



**United States
Department of
Agriculture**

Federal Crop
Insurance
Corporation

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DATE: April 28, 2005

TO: Board of Directors
Federal Crop Insurance Corporation

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

SUBJECT: Board Memorandum No. 792
Manager's Report

This memorandum serves as the Manager's Report to the Board of Directors (Board), Federal Crop Insurance Corporation (FCIC), for the April 28, 2005 meeting. The report relates to program issues as outlined below:

Program Issues:

Pasture/Rangeland and Forage Update – RMA recently awarded four contracts for research and development of new and potentially innovative crop insurance programs for pasture/rangeland, forage and hay. Positive progress continues on each of these four contracts. RMA expects that at least one proposal may be ready for the Board to consider for independent expert review as early as July 2005. If approved by the Board in late Fall 2005, pilot testing could begin as early as 2006.

2004 Loss Estimate Update - The total indemnity for the crop insurance program for 2004 is projected to be \$3.17 billion, resulting in a program-wide loss ratio of 0.76. This is the lowest loss ratio since 1997. This projection results in an average loss ratio for the last ten years (1995-2004) of 0.95. In addition, the 2004 reinsurance year was exceptionally profitable for the companies and their commercial reinsurers, with an estimated \$700 million in underwriting gain and a return on retained premium of approximately 22 percent. For 2004, total A&O reimbursement is estimated at \$889 million.

Soybean Rust – Asian soybean rust (*Phakopsora pachyrhizi*) is a fungal disease that can quickly defoliate plants and reduce pod set, pod fill, seed quality and yield. RMA has been working closely with a variety of organizations to stay abreast of developments and coordinate efforts where appropriate.

On March 24, 2005, RMA issued an updated press release on soybean rust that encouraged insured producers concerned about the impact of Asian soybean rust to use good farming practices by seeking and following recommendations of agricultural experts to control soybean rust. Further, RMA recommended that insured producers document the advice received and actions taken to combat this disease.

On March 28, 2005, RMA issued an Informational Memorandum to transmit a copy of the March 24, 2005 press release, a soybean rust brochure and Questions and Answers to help insured producers better understand the position of the RMA and the Federal crop insurance program in regards to providing crop insurance coverage to soybean crops potentially affected by soybean rust. The approved insurance providers were asked to distribute this information to all soybean policyholders.

RMA will participate in a Soybean Rust Extension and Management Scenario Workshop on May 3, 2005 to discuss strategies for responding to soybean rust outbreaks. Extension personnel and approved insurance providers will also be involved at this meeting.

Additionally, RMA is continually gathering up-to-date information and data regarding the spread and appropriate management of soybean rust. RMA participates in the National Soybean Rust Working Group's bimonthly teleconference. In addition, the Agency monitors and participates as necessary in discussions among State and Federal agriculture agencies regarding preventative and control measures. RMA holds a bi-weekly conference call with all Regional Office Directors to discuss their direct contact with local State and Federal agriculture officials to obtain any updated information or developments in the spread and control of the disease.

Regulatory Update:

Combination Regulation – A proposed rule that combines the existing Actual Production History (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 has been prepared and is with the Office of General Counsel (OGC) for legal review.

Subpart V General Administrative Regulations; Submission of Policies, Provisions of Policies, and Rates of Premium – The Final Rule incorporating the Board of Directors, Sense of the Board regarding disclosure of business relationships and marketability of products submitted under Section 508(h) has been completed and is pending final signature by the Administrator.

Nursery Crop Provisions – Responses to the comments received on the Nursery Proposed Rule are completed and the Final Rule is with OGC for legal review. Approximately 22 individuals or entities provided over 130 comments, some of which were quite technical and detailed in nature. The Final Rule is planned for implementation for the 2006 crop year.

Guaranteed and Quota Tobacco Crop Provisions – Because of the elimination of the Tobacco Quota Marketing Regulations, the Guaranteed and Quota Tobacco Crop Provisions (which provide burley tobacco insurance) will be revised and combined into a single policy. All references to quota will be removed and provide for insurance of all tobacco based on APH. The proposed rule will be prepared for publication in the Federal Register during this fiscal year, with implementation of the final rule targeted for the 2007 crop year.

Peanut Crop Provisions – Because of the elimination of the Peanut Quota and Support Price program by the Farm Service Agency, the Peanut Crop Provisions will be revised to remove all references to quota and provide for insurance of peanuts based on APH. The proposed rule will be prepared for publication in the Federal Register during this fiscal year, with implementation of the final rule

targeted for the 2007 crop year.

Actual Production History Regulations – A proposed rule is also being prepared to modify and update the APH regulations that are codified at 7 CFR, part 400, subpart G. This regulation requires updating to conform to basic provision changes and to provide clarification. It is targeted for completion in the 2007 crop year.

