

Proposed Rules

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This section of the FEDERAL REGISTER contains notices to the public of the proposed issuance of rules and regulations. The purpose of these notices is to give interested persons an opportunity to participate in the rule making prior to the adoption of the final rules.

DEPARTMENT OF AGRICULTURE

Federal Crop Insurance Corporation

7 CFR Part 400

RIN 0563-AB66

General Administrative Regulations; Nonstandard Underwriting Classification System

AGENCY: Federal Crop Insurance Corporation, USDA.

ACTION: Proposed rule.

SUMMARY: The Federal Crop Insurance Corporation (FCIC) proposes to remove and reserve Subpart O of the General Administrative Regulations, effective for the 2000 (2001 for Texas and Arizona and California Citrus) and succeeding crop years. This proposed action is intended to eliminate the unintended adverse effects of the Nonstandard Underwriting Classification System (NCS), simplify and update program underwriting rules consistent with the program's current and future anticipated experience, and to ensure that crop insurance premiums are applied to all producers in a fair and consistent manner.

DATES: Written comments and opinions on this proposed rule and related preliminary cost-benefit analysis will be accepted until close of business October 19, 1998 and will be considered when the rule and cost-benefit analysis are to be made final.

ADDRESSES: Interested persons are invited to submit written comments to the Director, Claims and Underwriting Services Division, Risk Management Agency, United States Department of Agriculture, 1400 Independence Avenue, S.W., STOP 0803, room 6749-S, Washington, D.C., 20250-0803. A copy of each response will be available for public inspection and copying from 7:00 a.m. to 4:30 p.m., EDT, Monday through Friday, except holidays, at the above address.

FOR FURTHER INFORMATION CONTACT: For further information and a copy of the

preliminary cost-benefit analysis to the General Administrative Regulations; Nonstandard Underwriting Classification System, contact Michael F. Hand, Director, Claims and Underwriting Services Division, Risk Management Agency, at the Washington, D.C. address listed above, telephone (202) 720-3439.

SUPPLEMENTARY INFORMATION:

Executive Order 12866

The Office of Management and Budget (OMB) has determined this rule to be economically significant and, therefore, this rule has been reviewed by OMB.

Cost-Benefit Analysis

A preliminary cost-benefit analysis has been completed and is available to interested persons at the address listed above. The preliminary cost-benefit analysis summarizes the impact of the rule in the following manner:

(1) NCS first was established in 1991 as an effort to control losses attributed to persons whose insurance experience differed materially from the norm for an area. For a number of reasons, it has come under criticism;

(2) A review of the current NCS process determined that it cannot meet desired performance goals under any circumstances. Therefore, a replacement is needed;

(3) Recent actuarial research and premium rate models developed for other products indicate that the current actuarial processes used by FCIC do not produce an adequate premium rate for yields lower than the county average in many situations, especially when the county average premium rate is relatively low. A simulation of the effects of higher premium rates at the lower yields indicates that the NCS-rated premiums paid by the few NCS individuals who chose to insure can be replaced. In addition, additional premiums will be collected from persons who have not yet been detected by the NCS, thereby reducing the number of persons who might qualify even if NCS were continued;

(4) This analysis concludes that the benefits of the current NCS are extremely small in terms of recovering accrued losses paid by individuals who are selected under it. It is a labor-intensive system that requires substantial resources, both computer and human, to operate. It adds

complexity to the delivery of the crop insurance product. In the aggregate, the benefits are small compared to the resources expended for its operation; and

(5) The proposed alternative process is consistent with the mandates of the Federal Crop Insurance Act that require simplification of the program to the maximum extent while assuring actuarial soundness. More producers will be affected in any year under the alternative, but many of these producers ultimately may have been selected under the NCS after 3 or more losses had occurred. The alternative targets specific units that may be the primary cause of losses rather than affecting the entire operation of individuals. It does not create the stigma currently associated with the NCS. The alternative is demonstrated to be actuarially sound, with the effect of reducing excess losses currently carried in the baseline. This reduction in excess losses offsets additional subsidies to producers and insurance providers that result from the change. The additional cost to producers occurs solely because those persons selected for the NCS now overwhelmingly elect to cancel insurance coverage rather than pay the sharply higher premiums that are imposed under it.

