<u>**Open Letter to USDA and Members of Congress**</u>

Re: Negotiation of Standard Reinsurance Agreement (SRA) under Federal Crop Insurance

Congress to USDA: Use Scalpel, Not Sledgehammer

In 2008, a renegotiation of the Standard Reinsurance Agreement (SRA) was authorized in the Farm Bill because Members of Congress reasonably assumed that a renegotiation could achieve efficiencies in the delivery of federal crop insurance without doing the violence that Members feared would result from House and Senate floor amendments.

Specifically, the Senate rejected an amendment to the Farm Bill proposing $2.3 billion in cuts to federal crop insurance by a vote of 63-32 (Record Vote Number: 428) and the House rejected an amendment proposing $2 billion in cuts by a vote of 250-175 (Roll no. 754).

A review of the debate on the amendments, contained in the Congressional Record, reflects bicameral, bipartisan objections because the amendments, Members warned, involved damaging cuts that would harm federal crop insurance and the farmers and ranchers who depend on crop insurance to manage risk, cover losses, and obtain credit. (See H8771-8774, S15404-15412, S15418-15420)

USDA Wields Sledgehammer

Now, fast forward to the U.S. Department of Agriculture's (USDA) first and second SRA drafts that entail $8.4 billion and $6.9 billion in cuts to crop insurance, respectively.

These cuts would come in addition to the $6 billion in cuts to crop insurance sustained in the 2008 Farm Bill, some of which are yet to be implemented, including the looming problems of delayed compensation to companies and early payment of premiums by producers.

SRA is about Spending on Government Programs, Not Helping Farmers and Ranchers or Reducing the Deficit

Yet, the magnitude of the SRA cuts – three and four times deeper than the cuts rejected by the House and Senate as too deep – cannot be passed off as deficit reduction.

As evidenced in the Administration's FY2011 USDA Budget, mused about in media reports, and articulated by the Ranking Member of the Senate Committee on Agriculture, Nutrition, and Forestry, USDA simply plans to use the savings from the cuts to fund government programs and further shift the focus of the Department away from production agriculture.

The level of cuts proposed by the first two drafts, the damaging policy underpinning the cuts, the appetite for increased spending on policies outside of agriculture, and USDA's supplanting of any semblance of a contract negotiation with an unprecedented PR blitz all at least imply a process driven by extraneous demands for money with little regard to the policy consequences.

Cut Twice Before Measuring Once

For instance, it is fair to conclude that USDA may be putting the cart before the horse when it proposes what is ultimately a 31% cut in administrative and operating (A&O) expense payments purportedly to bring such payments in line with actual costs when the Department concedes that it does not know what actual A&O costs are and plans to commission a study to determine the answer to that question *after* the SRA is completed.

A&O is Artificially Depressed; Violates the Law & General Principles of Insurance

In order to cut A&O by 31% on the heels of a 12% cut sustained less than two years ago, the Department goes through extralegal contortions, beginning by divorcing the calculation of A&O from commodity prices (and, consequently, premium) for the seven major row crops, instead using a reference price.

Such an unprecedented departure from general principles of insurance might not raise as many eyebrows had the Department elected to use reasonable reference price bands rather than artificially low reference prices that are not forecast by CBO over the next 11 years and are as much as 31% below projected market prices.

Consequently, the proposed A&O calculation is not only unhinged from general principles of insurance which provide that compensation for delivery be expressed as a percentage of premium in order to promote higher sales of higher coverage levels, heretofore a goal of federal crop insurance. But the calculation is also unhinged from any economic reality.

Making matters worse is the fact that the Department establishes these artificially low reference prices as a cap when calculating A&O but provides no cup in the event that crop prices unexpectedly collapse, thanks to an especially tortured reading of the statute.

Federal Government Proposes an Unprecedented Overreach Into Private Contracts

Finally, in a coup de grace, the Department now proposes to extend, in an unprecedented fashion, the federal government's overreach into a wholly private contract by capping the commissions a company may pay its agents, and it proposes to do so in a manner that ensures commissions are as artificially depressed as A&O.

A&O is Unhinged from Economic Realities Facing Employers Outside the Beltway, Undermines Goal of Creating and Savings Jobs

In light of the foregoing, it is certainly understandable why the Department goes the extra mile in explaining why this round peg fits a square hole.

The first supposition is that a product or benefit that was delivered for a certain amount four years ago can reasonably be expected to be delivered at little more than the same cost over the next five years, with RMA proposing to freeze A&O payments at little more than 2006 levels.

Assuming that costs are frozen in time for 5 to 10 years after 2006 is the kind of reasoning that greatly undermines public confidence in government.

