



**United States
Department of
Agriculture**

Federal Crop
Insurance
Corporation

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DATE: September 28, 2006

TO: Board of Directors
Federal Crop Insurance Corporation

FROM: Eldon Gould /signed/
Manager

SUBJECT: Manager's Report
Exhibit No. 2860

This memorandum serves as the Manager's Report to the Board of Directors (Board), Federal Crop Insurance Corporation (FCIC), for the September 28, 2006 meeting. The report relates to program issues as outlined below:

Program Issues:

Mitigating Declining Yields Update – Two separate development contracts are in the final stages for addressing solutions to declining Actual Production History (APH) yields due to successive years of crop losses. Science Applications International Corporation (SAIC) and AgriLogic, Inc. continue their development efforts.

- SAIC is developing an indexed yield approach where grower yields are stabilized by combining them with long-term trends developed from historical county average yield data. Approximately nine states are being proposed for the initial pilot program for corn, soybeans, cotton, and wheat. SAIC developed and presented RMA with the Indexed Yield pilot program material, which is currently under RMA review and consideration.
- AgriLogic, Inc. is developing several approaches to limit year-to-year decreases in a grower's APH. The limits will depend on the grower's individual yield history, choice of coverage level, and potentially, choice of unit structure. These approaches will be applicable to annual crops and may be applicable for perennial crops. AgriLogic just finished producer listening sessions. On August 31, 2006, they presented RMA with Declining Yield pilot program material. RMA's review will be completed by October 1, 2006.

The agency plans to send both approaches to the Federal Crop Insurance Corporation Board of Directors for consideration and independent expert review later this year or early next year. The targeted implementation of the first phase is set for the 2008 crop year, but is subject to approval by the FCIC Board of Directors.

Pasture, Rangeland, and Forage (PRF) Update - On July 20, 2006, a training session was held for Approved Insurance Providers (AIP) in Kansas City, Missouri on the two PRF products the Board approved for pilot testing on January 18, 2006. This training session was well attended and received. In addition, representatives from the offices of Kansas City, Washington, DC, and Oklahoma City attended the Beef Cattle Short Course at Texas A&M University, College Station, TX that was held from August 7 to August 9, 2006. On the first day of the short course, the PRF Vegetation and Rainfall Index pilot programs were announced at the general session. Cattlemen attending the conference showed a great deal of interest in the new pilots. The sales closing date for the new pilot programs is November 30, 2006 for the 2007 growing season.

Overall, RMA continues to work with the contractor on the remaining contract, which is estimated to come before the FCIC Board for consideration by independent expert review later this year or early 2007.

Livestock Program Evaluation Contract Status – The livestock evaluation contract work by Watts & Associates is completed. On September 19, 2006, Watts and Associates provided RMA with its final oral presentation. The contractor considered the following in the final presentation: 1) the history of the livestock programs, 2) review of rating and pricing methodologies, 3) market performance and producer acceptance, and 4) interviews with the submitters of the livestock plans of insurance. On November 2006, RMA and Watts & Associates plan to provide the Board with a full briefing of its findings.

Comprehensive Cotton Program Evaluation – On May 19, 2006, Sumaria Systems, Inc. was awarded a contract for a comprehensive evaluation of the current cotton program. The objective of the contracted evaluation is to develop a long-term strategy for improving the performance of the cotton program. On August 28, 2006, RMA held a conference call with representatives from Sumaria and the National Cotton Council (NCC) to discuss and develop the listening session schedule. Currently, the listening sessions will be held the weeks of November 27, 2006 and December 4, 2006 in the following cities: 1) Tipton, GA, 2) Memphis, TN, 3) Lubbock, TX, 4) Fresno, CA, and 5) Corpus Christi, TX,. Also, the NCC provided the contractor with a list of contacts for various regional interest organizations that can help notify producers of the listening sessions.

Partnership Agreements –RMA awarded \$20.8 million for projects to develop new risk management tools for farmers and ranchers, as well as outreach and education opportunities to limited-resource and other traditionally underserved farmers and ranchers.