Program Highlights/Announcements:

Premium Reduction Plan (PRP) – The Proposed Rule for PRP was published in the Federal Register on February 24, 2005, with a 60-day comment period. The comment period ended on April 25, 2005. RMA has received approximately 600 separate mailings pertaining to the PRP proposed rule.

Generally, the comments have expressed concerns about the potential for PRP to reduce agents' commissions and the effect this would have on the agent force and service to producers, particularly small, minority and limited resource producers. Several comments have expressed concerns that PRP will result in larger, lower-risk producers being "cherry-picked," while smaller producers would not be offered the discount. However, RMA has also received comments supporting PRP, stating that Crop1's Premium Discount Plan (PDP) has allowed producers to purchase higher coverage levels for less cost. Briefings on PRP for both the Senate and House Agriculture Committee staffs were also held.

Plans of Operations for 2006 – RMA received partial Plans of Operations for the 2006 reinsurance year from all current approved insurance providers by the April 1, 2005 deadline. RMA had recently issued additional guidance on certain Plan of Operations exhibits and had extended the deadline for submitting these remaining exhibits to May 1, 2005. The additional guidance covers risk assessments, contingency plans and critical financial reports. These documents will enhance RMA's ability to better assess the financial solvency of approved insurance providers and the operational continuity of the program. RMA expects to complete its evaluation of all Plans of Operation by the start of the 2006 reinsurance year on July 1, 2005.

Crop Insurance Industry Meeting – RMA met with approved insurance providers and crop insurance trade groups on April 19, 2005. The meeting covered a broad range of issues that had been raised by the industry. In the meeting, RMA and crop insurance officials also had the opportunity to express their views on the desired direction of the program. Several ideas for working with the companies to proactively address strategic and operational issues were discussed and agreed upon.

Puerto Rico – RMA and the Corporacion de Seguros Agricolas (CSA) have been working together to resolve several issues prior to the 2005 hurricane season. One of the key issues is a legislative proposal that is currently moving through the Puerto Rican legislature. The proposal would authorize a payment to all Puerto Rican crop insurance policy holders of 20 percent of total liability in the event that a hurricane hits the island. RMA has notified CSA that this legislation, if passed into law, would be considered a change in loss adjustment conditions and would therefore need to be approved by the FCIC Board before the affected policies would be eligible for reinsurance by FCIC. In addition, RMA emphasized that this change would be setting a dramatically new precedent for loss adjustment of FCIC products and outlined the difficulty that such a proposal would face in gaining approval by the Board.

Future Farmers of America (FFA) Risk Management Strategies Writing Contest – On April 1, 2005, RMA announced the 10 national winners of the eighth annual FFA Risk Management Strategies Writing Contest. The contest is sponsored by RMA, in cooperation with the FFA, as a means of making the nation's future farmers aware of ways of managing various risks associated with farming. The year's theme was "Risk Management Strategies for My Supervised Agricultural Experience (SAE) Program."

The 10 winners were chosen from 247 entrants on the basis of content, adherence to the assigned topic, grammar, organization, originality and creativity. The contest challenges FFA members to apply the principles of risk management to their own personal enterprises in a 1000-word essay. In May, winners and their advisors will visit Washington, DC, where they will visit USDA, their members of Congress and the Capitol.

Request for Applications (RFA) for Non-insurance Risk Management Tools – The 2005 Risk Management Agency RFA announcing the availability of approximately \$4 Million for partnerships to develop non-insurance risk management tools will soon be released. Applicants will have 60 days to develop proposals addressing at least one of 10 objectives identified in the RFA. Proposals will undergo a rigorous technical review and projects that provide the most benefit for producers will be awarded partnership agreements.

Compliance:

Operations Reviews – RMA has committed to reviewing all Approved Insurance Providers once every three years. These reviews assess insurance providers' adherence to the SRA, quality control guidelines and RMA approved policies and procedures. RMA is in the process of completing Operations Reviews on four companies in Fiscal Year 2005. These random reviews will also be used under RMA's plan to report an error rate to the Office of Management and Budget (OMB) under the requirements of the Improper Payments Act.

American Growers Update – On February 28, 2005, a hearing was held in the District Court of Lancaster County, Nebraska to determine whether the Nebraska Department of Insurance (NDOI) petition for liquidating American Growers should be granted. After hearing the evidence, the court ruled on the petition and issued an Order of Liquidation. This is the most recent of several actions taken by NDOI with regard to the financial insolvency of American Growers since the company declared that it could no longer meet its financial obligations in 2002.

Subsequent to the Order of Liquidation, RMA exercised the "cut-through" clause of the SRA and took responsibility for all future servicing of American Growers' policies. RMA has sent letters to producers with pending disputes indicating that as a result of the liquidation, RMA would be taking over the responsibility for future servicing of certain policy-related disputes on behalf of the FCIC. RMA also informed producers that the Liquidation Order issued by the court included an injunction eliminating any current or future actions or proceedings filed against American Growers, including disputes that were already in arbitration and litigation.

