



**United States
Department of
Agriculture**

Federal Crop
Insurance
Corporation

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DATE: February 15, 2006

TO: Board of Directors
Federal Crop Insurance Corporation

FROM: Eldon Gould
Manager

SUBJECT: Manager's Report
Exhibit No. 2836

This memorandum serves as the Manager's Report to the Board of Directors (Board), Federal Crop Insurance Corporation (FCIC), for the February 15, 2006 meeting. The report relates to program issues as outlined below:

Program Issues:

Mitigating Declining Yields Update – Two separate development contracts are underway on solutions to declining Actual Production History (APH) yields due to successive years of crop losses. In November and December of 2005, Science Applications International Corporation (SAIC) and AgriLogic, Inc. presented to RMA an oral presentation of their research and development efforts.

SAIC is developing an indexed yield approach and has completed the development of long-term yield trends and premium rates for corn and soybeans. Similar work on cotton and wheat is expected to be completed soon. Approximately nine states are being proposed for the initial pilot program for corn, soybeans, cotton and wheat. Rate transformation work for cotton and wheat is expected to proceed quickly following the completion of the corn and soybean work. SAIC is also exploring required adjustments that will need to be made to the APH program to accommodate spot losses or short dataset issues and developing procedures for updating the county expected yields. The procedures will evaluate the potential for linear, flat, or trend-based adjustments. Work will continue on the empirical estimate of rates in each of the crops in an assessment of the appropriate rate transformation.

AgriLogic is developing alternatives to the current APH yield methods that limit the amount yields may drop (yield floor and yield adjustments) for annual crops and analyzing applicability for perennial crops. Listening sessions are scheduled for late winter or early spring of 2006 with producers, agents, and companies in the four targeted states. AgriLogic is currently discussing with RMA the rating analysis for the proposed APH supporting methods and impacts and evaluating premium sufficiency. Additionally, AgriLogic is analyzing the various program components and providing a breakdown of

specific policy and procedural issues. A feasibility report and oral presentation to RMA is scheduled for May of 2006.

Pasture, Rangeland, and Forage Update – RMA’s four contracts for research and development of new insurance programs for pasture, rangeland, and forage continue to progress in various stages. At the January 18, 2006 Board meeting, two proposals were approved for pilot in the 2007 crop year. RMA and Grazingland Management Systems, Inc. are working on educational materials, final program materials and processing systems development for implementation of the pilot programs. RMA personnel are scheduled to work with Office of the General Counsel (OGC) the week of February 27, 2006 to finalize policy terms and conditions. In addition, RMA plans to issue program materials to approved insurance providers (AIPs) before June 1, 2006. RMA continues to work with the contractors on one remaining contract, which is estimated to come before the Board within the next two months for consideration of independent expert review. Work has ceased on further development of the other remaining contract.

Livestock Program Evaluation Contract Awarded – On December 23, 2005, the livestock evaluation contract was awarded to Watts and Associates. The evaluation will be completed in approximately six months. The contractor will consider the following: 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.

New Florida Fruit Tree Pilot Crop Insurance Program – A new Florida Fruit Tree (FFT) crop insurance program was approved for the 2007 crop year that will cover citrus and tropical trees. Sales were to begin on May 1, 2006. However, due to changes to the canker eradication procedures administered by Animal and Plant Health Inspection Service (APHIS) and the state of Florida, the new program may need some modification before it is implemented. The Florida Department of Agriculture, APHIS and producer groups will be developing the new canker management program over the next few months. The new FFT policy to be offered must function properly in an environment that is uncertain and likely to change during the coming season.

The new policy for FFT provides improvements that will help producers better cope with hurricanes and freeze. RMA is actively working with AHPIS to address the canker eradication issues. The Agency will be working with the citrus industry and the Florida Department of Agriculture to determine the best insurance policy design and approach to cover canker losses.

Regulatory Update:

Combination Regulation – On December 15, 2005, the RMA Administrator approved the proposed rule and it has been sent for Departmental review. The proposed rule 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. The final rule is targeted to be effective for the 2008 crop year.

