STATEMENT BY FCIC CHAIRMAN OF THE BOARD
DR. KEITH COLLINS

WASHINGTON, October 16, 2003 - The effort of the Federal Crop Insurance Corporation (FCIC) to explore a "Cost of Production" (COP) plan of insurance was directed by the Agricultural Risk Protection Act of 2000 (ARPA). In 2001, after a competitive process, the Risk Management Agency (RMA) selected a contractor, Agrilogic, Inc., to develop a COP risk protection plan of insurance. The development process has been extensive, and the proposed product has received much attention by the FCIC Board of Directors (Board).

The Board, RMA, and six independent experts in actuarial science and underwriting reviewed the proposed COP product during 2002. That process identified a number of concerns with the product, and the Board decided to continue product development. A final submission was presented to the Board in the summer of 2003, and the Board, RMA, and six independent experts again reviewed the revised COP proposed product. After evaluating all of the reviews, the Board concluded that there are several advantages and disadvantages to the COP product. The advantages of COP include:

- COP uses individual farmers' cost of production data innovatively to: determine a revenue guarantee, limit liability by capping covered expenses to what has been incurred at the point that the crop is destroyed, and permit increased coverage for unexpected cost increases.

- This product also protects against price declines below the loan rate, requires enterprise units which can reduce program abuse, and uses farmers' actual prices to determine revenue to count, which can address quality and basis risk.

Despite these positive aspects of the proposed COP product, the Board, RMA and most of the independent expert reviewers found fundamental problems with the product. For example, four of the six independent reviewers recommended rejection of the COP product, and the two reviewers who supported the product had a variety of concerns that needed to be addressed before they would consider approval. The problems identified through the Board's review process included:

- The use of each producer's estimated yield variance to establish a rate. This method was determined likely to be inaccurate for many producers and variable from year to year and across locations. Producers in similar situations could face different rates, and such disparate rate treatment would not be in the best interests of producers.

- It was also found that the process for setting base county rates and the level of rates compared with other insurance products would likely lead to adverse selection problems.

- The complexity of the COP product; the recordkeeping requirements for producers, insurance companies, and RMA; and the cost of delivery were identified as serious concerns because of the undue burden imposed on the program and its participants.

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- The complexity of the COP product, its delivery costs, as well as the current 94 percent participation rate by U.S. cotton producers in the five existing cotton insurance products, all raise serious issues regarding the marketability of the proposed COP product.

- Another set of concerns identified was the failure of the COP product to provide the benefits many producers are likely to expect. For example, because covered costs are limited by a producer's expected gross income, many producers would not have their full production costs covered.

- In addition, the feature that limits indemnity payments to costs incurred up to the time the crop is destroyed may result in many producers receiving an indemnity that is a small percentage of their expected income.

Because of these and other concerns, to go forward with this COP product would require further research expenditures and use of RMA resources. These added costs would come at a time when the FCIC has underway scores of pilot projects and research and development studies, many initiated as a result of ARPA, that are being completed, must be considered for approval for sale to U.S. producers, and if approved, then implemented.

Based on this evidence, the FCIC Board of Directors voted to disapprove the COP product. The Board will ensure that the COP product and all expert reviews are available to the public (on the RMA website) so that others may use this material to possibly develop a more workable COP product. The Board continues to search diligently for innovative risk protection products that meet the needs of farmers and ranchers that are actuarially appropriate and promote program integrity.

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