



**United States
Department of
Agriculture**

Federal Crop
Insurance
Corporation

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DATE: October 28, 2004

TO: Board of Directors
Federal Crop Insurance Corporation

FROM: Ross J. Davidson, Jr. /signed/
Manager

SUBJECT: Board Memorandum No. 775
Manager's Report

This memorandum serves as the Manager's Report to the Board of Directors (Board), Federal Crop Insurance Corporation (FCIC), for the October 22, 2004 meeting. The report relates to program issues as outlined below:

Program Issues:

Livestock Price Reinsurance Agreement – Livestock sales resumed on October 1, 2004. There are currently nine companies selling livestock policies, with each authorized to write a specific amount of premium. A final draft of the Livestock Price Reinsurance Agreement (LPRA) for the 2005 reinsurance year was distributed to all reinsured companies on August 17, 2004 for editing comments and technical corrections. The LPRA was finalized and announced on August 31, 2004.

Approval of Reinsured Companies for 2005 – The Risk Management Agency (RMA) conditionally approved the SRA of Westfield Insurance Company (MGA: John Deere Risk Protection Inc.), increasing the number of crop insurance providers to sixteen. All 14 reinsured companies from the 2004 reinsurance year have applied to continue in the federal crop insurance program for 2005 and have requested and received conditional authorization to write an increased level of premium. Most companies have also requested authorization to increase the number of states they intend to serve. RMA is reviewing several other serious applicants. Conditional authorization to write for 2005 was based on RMA's determination from a financial review that all companies had sufficient financial resources. Final approval is conditional on the satisfactory completion of Plans of Operations for 2005, which for the first time will include the required submission of sufficiently comprehensive risk assessments and contingency plans.

Hurricanes Charley, Frances, Ivan and Jeanne – On August 13, 2004, Hurricane Charley struck Florida. Subsequently, Hurricanes Frances, Ivan and Jeanne hit the southeastern United States between September 8 and 25. These storms caused catastrophic damage to crops in the state of Florida. The destruction of power lines, communication systems and debris has made travel and communications difficult. In many areas, power and basic services are only now being fully restored. The collection and removal of debris continues. The ability to deal with the claims process was limited due to the succession of storm activity. Now that other storms are not imminent, the mobilization of all available loss adjustment personnel to assure timely settlement of claims is proceeding. Approved Insurance Providers (AIPs) report they are adequately managing

the current combination of hurricane (excess moisture) and frost claims as well as servicing the balance of the nation's insured losses.

Due to the catastrophic damage from Hurricane Charley, RMA authorized emergency loss procedures on August 24, 2004. These procedures streamlined certain loss determinations to assist in expediting loss adjustment and issuance of indemnity payments to crop insurance policyholders in the affected areas. RMA recently issued a Manager's Bulletin to expand and provide additional emergency loss procedures to designated counties in Florida, Alabama, Georgia and North Carolina. The hurricanes also affected South Carolina, Mississippi, Tennessee, Pennsylvania, Ohio and West Virginia, but not to the extent that emergency loss procedures are warranted. The application of the emergency loss procedures is limited and should not adversely affect program integrity.

For the 2004 crop year, the total crop insurance liability for all crops in Florida is presently over \$2.6 billion. The crop insurance program has currently indemnified insured producers by approximately \$32.2 million in Florida for damage suffered during the 2004 crop year. RMA is currently estimating that \$303 million in indemnities will be paid to farmers due to the hurricanes. Final indemnity amounts could vary by \$50 million. In 2003, the federal crop insurance program paid Florida producers \$50 million for insured causes of loss.

Freeze Damage – Thirty-two counties in Minnesota and 26 counties in North Dakota counties were affected by an early frost that occurred on August 20, 2004. During the 2004 crop year, the growing season was abnormally cool and wet, causing crops to be two to three weeks behind the normal or average maturity. These growing season conditions have apparently caused grain to have a higher than normal moisture content and lower than normal test weight at harvest. In accordance with existing procedure, most insurance providers authorized the use of Early Freeze Damage Appraisal Modification for field corn damaged by frost. This modification considers the maturity of the crop at the time of the freeze and allows a more accurate estimate of production potential.

Kansas Wheat Sprout – USDA's Risk Management Agency (RMA) announced a clarification of the application of its loss adjustment procedure standards for quality adjustment from blended samples of agricultural commodities on a unit basis, consistent with modifications made by the 2002 Farm Bill. On September 3, 2004, the agency posted a Manager's Bulletin on its website to clarify the procedures.

Tobacco Buyout – RMA is preparing draft tobacco conversion procedures to address needed changes in the tobacco crop insurance program in light of recent tobacco buyout legislation. The draft procedures will be distributed for industry comment prior to finalization.

Program Highlights/Announcements:

Risk Management Partnership Agreements – On October 22, 2004, Agriculture Secretary Ann M. Veneman announced fiscal year 2004 awards of \$19.8 million in risk management partnership agreements. The agreements will support the development of new risk management tools and outreach and education opportunities for traditionally underserved producers.

Fifty-nine competitively awarded partnerships with community-based, educational and nonprofit organizations will use \$5 million to educate women, limited resource, and other traditionally underserved farmers and ranchers. Twelve research partnerships were awarded \$5.1 million for the research and development of new non-insurance risk management tools. The Targeted States Program will use \$4.4 million to deliver crop insurance education to producers in 15 historically underserved states through cooperative agreements. Specialty crop, livestock, nursery and horticulture producers will benefit from \$5.3 million, which will be spent on 41 education partnership agreements for commodity partnership programs.