The cost to the Federal government for the failure of Growers stands at approximately \$41.7 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.

As a result of RMA's decision not to grant certain waivers to Rain and Hail Insurance Company in 2002 relative to the sale of American Growers, Acceptance (American Growers parent company) has sued the USDA seeking damages for the failure. USDA is in receipt of formal interrogatories that have been distributed to those employees who were part of the decision making process leading up to the denial of the requested waivers.

Annual Report to Congress – The 2003 Crop Year Compliance Annual Report to Congress is going through concurrence and shows a continuing trend to identify and control waste fraud and abuse. The report demonstrates these gains from the use of data mining, other new technologies and more sanctions to identify anomalous program results and exclude violators from the program. The SRA for 2005 builds 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.

Data Mining Report Results Sent to Companies –RMA recently provided copies of the ARPA Anomalous Agent Adjuster List on CD for each AIP. The list is for their review and action according to the ARPA statute requirements.

Supplemental Guidance on Conflicts of Interest – As a result of changes to the SRA regarding conflict of interest reporting and prohibited conduct, RMA has been preparing supplemental guidance to assist companies. In October of 2004, RMA hosted a meeting in Kansas City for the companies to discuss various compliance-related issues. RMA agreed to issue supplemental conflict of interest guidance due to continuing confusion about the 2005 changes.

On March 9, 2005, RMA released an Informational Memorandum to all approved insurance providers titled "Prohibition Against Agent Involvement in Loss Adjustment Activities." RMA briefed congressional staff on this issue on April 22, 2005 and will be releasing additional guidance to the companies on conflict of interest provisions of the SRA, including more information on the permissible activities of agents during the claims process.

Based on the identification of certain problems in past audits and investigations, in addition to the apparent disregard for prohibitions contained in earlier Standard Reinsurance Agreements, RMA has determined that the new requirements and the supplemental guidance are necessary to promote program integrity and adequate internal controls. RMA expects to release the additional guidance in the near future.

Wentworth Agricultural Insurance Agency Investigation – RMA's Central Regional Compliance Office is assisting the Office of Inspector General (OIG) in a criminal/civil investigation of the Wentworth Agricultural Insurance Agency (Wentworth). The OIG initiated the investigation as a result of RMA reviews that identified the appearance of waste, fraud, and abuse in the crop insurance policies serviced by Wentworth. Currently, the U.S. Attorney's office and OIG are in charge of the matter, with RMA and the impacted insurance providers assisting to bring this matter to a close as soon as possible.

Wentworth serviced a large book of business of over 400 crop insurance policies in Nebraska and South Dakota. Based on complaints received from the Farm Service Agency, RMA began investigating the appearance of fraudulent activities of Wentworth for the 2000, 2001 and 2002 crop years. On review, RMA found significant misrepresentations of the production and acreages covering several years in policies serviced by Wentworth. The misrepresentations included several cases in which producers certified having planted crops they had never grown or had not grown in several years, and producers certified having an interest in a crop(s) in which they had no interest. There were also instances of inflation or deletion of production histories involving multiple crop units and years, which had the effect of inflating the producers' guarantees. As a result, the producers had inflated Actual Production History (APH) databases; incorrect insurance premiums; and received overpaid indemnities, many occurring over a period of several years.

Some producers have been identified as being complicit in obtaining inflated coverage and indemnities to which they were not entitled. USDA is also addressing certain civil actions that are taking place as a result of the ongoing investigation. In response to a request filed by some Wentworth producers, an agreement was reached regarding a Temporary Restraining Order request, with RMA agreeing to stay any ineligibility actions for the 2005 crop year and to re-determine the impact of the discrepancies on policyholders to ensure consistent treatment of those impacted.

Information Technology (IT):

System Development for the eWritten Agreement System – The RMA Information Resources Management (IRM) Review Board gave approval to the Chief Information Officer to proceed on the requirements phase of developing a new, state of the art computer system that will allow the implementation of the revised written agreement procedures. The FCIC Board approved the new procedures last fall and directed the development of a new system to support the new procedures. This system will be owned by RMA's Office of Insurance Services, which will lead the requirements collection over the next few months. RMA's system integration contractor, Science Applications International Corporation (SAIC), has put together a team of professionals to support this initiative and work with RMA staff through the development phase of the project.

Comprehensive Management Information System (CIMS) – RMA continues to move forward with the CIMS project. The project charter and announcement have recently been reviewed by OGC and will be issued soon. The project planning is being completed to meet the OMB 300 requirements and the finalization of the project work plan. The hardware and software for the project is arriving and being installed. FSA is reviewing the recommended counties for the 2006 pilot. The CIMS Pilot Procedure will establish the roles and responsibilities for the Pilot. The 2006 pilot will focus on the sharing and analysis of existing RMA and FSA producer and acreage data. RMA staffers are reviewing the recommendations from the CIMS workgroups for consideration of implementation into 2006 and 2007.