



United States
Department of
Agriculture

Farm and
Foreign
Agricultural
Services

Risk
Management
Agency

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INFORMATION MEMORANDUM NO.: IS-11-006

TO: All Approved Insurance Providers
All RMA Field Offices
All other Interested Parties

FROM: Michael A. Alston /s/ David L. Miller, for 7/22/2011
Deputy Administrator for Insurance Services

SUBJECT: Agent Compensation – Schemes or Devices

BACKGROUND:

Section III(a)(4)(E) of the Standard Reinsurance Agreement (SRA) states:

If FCIC discovers that the Company, its MGA, or affiliate has paid compensation in excess of the amounts allowed in subparagraphs (B) or (C), the Company will be subject to any sanction described in this Agreement or applicable regulations. Any scheme or device to circumvent the limitations in subparagraphs (B) or (C) will be considered a violation of this Agreement.

Approved insurance providers (AIPs) have asked the Risk Management Agency (RMA) to provide guidance regarding what scheme or devices have been identified by RMA to circumvent the limitations in section III(a)(4)(E) of the SRA. A scheme or device is the making of a payment or benefit that meets the requirements for compensation paid to persons involved in the direct sale and service of eligible crop insurance contracts when such benefit or payment should be counted as compensation.

RMA has compiled a list of identified and potential schemes or devices included herein that will be posted on RMA's website, www.rma.usda.gov under "Frequently Asked Questions." Most of these scenarios were identified from questions posed by the AIPs and other interested persons and not necessarily actions discovered by RMA. These scenarios will be updated as RMA receives additional questions from AIPs or others in the industry.

Nothing in the SRA, Manager's Bulletin MGR-10-011.1 (Bulletin), or this memorandum constitutes approval or disapproval by RMA of any particular payment or benefit, and nothing in this memorandum constitutes a prohibition of any business practice or transaction by any AIP. The AIPs are free to conduct business as they determine in their best interest, provided that it does not otherwise



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And Oversees All Programs Authorized Under
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violate any other provision of the SRA. The only purpose of this document is to specify those situations where RMA has determined a payment or benefit to be considered as compensation, and a business practice to be a potential scheme or device under the terms of the SRA or Bulletin.

Section III(a)(4) of the SRA sets forth requirements and limitations on compensation paid by AIPs to persons involved in the direct sale and service of eligible crop insurance contracts. On October 29, 2010, RMA issued the Bulletin to provide guidance regarding section III(a)(4) of the SRA and agent compensation. The AIPs have asked that RMA provide a list of those situations where it has, or has not, found that a particular payment or benefit constitutes compensation for the purposes of section III(a)(4) of the SRA, or whether a business practice constitutes a scheme or device in accordance with section III(a)(4)(E) of the SRA and item 12 of the Bulletin.

For the purposes of this memorandum, the term “payment or benefit” includes anything of value provided to the agent such as money, trips, dinners, insurance, or any other thing of value or benefit not otherwise excluded from compensation in the Bulletin. RMA considers “policy compensation” to be commissions, salary, bonuses, and profit sharing, which are Action items 1(a), (b), (c), and (d) respectively, of the Bulletin. Furthermore, RMA considers “non-policy compensation” to be any additional payments or benefits that constitute compensation under the SRA or Bulletin such as health benefits, etc.

In determining whether a particular action is a scheme or device, RMA has taken into consideration whether the action would provide the means for the AIP to provide a payment or benefit in addition to the commission, salary, bonuses, and other payments or benefits customarily included in the agent contracts, and not otherwise excluded from compensation in the Bulletin. Failure to treat such payments as compensation would create unfairness in the marketplace. To ensure an even playing field for all AIPs, RMA is providing these guidelines.

SCHEMES AND DEVICES:

Agency Acquisitions

Agency acquisitions by AIPs are not per se a scheme or device. However, RMA has identified certain scenarios where the acquisition of an agency would be considered a scheme or device if the payments are not counted as compensation. Action item number 12 of the Bulletin offers several examples of how an “agency acquisition” could be employed as a scheme or device to avoid the limits on agent compensation.