Fiscal Year 2004 awardees have been notified, and the majority of them have received a signed copy of their

agreements. The Risk Management Education (RME) Division is in the process of scheduling entrance conferences, which will be conducted via telephone, with awardees. A face-to-face meeting with grantees is tentatively planned for December 2004.

Peanut Crop Provisions – RMA, with the consent of the Board, proposed a rule in the Federal Register to revise peanut crop provisions to allow unit division by Section, Township, and Range consistent with other crops in the areas where peanuts are insured. Peanut producers requested this change due to the removal of the federal peanut price support and quota program. The Final Rule will be published in the Federal Register effective for the 2005 crop year.

Silage Sorghum Pilot Program – On May 6, 2004, the Board approved a Silage Sorghum Pilot Plan of insurance for two counties in Colorado and 37 counties in Kansas. Sorghum varieties grown for harvest as silage will be eligible for coverage under the new pilot program beginning in the 2005 crop year and continuing through the 2008 crop year. Non-silage varieties will not be covered under this pilot program. Policy materials were released October 13, 2004. The sales closing date is set for March 15, 2005.

AGR-Lite Expansion – On May 6, 2004, the Board approved expansion of AGR-Lite to Alaska, Idaho, Oregon, North Carolina and Washington, provided that actuarially appropriate premium rates were submitted to RMA. The North Carolina Department of Agriculture and the Washington State University Extension Service worked throughout the summer on the expansion effort and have provided actuarially appropriate premium rates to RMA. The agency is awaiting final revisions to the AGR-Lite handbook, and anticipates that AGR-Lite expansion, as approved by the Board, will be released on the RMA website during the week of October 25, 2004.

Compliance:

Operations Review Process – RMA received notification that the Office of Management and Budget (OMB) has accepted RMA's proposal to use the three-year review cycle of insurance providers to determine the Federal crop insurance program's error rate. With one Company Operations Review completed and another under way, RMA's Compliance Office is on track to complete review of one-third of the companies during fiscal year 2005. The Compliance Office's schedule for the rest of 2005 has been determined and will be announced as it proceeds.

Company Operations Reviews will be routinely performed on SRA holders and will be used to provide the necessary data to establish a program error rate. OMB will also use the review results as reported by RMA to satisfy the statutory requirements of the Improper Payments Act. These reviews assess insurance providers' adherence to the SRA, quality control guidelines, and RMA approved policies and procedures. The intent is to review all participating companies over the next three years.

American Growers Update – RMA continues to work with the Nebraska Department of Insurance on a number of outstanding issues related to the closeout of American Growers Insurance Company. The state continues to oversee the company in rehabilitation pending a final decision on how the American Growers in Rehabilitation close-out will be accomplished. RMA continues to work on the few remaining open claims for the 2002 and prior crop years, in addition to assisting in arbitrations and lawsuits between the company and policyholders. The USDA, Office of Inspector General for Audit (OIG), and the Government Accountability Office (GAO) have completed their respective audits of the American Growers failure. GAO has issued its final report and RMA has responded to the related recommendations. The OIG discussion draft has not yet been received.

The current cost to the federal government for the failure of Growers currently stands at approximately \$40.7 million with minimal outputs still accruing to the cost of the run-off. Some recovery of residual assets is

expected to offset this amount as the closeout is accomplished.

Annual Report to Congress – The 2002 Crop Year Compliance Annual Report to Congress is in final clearance with the Department’s Office of Communications and should be ready for publication soon. The report shows continuing gains against waste, fraud, and abuse from the use of data mining and remote sensing to identify anomalous program results. The SRA for 2005 will build on these results by incorporating data mining into the selection of policies that will be reviewed by the companies as part of their quality control requirements. The Compliance Office’s work toward a final draft of the 2003 Annual Report is on track with RMA’s schedule.

Deputy Administrator Hosts Appendix IV Meeting With SRA Holders – The Deputy Administrator for Compliance held a meeting on October 14, 2004 with representatives of the SRA holders to discuss issues arising from the 2005 SRA and Appendix IV. RMA substantially rewrote the former Manual 14 to address program vulnerabilities and deficiencies, as well as to add data mining to the quality control process. The successor to Manual 14, Appendix IV of the 2005 SRA, directs the companies to perform reviews that will increase the effectiveness of required activities in light of reduced administrative costs. Topics that continue to cause concern for the companies and other interested parties include the conflict of interest provisions, quality control reporting, error correction requirements and litigation support. RMA has made a commitment to continue working with the companies to ensure a common understanding of the requirements and to incorporating cost/benefit assessments for Appendix IV requirements.

Data Mining Report Results Sent to Companies – On October 10, 2004, the Compliance Office notified the companies that as a result of data mining, RMA had identified potential debt on approximately 14,000 policy units. The notification also contained a request to hold policy records for these units beyond the three-year record retention requirement, if applicable. The “McP III report” covers crop years 2001, 2002 and 2003, and identified policies where a comparison of past claims and APH data indicated that claim production data was not used to establish the APH as required by procedure for the following year(s). Although the request did not require the companies to review these policies, several companies have initiated reviews to determine the extent of the problem and potentially preclude incorrect payments on crop year 2004 claims. Some companies have already notified RMA of certain procedures that account for the discrepancies, highlighting the fact that data mining results identify anomalous data, but still require review to determine whether or not an error exists for the policy.

Information Technology (IT):

Program Management – RMA faces budget problems that will require significant IT changes for the agency. Through careful planning by IT and program area personnel, the agency will be able to minimize the potential impact to FCIC programs. In order to effectively control expenditure of the limited IT funds available to RMA, senior management will implement sound IT project management that follows a workable Systems Development Life Cycle (SDLC). This will enable senior management to monitor the use of agency resources within the established controls.