- Research and Development –\$3.6 million
- Community Outreach and Assistance – \$7.1 million
- Education and Targeted States – \$10.1 million

In addition, two interagency agreements were finalized. The first agreement with the Agricultural Marketing Service (AMS), for \$1.2 million, is to collect organic price information and provide producers with market information. This project will allow AMS to expand existing systems and data collection efforts to include organic markets. The second agreement with Cooperative State Research Education and Extension (CSREES) is to support and extend the work on the Soybean Rust Monitor

and to increase the surveillance, reporting, and management for leguminous crops for the upcoming growing season.

Hawaiian Tropical Fruit and Tree Programs –The pilot Hawaiian Tropical Fruit and Tropical Tree insurance programs are being finalized. Feedback on program materials from AIPs and the National Crop Insurance Services (NCIS) is being reviewed. The programs are scheduled for public release by the end of September with a sales closing date of December 31, 2006.

Modified Unit Discount Procedures - The FCIC Board of Directors approved sending the Unit Division Structure Review to five independent expert reviewers at its July 2006 Board meeting. The modified unit discount procedure would replace the current fixed unit discount with variable unit discounts based on certain producer characteristics. The expert reviewers have recently completed their reviews and submitted their comments to RMA. RMA and its contractor are evaluating the comments in preparation of bringing the program to the Board for approval or disapproval.

Soybean Rust Confirmation Update – On September 15, 2006, Soybean rust was reported in a fungicide test plot in the Jefferson Davis Parish in southwestern Louisiana and in a commercial field in Iberville Parish in southern Louisiana. Currently, rust has been found infecting this year's soybeans in thirty-seven different counties in the following eight states: Alabama, Florida, Georgia, Louisiana, Mississippi, South Carolina, Texas, and North Carolina. Including reports on kudzu, there is a total of 57 counties in eight states with rust this year including five in Alabama; thirteen in Florida; ten in South Carolina; eleven in Georgia; twelve in Louisiana; three in Texas; two in Mississippi; and one in North Carolina. Also, spore trapping continues throughout the United States using both active and passive traps. Any positive spore trap information does not imply infection has taken place and plant samples are used exclusively for recording positive rust occurrence. Recent rain shower activity has been reported in some of the infected areas and local infection has increased in most cases as a result. Much like the 2005 season, more soybean rust finds are expected late this season through the next several months. Growers are encouraged to consult their state commentary for more detailed information about conditions in their state. So far, RMA has not received any notices of loss associated with soybean rust for the 2006 crop year.

Aflatoxin Update – Aflatoxin continues to be a concern in the state of Texas and RMA has held two informational meetings there. One meeting was held in Lubbock to cover FCIC aflatoxin loss adjustment procedures. The other meeting was in Austin, and the meeting included, in addition to crop insurance procedures, presentations regarding the occurrence and management of aflatoxin, the laws and regulations of the Food and Drug Administration and the State of Texas, and the sampling and grading requirements of the US Grain Inspection, Packers and Stockyard Administration.

Currently, the agency is exploring options to improve the management of aflatoxin loss claims when the value of infected grain is not readily available to approved insurance providers and insureds.

Harvest Will Not Meet Estimates - California's processing tomato harvest is not expected to reach the originally estimated amount of more than 11 million tons. Late spring rains delayed and damaged plantings while triple digit temperatures caused stress and death to this year's crop. Harvest has already begun in the state and production is expected to reach between 9.5 and 10.5 million tons. This

decrease in production will keep prices up for the 2007 crop year, but will also open up the market to imports to compensate for the shortage. As for now, producers are hoping that no rain will occur until the middle of October 2006.

Alfalfa in California and Arizona - The effect of the triple-digit weather has killed more than 16,000 dairy cows and is beginning to put a damper on the alfalfa market and milk prices. Dairy cows are the largest users of alfalfa. Because of the unfavorable pricing, dairymen are buying short-term contracts for the purchase of alfalfa hay vs. a four/five-month term. Late spring rains flooded fields and record-breaking temperatures stressed the plants. Arizona cotton ground is now shifting alfalfa acreage, and there are about 240,000 acres in the state. Growers experienced damage from the monsoon rains and treehoppers. The value of the crop for these two states is estimated at \$230 million.