In addition to the scenarios listed in item 12 of the Bulletin, AIP payments to acquire an agency's book of business will be considered a scheme or device if any of the following criteria are met:

1. The acquisition price exceeds the Fair Market Value (FMV) of the assets at the time of purchase. This includes both the fixed price if a single payment is made at the time of purchase, or the present value of annual installment payments. If the price exceeds the FMV, then the "excess payment" will be deemed agent compensation. For example, if an agency's FMV at the time of purchase is \$10 million, but an AIP pays the seller \$12 million, the difference of \$2 million will be considered agent compensation. A third party independent FMV assessment must be provided to RMA and be based on generally accepted accounting principles for valuing insurance assets.
2. The sellers of the agency have not completely divested themselves of any interest in the book of business and all affiliation with the acquiring AIP. If an agent continues to work for the AIP, and in many cases, still services the book of business, the agent is still doing the same work as before and receiving payment as a contractor or employee. This means the agent would be receiving additional payments and benefits for servicing the same book of business. At best, such payments or benefits would be no different than the transfer or retention bonuses paid to agents that are considered compensation. Allowing the seller to remain associated with the book of business purchased, and receive a purchase payment along with any additional compensation payments, provides a mechanism for abuse, so the purchase price must be considered as compensation. Further, even if there are claims that the agent would work in another capacity with the AIP, there is no way to verify that the agent has no involvement with the book of business they sold. Therefore, allowing the seller to remain affiliated in any way with the AIP that purchased the book of business provides a mechanism for abuse and will be considered a scheme or device unless counted as compensation.
3. Acquisition terms based on annual installment payments provide for an increase in an annual installment payment based on an increase in the total premium volume of the book of business. However, terms that only provide for downward adjustments to annual installment payments where such adjustments are based on a decrease in the total premium volume of a book of business, thereby reflecting a reduced market value, are not considered a scheme or device unless counted as compensation.
4. The acquisition terms include any type of buy-back clause or provision whereby the seller could repurchase the book of business or agency at any future date. Further, even if the acquisition terms do not include a buy-back provision, if the seller repurchases the book, the acquiring AIP's original purchase price will be deemed compensation for those reinsurance years in which payments are made as part of the purchase agreement and may require accounting adjustments in accordance with the

SRA for those years. Again, in many of these cases, the agent is receiving additional payments or benefits for servicing the same book of business, the purchase price and commissions, salaries, bonuses, etc. There is no way to prove the original sale was legitimate so this is considered a scheme or device unless counted as compensation.

5. If an AIP acquires an agency, or other similar entity, and the seller pays a portion of the purchase price to the agents affiliated with the agency. In such cases the affiliated agents would be receiving additional payments for servicing the same book of business. Such payments would be considered a scheme or device unless counted as compensation.

There are numerous other transactions that could be related to acquisitions of books of business. It is impossible to list all of them here, as not every type of transaction that could arise can be envisioned. However, as a general rule, if the seller has the potential to receive additional payments or benefits from the AIP in addition to the acquisition, then RMA will consider all payments or benefits made to the seller to be a scheme or device unless such payments or benefits are counted as compensation.

Allocation of Payments or Benefits

RMA has identified the use of “allocation of payments” as a potential scheme or device. A general example is offered in Action item 12(a) of the Bulletin. There have been numerous scenarios regarding the allocation of payments or benefits between different lines of insurance or different States.

1. If an agent writes both Multi-Peril Crop Insurance (MPCI)¹ and other lines of business, the agent payments/benefits can be allocated across lines of business if all of the following criteria are met:
 - The payments or benefits are commensurate with the premium volume sold for each line of business;
 - Contracts are provided for all lines of insurance showing the amounts of payments or benefits; and
 - The AIP provides evidence satisfactory to RMA documenting the premium volume sold for each line of business, and that the payments or benefits do not exceed the amount authorized in the contracts.

¹ For the purposes of this Memorandum, MPCI includes all plans of insurances authorized for sale under the SRA and reinsured under the SRA.

- If all of these criteria cannot be met, then the payments or benefits will be considered as a scheme or device unless they are counted as compensation.
2. If an agent writes multiple lines of insurance in multiple States, any non-policy compensation must be allocated to the line of insurance and the State based on the agent's premium volume in each state. Failure to properly allocate such non-policy compensation will result in a finding of a scheme or device.
 3. An AIP wishes to provide its agents free map books with Common Land Units (CLUs) for completing Acreage Reports. This would not be considered compensation because such map books are tools, similar to the software that is not considered compensation under item 2(g) of the Bulletin, necessary for the agent to perform the tasks to service eligible crop insurance contracts.

