



September 16, 2013

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RE: Federal Register, Vol. 78, No. 158
Docket ID No. RMA-2013-0001

Mr. Harkey:

The Federal Register notice referenced above announced the reopening of the comment period for the proposed survey and interview instruments developed for RMA's contracted cost of delivery study. The following response is being submitted by National Crop Insurance Services, Inc. (NCIS) on behalf of its member companies. NCIS is a service organization that supports the eighteen companies that deliver the Federal Crop Insurance Program to America's farmers and ranchers. NCIS has previously submitted responses to each earlier request for input related to the cost of delivery study. Our September 2012 and March 2013 responses are attached.

In preparing this response, NCIS obtained copies of the updated agent and producer surveys and the AIP interview guide. These were compared to the previous versions of each document. All three instruments have been reviewed in light of the comments and critiques provided in our September 2012 and March 2013 responses.

Before commencing our review of the survey instruments, NCIS wishes to express its disappointment with the absence of significant improvements to the proposed study since our previous review. The only noteworthy change has been the expansion of the AIP interview guide from a single page to seven. In our view, the updated survey documents have not addressed the concerns identified in our previous responses. We briefly reiterate those issues and provide additional comments below.

Quality of Service

Our previous responses emphasized that the cost of delivery of the crop insurance program is a function of the level and quality of services provided to farmers, which depend on competition in the marketplace. These two aspects of the program cannot be divorced from one another. Any attempt to evaluate the cost of delivery must first establish the level of service that RMA intends for companies and agents to provide to farmers. Economic research indicates that the evaluation of costs when information regarding the quality of service is unavailable or inaccurate can bias the estimation of the parameters of the cost function. Unless a benchmark is established for the level of service that should be provided to farmers, any analysis of costs may result in misleading conclusions regarding the cost of supplying insurance. The only explicit recognition we found relating to this issue was in the Federal Register notice itself.

Design of the Study

As designed, the study appears to be incapable of addressing differences in delivery costs across segments of the program or across the agency force. In addition, despite the stated objectives for the study, the study continues to focus on agents' accounting costs rather than the opportunity costs associated with the delivery of crop insurance.

More generally, the study is designed in a way that suggests that there is a market failure of some sort that results in a difference between the amount agents earn as compared to the cost of providing service to farmers. If the purpose for this study is to investigate this issue, the design of the study needs to address the problem at a conceptual level within the theoretical framework of microeconomics and industrial organization of crop insurance markets. If the purpose for this study is to identify opportunities for cost containment, we reiterate our previous comments that cost containment is no longer an issue due to the cap on total A&O compensation imposed by the 2011 SRA. Agent compensation was capped as part of that same agreement.

In our previous response we indicated that the objectives of any study should address the major issues faced by the crop insurance program. These included "(1) whether the incentive structure is designed in a way that encourages high participation for all states and commodities, (2) whether agents and companies are being adequately and competitively compensated for their efforts, (3) whether the incentive structure ensures that A&O is sufficient to cover all expenses (as compared to companies absorbing a portion of the cost), and (4) whether the current incentive mechanism has unintended consequences including a shift in A&O between states as commodity prices change." We also recommended that the study "should also attempt to identify inefficiencies and program management decisions that contribute to the cost of delivering the program." To all appearances, none of these issues have been addressed in the proposed study.

Intended Use of the study

The primary concern we have with the design of the study is that it appears to have been designed to produce a foregone conclusion. RMA has previously announced its intentions to use the information obtained from the study in future SRA negotiations:

“With this study, RMA is seeking information regarding the reasonable and necessary economic costs for program delivery which can be used to better establish the level of A&O payments in future SRA negotiations...”

(OMB Package Supporting Statement A, page 10, first paragraph, last sentence)

NCIS has carefully examined the AIP interview guide, Farmer survey, and Agent survey in light of this stated objective. As currently designed, the proposed study is incapable of fulfilling this function. To illustrate this point, we note that Question III. 5. d. of the AIP interview document presumes that A&O is intended solely for agent compensation rather than to cover the full amount of AIP expenses. A related concern was raised during the July 10, 2012 KPMG presentation to the industry. Slide 10 of the KPMG presentation included the following statement:

“Insurance company’s operating expenses are expected to be covered by the A&O allowance.”

While the question in the AIP interview guide is untrue on its face, the statement on slide 10 is true in concept but not in practice. The harsh reality is that A&O has been insufficient to cover industry operating expenses over the entire period from 1997 to the present. Exhibit 5.1 of the 2012 Grant Thornton Profitability and Effectiveness Update¹ reports that the shortfall in A&O payments to companies was 4.7% of gross premium in 2011, 6.9% in 2010, and 5.5% in 2009. Unless the study is designed in an unbiased manner that allows the contractor to investigate whether the amount of A&O paid to the industry covers the reasonable and necessary economic costs for program delivery, the validity of any conclusions from the study can and should be called into question.