Regulatory Update:

Onion Policy Changes – RMA’s Spokane and Davis Regional Offices (ROs) are collaborating with the Product Administration and Standards Division (PASD) in Kansas City, Missouri to provide recommended changes on the Special Provisions of Insurance for the Onion Crop Insurance policy. The recommendations were submitted to PASD through Insurance Services for improvements to these policies including end of insurance period dates, stage guarantees, and other items. The targeted implementation is the 2007 crop year for recommended SPOI Statements and the 2009 crop year for the crop provision changes.

Stonefruit Policy Changes - Several RMA ROs including the Spokane and Davis Offices are collaborating with the PASD in Kansas City to provide recommended changes on stonefruit crops (Fresh Peaches, Plums, etc.). Recently, the recommendations were submitted to PASD through RMA Insurance Services for these policies. The targeted implementation is targeted for the 2009 crop year.

Mustard Pilot Crop Provisions – Recently, RMA’s Billings and Spokane ROs has worked closely with the PASD in Kansas City to revise and rewrite the Mustard Pilot Crop Provisions since the FCIC Board approved its conversion to a permanent program. PASD has received the Office of General Council (OGC) comments and is preparing the final document for proposed rule. The final rule is targeted to be effective for the 2008 crop year.

Dry Pea Crop Provisions – RMA’s Billings and Spokane ROs has worked closely with the PASD to revise and rewrite the Dry Pea Crop Provisions. A revised draft of the Dry Pea Crop Provisions was forwarded to the PASD and is currently going through the Product Management’s internal concurrence process. The projected implementation is planned for the 2009 crop year.

Grape and Table Grape Crop Provisions – Several of the RMA ROs are collaborating with the PASD to revise and rewrite the Grape and Table Grape Crop Provisions. A revised draft of these two crop provisions is currently going through the internal concurrence in Product Management. The projected implementation is for the 2008 crop year.

Combination Regulation Update – On September 12, 2006, the comment period ended for the proposed rule that combines the existing APH, Crop Revenue Coverage (CRC), Income Protection

(IP), Indexed Income Protection (IIP) and Revenue Assurance (RA) plans of insurance into one consolidated plan of insurance. However, RMA has reopened and extended the public comment period for an additional 30 days based on a number of requests it received from producer associations and other interested parties. The final rule is to be effective for the 2009 crop year.

Peanut Crop Provisions – On March 27, 2006, the public comment period for the proposed rule on peanut crop provisions ended. RMA prepared responses to the comments as part of the final rule process. On August 25, 2006, the final rule was cleared by OGC, and the rule will be published in the Federal Register to be effective for the 2007 crop year. The rule updates the peanut crop provisions to be consistent with the elimination of the peanut quota program, makes peanut unit crop provisions consistent with other crop provisions, and provides for insuring peanuts based on a contract price.

Mint Crop Provisions – On April 24, 2006, the public comment period for the proposed rule on the mint crop provisions ended. RMA prepared responses to the comments as part of the final rule process. The rule converts the mint program from a pilot program to a permanent program based upon the FCIC Board's approval for such action. The final rule is targeted to be effective for the 2008 crop year.

Northern Potato Crop Provisions and Southern Potato Crop Provisions – The proposed rule was published in the Federal Register for public comment on July 28, 2006 with a 60 day public comment period. The proposed rule would make changes to the Storage Coverage Endorsement and in determining production to count for claims purposes. The changes are targeted toward improving program integrity. The final rule is targeted to be effective for the 2008 crop year.

Almond and Walnut Crop Provisions – On May 22, 2006, the proposed rule public comment period for the almond and walnut proposed rule ended. RMA prepared responses to the comments as part of the final rule process and is working with OGC's in preparation of the final rule. The rule will reduce the age requirements for almond and walnut trees for crop insurance purposes. The final rule is targeted to be effective for the 2008 crop year.

Millet Crop Provisions – The proposed rule was cleared by OGC. Currently, USDA's Office of Management and Budget is reviewing its designation of the proposed rule. The proposed rule removes the indemnity reductions for unharvested acreage a provision that has caused producer and others concern for several years. The final rule is targeted to be effective for the 2008 crop year.