FCIC encourages and welcomes any comments you may have with respect to the preliminary cost-benefit analysis findings. Before publishing the final rule, FCIC will complete a final cost-benefit analysis and your comments will be taken into consideration in developing that final cost-benefit analysis.

Paperwork Reduction Act of 1995

This rule does not contain information collection requirements that require approval by OMB under the Paperwork Reduction Act of 1995 (44 U.S.C. chapter 35).

Unfunded Mandates Reform Act of 1995

Title II of the Unfunded Mandates Reform Act of 1995 (UMRA), Public Law 104-4, establishes requirements for Federal agencies to assess the effects of their regulatory actions on State, local, and tribal governments or the private sector. This rule contains no Federal mandates (under the regulatory provisions of title II of the UMRA) for State, local, and tribal governments or

the private sector. Therefore, this rule is not subject to the requirements of sections 202 and 205 of the UMRA.

Executive Order 12612

It has been determined under section 6(a) of Executive Order 12612, Federalism, that this rule does not have sufficient federalism implications to warrant the preparation of a Federalism Assessment. The provisions contained in this rule will not have a substantial direct effect on States or their political subdivisions, or on the distribution of power and responsibilities among the various levels of government.

Regulatory Flexibility Act

This regulation will not have a significant economic impact on a substantial number of small entities. NCS program determinations are applied equally to all producers on a county basis and affect only a small number of policyholders (approximately 1–2 percent of all policyholders nationwide). Further, since this rule proposes to eliminate the NCS program, the burden on the insurance providers will be significantly reduced. Therefore, this action is determined to be exempt from the provisions of the Regulatory Flexibility Act (5 U.S.C. 605), and no Regulatory Flexibility Analysis was prepared.

Federal Assistance Program

This program is listed in the Catalog of Federal Domestic Assistance under No. 10.450.

Executive Order 12372

This program is not subject to the provisions of Executive Order 12372 which require intergovernmental consultation with State and local officials. See the Notice related to 7 CFR part 3015, subpart V, published at 48 FR 29115, June 24, 1983.

Executive Order 12988

This rule has been reviewed in accordance with Executive Order 12988 on civil justice reform. The provisions of this rule will not have a retroactive effect. The provisions of this rule will preempt State and local laws to the extent such State and local laws are inconsistent herewith. The administrative appeal provisions published at 7 CFR part 11 must be exhausted before any action against FCIC for judicial review may be brought.

Environmental Evaluation

This action is not expected to have a significant impact on the quality of the human environment, health, and safety. Therefore, neither an Environmental

Assessment nor an Environmental Impact Statement is needed.

Background

FCIC proposes to remove and reserve the General Administrative Regulations (7 CFR part 400, subpart O; Nonstandard Underwriting Classification System) effective for the 2000 (2001 for Texas and Arizona and California Citrus) and succeeding crop years.

NCS began as an underwriting process in 1991 to identify those insureds who were collecting a disproportionate percentage of all crop insurance indemnities and individually adjust their coverages and rates to offset their higher risk. NCS has been used to avoid inequitable, across-the-board rate increases which would otherwise be required to achieve actuarial sufficiency.

Under NCS, rate increases can be substantial, and coverage reductions severe, depending upon an insured's loss experience. Insureds selected may request a reconsideration, followed by two levels of appeal. The insured also retains recourse to formal litigation.

Insureds are selected for NCS based on loss frequency and loss severity as compared with general crop insurance experience in the area. An insured must have at least three years of insurance experience in which indemnities exceed the annual premiums paid by the producer. Loss years also must represent 60 percent or more of the years the person was insured during the 10-year base period. To meet the loss severity requirement, the insured generally must have an "adjusted loss ratio" (a loss ratio adjusted to account for different premium rate levels) of 2.0 or greater. Loss severity requirements are established by crop and region to recognize different premium rate levels between different crops and regions.