Before commencing with its study, the contractor needs to demonstrate the validity of its methodology using hypothetical data (combining with the third-party data sources, if need be). A complete description of the workings of their whole methodology should be made available for public comment before conducting the analysis.

Non-essential Expenses

We also wish to register our concerns with the Federal Register notice itself. The reference to agents’ essential expenses suggests that the study is intended to identify non-essential expenses. If RMA is intending to substitute its own judgment for the judgment of agents and farmers, the

¹ http://www.ag-risk.org/NCIS PUBS/SpecRPTS/GrantThornton/Grant_Thornton_Report-2012.pdf

study should be designed to collect sufficient data to allow RMA to determine which activities are essential and which are not. This is not feasible given the current design of the study.

The Federal Register notice also refers to the number of agent visits required for farmers to make informed decisions. Agents need to meet with farmers for a variety of reasons other than to educate farmers about the available options and to sell policies. They meet with farmers to collect essential acreage and production information on policies written through that agent. They also meet with farmers in order to maintain or grow their customer base. The farmer benefits from this activity by becoming better informed on the choices available and by finding an agent who can more effectively provide services the farmer needs. The design of the cost of delivery appears to be predicated on the theory that agents are merely order takers whose costs can be measured in terms of the number of producer visits or the number of policies sold. However, agents also incur expense in serving prospective customers even when the agent is unsuccessful at closing the sale. This is an essential aspect of the business, as Congress recognized when it brought private sector delivery into the program. If these legitimate expenses are excluded from consideration due to improper study design, the conclusions drawn from the study will misstate the true cost of private sector delivery.

Administration of Surveys and Interviews

The ability to obtain useful information from the proposed surveys and interviews depends on the extent of participation the contractor achieves among the various companies, agents, and producers. The survey and interview instruments should indicate that participation is optional and explain how participation benefits the respondent. If participation is not optional, RMA should specify the legal authority that stands behind the administration of the surveys and interviews.

A critical issue with regard to the information collection process is the confidentiality of private information obtained in the course of the study. The willingness of prospective respondents to participate in the process may depend on whether their information will be available solely to the contractor or shared with RMA. Any private information shared with RMA should eliminate all characteristics that could potentially identify the source, and should preferably be limited to industrywide aggregations. If RMA is to have access to detailed information collected by the contractor, this decision should be clarified in advance.

As a final point, RMA should clarify whether the interviews with AIPs will be in the form of written responses or in-person interviews, and whether the AIP has any choice in this matter.

Comments on the Survey Instruments

Prior to discussing the survey instruments in detail, we note that the documents currently refer to policies for crops harvested in 2011. Each of the documents will need to be updated prior to their release to refer to crops harvested in either 2012 or 2013, whichever is more relevant.

AIP interview guide:

The stated objective of the AIP interview guide is to provide information to "...design the data collection approach that will be used to collect information relevant to the costs...." Because the survey instruments for agents and farmers are already designed, the objective of the interview guide cannot be as stated.

The nature of the interview guide is quite different from the survey questionnaire to be used for agents and farmers. Many interview guide questions elicit judgmental responses that cannot be quantified and compared across companies. Examples include "What are the strategies you think are most effective...?" (II. 1. c.), "What is your company's operating model? Is your business centralized or decentralized?" (II. 2. a.), "Do the contracts vary considerably...?" (III. 1. c.), "How difficult is it ...?" (III. 2. c.), and so on.

Other questions ask for information that could be quantified, but the question is so general that either a quantitative or qualitative response appears acceptable. Examples include "What level of automation is there for underwriting and rating?" (II. 3. c.) and "What is the turnover rate for crop insurance agents?" (III. 2. c.). Questions should be designed to elicit responses that can be quantified or ranked so they can be compared across companies or aggregated into a meaningful metric for the industry.

Other questions seek a quantitative response but omit more important information. For example, "What is the percentage of captive agents...?" (III. 2. a.). Percentages based on the number of agents may be less informative than percentages based on the sale volume generated by those agents. Other questions introduce arbitrary distinctions, such as the use of "past 5-10 years" (III. 5. c.). Crop insurance is a fast-paced industry that has undergone significant changes in recent years, and different agents may have adopted distinct solutions for dealing with those changes based on their own business objectives and the needs of their policyholders.

