United States Department of Agriculture

Federal Crop Insurance Corporation

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DATE: September 22, 2005

TO: Board of Directors
Federal Crop Insurance Corporation

FROM: Ross J. Davidson, Jr.
Manager

SUBJECT: Manager's Report
Exhibit No. 2800

This memorandum serves as the Manager's Report to the Board of Directors (Board), Federal Crop Insurance Corporation (FCIC), for the August 5, 2005, meeting. The report relates to program issues as outlined below:

Program Issues:

Hurricane Katrina - Hurricane Katrina caused catastrophic damage to crops in many counties in Alabama, Louisiana, and Mississippi, as well as Broward and Miami-Dade counties in Florida in late August.

The Risk Management Agency (RMA) worked with Approved Insurance Providers (AIPs), to expedite the claims process and issued a Manager's Bulletin with appropriate instructions. RMA authorized the use of emergency loss adjustment procedures for Baldwin, Bibb, Choctaw, Clarke, Colbert, Fayette, Franklin, Greene, Hale, Jefferson, Lamar, Lauderdale, Lawrence, Marion, Mobile, Monroe, Marengo, Perry, Pickens, Sumter, Tuscaloosa, Walker, Washington, Wilcox, and Winston counties in Alabama, all counties in Louisiana and Mississippi and for Broward and Miami-Dade counties in Florida impacted by Hurricane Katrina.

Application of the emergency procedures is limited to those situations where use of regular loss adjustment procedures would result in unnecessary delays in processing claims. AIPs must place documentation in claim files noting the use of these procedures and stating the damage is so extensive that application of the existing Federal Crop Insurance Corporation (FCIC) issued loss adjustment procedures would cause unnecessary delays in processing claims.

RMA will continue to monitor the situation taking additional actions as appropriate to expedite claims in the impacted areas, especially as crop specific situations may arise.

Florida: There was significant damage to nurseries in Miami-Dade County when the storm hit Florida on August 26, 2005. The estimated liability for Florida is $432 million and current indemnity estimates range from $80-100 million. Forty-four percent of the policies were CAT with a 59 percent overall coverage level insured. Insured crops affected were avocado fruit, avocado trees, mango fruit, mango trees, and nursery. Vegetable crops were not planted in this area prior to the storm. Insurance indemnities will be substantial. The major crop insurance loss (at least 95%) will be on nursery.

Louisiana: When Katrina hit Louisiana on August 29, crops affected were corn, soybeans, sugarcane, and nursery. The estimated crop liability is approximately $176 million in Louisiana with current indemnity estimates less than $1 million. Corn, soybeans, nursery, and sugarcane were affected. Forty percent of the policies were insured at the CAT level with an average overall coverage level of 55% insured. Nurseries in some Louisiana Parishes sustained damage, but most of the inventory had been sold. Reports indicate that sugarcane that was blown over but should be harvestable. Eighty-six percent of the sugarcane policies are CAT and the total liability for all sugarcane policies is $61 million. Since the vast majority of sugarcane policies are CAT and only a 30 percent production loss is expected, no major losses are expected for sugarcane. As of this date, real information on losses is incomplete.

Mississippi: The hurricane brought extensive winds and rain across Mississippi. . Total liability is approximately $393 million and the current indemnity estimate is $20.6 million. Forty-seven percent of all policies in Mississippi are CAT with an overall coverage level of 58 percent insured. South Mississippi crops received the brunt of the storm winds and damage was significant. Reliable reports are still not complete as there are still wide areas of southeast Mississippi where power and telephone service have not been restored. Crops impacted were corn, cotton, peanuts, rice, soybeans, and nursery

Alabama: In Alabama, corn, cotton, peanuts, pecans, nursery, and soybeans were affected. The estimated liability is $30 million with a current indemnity estimate of $14 million. Seventeen percent of the policies are CAT with an overall coverage level of 62% insured. The nurseries and the pecan crop are reported to be a total loss. The corn crop was mostly harvested. The cotton, peanut and soybean crops received some damage but are expected to go to harvest.

Cotton and sugarcane production are expected to increase nationally despite Hurricane Katrina. The river and the key agricultural port, the Port of New Orleans, are operating at a reduced capacity while facilities are brought back up to speed. It is too early to determine the hurricane’s ripple effect on the agricultural economy, which depends heavily on foreign sales of crops, many of which are shipped for export down the Mississippi River through Gulf Coast ports and waterways ravaged by Katrina. In a monthly update of crop size, USDA raised its harvest forecasts for the nation’s major crops, including cotton and rice, as the damage inflicted by Katrina was more than offset by improving weather elsewhere

Declining Yield Contracts Awarded – On August 16, 2005, RMA hosted “kick off” meetings with AgriLogic, Inc. and Science Applications International Corporation (SAIC) in Kansas City, MO. Contracts were awarded on July 25, 2005, to develop new and innovative approaches to mitigate declines in yield guarantees following successive years of low yields. The contractors immediately began their work and are proceeding accordingly. Because multiple years of low yields in some drought-affected areas have an impact on the producers’ actual production history (APH), RMA sought proposals for procedures to establish approved APH yields that are less subject to decreases during successive years of low yields as compared to current procedures, and are equitable across insureds with differing average yields, and are broadly applicable to all crops and regions.