For instance, one small business owner, not connected to federal crop insurance but in sales, indicated that her costs of doing business have increased by nearly 100% since 2006, citing increases in payroll taxes, health insurance, unemployment insurance, energy-related expenses, rent, computer and technology-related expenses, to name just a few key culprits. The small business owner noted that the substantial increase is partially explained by increased investments and sales, but this is a point also made by companies and agents in the context of this SRA process.

If required to do business this year and over the next five years at little more than 2006 levels, the small business owner indicated the obvious: that the result would be employee layoffs, reduced salaries and benefits, and delayed or reduced investments in the business that would otherwise create jobs in her community.

The situation is no different for the small businessmen and women delivering federal crop insurance and, as such, the SRA drafts will seriously undermine the Administration's objective of creating and saving American jobs.

Cuts Ignore Near Doubling of Sales

The Department's rationalization does not stop there. USDA also hangs its hat on the lower number of actual policies sold since 2006 in order to justify the level of cuts – while ignoring completely the proverbial elephant in the room: the virtual doubling of sales over the same period.

Problem of 2008 is Already Self Correcting

The ostensible principle served by the proposed change to A&O calculation is, of course, to prevent a repeat of the sharp increase in costs associated with the run up of crop prices in that truly anomalous crop year, 2008. But, undercutting the need for such a radical correction to a one year problem in the past is the private market which has already cut premium-based A&O and agent commissions by 21% from 2008 to 2009, with yet another round of cuts expected in 2010.

SRA Means Consolidation; Government Run Delivery?

Relative to risk sharing between companies and the government, the draft SRA does not simply require companies to take on greater risk but actually seeks to sharply reduce opportunity for potential profits, resulting in a 25% cut in expected underwriting gains and raising at least the question of whether the Department may be eying the nationalization of private sector crop insurance delivery with all its adverse implications for producers and taxpayers.

In a private-public partnership, it is one thing to increase risk sharing but it is quite another to deny the potential for profit. As one news publication recently reported, the results of the SRA are "startling" with average year profits for at least one company turning to losses and actual return on equity going into the red.

Ironically, even as USDA focuses on reining in concentration in agricultural markets, its first and second draft SRAs may well result in the kind of massive consolidation it seeks to avoid.

SRA Undermines Federal Crop Insurance, Agriculture Budget

At stake in all of this is nothing less than the single most relevant and reliable personal business risk management tool available to many farm and ranch families today, wherever the region and whatever the commodity, offering narrowly tailored risk protection that is based on actual price and production while fully protecting producer privacy, being wholly compliant with our nation's trade commitments, understandable to the taxpayer, permanent, and, not insignificantly, paying indemnities on time.

Further underscoring the importance of federal crop insurance is the conclusion reported to have been reached recently at a meeting of lenders that, "Farmers and ranchers will need to handle more risk themselves through changes such as more reliance on federal crop insurance and building up more equity to cope with more volatility and tougher credit standards."

Beyond this is the agriculture budget which the draft SRAs propose to slash in the advent of what may be a baseline Farm Bill in 2012 and a possible budget reconciliation measure that some expect next year.

In fact, due to the magnitude of the cuts proposed under the first and second draft SRAs, CBO has already reduced the budget baseline for crop insurance by $2 billion. A more responsible level of proposed savings might have avoided this outcome.

***Responsible* Savings Should Be Reinvested into Federal Crop Insurance to Help Farmers & Ranchers**

This may explain why national farm organizations, companies, and agents have all called on the Department to reinvest any *responsible* savings into improving risk management tools for producers under federal crop insurance.

Capitol Hill Shares Deep Concerns

It may also explain why senators and congressmen, both Democrats and Republicans, have expressed their grave concern over the SRA negotiations and urged the Department to exercise greater judgment in terms of the magnitude of cuts it proposes as well as how to achieve those cuts.

Down the Wrong Road

Nevertheless, the Department at least appears determined to erase the advances made since 2000 under ARPA, devote the dollars elsewhere, and mark the biggest retreat in the progress of federal crop insurance in more than a half century.

Given the ever-shrinking commodity title funding and repeated attacks on federal crop insurance, it is reasonable to ask: are we still committed to providing farmers and ranchers with a stable, long-term farm policy anymore or are we merely managing attrition?

Given the economic condition of our country, the number of jobless Americans, and the overwhelming competitive edge that countries such as China already have, we sincerely hope that American food and fiber production capacity is not to be exported as our manufacturing jobs were a little more than a decade ago.

In looking for answers to the question above, for rural Americans, the handling of federal crop insurance under the first and second drafts of the SRA is not at all reassuring.

Sincerely,

Crop Insurance Professionals Association
American Association of Crop Insurers
Independent Insurance Agents & Brokers of America
National Association of Crop Insurance Agents
National Association of Professional Insurance Agents