Peanut Crop Provisions – On January 25, 2006, the proposed rule on peanut crop provisions was published in the *Federal Register* for public comment. 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. The regulation is targeted to be effective for the 2007 crop year.

Mint Crop Provisions – On February 6, 2006, the proposed rule dealing with mint crop provisions was published in the *Federal Register* for public comment. The rule converts the mint program from a pilot program to a permanent program. The final rule is targeted to be effective for the 2008 crop year.

Northern Potato Crop Provisions and Southern Potato Crop Provisions – On January 5, 2006, the proposed rule was sent to OGC for review and approval. The rule will make changes to the Storage Coverage Endorsement and in determining production to count for claims purposes. The changes are targeted toward improving program integrity. This final rule is targeted to be effective for the 2008 crop year.

Almond and Walnut Crop Provisions – On January 19, 2006, the proposed rule was approved by OGC and is being prepared for publication in the *Federal Register*. The rule reduces 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.

Program Highlights/Announcements:

Wyoming Producers Buy Crop Insurance – The state of Wyoming saw a big jump in the number of producers purchasing crop insurance for the 2005 crop year. The total amount of liability jumped by 29 percent from the 2004 to the 2005 crop year. The total liability grew from \$66 million to \$93 million, which is a net gain of \$27 million in total liability. The major reason RMA has seen the liability jump from the previous year was the introduction of a rangeland product. In 2005, a Group Risk Plan Rangeland Pilot was introduced into 10 Wyoming counties. Wyoming has vastly more rangeland acres than cropland acres, as evidenced by the sale of the 4,600 rangeland policies totaling \$27 million in liability.

Drought in Oklahoma and Texas – The extreme fire danger in this region is a concern to all rural and urban residents and will be until there is a break in the continuing drought. Several areas are short of rainfall for the past six months. The drought continues to spread while the fire danger risk increases. All outdoor burning and activities (welding, fireworks, etc.) that may cause a fire are banned until further notice.

The extreme drought is having an effect on the winter wheat, with some producers already turning in claims. The drought continues to get worse each day because there is no rain. There will be a great deal of prevented planting across the region due to the drought. RMA's Oklahoma City Regional Office continues to receive questions about prevented planting and how it is administered.

Arizona Drought – Arizona is experiencing one of its driest winters ever. If things do not change, there is a real possibility of prevented planting payments on cotton in Graham County and Pinal County due to a shortage of water. RMA has estimated that due to the possibility of prevented planting, payments caused by shortage of irrigation water (failure of the irrigation source) could be \$6 to \$7 million for the state.

Electronic Written Agreements (eWA) project – The eWA system will be the replacement for virtually all of the RMA and FCIC processing systems. The user requirements phase of the project is nearly complete. The next step is to analyze the user requirements and then design, develop and deploy the new system. System implementation is planned to coincide with implementation of the combination regulation.

Federal Enterprise Architecture – The Federal government has placed a high priority on a Federal Enterprise Architecture (FEA) that facilitates compatibility of business and processing systems across government. RMA is preparing a submission of its “as-is” architecture to meet the Office of Management and Budget’s (OMB) deadline of February 28, 2006. Additional submissions and the design of the RMA FEA compliance architecture will continue throughout the year.

Information Technology (IT) Contract – The IT integration contract that provides most contracted IT services for RMA and FCIC ends May 2006. The contract is being offered again for RMA by the General Services Administration (GSA), which contracts for much of the IT services for Federal government. The new IT integration contract is scheduled to be in place in May 2006. Additionally, the data mining/data warehousing contract with Tarleton State University’s Center for Agricultural Excellence (CAE) ends on August 31, 2006. The negotiations to re-offer the data mining/data warehousing contract have begun, with an expected award date of August 2006 for the new contract.