The NCS process is standardized to ensure equitable treatment of all insureds. Disaster adjustment procedures have been developed to recognize catastrophic conditions affecting crop production. Under this process, the loss history of the insured is adjusted when area-wide disasters affect crop production. For years in which the county yield deviates greatly from the long-term county average, a factor is determined to reduce the amount of indemnity which is used for NCS purposes for that crop year, thus mitigating the effect of widespread crop disasters.

NCS has been criticized by producers and their representatives for several years and became a major issue with the repetitive floods in the Upper Midwest

and multi-year droughts in the Southwest. Complaints have included claims that the current NCS procedures: (1) do not adequately exclude widespread causes of loss (disaster adjustment) as intended; (2) fail to recognize diverse conditions within a county; (3) unfairly impact new or marginally profitable insureds caught by repetitive disasters; (4) set too high a premium for those insureds listed; and (5) are applied unfairly to non-NCS insureds through share arrangements with insureds selected for NCS. Additionally, the current NCS process can be complicated to explain to the insureds and their agents who service crop insurance policies. The NCS process is also labor intensive for RMA and insurance providers at a time of increasingly smaller budgets and reduced resources. Reducing or eliminating program regulations that provide little benefit or can be accomplished through other more appropriate or cost efficient means is consistent with the Federal Crop Insurance Act requirement for simplification and the Administration's emphasis for regulatory reduction.

On Wednesday, September 17, 1997, FCIC published an Advanced Notice of Proposed Rulemaking (ANPR) in the **Federal Register** at 62 FR 48798 to announce a public comment period and to seek comments from the public on options to improve NCS. Following publication of the ANPR, the public was afforded 30 days to submit written comments and opinions. Twenty-two comments were received from crop insurance agents, producers, insurance providers, and producer associations in response to the ANPR.

Three comments received from a crop insurance agent and insurance provider were substantive and contained proposals that were considered in the review process. The proposals included using a yield floor surcharge as a means of increasing rates for producers with below average production histories and a recommendation to reinstate experience tables, which had been used in the past to surcharge insurance premiums on the basis of the producer's loss ratio. Additionally, nine comments recommended that NCS be eliminated altogether, six suggested that a moratorium be imposed while further study was conducted, four noted that the current actual production history (APH) program sufficiently addresses adverse crop insurance loss experience, and one did not address NCS specifically, advocating a production expense insurance plan in place of the current crop insurance program.

FCIC stated in the advanced notice that if NCS were eliminated, with no additional action taken for adverse loss experience, the average policy premium would have to increase by \$78 to offset NCS losses not currently used to calculate premium rates. FCIC's objective has been to derive an alternative that would result in an equitable process to charge appropriate premiums for insureds with adverse experience, but not to the extent of the premium increases that can result under the current NCS program.

The current APH process assesses higher premiums on insureds with lower than average yields. Three comments suggested that the APH process could be used to offset the increased rates that would be necessary if NCS were abolished. RMA analyses conducted during the development of the Revenue Assurance crop insurance program, and separately in a study conducted by Millman and Robertson (a consulting actuarial firm), indicate a need to raise the rates for insureds with lower than average yields. RMA has reviewed its current APH program and developed an alternative rating methodology to adjust premium rates for below average yields to compensate for the additional risk associated with adverse loss experience. RMA recognizes that further analysis and study had to be completed of NCS producers and their adverse experience to determine the impact on the crop insurance program.

A recommendation from the ANPR relating to yield floor surcharges suggested that rates should be increased based on the number of times producers fall below the yield floor. For the major crops, premium rates are calculated on the actual APH yield, recognizing the risk for that yield (for other crops, there are procedures that apply a 5 percent surcharge to the applicable rates found on the actuarial table in order to accomplish the same result). The comment to the ANPR suggested that for every succeeding year a producer falls below the floor, the premium surcharge would be raised to recognize the increased risk associated with lower actual yields.