Pasture/Rangeland and Forage Update—RMA's four contracts for research and development of new and potentially innovative crop insurance programs for pasture/rangeland, forage and hay continue to progress. At the August Board meeting, two proposals were approved for independent expert review. The Kansas City Pasture, Range, and Forage Team, along with Grazingland Management Systems, Inc. provided a pre-brief to the independent expert reviewers on August 29, 2005. Comments from the independent expert reviewers are due October 21, 2005. If approved by the Board in late 2005, it is possible that pilot testing could begin as early as summer 2006, providing all final program materials, educational efforts and processing systems development and deployment can be completed well in advance of the initial sales closing date. The remaining two contracts are progressing through the development stage, and RMA is working closely with the contractors as they continue to work through various issues.

Asian Soybean Rust— RMA is implementing the reconsideration of Good Farming Practice (GFP) determinations under MGR-05-010 as authorized by the Agricultural Risk Protection Act of 2000. For all FCIC re-insured policies, approved insurance providers (AIPs) that sell and service crop insurance routinely assess whether a producer has followed GFP as one part of the loss adjustment process. The GFP determination and reconsideration process ensures that indemnities are paid according to statutory authority and allows a process to settle disputes between producers and AIPs regarding what constitutes a GFP. Producers still have the ability to make necessary management decisions. Those few who may have created a loss by apparently not following GFPs may be asked to prove they followed GFPs as part of the loss adjustment process. These procedures exempt emerging diseases such as Asian Soybean Rust, which are dealt with under separate guidance.

Geneva and Clarke counties in Alabama are the newest counties to report ASR. Oconee County in Georgia is the furthest northern location where soybean rust has been found in 2005. Calhoun County in South Carolina is the furthest east that soybean rust has been found while Pearl River County in Mississippi is the furthest west that rust has been found in 2005.

Alabama now has 15 counties reported positive with rust; Florida has 22; Georgia has 16; Mississippi has two; and South Carolina has three. There were 35 counties reporting soybean rust in the month of August with seven reports so far in September. New reports of soybean rust are expected to continue within states already reporting rust and adjacent states to the north. With the potential movement of spores by Hurricane Katrina to the north, chances of deposition and infection increase beyond states that already have reported soybean rust.

Most soybeans have reached R5 to maturity. ASR has not been a significant threat so far, as its spread has generally occurred after soybeans produced pods and reached maturity.

Aflatoxin—Missouri weather conditions have made the mold, aflatoxin, a threat to this year's corn. The impact of high levels of aflatoxin on producers varies from a discount in price to the requirement to destroy the grain. Aflatoxin losses are an insurable cause of loss as long as the samples of the grain are obtained by the loss adjuster for aflatoxin testing before being moved into commercial or on-farm storage or the insured has arranged with the insurance provider to leave representative areas of unharvested crop from which the adjuster can obtain samples for aflatoxin testing. RMA has listed approved testing facilities on our website, and provided the information to Regional Offices, Farm Service Agency (FSA) offices and CSREES offices. Insureds should notify their insurance agent before harvesting and/or placing harvested grain in storage if they suspect that their grain contains aflatoxin. Because mold can worsen in storage, losses attributed to farm storage or that cannot be determined because proper testing was not completed prior to storage are not covered under the crop insurance policy.

Illinois Drought—Illinois is still considered to be in a drought even though rains in mid-August helped the soybean crop. This year is the seventh driest in the last 100 years based on the March-August growing season. Yields of corn and soybeans will be down, but the NASS report for September 12 raised the expected corn crop 11 bushels to 136 and the soybean crop two bushels to 41. Based on historical data, the losses this year will be in areas of the state that have not had major losses since 1988. The north and north central part of the state will have the majority of claims. Yield checks and early harvest results show huge variations in yields throughout the state. Based on this, we expect to see some producers will have units having no claim activity while other units will experience substantial losses. RMA can expect an increase in claims from previous years, but the increase in yield estimates in the September NASS report will substantially reduce the indemnities paid. Corn will see the majority of claim activity as August rains improved soybean yields.

