

***Private Hail Insurers' Response
To
Saskatchewan Municipal Hail Insurance
Application for Expansion of its Basic Coverage***

***Presented to the
Honorable Chris Axworthy
Saskatchewan Minister of Justice***

November 2001

Private Hail Insurers' Response To

Saskatchewan Minister of Justice

<u>SECTION</u>	<u>CONTENTS</u>	
1	INTRODUCTION.....	1
2	HISTORY	1
3	CURRENT MARKETPLACE.....	2
4	COMPARISION OF BUSINESS COMPONENTS	3
5	FINANCIAL IMPACT	6
6	RECOMMENDATIONS	6
7	CONCLUSIONS.....	7
 <u>APPENDIX</u>		
A	Insurance Premium & Taxes Tables and Charts	

Private Hail Insurers' Response To

Saskatchewan Minister of Justice

1 INTRODUCTION

Since 1917, the Saskatchewan Municipal Hail Insurance Association ("SMHI") has provided basic hail insurance coverage to Saskatchewan producers on a subsidized basis. During the same time period, private insurers have provided competitive insurance coverage underwritten by several regional, national and international insurance companies.

Various conditions exist under which both the private and public insurance providers must operate. Some of those conditions apply to both groups and some apply to only one of those two groups.

SMHI has applied for an expansion of its Basic Cover from \$100/acre to \$150/acre. In asking to expand their Basic Cover, SMHI is attempting to further capitalize on a number of advantageous conditions, described later in this report. These advantages make it an unfair competitor with tax paying insurers. This proposed change is, therefore, of concern to the private hail insurance industry in Saskatchewan given the direct, negative impact it will have on the economic viability of their businesses. The concern and opposition to this proposed change is unanimous among the private industry providers directly affected.

2 HISTORY

SMHI was created to provide basic "at cost" crop hail insurance coverage to landowners in Saskatchewan. Their policies for pricing and rules for participation were established when the crop hail industry was in its infancy to ensure the payment of municipal taxes and, presumably, to ensure affordable coverage was available so producers would not require government support payments during periods of crop loss.

Additional Municipal Hail Limited ("AMHL") was established to provide spot loss crop hail insurance coverage on an increased level to its members as well as coverage to farmland tenants (only owners can be insured under SMHI) in Saskatchewan. This company operates under rules that are similar to private insurers. The formation of AMHL has allowed SMHI the ability to offer increased amounts of coverage without any change to their provincial regulations or the need for permission from our provincial legislature.

The rationale for the establishment of SMHI as a subsidized service to farmers, and therefore the rural communities in the beginning of the last century, was in part the absence of a fully competitive marketplace. The failings of the marketplace at that time are not existent today. The market now reflects good competitive characteristics. Additionally, governments have added other programs and stabilizing mechanisms (PFAA, Crop Insurance, NISA, CFIP, CSAP) to provide farmers, and therefore those who rely on them to pay their taxes and farm expenses, with greater operating security. This puts in question the merit of having a government subsidized insurance product that directly threatens a very competitive private hail insurance industry on which most farmers rely.

Private Hail Insurers' Response To

Saskatchewan Minister of Justice

In 1938 the government established the Prairie Farm Assistance Administration (PFAA). This program provided a mechanism that paid cash to farmers when crop yields were disastrous.

In the early 1960's, an all risk crop insurance program replaced PFAA and has subsequently gone through many transformations over the years. Among the changes was the introduction of a subsidized spot loss hail provision that competes against private insurance companies. The hail spot loss provision was introduced as a loss leader to sell crop insurance to a greater base of farmers since the program's features did not attract the desired level of farmer participation. The damaging impact on private insurers was immediate when tax-paying insurers began operating in direct competition with a federal/provincial subsidy on their primary product.