Florida Citrus Fruit – On September 9, 2006, OGC cleared the proposed rule. The proposed rule will be published in the Federal Register with a 60 day public comment period. The proposed rule clarifies insurable citrus crops and provides coverage for wind damage on fresh fruit when in conjunction with a hurricane or tornado. The final rule is targeted to be effective for 2008 crop year.

Nursery – On September 1, 2006, the proposed rule was published in the Federal Register. The rule clarifies the definition of nursery liners for insurance purposes. The final rule is targeted to be effective for the 2008 crop year.

Program Highlights/Announcements:

2007 Risk Management Writing Contest – On October 25 to October 27, 2006, RMA's Risk Management Education Division (RMED) will kick off the 2007 Risk Management Writing Contest during the National FFA Convention being held in Indianapolis, Indiana. This deadline for this contest is due January 31, 2007.

Soybean Rust Website Update - RMA recently provided \$3.5 million to continue funding of the Legume Pest Information Platform for Extension and Education (PIPE) known as the USDA Soybean Rust Website (<http://www.sbrusa.net>). This funding will be used for further enhancements of the site and to expand add additional crops and pests. A steering committee has been formed to address future changes to the site. The newly developed Good Farming Practices Documentation Tool is a comprehensive one-stop shop for soybean producers to review all the available information on the prevention and control of Asian Soybean Rust. In addition, USDA's Natural Resources and Conservation Service has used the information collected from the documentation tool for their conservation programs. RMA will be working with NRCS to discuss its needs during the development of a system of records to announce routine uses for this information, the collection and storage of data, and other regulatory requirements for data collected through the site.

Well Shutdowns Ordered by the State of Colorado - Prior to May 5, 2006, Colorado growers, who were served by the Central Colorado Water Conservancy District and its Well Augmentation Sub-district (WAS) in the State of Colorado, had been informed that they would have 15 percent pumping quota from the wells. This information was based on above average snow packs for the winter and the expectation of normal rainfall in the spring. However, after announcing the 15 percent allotment of water, very little snow fell in April 2006, snow packs melted and evaporated, and the normal spring rains did not materialize.

As a result of ongoing litigation regarding the WAS augmentation plan and temporary substitute water supply plan, the Court had given WAS the following two options for 2006: 1) proceed with pumping, provide replacement water and 2) have a hearing in which objectors could challenge the WAS 2006 plan, or cease pumping until the scheduled trial. WAS chose the second option and agreed not to allow pumping under its plan for 2006 on the condition that it be allowed to store the water it had assembled for 2006 and save it for future years. On May 5, 2006, the Colorado State Engineer, in compliance with the Court Order, issued "cease and desist" orders to some 449 well owners. The additional water was expected to come from rainfall during the 2006 crop year that could be stored for future release.

On June 29, 2006, RMA issued an Informational Memorandum stating the following: From all available information, it appears that the cause of the shutting of the wells and the loss of the allotments was drought. Since, drought is an insurable peril and at least some insureds had a reasonable expectation of receiving 15 percent of their allotment of water until May 5, 2006, such producers may be eligible for prevented planting and indemnities for planted acreage that subsequently failed.

Earlier this month, RMA officials traveled to Colorado to meet with the Colorado Agriculture Commissioner, Don Ament, as well as with officials from the concerned water district. Mr. Ament

stated that some water data was not considered during the initial meetings. The agency agreed to continue working with Colorado officials to review any additional water data and to evaluate all information presented with the aim of doing our best within the laws and regulations by which RMA administers and regulates the Federal crop insurance program to assist Colorado farmers.

The RMA Topeka Regional Office continues to make the Producer Documentation Tool available to producers in documenting water expectations and their decision on planting based on those expectations. The tool is available through the RO's following website:

http://www.rma.usda.gov/aboutrma/fields/ks_rso/.