The dry, hot weather the past three weeks seems to have reduced the potential aflatoxin problem for Illinois. If the next month stays dry, we do not expect much of a problem with molds such as aflatoxin.

Guidance on Conflict of Interest – On September 13 and 14, RMA sent out a revised draft Managers Bulletin on Conflict of Interest to approved insurance providers and crop insurance agent associations for comment. The Bulletin provided guidance to insurance providers and affiliates on prohibited and allowable interactions between agents and loss adjusters during the loss adjustment process.

Company Reviews of $100,000 Claims – RMA has sent a draft Informational Memorandum on $100,000 claims reviews to approved insurance providers for comment. The memo clarifies the language of the SRA which requires insurance providers to perform mandatory APH reviews on claims greater than $100,000. The clarification was necessary because of the prospect of large claims associated with Hurricane Katrina and because RSD had received reports that several insurance providers were not performing the mandatory reviews because they interpreted the SRA differently than what was intended.

Premium Reduction Plan: Nine Companies Eligible for 2006 -- On August 30, 2005 RMA notified nine companies that they were eligible for the opportunity to offer premium reduction plans, in selected states, for the 2006 reinsurance year. RMA subsequently posted the list of eligible companies and the respective states on RMA's website. The nine eligible companies cover all fifty states for the 2006 reinsurance year.

Premium Reduction Plan: Agent Disclosure -- RMA has prepared a draft manager's bulletin that provides clarification and guidance with respect to the timing and content of notification and disclosure by agents to producers as required by section 400.719(c) of the premium reduction plan interim rule. RMA has received comments on the draft from approved insurance providers and company trade associations. After receiving and incorporating input from the companies, RMA will send the draft to agent groups this week for review. RMA intends to publish the final bulletin prior to the upcoming September 30 sales closing date.

Regulatory Update:

Combination Regulation—The Office of General Counsel (OGC) and RMA have been working since the week of August 8, 2005, to review the 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. OGC and RMA staff continue to work together to complete the rule so that it may begin Departmental Clearance targeted to start October 11.

Peanut Crop Provisions —A proposed rule making changes to the Peanut Crop Provisions has been completed and submitted for OGC review. The regulation updates the 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. The regulation is targeted to be effective for the 2007 crop year.

Information Technology:

eWritten Agreement —Work continues on collecting user requirements for the eWritten Agreement system authorized by the Board last fall. The requirements team met with the AIP IT leadership on August 30, and continues working with RMA staff on requirements collection. A series of requirements collection sessions with Washington, D.C. based offices of RMA is scheduled for the last week of September.

Subpart V General Administrative Regulations; Submission of Policies, Provisions of Policies, and Rates of Premium—The final rule establishing guidelines for submission of crop insurance policies, plans of insurance, and rates of premium to Federal Crop Insurance Corporation (FCIC) Board of Directors (Board) under section 508(h) of the Federal Crop Insurance Act was published August 2, 2005, in the Federal Register. This regulation revises procedures for the submission of policies under Section 508(h) of the Federal Crop Insurance Act (Act) (U.S.C.1501 et.seq), which private entities wish to offer under the Federal Crop Insurance Program, to the FCIC Board for consideration. In addition, this regulation establishes requirements and guidelines for the reimbursement of research, development, and maintenance costs for such products approved by the Board as required by the Agricultural Risk Protection Act of 2000. This regulation also prescribes guidelines for the timing, content, approval process and use fees for policies submitted under section 508(h) of the Act.

Compliance:

R&V Warren Farms Sentencing—On September 8, 2005, Gretchen C. F. Shappert, United States Attorney for the Western District of North Carolina, announced the sentencing of Robert and Viki Warren, a husband and wife, following their guilty pleas in federal court on charges related to a massive crop insurance fraud scheme. The Warrens, of Candler, North Carolina, were indicted by a grand jury on October 8, 2003. The indictment charged the Warrens, as well as two of their employees, an insurance agent, and an insurance adjuster, with participating in an extensive scheme to defraud the FCIC and several private insurance companies of more than $9 million between 1997 and 2001, and of attempting to obtain an additional $2.8 million in 2001 through 2003. On July 15, 2004, Robert Warren pled guilty to conspiracy to defraud the FCIC, and conspiracy to commit money laundering. Viki Warren pled guilty to conspiracy to defraud the FCIC and to one count of mail fraud. In their plea agreements, the Warrens agreed to the forfeiture of $7.3 million in proceeds of their crimes, and $9.15 million in restitution to the United States Department of Agriculture.