Recognition-Entertainment Expense

1. An AIP wants to allocate payments and benefits for agent recognition-entertainment expenses between MPCI and non-MPCI policies written by the agent. Action item 1(m) of the Bulletin states that up to \$200 of payments or benefits can be provided for agent recognition-entertainment costs and that any amount in excess of that will be considered as compensation. Non-policy payments and benefits can be allocated between lines of insurance and States because such payments are fixed in the agent's contract and are easily calculated based on the agent's premium volume in a State. However, agent recognition-entertainment is not a contractual obligation and there is no way to establish the basis for which such payment is made because it is generally used as an inducement or reward. Therefore, it provides a mechanism for abuse, and any payment or benefit for agent recognition-entertainment in excess of \$200 is considered compensation and failure to report such payments and benefits in excess of \$200 as compensation will be considered a scheme or device.
2. An AIP wants to apply the \$600 agency recognition-entertainment payment or benefit limit to the subagents of the contracted agency. Action item 1(m) of the Bulletin makes it clear that the \$200 limitation applies to **individual** agents and the \$600 limitation applies to **all agents and other employees of an agency**. Subagents of an agency are considered agents or employees of an agency and, therefore, are subject to the \$600 limitation. This exception to the compensation rules is not intended to provide additional benefits to agents, such as trips, golf clubs or other such benefits. It is simply to allow AIPs a means to provide nominal recognition for agents. Failure to report amounts paid in excess of the \$600 limitation will be considered a scheme or device unless such amounts are reported as compensation.
3. An AIP had an incentive program based on crop insurance sales (MPCI, Crop Hail, Named Peril, etc.) established prior to the 2011 reinsurance year, and they continue the program for the 2011 and subsequent reinsurance years with the exclusion of the

MPCI business. Similar to agent recognition and entertainment, incentive programs are not contractually obligated and there is no way to establish the incentive is not for MPCCI even if it is not included in the calculation of the amount. Therefore, it provides a mechanism for abuse, and the incentive program payment or benefit would be subject to the \$200 and \$600 limitation contained in Action item 1(m) of the Bulletin and failure to properly report such payments and benefits in excess of the \$200 and \$600 limitation will be considered a scheme or device unless such amounts are counted as compensation.

Processing Fees

1. An AIP wants to make advance processing fee payments to an agency. Processing fees are payments for services rendered. Therefore, the payment must be made at the time or after receipt of service. Advance payments for future processing will be considered a scheme or device unless counted as compensation.
2. An AIP pays a processing fee to a processing center. Action item 11 of the Bulletin provides that payments to agents agencies, and affiliates for costs of processing, up to and including 5 percent of the A&O subsidy and CAT LAE, will not be deemed by RMA to be compensation for the sale and service of eligible crop insurance contracts, provided that certain criteria in section III(a)(4) of the SRA are met. Processing centers are considered affiliates and, therefore, are subject to the 5 percent limitation. Failure to report payments to a processing center for processing in excess of the 5 percent limitation is considered a scheme or device unless such amount is reported as compensation.
3. An AIP pays a 5 percent processing fee to an agent whose business is subsequently processed by a separate processing center. AIPs can either choose to pay a processing fee allowance (up to the 5 percent) to agents or to utilize a processing center, which might be more cost effective. If an AIP utilizes a processing center to process an agent's book of business, then any processing fee payment to agents who sell and service the eligible crop insurance contracts will be considered a scheme or device. In addition, for AIP payments to processing centers not to be deemed as agent compensation, the processing center must be a distinct, unique entity not affiliated with any particular agent or agency. Otherwise, the potential for abuse exists and RMA will consider any payments to such entities affiliated with the agents to be a scheme or device.

Cooperative Advertising

An AIP wants to pay cooperative advertising expenses for non-MPCI products. Cooperative advertising expenses for insurance products totally unrelated to MPCCI products are not considered agent compensation provided the AIP can provide evidence satisfactory to RMA that the payments made correspond to advertisements placed for the

non-MPCI products. Any payments in excess of such amounts will be considered a scheme or device unless counted as compensation.

Benefits

An AIP pays a portion of an agent's health insurance, pension plans, or other such benefits. These payments are considered to be agent compensation. In accordance with item 10 of the Bulletin, any benefit plan, or a portion paid thereto, not required by Federal, State or local law, will be considered agent compensation. Failure to properly report such payments will be considered a scheme or device.

DISPOSAL DATE:

This memorandum will remain in effect until rescinded or until incorporated into procedures.