RMA Apple Loss Adjustment Issues - During the period from the end of May 2006 through July 5, 2006, the Pacific Northwest was hit by a series of severe hail storms across many areas of the Columbia Basin and Eastern Washington. The damage from the hail storms has been significant in many areas. The earlier storms (May 17 weekend) damaged between 8 and 10 million packed boxes of apples. Additional storms from Yakima County in the south through Okanogan County in the North on Memorial Day and over the July 4 holiday has raised the estimated damage to 15 and 20 million packed boxes of apple production lost. The storms consisted of rain, high winds, and lots of hail. In addition, damage reports were received of other fruit crops including cherries, grapes, pears, and stonefruit.

Currently, the agency has insurance available for fruit and annual crop producers, and the approved Insurance Providers have adjusters in the field completing claims. Also, the 2006 insured acreage and participation data for the crops mentioned is shown below in figure 2 as of September 11, 2006.

Crop	NASS*	Acres Insured	Percent Participation	Coverage
Apples	176,000	125,052	71%	\$280,751,810
Cherries	40,000	19,969	50%	\$32,933,536
Grapes	62,000	46,658	75%	\$55,720,014
Pears	31,000	14,885	48%	\$19,829,529
Stonefruit	7,200	3,664	51%	\$5,759,950

Figure 2: National Agricultural Statistics Service (As of 9/11/06)

IT Contracts Status - In July 2006, the IT integration contract that provides most contracted IT services for RMA and FCIC was awarded to SAIC by the General Services Administration (GSA), which contracts for much of the IT services for Federal government. This performance based contract will be in place for up to five year and is valued up to \$120 million.

In addition, the data mining/data warehousing contract with Tarleton State University Center for Agricultural Excellence (CAE) was scheduled to end on August 31, 2006. However, an extension of up to six months has been approved. The preparations to re-compete the data mining/data warehousing contract have already begun, and an award for a new contract is expected in early calendar year 2007.

Electronic Written Agreements (eWA) Project - The eWA Investment project is an initiative to replacement the current RMA automated systems and methodologies. The initiative consists of the

development of an enterprise architecture and platform necessary to support the RMA processes and store current and historical data. Some key features being designed into the new system include but are not limited to the following:

- An integrated relational database; interface between RMA, AIP's and other USDA agencies, (e.g., CIMS, producer addresses); expanded decision support tools within systems, as necessary (e.g., loss history test for written agreements); transfer and conversion of existing historical RMA data into the new database structure; integration of RMA's data warehouse (and data mining and pattern-recognition capabilities (if appropriate) and hardware configuration required to support the new functionality, new database design, and interfaces, whether real-time or batch.

The design phase of the project officially began with a project kick off meeting in Kansas City on September 19, 2006. Due to the great impact on their processing systems, RMA has folded the AIPs into the project and AIP's will be involved in various design phase meetings and teams. An Extranet SharePoint site has been set-up as a primary means to communicate and share information on the project with AIPs, and RMA is moving select information to the site as it is updated on a weekly basis. The eWA team members are participating in monthly-industry IT update calls and provide regular updates and discussions at IT Managers Meetings.

Deputy Manager, Federal Crop Insurance Corporation – James Callan, Associate Administrator, Risk Management Agency, has been appointed Deputy Manager, FCIC effective in August 2006. Jim brings over 25 years of professional experience to this position, which serves as first alternate on the FCIC Board of Directors in the absence of the Administrator.

Compliance:

Compliance End of Fiscal Year Notes – Compliance followed through with the 2006 priorities as follows:

- Monitored and improved the Spot Check List by revising procedures and improving communication with FSA.
- Emphasized other data mining results and distributed reports to AIPs on the Misapplied Yields (MAYS), Losses Not Reflected in APH Database (McP), and the Prohibited Conduct for Agents and Loss Adjusters reports. Compliance used the feedback on the Prohibited Conduct report to continue to educate the companies on the changes in the new Standard Reinsurance Agreement (SRA) or to emphasize areas of non-compliance under the old SRA. The Prohibited Conduct Report identified Agents who adjust policies, and Loss Adjusters who are selling policies in direct conflict with the SRA. This highlights additional Conflict of Interest issues and makes RSD's initiative to get the COI bulletin issued even more critical.
- Compliance staff maintained public awareness of its mission efforts by increasing and publicizing use of technology, company reviews, sanctions, and prosecutions.