Another concern is the use of terms that are left to the respondent to define. Examples are "decentralized" (II. 2.), "automation" (II. 2.), "vary considerably" (III. 1. c.), "part time agents" (III. 2. a.), "underwriting profit" (III. 4.) (perhaps the author means "gain" in lieu of "profit"), "fixed and variable costs" (III. 5. a.) (fixed costs become variable over some time period; perhaps the author means "overhead" costs), "profit-sharing scheme specified within the SRA" (IV. 1. c.) (the SRA does not specify a profit-sharing scheme; it specifies the sharing of underwriting gains and losses), "fairly compensate the agents" (this presumes a value judgment on what the "fair" level of compensation would be) (III. 5. d.) and "Have you made any efforts to measure the actual cost of delivery incurred by the agent and compare that to your current commission payment to ensure agents are appropriately compensated?" (III. 5. a.) (as stated in our previous responses, the "actual cost of delivery incurred by the agent" is a function of the level of service provided rather than a fixed cost; in addition, the use of "appropriately" once again presumes a value judgment).

The first point under Question III. 5. d. is worded in a manner that presumes that A&O is solely intended to cover the cost of agent compensation. The true purpose of A&O is to cover company

delivery costs, of which agent compensation is only a portion. The 2011 SRA prohibits agent compensation (including processing fees) from exceeding 105% of A&O in aggregate.

The interview guide is in need of a thorough editing effort. There is frequent use of incorrect tenses, typographical errors, and redundant and extraneous words. Here are some examples (not exhaustive):

- “How are the services provided to crop insurance agents comparing to those provided to sales agents for other lines of insurance? (III. 2. b.). Because of the tense used in the word “provided,” the word comparing should be “compared.” This use of “comparing” occurs several times.
- “Are there any services unique about the crop insurance?” (III. 2. b.). The word “the” should be deleted. There are numerous times in the guide that “crop insurance” is preceded by an unnecessary “the”.
- “Are they different across crop types, region, plan of insurance, size of insurance agency, new vs. renewal business, different products such as revenue or GRIP?” (III. 3. a.). This question asks about “plan of insurance” and “products such as revenue or GRIP”. Revenue and GRIP are different plans of insurance, so the sentence is redundant in asking about “plans of insurance” and then “products”. In addition, the question is enormously broad, encompassing the entire scope of the program. If the goal of the interview is to gain insight into the cost drivers of the program, far greater care needs to be taken in drafting the questions.
- “Do you think the actual cost of delivery vary by...?” (III. 5. b.) The word “vary” should be “varies.”
- Do you think it generally costs less for a captive agent to sell the crop insurance... (III. 5. e.) Delete “the”.
- The texts under III. 4. and in question III. 4. a. capitalize the word “Agent” within a sentence. The word is not capitalized when used elsewhere.
- Do you think the actual cost of delivery vary by region, crop, insurance plan (e.g., CAT), crop insured under the FCIP, and size of Agency? (III. 5. b.). The use of “crop” and “crop insurance under FCIP” is redundant. Also, it is unclear what is meant by “FCIP”.
- “Office” (III. 5. c., 1st bullet) should not be capitalized.
- The following sentences are not clearly written:
“Can you discuss whether the relationship with other types of agents is different from that with crop insurance agents?” (III. 2. a., 3rd bullet), and “Please describe best practices in terms of what are efficient agent operations” (III. 5. c., 4th bullet).
- Instead of “your perspectives” “your views” could be used (IV. 3.).
- “We recognize there are two types of ...” could be better expressed as “We understand that there are two types of...” (V. 1.).

Farmer survey:

One concern with the farmer survey is how it will be used. It is unclear how the questionnaire responses will be used as a check on agent responses.

Another concern is questions that are unclear or omit potentially important information. For example, questions 2.3 and 2.4 ask “What percent of the Federal crop insurance policies you

purchased...” It appears that the number from which the farmer is to take a percentage is the number of separate policies the farmer purchased. If the farmer has two policies, one for 10 acres of specialty crops in a dollar plan and one for 2000 acres of corn in Revenue Protection (RP), the response would show the farmer to be 50% specialty crops and 50% other plans, which gives a misleading indicator of the importance of corn and RP to the farm.

Question 2.2 Delete the term “For about”.

Questions 2.4 under “Revenue Protection” should mention RP and RP-HPE. “Other plans” should mention AGR and AGR-Lite, which are time consuming plans in some regions.

Question 2.5 refers to “Farmer Premium” but should use “Farmer-Paid Premium” instead.

Question 3.1 asks “From how many insurance agents did you purchase Federal crop insurance policies for crops harvested in 2011? _____agent(s)”. The question is unclear in that a farmer may have talked with two agents from the same agency but only one signed the contract.

Question 4.2 asks the nature of farmer’s interaction with agent(s) “in percent of total time spent on average across policies”. The preceding quoted expression is unclear.