Compliance:

New General Accountability Office (GAO) Assignment – On February 3, 2006, RMA received a memorandum advising that GAO is planning to conduct a new audit entitled *Insurance Risks from Climate Change*. RMA has been designated as the lead USDA agency for this audit that will look at historical losses, expectations and the perceived risk of climate change. An entrance conference will be scheduled shortly with GAO to obtain more details.

GAO Report on Fraud, Waste and Abuse – The draft *Statement of Action* for this report has received approval from RMA, the Farm Service Agency (FSA), OGC and Office of Budget and Program Analysis (OBPA). The report has been delivered to the Office of Inspector General for final review and will then be signed by the Secretary. The statement is consistent with those actions RMA previously indicated were in progress, including:

- 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. FSA has flatly stated that without additional resources, it will be unable to perform 100 percent of the designated growing season inspections.
- Distributing to each AIP is 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.

- Finalizing the Trivalent project that is intended to help RMA assess the quality controls used by the AIPs. RMA Compliance staff will continue to test AIP quality control programs during scheduled national operations reviews.
- Finalizing the implemented sanctions regulations from the Agriculture Risk Protection Act of 2000 (ARPA) 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.

Compliance in the News – Since the airing of the National Public Radio (NPR) series on the Agency’s fraud, waste and abuse program last November 2006, RMA Compliance and the work of the Strategic Data Acquisition and Analysis staff has garnered favorable press reports. A few stories have been written about various program violation investigations that were assisted by data mining and satellite imaging and the use of these tools in general to assist with program compliance. Most recent was an Associated Press story on January 10, 2006 about how USDA uses satellite images to monitor farming operations.

Peterson Farms – On January 27, 2006, a verdict was reached and a North Dakota jury found Peterson Farms, et al innocent on all counts of a 49 count criminal indictment. The U.S. Attorney’s Office has begun consultations regarding further actions that may be pursued in this case. The case was primarily about creating false entities to avoid FSA payment limitations.

National Operations Reviews (NOR) – RMA Compliance is in the process of completing NOR reports on four insurance providers for the 2005 crop year. These providers include Great American, Hartford, NAU Country and Rural Community. The Kansas City Compliance Office issued a NOR report on Farm Bureau Mutual Insurance Company on August 29, 2005. RMA has committed to reviewing all approved insurance providers once 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 conducts random policy reviews during the NOR in order to report an error rate to OMB under the requirements of the Improper Payments Act. In addition, the Agency has reported an error rate for 2004 using the random contract reviews required under Manual 14. RMA Compliance has been conducting these reviews using draft procedures. With an eye toward completing the first round of reviews for 2005 crop year, RMA anticipates that it will be able to finalize the NOR procedures before the end of the year.

In addition, RMA announced the review schedule for 2006 at the recent NCIC National Claims Manager’s Conference. The following Compliance Offices will conduct operations reviews of these companies:

- Dallas – *Rain and Hail*
- Davis – *Crop USA*
- Indianapolis – *Country mutual*
- Kansas City – *ProAg*
- Raleigh – *American Agricultural*
- St. Paul – *Farmers Crop Insurance Alliance (closeout)*

Annual Report to Congress – The *2003 Crop Year Compliance Annual Report to Congress* has been signed by the Secretary and has been delivered to both the House and Senate. The report shows a continuing trend to identify and control fraud, waste and abuse. Additionally, the report demonstrates gains from the use of data mining, new technologies and increased sanctions to identify anomalous program results and exclude violators from the program. The 2005 SRA builds upon 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 – At the request of the U.S. Attorney in charge of the civil side of this case, RMA Compliance staff met on January 11, 2006 with producers adversely impacted by this investigation in order to show them the evidence used to determine that their individual APH yields were incorrect. Previously, RMA had sent letters to the companies indicating actions required to maintain reinsurance on these and other affected policies. The companies have nearly completed corrective actions, and the Agency has received some feedback from affected producers who are unhappy about the size of the determined indemnity overpayments and premium understatements under the court-approved process. The Agency has made or is making certain changes to the data.

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