3 CURRENT MARKETPLACE

The hail insurance industry in Saskatchewan is a cornerstone of current farm risk management practices and ensuring a competitive environment is critical to the industry's success. There have been approximately \$1.27 billion in premiums collected over the past 25 years by the private sector and SMHI. These premiums exclude the Canada-Saskatchewan Crop Insurance Corporation that for the year 2000 generated over \$40 million in premiums from their spot loss hail program. *Appendix A* shows a statistical compilation of the hail insurance premiums written in Saskatchewan from 1975 to 2000.

Hail insurance is a significant business for the insurance providers and the economy of our province. The private insurers currently pay premium taxes at the rate of 3% of the total premiums collected. Based on the insurance premiums collected by insurers from 1975 to 2000, the private insurers have paid approximately \$18.5 million in premium taxes. The calculations per year are shown in *Appendix A*. SMHI is not required to pay premium taxes. This exemption provides them with a significant competitive advantage in relation to the private insurers. Assuming that SMHI were required to pay the same premium tax as the private sector, close to \$16.5 million in taxes would have been paid.

In addition, the Saskatchewan Crop Insurance Corporation hail premiums are not taxed. These premiums would have generated tax of \$1.2 million in 2000 and a further \$1.6 million in 2001.

As an ongoing cost of doing business, the private insurers are required to pay their sales agents a commission based on the premiums that are collected. Since sales agents choose whether to sell the insurance or not, it is reasonable to say that the commission rate would reflect current market conditions. Private insurers are currently paying commission at the average rate of 13%. Based on the premiums collected in the past 25 years and the rate above, the private sector has paid approximately \$88 million in commissions to agents across Saskatchewan. The industry provides a direct, significant contribution to the rural economy of Saskatchewan that is further multiplied when one considers the local impact of the marketing expenses and the benefits of additional income taxes generated for both the federal and provincial governments. SMHI pays a fee to the Rural Municipal Administrators, a captive agent, who sell their product. The current fee is approximately 2% of the premiums collected. The difference in rates paid

Private Hail Insurers' Response To

Saskatchewan Minister of Justice

between the private insurers and SMHI would approximate 11% of the premiums collected by SMHI or \$59 million from 1975 to 2000.

The premium rates currently being charged to the farmer by SMHI and AMHL are exactly the same. One can only conclude that either SMHI is overcharging their clients or it is subsidizing the rates for AMHL. This situation warrants further review.

4 COMPARISON OF BUSINESS COMPONENTS

Private insurers see the industry regulations in Saskatchewan as unfair and inequitable.

I. ENVIRONMENT

The environment in Saskatchewan has changed considerably over the past century. Historically, hail insurance was operating in a less competitive marketplace where the regulations established a stable, fair and affordable insurance option for farmers. It also provided protection for the municipal tax levy on which municipal councils rely. Over time, adjustments have been made to coverage levels under Basic Municipal Hail Insurance to adjust for higher farm operating costs. This basic coverage is provided with several subsidies and special allowances, as follows:

- 1) The Basic Cover pays no Premium Tax (private insurers pay 3%).
- 2) The Basic Cover pays a small fee to agents (Rural Municipal Administrators). The commission is approximately 2% compared to an average of 13% that is paid by private insurers. As a result, the local taxpayer pays most of the cost of acquisition through their taxes, which translates into an indirect tax subsidy to the program.
- 3) The Basic Cover Premiums are collected in the fall as taxes and are allowed a discount for early payment. Requirements of regulations and the operating realities of business make this practice impossible for private insurers.
- 4) Private insurers pay income tax and SMHI does not.

The failings of the marketplace in the beginning of the last century are not existent today. The market now reflects good competitive characteristics. Additionally, there have been other tools to provide farmers greater operating security and improve their ability to pay property taxes and farm expenses.

This situation where private insurers are competing with a federal/provincial subsidized product and a municipal subsidized product is far from just and threatens the viability of the private insurance market in Saskatchewan.

