



United States
Department of
Agriculture

Risk
Management
Agency

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BULLETIN NO: MGR-07-001

TO: All Reinsured Companies
All Risk Management Agency Field Offices
All Other Interested Parties

FROM: Eldon Gould /s/ *Eldon Gould* 01/11/07
Administrator

SUBJECT: Guidance Regarding PRP Payment Authorization Requests for 2006

BACKGROUND:

On July 20, 2005, an interim rule was published in the Federal Register which sets forth regulations governing Premium Reduction Plans (PRP) for the 2006 and subsequent reinsurance years. The interim rule implements section 508(e)(3) of the Federal Crop Insurance Act (Act) and is incorporated into 7 C.F.R. part 400, subpart V (subpart V). To pay a premium reduction to policyholders, the interim rule requires that an approved insurance provider (AIP) must prepare and submit audited expense statements used for the Plan of Operations under the Standard Reinsurance Agreement (SRA). The statements must be certified as to their accuracy and completeness by an independent certified public accountant with experience in insurance accounting. The interim rule also indicates that the Risk Management Agency (RMA) will issue procedures describing the method by which RMA will calculate cost efficiencies and corresponding premium reductions from the required, audited expense statements.

On July 25, 2005, RMA published Manager's Bulletin MGR-05-011, "Calculations of Premium Reductions under section 400.720(b)(2)." MGR-05-011 provides the procedures referenced in the interim rule along with an electronic PRP Spreadsheet calculator. RMA will use these procedures and calculator to determine whether an eligible AIP has achieved the cost efficiencies required by the PRP interim rule and is, therefore, authorized to pay various State-level premium reductions.

Because the 2006 reinsurance year was the first year for implementation of the interim rule, RMA solicited comments from AIPs, who were determined by RMA to be eligible for the opportunity to offer a premium discount according to section 400.718, regarding whether there are issues or procedures that require additional guidance or clarification by RMA. Being eligible for the opportunity to offer a premium discount does not constitute authority to pay a premium discount. The payment of a premium discount is authorized only after the reinsurance year and only after a PRP-eligible AIP has met the requirements of section 400.720. This bulletin seeks to clarify those issues raised by



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PRP-eligible AIPs regarding authorization to pay a premium discount. Nothing in this bulletin changes, modifies, or amends the provisions of subpart V related to PRP. PRP-eligible AIPs must be in compliance with all requirements of subpart V related to PRP, MGR-05-011, and this bulletin to be approved to pay a premium discount.

ACTION:

RMA will review requests to pay a premium discount from AIPs that have been determined by RMA to be eligible for the opportunity to offer a premium discount, according to the procedures set forth in sections 400.700 through 400.722 and MGR-05-011. The following items provide clarification and guidance regarding these procedures:

1. Statements to be submitted. Prior to approval to pay a premium discount, section 400.720 requires a PRP-eligible AIP to submit expense statements in a format approved by RMA, according to the exhibits that are prepared with an AIP's annual Plan of Operations. However, the interim rule requires that the expense statements must be audited and certified as to accuracy and completeness by an independent certified public accountant familiar with insurance accounting methods. MGR-05-011 identifies the specific required statements as items 10.m, 10.n, and 10.o of Appendix II of the SRA for two reinsurance years—a “baseline” and a “PRP” reinsurance year. For requests to pay a premium reduction for the 2006 reinsurance year, expense statements for the baseline year will cover the 2005 reinsurance year—the period July 1, 2004 through June 30, 2005. Expense statements for the PRP year will cover the 2006 reinsurance year—the period July 1, 2005 through June 30, 2006.
2. Applicable accounting method. Guidance provided by RMA for an AIP's annual Plan of Operations indicate that expenses for Exhibit 10.o. “are to be prepared according to the National Association of Insurance Commissioners (NAIC) Annual Statement Instructions.” RMA's existing guidance for the annual Plan of Operations also includes certain modifications required by RMA to account for the unique expenses associated with the Federal crop insurance program and the fact that the statements are to be prepared on a reinsurance year basis. Thus, an AIP and its auditors are to follow the NAIC Annual Statement Instructions, as modified by existing RMA guidance, in preparing Exhibit 10.o. The preparation of Exhibits 10.m. and 10.n. should follow existing RMA guidance for the SRA Plan of Operations. RMA recognizes that additional expenses related to a reinsurance year in question, such as loss adjustment or litigation expenses, may accrue after the annual settlement date. An AIP, its actuaries, and its auditors must establish adequate reserves to account for expenses that are expected to be incurred for the applicable reinsurance year, as required by applicable NAIC Annual Statement Instructions. The accounting principles, methods, and standards identified in subpart V related to PRP, MGR-05-011, and this bulletin

supersede the use of any other accounting principles, methods, or standards that may have been used previously to prepare and evaluate PRP expense statements for reinsurance years prior to 2006.

