

RISK ASSESSED MARKETING

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[Home](#)

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Disclosure: Dr. Barnaby's research was the basis for the privately developed Crop Revenue Coverage.

American Agrisurance Under Control of Regulators¹

Within the past few weeks, American Agrisurance (Am Ag) was taken over by the Nebraska Insurance Department and the Risk Management Agency². They have been ordered to close down and to issue no new policies. Am Ag was the largest crop insurance company. It is expected that Am Ag will go out of business after current crop insurance contracts are settled.

I just returned from the East Coast where I was doing risk management workshops for the Extension Service. Many of those states do not have the Revenue Assurance (RA) offer. Therefore, those growers are wondering what will happen with Crop Revenue Coverage (CRC) that is owned and maintained by Am Ag.

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² American Agrisurance is the marketing part of the company and the name recognized by farmers, lenders, and policy makers. The insurance company American Agrisurance marketed for was American Growers and American Growers is under the "Order of Supervision" by the Nebraska Insurance Department. The name Am Ag is used as a common name to represent both American Agrisurance and American Growers. Hopeful this will it make easier for the reader to follow the issue.

The 2003 rates and underwriting rules for CRC have been filed and approved. Therefore, there should be no problem purchasing a CRC contract on 2003 spring planted crops. Growers will be able to buy CRC from one of Am Ag's competitors. If growers were an Am Ag customer their new contract will be with a different company but likely the same independent crop insurance agent.

The real question is will the CRC contract be available on the 2004 winter wheat crop with a sales closing date on September 30, 2003. All companies are allowed to sell the CRC contracts. But who will update the rates and maintain CRC?

It has been widely reported that Rain & Hail submitted a bid for Am Ag but the offer was rejected by the Risk Management Agency (RMA) in USDA. Therefore, it is unlikely that any private company will take over maintaining the CRC contract. If CRC remains as a crop insurance offer, then likely RMA will take over the contract. Future rates and underwriting rules for CRC will then be provided by RMA. RMA would likely need to contract any future improvements or changes to the CRC contract.

Another option is for RMA to cancel the CRC contract. This will likely be an unacceptable option in states that only have the CRC offer for revenue insurance.

The other option is for the RA contract to expand to the states that currently only have the CRC contract. Those farmers would then have access to revenue-replacement coverage crop insurance through the RA contract. RMA could then cancel the CRC contract and no future CRC offers would be made.

Am Ag was also the owner of Group Revenue Insurance Plan (GRIP). The GRIP contract was developed by IGF but IGF was merged with Am Ag. This contract has no counter part therefore RMA will have to assume the maintenance roll assuming this policy will be offered in the future.

Am Ag and Iowa Farm Bureau formed an LLC to develop the Livestock Gross Margin (LGM) contract. The LGM was a new contract on the market this year in Iowa. As the owner of the LLC, future changes, expansion, and maintenance on LGM will be preformed by Iowa Farm Bureau.

What is less clear is will RMA expand these products to other states? Currently Am Ag has filed for the expansion of CRC on winter wheat in the Northeast. It is unlikely that any one from Am Ag will attend the Board meeting when the expansion submission is considered.

Am Ag developed the private product Market Value Protection (MVP) that was the first crop insurance product with price risk included. This contract was first introduced in 1990 and was the first replacement contract that later turned into CRC. Am Ag also developed the private product CRC PlusTM. Am Ag was working on a Cost of Production (COP) contract but when COP is introduced Am Ag will not be a part of its development.

RMA has already stated that they stand ready to make sure all crop insurance claims will be paid. If it becomes necessary for RMA to pay claims, there maybe a delay in actual payments. It would not be unusual for USDA to need some "start up" time. While farmers will be paid their insurance claims, it appears that any unpaid crop insurance agent commissions are at risk. Currently commissions due in December are being processed and are expected to be released after approval is obtained from the Nebraska Department of Insurance and RMA.

While it appears there will be little impact on farmers the same may not be true for crop insurance agents. Am Ag agents with a large book of business in Iowa or Illinois probably have already been recruited heavily by the other companies to place their book with them. However, Am Ag agents with small books in high risk growing states like North Dakota or Texas may find it more difficult to find a new company. Even if they find a new company they may not like the commission rates.