- Improved OIG and GAO communications and continued to improve relationships with other law enforcement and regulatory agencies.
- Compliance supported company efforts to combat waste, fraud, and abuse with the highlight for this year focusing on the recent Program Integrity Conference.

Compliance continued to stress the need for equilibrium between Quality Control and Enforcement efforts. This will remain an overall RMA Compliance goal that can not be achieved without industry cooperation and continued emphasis in going forward into 2007.

National Association of Insurance Commissioners - The National Association of Insurance Commissioners (NAIC) has established an antifraud task force with a mission statement to serve the public interest by assisting the state insurance supervisory officials, individually and collectively, to promote the public interest through the detection, monitoring and appropriate referral for investigation of insurance crime, both by and against consumers. One of the charges of the task force is to coordinate with state, federal, and international law enforcement agencies in addressing antifraud issues relating to the insurance industry.

The NAIC Fraud Coordinator has indicated that many of the states have established fraud divisions that investigate cases similar to RMA's in other lines of insurance and have enacted specific insurance fraud statutes. RMA has been pursuing ideas as to how we can cooperate with willing state fraud divisions to assist Compliance in investigating crop insurance fraud.

Risk Compliance is developing a working relationship with the NAIC to educate members of the antifraud task force and state insurance fraud directors of the potential impact of crop insurance fraud. As a first step in this process, RMA Compliance presented crop insurance program information to the antifraud task force at the recent NAIC meeting in Orlando, Florida.

Our goal is to have a protocol worked out for referring specified cases for prosecution to State authorities as a part of the cooperative effort between NAIC and RMA.

National Operations Reviews (NOR) – RMA Compliance has only seven final policy findings remaining to be issued out of the 300 random policies (2004) selected for the 2005 NOR reviews. These policy reviews help assess the insurance providers' adherence to the Standard Reinsurance Agreement (SRA), quality control guidelines and RMA's approved policies and procedures. The Agency conducts random policy reviews during the NOR to report an error rate to OMB under the requirements of the Improper Payments Information Act of 2002. Also, RMA has issued the NOR procedures for conducting these reviews and will modify them as necessary based on the experience comments of the reviewers who have used them in the field.

RMA announced the review schedule for 2006 at the recent NCIS National Claims Manager's Conference. The Compliance offices will conduct Operations Reviews of the following companies:

- Dallas – *Rain and Hail*
- Davis – *Crop USA*

- Indianapolis – *Country Mutual*
- Kansas City – *ProAg*
- Raleigh – *American Agricultural*
- St. Paul – *Farmers Crop Insurance Alliance (closeout)*

The 2005 random policy selection occurred during the week of April 17, 2006. By waiting until this date, RMA expected to see some Group Risk Plan and Group Risk Income Protection indemnities in the selection pool available as part of the review population. Due to recent concerns raised regarding these products, Compliance will assess over the summer of 2006 if a special review on these products is necessary.

GAO Report on Fraud, Waste, and Abuse – This audit provided recommendations to RMA as to how we could improve compliance efforts. RMA agreed in principle with most of the GAO recommendations and agreed to proceed on the following items:

- Adjusting the producer spot-check list procedures to permit FSA to review fall seeded crops for the following year as opposed to the current year, which was ineffective. RMA discussed the possibility of separating the data mining algorithms for the fall and spring, but determined that essential data would be excluded in the process. Farm Service Agency has stated that without additional resources, it will be unable to perform 100 percent of the designated growing season inspections.
- Distributing to each AIP the listing of its policyholders whose tax identification numbers or shareholders with substantial beneficial interests did not reconcile with FSA’s permitted entity file. RMA will formally require the AIPs to review the discrepancies under Appendix IV and report the results at some point in time
- Finalizing a quality control program for the AIPs intended to help RMA assess the effectiveness of the quality controls used by the AIPs. Also, RMA Compliance will continue to test AIP quality control programs during scheduled national operations reviews.
- Finalizing the ARPA-implemented sanctions regulations as soon as OGC has completed its review of the current draft. RMA informed GAO that the lack of these regulations had not hindered RMA from using the statutory authority to sanction some producers. However, getting the regulations in place should help improve the overall sanctions process.

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