3. Treatment of compensation expenses. Section 400.701 provides a detailed definition of “compensation” and “profit sharing arrangements.” All payments to AIP employees and affiliates must be reported as compensation expense, except for certain payments that qualify under the definition of “profit sharing arrangement.” If the sum of all such profit sharing arrangement payments exceeds the AIP’s retained underwriting gain, then the difference must be reported as compensation and, in the case of agent payments, be prorated by State and included in Exhibit 10.m. AIPs are reminded that section 400.720 requires that the AIP provide RMA with a detailed description of all profit sharing arrangements.
4. Treatment of contingency fund payments. For purposes of determining whether an AIP qualifies to pay a premium reduction, RMA will consider the amount of A&O subsidy provided to the AIP during the reinsurance year, less any amount paid or obligated by the AIP to the Federal Crop Insurance Corporation (FCIC) contingency fund, as described in section II.B.12 of the SRA. A reduction in the A&O subsidy for contingency fund obligations, if applicable, will be apportioned across States according to buy-up premium volume.
5. Required audit certification. Section 400.720 states that the independent certified public accountant who audits the applicable PRP expense statements must be experienced with insurance accounting principles and certify as to the accuracy and completeness of all submitted expense statements. “Independent” means that the certified public accountant must not be an employee of the AIP or its parent company and must not be under contract with the AIP or its parent company for consulting or any other service than that of auditing the financial statements of the AIP or its parent. For all reserves established and reported in the expense statements for expenses that are expected to accrue to a reinsurance year, such as loss adjustment and litigation expenses, RMA may require that such reserves be certified as reasonable and adequate by an outside actuary before it will accept the certification of the auditor. If the expense statements are submitted before the date when virtually all loss adjustment expenses have been realized and reported, normally July following the annual settlement for the reinsurance year, a certification of estimated reserves by an independent actuary will be required. Also, section 400.720(a)(1), requires that all expenses associated with the audit and statement certification are to be included in the expense statements for the PRP reinsurance year submitted with the request to pay a premium discount. RMA will accept only those audit certifications from independent public accountants that contain the following:

- A statement specifically describing the auditor's auditing or other accounting experience using insurance accounting principles (the NAIC Annual Statement Instructions).
 - A statement indicating that the audit has been conducted in accordance with auditing standards generally accepted in the United States of America and that those standards require that the auditors plan and perform the audit to obtain reasonable assurance that the expense statements submitted are free of material misstatements.
 - A statement that certifies that expense Exhibit 10.o for both the 2005 reinsurance year (July 1, 2004 through June 30, 2005) and the 2006 reinsurance year (July 1, 2005 through June 30, 2006) have been prepared using accounting methods prescribed or permitted by the NAIC Annual Statement Instructions, as adjusted by the Risk Management Agency's existing SRA guidance, and that expense Exhibits 10.m and 10.n have been prepared using the Risk Management Agency's existing SRA guidance.
 - An opinion of the auditor indicating, to the best of the auditor's knowledge, that the information contained in the expense statements submitted is accurate and complete and present fairly, in all material respects, Federal crop insurance delivery expenses for the AIP for the respective reinsurance years.
6. Applicable time frames. RMA will not accept requests by eligible AIPs to pay a premium discount prior to the annual settlement date corresponding to the reinsurance year for which the AIP requests to pay a premium reduction. The last day on which an eligible AIP may make such a request is December 31 following the annual settlement date. For the 2006 reinsurance year, the annual settlement date is February 16, 2007. Consequently, an eligible AIP may file a request to pay a premium reduction anytime between February 16, 2007 and December 31, 2007. An AIP may choose to not file a request to pay a premium reduction; however, any AIP that does not file a request to pay a premium reduction is not authorized to pay a premium reduction. Subpart V related to PRP does not provide a deadline for RMA to evaluate a request to pay a premium reduction after it has been submitted. However, eligible AIPs making a request to pay a premium reduction should anticipate that, for requests for which no significant questions or issues arise, RMA will need 30 to 60 days to evaluate and respond to a request. Requests for which significant questions or issues arise will likely require a longer evaluation time by RMA.
7. Consequences of submitting under-reported expenses. Section 508(e)(3) of the Act permits an AIP to provide a premium discount to producers only up to the cost efficiencies achieved by the AIP relative to the A&O subsidy. Therefore, if RMA approves an AIP's request to pay a premium discount and later discovers that expenses were understated to the extent that the premium discount paid by

the AIP would violate the Act, this would constitute a violation of section 400.720. The sanctions for such violation are contained in section 400.719(j). However, RMA will not penalize insureds for the mistakes of the AIP. Therefore, RMA will impose other sanctions authorized under the SRA, which includes suspension and termination of the SRA, depending on the severity of the mistake. Consequently, it is important to all parties that all AIPs prepare expense statements that are accurate and complete and that expense reserves be fully adequate.

DISPOSAL:

The guidance in this Manager's Bulletin will remain in effect until rescinded or upon publication of revised procedures in the Code of Federal Regulations.