Question 4.4 b. asks to quantify the frequency and time spent “Consulting with your agent(s) on other farm programs/issues.” It is important for the contractor to recognize that farm programs and crop insurance are interconnected. The 2008 Farm Bill included programs like ACRE and SURE that covered revenue losses and, in the case of SURE, were directly tied to the MPCCI coverage decision of the farmer. There is a strong need (and likely to grow under the next farm bill) for the agent to have expertise in farm programs and to be able to advise the producer how crop insurance and farm programs may complement or substitute for one another. Advising on farm programs is going to be an essential part of the sales effort for many agents.

Agent survey:

The main concern with the questionnaire is that it is not clear how the questions are going to address the issue of accounting cost versus economic cost (in other words, opportunity cost). If the contractor believes that other, third-party data sources are going to be used to complement the survey information, the method and data to be used to estimate economic costs should be identified and made available for public comment before conducting the analysis.

In Question 2.1, the term “premiums” should be defined.

In Question 3.3, the term “the average work week” needs to be defined.

Is the time for performing the tasks listed in 3.9 limited to the time expended by the agent directly or does it include the time spent by support staff?

Item b under question 3.9 identifies the percent of time spent on “consulting with producers on other farm programs/issues.” As noted above, farm programs and crop insurance are

interconnected, and advising on farm programs is an essential part of the sales effort for many agents.

Question 3.9 should clarify what is meant by “internal” agency compliance. Define “internal” and “compliance.” Indicate whether “agency” refers to RMA or the insurance agency itself. In addition, the question should indicate whether these compliance activities refer to those established by RMA, or are other activities required by the AIP or the insurance agency itself.

The allocation of an agent’s time to the various tasks listed in question 3.9 will depend on the types of crops, insurance plans, and geographical dispersion of the agent’s book of business. If the goal of this study is to gain insight into the cost drivers of the program, the design of the survey needs to be improved to quantify the relationship between costs and the factors driving those costs.

Question 3.10 compares a typical new Federal crop policy with “a property/casualty policy”. Consideration needs to be given to the definition of “a property/casualty policy”. The question should indicate whether this is referring to a new or already existing property/casualty policy. In addition, it should clarify whether the property/casualty policy is comparable to Federal crop policy in terms of premium or other factors.

In questions 3.13 and 3.14, “Revenue Protection” should mention RP and RP-HPE. “Other plans” should mention AGR and AGR-Lite, which are time consuming plans in some regions.

In Question 3.14, the terms “little effort” and “a lot of effort” must be defined based on objective criteria such as the amount of time required to sell and service each type. Otherwise, this question is highly subjective and prone to judgmental errors.

Question 3.15 includes this note: “(Note: For the purposes of this question, a new policy is defined as a policy where the agent must build a new Actual Production History (APH), i.e., these new policies require more effort than a typical renewal policy).” The statement that a new policy involves more work should be evaluated as a testable hypothesis rather than a conclusion of the interviewer.

Question 3.15 asks for the number of new policies. The phrasing of this question provides no context for evaluation. The response cannot be compared to the response to Question 3.1, which asks for the number of producers rather than the number of policies.

Question 3.16 designates thresholds that distinguish small, medium and large policies. The contractor should explain the choice of the selected thresholds to enable the industry to evaluate their reasonableness. For example, if these are based on the percentiles of premium distribution in crop insurance policies, it would be useful to know which percentiles have been selected. In addition, the question should define the term “gross premium.”

The design of Question 4.1 raises questions on how the responses to this question will be used. For example, can the contractor demonstrate use of it with some hypothetical data (combining with the third-party data sources, if need be)? We request the opportunity to review their entire

methodology in advance of the information collection process to gain assurance that the methodology can be used to extract meaningful information. As this appears to be a critical component of the study, it needs to be able to quantify the relationship between costs and the factors driving those costs.

In Question 5.1, the term “policyholder” must be clarified. The response to this question could differ for a large policyholder as compared to a policyholder with median premium in the agent’s book of business. It could depend on the number of policies purchased by each policyholder, the number of acres, the number of crops, and so on.

In Question 5.2, how is the term “an average policyholder” defined?

In Question 6.1 and 6.2, the term “Areas” (see top rows in each panel) is ambiguous. Moreover, it is also not clear how respondents will separately indicate added or saved hours per month, or whether the agent should check at most one box on each row.

Conclusion

NCIS and the crop insurance industry wish to express their appreciation for this opportunity to provide constructive input for this important study. The industry offers this response with the intent that it be used to strengthen the study and ensure that it provides reliable and useful information regarding our industry. NCIS regrets that the proposed study, as currently designed, appears to prejudge the very issue it seeks to resolve and does not provide enough assurance in its capability of fulfilling its intended purpose. The crop insurance industry, along with RMA, shares an interest in ensuring a stable and effective program to protect American agriculture in a manner consistent with the concerns of Congress, American taxpayers, and the public interest.

Submitted by:

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