Robert Warren was sentenced to 76 months imprisonment, to be followed by three years of supervised release, and a $200 special assessment. Viki Warren was sentenced to 66 months imprisonment, to be followed by three years of supervised release, and a $200 special assessment. In addition to the Warrens, three other defendants named in the indictment have pled guilty: George Kiser, an insurance agent from Lebanon, Virginia; Thomas Jeffrey Marsh, an insurance claims adjuster from Bulls Gap, Tennessee; and Demetrio Jaimes, a foreman for the Warrens from Candler. The final defendant in the indictment, Harold Dean Cole, was convicted at trial last year on a charge of making false statements to the FCIC. Kiser, Marsh, and Cole are awaiting sentencing. Jaimes, who cooperated with the investigation and testified at Cole's trial was sentenced earlier.

Iowa Producer Sue Hoffman Sentenced—On September 7, 2005, United States Attorney Charles W. Larson, Sr. announced that Iowa Farmer, Sue A. Hoffman, was sentenced to three months home detention as a special condition of receiving five years probation, and ordered to pay restitution of $93,350.00 to FSA. She also agreed to be disbarred from participation in all United States Department of Agriculture farm benefit and crop insurance programs after pleading guilty to conspiracy to commit false statements with her spouse Mark J. Hoffman, regarding the conservation compliance of approximately 338 acres of leased farm ground in Carroll County.

In the crop years 1997 and 1998, Sue and Mark J. Hoffman were engaged in the farming and trucking of farm crops in Carroll County, Iowa, and in South Dakota. Sue Hoffman assisted in their farm operation by preparing financial documents, having contact with USDA officials related to farm program issues, and communicating with creditors. For several years prior to 1997, the Hoffmans cash rented approximately 338 acres of cropland in Carroll County, Iowa in addition to leasing several hundred acres of area farmland. In early January 1997, Sue Hoffman informed the FSA office in Carroll County that she and her spouse Mark J. Hoffman would not be farming the 338-acre farm since it was not in conservation compliance with the Department of Agriculture.
However, unknown to FSA, they continued to farm the 338 acre farm even though it was out of conservation compliance which would have prohibited the couple from receiving some $255,000 in federal farm program benefits. In order to conceal their scheme to defraud FSA, Mark J. Hoffman caused one of the employees of his trucking business to go to the FSA office in Carroll County, and represent that he was the operator on the 338 acre farm and was cash renting the land from the landowner. The hired hand was not a farmer and did not plan to farm the land.

Sue Hoffman will begin serving her sentence of home confinement within thirty days. She will be required to wear an electronic monitoring device and make scheduled restitution payments. All other pending counts of a 20 count Indictment on charges of bank fraud, farm program fraud, federal crop insurance fraud, and bankruptcy fraud were dismissed in accordance with a special plea agreement entered into by the government.

Operations Reviews—The Kansas City Compliance Office issued a National Operations Review (NOR) report on one company on August 29, 2005. RMA has committed to reviewing each AIP every three years. These reviews assess insurance providers' adherence to the Standard Reinsurance Agreement (SRA) quality control guidelines and RMA's approved policies and procedures. RMA is in the process of completing NORs on four additional insurance providers in 2005. RMA conducts random policy reviews during the NOR in order to report an error rate to the Office of Management and Budget (OMB) under the requirements of the Improper Payments Act. RMA reported an error rate for 2004 using the random contract reviews required under Manual 14.

Annual Report to Congress – The 2003 Crop Year Compliance Annual Report to Congress is at the Office of the Executive Secretariat for review and concurrence. The report shows a continuing trend to identify and control fraud, waste, and abuse. The report demonstrates these gains from the use of data mining, new technologies and more sanctions to identify anomalous program results and exclude violators from the program. The 2005 SRA builds on these results by incorporating data mining into the selection of policies reviewed by the companies as part of their quality control requirements.

Wentworth Agricultural Insurance Agency Investigation – RMA continues to assist the OIG in a criminal/civil investigation of the Wentworth Agricultural Insurance Agency (Wentworth). The OIG initiated the investigation based on RMA reviews that identified the appearance of fraud, waste, and abuse in the crop insurance policies serviced by Wentworth. The central issue surrounds allegations that Actual Production History databases were falsified over a number of years to increase producer's indemnities. Currently, the U.S. Attorney's office and OIG are in charge of the matter, with RMA and the impacted insurance providers assisting to close this matter as soon as possible.

The U.S. Attorney in charge of the civil side of this case continues to monitor the implementation of the Temporary Restraining Order agreement. RMA sent letters to the companies indicating actions required to maintain reinsurance on the affected policies. Companies are making the required changes, while RMA continues to address the producers' complaints, and RMA is making certain changes to the data acceptance system to accommodate the required Actual Production History adjustments. RMA continues to be optimistic about a reasonable conclusion to the civil litigation in the near future.