fycost2003-12.pdf

12 USDA Risk Management Agency (RMA), Fiscal year of government cost of federal crop insurance. Accessed 11/12/14, www.rma.usda.gov/aboutrma/budget/fycost2003-12.pdf

13 USDA Risk Management Agency (RMA), Crop Year Statistics for 2004; Crop Year Statistics for 2008. Accessed 11/19/14; www3.rma.usda.gov/apps/sob/current_week/crop2004.pdf; www3.rma.usda.gov/apps/sob/current_week/crop2008.pdf

14 Shields, Dennis A. "Federal Crop Insurance: Background" 12/12/13. Congressional Research Service. www.crs.gov



tration reimbursements, adjusted for inflation. Yet in the four years since, the reimbursements have been almost exactly $1.3 billion annually, and there is still little accountability on the part of insurance companies as to how they justify receiving maximum payments each year.

The bottom line is that the public is bankrolling an unaccountable reimbursement system that is tilted heavily in favor of private interests. These payments need to more accurately correspond with real administrative costs, and encourage increased efficiency in offering and servicing crop insurance.

Risk-sharing agreements

As another incentive, the federal government has established risk-sharing agreements with the approved insurance corporations. In any insurance business, a company profits when total premiums (paid by customers) exceed total paid claims. When that happens, the resulting profit is called an "underwriting gain." In the opposite case, when paid claims exceed premiums, there is an "underwriting loss." In the crop insurance business, insurers assign nearly all policies that they issue to two separate risk pools: the "assigned risk pool" and the "commercial risk pool." The insurance corporations choose where to place a policy based on the risk they want to assume. That's because the federal government and insurance corporations have a risk-sharing agreement which establishes different degrees of responsibility for paying claims, depending on which pool the policy is placed in. The federal government takes much more responsibility for the assigned risk pool, where the most risky policies are placed, while insurance corporations take more responsibility for the commercial risk pool, where they put the least risky policies.[15]

Crop insurance corporations have banked underwriting gains in all but three years since 1993. In just the past 10 years this risk sharing agreement has resulted in $10 billion in underwriting gains for insurers, while the public paid $2.8 billion in underwriting losses alone, and $58.7 billion for crop insurance overall.[16] While this risk-sharing agreement may have

15 Babcock, Bruce A., Chad Hart. "Crop Insurance: "A Good Deal for Taxpayers?" *Iowa Ag Review*, Summer 2006, Vol. 12, No. 3 www.card.iastate.edu/iowa_ag_review/summer_06/article1.aspx

16 Lynch, David. "Safety Net for Crops Means $14 Billion tab for Taxpayers," *Bloomberg*, 11/18/13, www.bloomberg.com/news/2013-09-10/crop-insurers-14-billion-some-see-as-money-laundering.html

been conceived in order to encourage corporate participation in crop insurance, it has evolved into a system where taxpayers are paying claims while Wells Fargo, Archer Daniels Midland and other corporations consistently garner big profits. When combined with administrative and operating reimbursements, underwriting gains can produce massive profits for private industry at public expense. In some cases, these gains vastly overshadow the benefits being passed on to the group of people the crop insurance system was supposedly set up to serve in the first place — farmers. For example, between 2005 and 2009, for every $1 in insurance benefits transferred to farmers, insurance companies garnered $1.44 in administrative and operating subsidies and underwriting gains.[17]

Conclusion

As a result of the significant subsidies crop insurance corporations receive, they consistently generate profits that are far above what is considered a reasonable rate of return for their industry.

Between 1989 and 2009, crop insurance companies averaged a 17 percent return on equity at a time when the "reasonable" rate was just under 13 percent, according to USDA analysis. In 2009 alone, crop insurers enjoyed an astounding 26 percent rate of return, more than double the reasonable rate of return calculated by economists for that year.[18]

These excessively high rates of return are set to only become greater, given the unprecedented expansion of the crop insurance program in the 2014 Farm Bill. A recent issue of Choices, the publication of the Agricultural & Applied Economics Association, did an in-depth analysis of the new agriculture law and called out crop insurance in particular for its "inefficient" use of tax money. As agricultural economist Brian Davern Wright put it: "The government is thus expanding an insurance program that would not be sustainable on a free market owing to its inherently high cost of administration and reinsurance."[19]

17 Wright, Brian D. "Multiple Peril Insurance," Choices, 3rd Quarter 2014, Agricultural & Applied Economics Association, www.aaea.org/publications/choices-magazine

18 "RMA Releases Updated Studies About the Federal Crop Insurance Program," USDA Risk Management Agency, April 2, 2010, www.rma.usda.gov/news/2010/04/analyses.html

19 Wright, Brian D. "Multiple Peril Insurance," Choices, 3rd Quarter 2014, Agricultural & Applied Economics Association, www.aaea.org/publications/choices-magazine

White papers in the "Crop Insurance: How a Safety Net Became a Farm Policy Disaster" series

- Crop Insurance — The Corporate Connection
- Crop Insurance Ensures the Big Get Bigger
- How Crop Insurance Hurts the Next Generation of Farmers

To read all of these white papers and for more information on the Land Stewardship Project's "Crop Insurance: How a Safety Net Became a Farm Policy Disaster" initiative, see: www.landstewardshipproject.org/organizingforchange/cropinsurance.

More information is also available by contacting **Mark Schultz**, **Land Stewardship Project Policy Program Director, at 612-722-6377 or marks@landstewardshipproject.org.**