4 COMPARISON OF BUSINESS COMPONENTS – CONT'D

II. THE PRESENT MUNICIPAL HAIL APPLICATION

Private insurers see the present SMHI application for a \$50 per acre increase (or any increase at all) as alarming and threatening. The number of private insurers active in Saskatchewan has diminished from 11 to 6 since 1992. Many of the remaining private insurers believe that SMHI's objective is to further reduce their direct competition in Saskatchewan. The government stands to lose \$1.1 million in premium taxes and sales agents would lose \$5.1 million in commissions if the private sector, at present market share, were eventually eliminated from the market place. Even more importantly, farmers would lose a key risk management tool at a time when they are needing more options, not fewer, to manage their risks creatively and affordably.

While a detailed analysis of these questions is required, a cursory glance would indicate SMHI provides no great benefit to farmers other than the deferral of the payment of premiums and the end of season discount for early payment. The surplus in the reserve fund now exceeds \$100 million, which approximates the present value of accumulated tax benefits SMHI has enjoyed over the years. The Municipal Hail Act provides for provincial guarantees of operating shortfalls (Section 45 of the Municipal Hail Act), which would appear to make a surplus fund of this size unnecessary.

Additionally, the cost to taxpayers in foregone revenue and in reducing business opportunity discourages higher levels of business presence and activity. Saskatchewan cannot afford to be discouraging business and turning away their tax revenues in today's local, national and international trade environment.

The private insurers are left asking a few key questions:

"Why would SMHI make this application when it already has, through AMHL, the opportunity to sell policies on a competitive market basis to a level of \$150.00/acre and more if they so choose?"

"Does SMHI really need a subsidy at all?"

"Are farmers benefiting from the subsidy?"

"Why are the private insurers paying premium taxes that SMHI is not required to pay?"

"Why has the reserve fund been allowed to accumulate to such a level?"

Private Hail Insurers' Response To

Saskatchewan Minister of Justice

4 COMPARISON OF BUSINESS COMPONENTS – CONT'D

III. WHY IS THE PLAYING FIELD NOT LEVEL?

The table below compares SMHI to private industry in a number of key business components. The areas of concern are indicated as an advantage (+) or a disadvantage (-).

<u>SMHI</u>	<u>Component</u>	<u>Private Sector</u>
(+) Allowed	Discount for cash	(-) Not allowed
(+) All are continuous	Continuous Policy	(-) Not allowed
(+) Admin. fee (Approx. 2%)	Acquisition Costs	(-) Approx. 13%
(+) Do not pay	Premium Tax	(-) Required to pay
(+) Do not pay	Income Tax	(-) Required to pay
(+) Government guaranteed	Underwriting Losses	(-) No guarantees
(+) Not required	Agent License	(-) Fee & Exam
(+) Yes	Lien for security	(-) Via court action
(+) Deferred to Dec. 15	Loss payment	(-) Paid promptly in 60 days
(-) Restricted	Coverage per acre	(+) Unlimited
(-) Only owners	Clients	(+) Owners and tenants

The advantages above given to SMHI through legislation far out weigh the benefits held by the private sector. These inequities need to be addressed and measures taken to level the competitive playing field in the hail insurance industry.

5 FINANCIAL IMPACT

AMHL affords SMHI the ability to offer a reasonable amount of coverage without any change to their provincial regulations. Private insurers view this initiative by SMHI as intending to further their dominance, which is afforded by unfair advantage.

By increasing the coverage within their Basic Program, SMHI simply eliminates more taxes from the treasury, more revenue from rural agents, income taxes associated with their earned commissions, and competition.

6 RECOMMENDATIONS

The issues outlined in this report clearly show an inequitable environment in which the private sector is forced to compete against its own government.

The following steps need to be taken:

- A. Immediately decline SMHI's application to increase their coverage from \$100 to \$150 per acre.
- B. Consider a reduction in the base coverage and let SMHI compete in the marketplace through AMHL.
- C. Commission an independent study to determine the need for SMHI's continued existence and its impact on the private sector.