What caused Am Ag to be placed under “Order of Supervision” by the Nebraska Insurance Department is likely a collection of events. While there are many rumors, it will likely be a while before a report is issued by the RMA on what caused Am Ag’s financial losses.

However, there are some obvious conditions that did not help the Am Ag situation. A major issue for the past three years was the duplication of the CRC contract under RA-HPO (RA with the harvest price option). RMA approved the sale of a CRC clone as RA-HPO with no limit on the harvest price increase (RA-HPO is an unlimited liability) but often for less premium. In some locations RA-HPO cost less than MPCI-APH but provided the same or greater coverage than CRC. Therefore, companies are taking an unlimited risk on RA-HPO with the lower premiums that also generates lower expense payments³. There are state limits on how much of the higher risk RA-HPO can be shifted to the government (assigned risk pool). For example, companies can not transfer more than 20% of their Kansas business to the assigned risk pool so they must retain a large share of the unlimited RA-HPO liability.

Most private products have an expense load from 30 to 35 points. Currently companies are paid 24.5 points on MPCI-APH but only 21.1 points on revenue insurance. The logic for the lower rate was that CRC cost more so that a lower load would generate the same amount of expense dollars. That is no longer true because in many markets RA cost less than CRC and in some cases less than MPCI.

Most companies with their current book probably generate about 22 to 23 points of expense payments because large shares of their sales are revenue products that carry the lower expense reimbursement rate. An efficient property-casualty insurer probably has about a 30 point expense load. Because the crop insurance industry has been under very competitive pressure, it is reasonable to assume the most competitive companies have cut their expenses to about 27 to 28 points. A low cost company with 27 points of expenses will require an underwriting gain of 5 points on “pure” premium just to breakeven in a market that on average has an underwriting loss of 5 points. Cutting rates under RA in markets that have high loss ratios makes it more difficult to achieve an underwriting gain that is necessary to cover expenses.

RMA has proposed canceling the Standard Reinsurance Agreement (SRA) that backs all of the crop insurance contracts. RMA wants a new SRA that will put even more of the risk on the private insurance companies. RMA also wants to cap underwriting gains at 12.5 points. Because of the shift to RA that carries premiums that are 20 to 30% less than CRC, it would require a very unusual year for a company to exceed 12.5 points. If these changes occur it may cause some companies to stop writing crop insurance in some of the states with high loss ratios.

³ Companies would have unlimited risk on RA-HPO contracts versus MPCI or CRC that have a limit on liability. However, companies would have a stop loss on the entire state book that includes both contracts with unlimited liability and limited liability. The current state stop losses may be changed if a new SRA is developed by RMA.

Because it was the same companies selling CRC and RA, the result is these companies collected less premium and lower expense reimbursements but paid out the same indemnity payments caused by growers switching from CRC to RA-HPO. While this was a good deal for farmers it clearly put the squeeze on the bottom line for all of the insurance companies. Several European reinsurance companies have raised question about the actuarial soundness of rates and one large German reinsurance company has withdrawn from the crop insurance market and put their crop insurance book up for sale, but have found no buyers.

Because of all of these economic pressures on the private crop insurance sector, many people in the press have speculated about the financial condition of the other companies. Many of these companies are owned by larger corporations, so there is “little” chance they will be placed under “Order of Supervision”. A more likely scenario is they will either sell off their crop insurance division or they will close down the division if the margins do not improve. These companies will leave the crop insurance market and allocate their capacity to other property-casualty lines where they have a greater chance of a return.

The drought increased the number of claims. Am Ag was a big writer in Nebraska and other states that were hard hit by drought claims. However, the impact may have been larger on Am Ag than other companies because they did have a lot of policies in the Great Plains.

While I am sure there will be much “finger pointing” and perhaps even Congressional hearings, I don’t expect much impact on growers caused by Am Ag’s problems. However, many people will need to rethink their rhetoric that “companies selling Federal crop insurance policies make lots of money with no risk.”

On a passing note, I am very sorry and sad to see Am Ag leave the market. I have had a long relationship with Am Ag and worked on CRC, MVP, CRC Plus™, and COP. Hopefully those ideas have changed the crop insurance industry and provided better risk management products for farmers.