RMA examined increasing premium rates based on the producer's lower APH yields and using a yield floor surcharge to determine if this process would adequately address the need for increased premiums to account for adverse loss histories based on the frequency and severity of losses. Surcharges based on the frequency with which floor yields apply are not effective because they would not serve to simplify administration of the crop

insurance program and could penalize insureds under prolonged and unfavorable growing conditions. The administrative complexities of this suggestion outweighed the expected program benefits.

By February 1998, RMA had completed the final review of the NCS program. The results indicated that modifying the existing NCS regulations would not address most of the criticism. The review also confirmed that the overall impact of NCS was relatively small. For the 1997 crop year, NCS was applied to approximately 50,000 crop policies, equaling 1–2 percent of the total crop policies nationwide. NCS included approximately \$2.2 billion (about 2 percent of the total) in liability and \$0.9 billion (nearly 10 percent of the total) in losses during the life of the program.

The review indicated that NCS had been applied to only a small percentage of the total number of insureds who had collected at least three losses, had adverse loss ratios, and were responsible for a significant share of the losses paid. The analysis also indicated that the number of active NCS policies had declined 52 percent from 1996 to 1997 (4,800 to 2,300) and that the liability associated with NCS policies declined from \$37 million in 1996 to only \$20 million in 1997.

The results indicated that many insureds selected for NCS canceled their insurance policies because, in general, NCS was applied after losses had reached a point where the cost was too high for these insureds to continue to participate in the program. The conclusion was that any replacement to NCS must intervene more quickly before losses are too great to expect recovery.

The Federal Crop Insurance Act, as amended, directs the premium rate to be adequate to cover anticipated losses and a reasonable reserve. Program improvements, including revised APH procedures, improved policy underwriting, updated T-yields, other actuarial modifications, and improved producer tracking implemented since 1991 have corrected many of the problem areas that created the need for NCS.

In order to correct the identified NCS deficiencies, RMA determined that any rate adjustment must fit the existing actuarial structure, avoid excessive operational changes, and promote simplification, as mandated by the Federal Crop Insurance Act.

When the existing NCS regulation is removed, RMA will replace NCS with an alternative rating system that increases the rate for insureds with lower than average yields in recognition

of the additional risk associated with these insureds. This change in the rating process will be more proactive in recognizing situations which may result in adverse loss experience and determining a rate appropriate for these situations.

By using an alternative that simply requires adjustment to the current rating methodology as a replacement for NCS, the proposed removal of the NCS regulation can be implemented beginning with crops planted in the fall of 1998. The general financial impact on insureds will be variable (but generally moderate) rate increases for those units with lower than average yields. More specific details on the financial impact of this action can be found in the "cost-benefit analysis".

By implementing this alternative rating process, RMA will: (1) eliminate the "lag" year currently included in the process; (2) make adjustments automatic, thereby improving the process for insureds, agents, and RMA; (3) incorporate the adjustments into the actuarial tables, which will eliminate the currently maintained lists and required notification requirements; (4) calculate adjustments on a unit rather than policyholder basis; and (5) increase premiums less abruptly once adjustments are triggered.

List of Subjects in 7 CFR Part 400

Crop insurance, Nonstandard Underwriting Classification System.

Proposed Rule

Accordingly, for the reasons set forth in the preamble, the Federal Crop Insurance Corporation hereby proposes to amend 7 CFR part 400, subpart O, as follows:

PART 400—GENERAL ADMINISTRATIVE REGULATIONS

Subpart O—Nonstandard Underwriting Classification System; Regulations for the 1991 and Succeeding Crop Years

1. The authority citation for 7 CFR part 400, subpart O, is revised to read as follows:

Authority: 7 U.S.C. 1506(1), 1506(p).

§§ 400.301–400.309 (Subpart D) [Removed and Reserved]

2. In part 400, subpart O is removed and reserved.

John Zirschky,

Acting Manager, Federal Crop Insurance Corporation.

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