7 CONCLUSIONS

Farmers need the greatest variety of risk management tools at their disposal. In today's open market environment, the greatest hope for creating a variety of tools to serve the increasingly diverse risk management needs of the farm sector lies in the private sector and in partnerships between the public and private sectors. The private sector has the ability to respond quickly to changes in market demand if it is on a level playing field. This area of government policy needs urgent attention but one thing is clear, this is not the time to disable the private sector insurers with requests for increasing government subsidized competition.

Fair competition is beneficial for both the economy and the consumer. Unfair competition can benefit the consumer only in the short term, but will unquestionably hurt the consumer in the long run.

The time you have taken to examine this issue and to understand the negative impact of the proposal you have been asked to consider is appreciated. Private insurers look forward to working with farmers, with you and your government in making positive changes in helping deal with farm risk management issues for the future.

Private Hail Insurers Response To

Saskatchewan Minister of Justice

APPENDIX A

***Private Sector vs Municipal Hail Association
Insurance Premium and Taxes Tables and Charts***

Private Sector vs. Municipal Hail Association

	<u>Private Sector</u>	<u>Municipal</u>	<u>Premium Tax Paid</u>	<u>Premium Tax Lost</u>	<u>Commission Paid</u>	<u>Commission Lost</u>
2000	39,538,889	33,944,600	1,186,167	1,018,338	5,140,056	3,394,460
1999	41,364,103	34,806,000	1,240,923	1,044,180	5,377,333	3,480,600
1998	47,527,902	42,808,000	1,425,837	1,284,240	6,178,627	4,280,800
1997	45,752,578	53,102,400	1,372,577	1,593,072	5,947,835	5,310,240
1996	54,284,726	53,133,000	1,628,542	1,593,990	7,057,014	5,313,300
* 1995	37,209,582	43,578,000	1,116,287	1,307,340	4,837,246	4,357,800
1994	35,491,673	34,865,000	1,064,750	1,045,950	4,613,917	3,486,500
1993	31,556,370	26,216,000	946,691	786,480	4,102,328	2,621,600
1992	25,837,947	23,676,800	775,138	710,304	3,358,933	2,367,680
1991	24,195,015	20,118,000	725,850	603,540	3,145,352	2,011,800
1990	21,567,218	15,991,700	647,017	479,751	2,803,738	1,599,170
1989	23,257,854	17,735,000	697,736	532,050	3,023,521	1,773,500
1988	15,588,705	13,198,500	467,661	395,955	2,026,532	1,319,850
1987	20,075,888	21,573,000	602,277	647,190	2,609,865	2,157,300
1986	28,997,355	24,398,899	869,921	731,967	3,769,656	2,439,890
1985	27,938,318	24,551,999	558,766	491,040	3,631,981	2,455,200
1984	35,976,285	20,188,760	719,526	403,775	4,676,917	2,018,876
1983	28,927,919	16,905,511	578,558	338,110	3,760,629	1,690,551
1982	22,124,363	15,395,793	442,487	307,916	2,876,167	1,539,579
1981	16,730,864	13,474,362	334,617	269,487	2,175,012	1,347,436
1980	8,941,706	9,414,621	178,834	188,292	1,162,422	941,462
1979	11,118,180	9,573,548	222,364	191,471	1,445,363	957,355
1978	10,815,667	8,824,815	216,313	176,496	1,406,037	882,482
1977	5,988,386	5,931,024	119,768	118,620	778,490	593,102
1976	9,788,233	5,019,440	195,765	100,389	1,272,470	501,944
1975	6,847,549	4,255,463	136,951	85,109	890,181	425,546
	677,443,275	592,680,235	18,471,324	16,445,054	88,067,626	59,268,024

Note: Premium Taxes Increased from 2% to 3% in 1995.

Note: Commission estimates for Private Sector is 13% and Municipal is 2%.