



**United States
Department of
Agriculture**

Federal Crop
Insurance
Corporation

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TO: Board of Directors
Federal Crop Insurance Corporation

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

SUBJECT: Transmittal Memorandum
Docket No. CI-Group Risk Income Protection (GRIP)
Expansion to Wheat-Expert Review-05-01

Attached for Board consideration of approval or disapproval is the Risk Management Agency's (RMA) docket for Board action regarding whether the Board should send the Group Risk Income Protection (GRIP) Expansion to Wheat Product out for expert review.

Expert Review of the Group Risk Income Protection (GRIP) Expansion to Wheat,
beginning with the 2006 Crop Year
Docket No. CI-Group Risk Income Protection (GRIP) Expansion
to Wheat-Expert Review -05-01

EXECUTIVE SUMMARY

Statement of Action

The action before the Board is to decide whether to send for expert review a proposed product that would expand the Group Risk Income Protection (GRIP) Plan of Insurance to wheat. If the Board decides to send the plan of insurance to expert review, it must also approve a list of reviewers and alternates and a task order statement of work for the review.

If the product is eventually approved by the Board after expert review, it will be offered in all counties which have a Group Risk Plan (GRP) wheat program, and any additional counties approved for GRP wheat in the future, beginning with the 2006 crop year (see Attached map):

- 26 states
- 608 counties

Past Action

GRIP, which was originally submitted by the IGF Insurance Company, was approved by the Board for all GRP corn and soybeans in Iowa, and selected GRP corn and soybean counties in Illinois and Indiana beginning with the 1999 crop year. Over the past three years, the Board has approved three expansions, two for corn and soybeans, and one expansion of GRIP to grain sorghum. RMA became the owner of the GRIP product effective December 31, 2002. GRP is a permanent program codified in the Federal Regulations. GRIP has yet to be codified, however, it is RMA's intention to combine GRP and GRIP into a single product via a proposed and final rule as RMA's resources and time permit, currently targeted for the 2008 crop year.

The GRIP Plan of Insurance has previously been reviewed by RMA and independent expert reviewers. However, since the price discovery periods and markets used in the proposed GRIP Wheat Plan of Insurance were never reviewed under the previous GRIP policies and have not specifically been reviewed under any other plans of insurance, expert review is necessary under current Board internal procedures.

Background Information

RMA has received requests from producers, agents, Companies and Congressional staff to expand the Group Risk Income Protection (GRIP) program to wheat in all states and counties where Group Risk Plan (GRP) wheat is currently offered beginning with the 2006 crop year, and for any additional counties approved in the future for GRP wheat. For crop year 2005, GRP wheat acreage in the 26 proposed GRIP wheat expansion states totals approximately 80,851 acres. (See attached map.) Additionally, on January 13, 2005, the Board approved expansion of the GRIP Harvest Revenue Option (GRIP-HRO) to all states and counties where the GRIP plan of insurance is currently offered, and where GRIP crop programs are offered in the future. Therefore, GRIP-HRO will be available for approved GRIP wheat states and counties.

The terms and conditions of the GRIP Basic Provisions and Crop Provisions are similar to the standard GRP Basic Provisions and Crop Provisions. GRP provides coverage for loss of yield in a county. GRIP provides coverage for loss of revenue in a county.

The amount of protection per acre selected by the insured can be from 60 to 100 percent of the maximum amount of protection shown on the actuarial documents. The GRIP policy offers coverage levels in 5 percent increments from 70 percent to 90 percent.

The GRIP expected county revenue is the expected county yield for wheat, as calculated by RMA based on National Agricultural Statistics Service (NASS) data, multiplied by the expected price (simple average of the final daily settlement prices for the discovery period shown in the GRIP Mandatory Actuarial Document Endorsement, Commodity Exchange Endorsement for wheat, and for the appropriate Board of Trade for the state and the type of wheat insured). For example, for winter wheat counties in Kansas, the expected price is determined based on the August 15 to September 14 pre-harvest year's average daily settlement price for the harvest year's Kansas City Board of Trade (KCBOT) July hard red winter wheat futures contract.

The methodology for determining the expected and harvest price required under the GRIP plan of insurance are generally the same as CRC wheat. However, the CRC reference markets for Portland and Minneapolis are not appropriate for determining the price volatility factors, as required under GRIP methodology. Therefore, the price discovery period and market (e.g. Kansas City Board of Trade (KCBOT) rather than Portland, and the Chicago Board of Trade (CBOT) rather than Minneapolis) will be used for GRIP wheat. The price discovery period and market for these areas were thoroughly analyzed and reviewed by RMA and the developers of the GRIP, GRIP-HRO and Revenue Assurance products. The GRIP price discovery periods will all be aligned, as appropriate, with those utilized in the policy that combines the Actual Production History (APH), Crop Revenue Coverage (CRC), Revenue Assurance (RA), Income Protection (IP) and Indexed Income Protection (IIP) plans of insurance into a single product, when implemented.

Harvest Price determination periods are also contained in the GRIP Wheat Mandatory Actuarial Document Endorsement, Commodity Exchange Endorsement, which attaches to the GRIP Wheat Crop Provisions. The policyholder's trigger revenue is the expected county revenue multiplied by the selected coverage level.

For winter wheat counties in Kansas, the harvest price is the June harvest year's average daily settlement price for the harvest year's KCBOT July hard red winter wheat futures contract. The harvest price cannot be less than the expected price minus two dollars (\$2.00), or greater than the expected price plus two dollars (\$2.00).

For GRIP, if the county revenue is below the policyholder's trigger revenue, the indemnity per acre is calculated by subtracting the county revenue from the trigger revenue, dividing this amount by the trigger revenue, and multiplying this factor by the policyholder's amount of protection per acre.

Overall, GRIP insurance experience has been favorable over the six-year span, 1999 through 2004, in which the product has been offered for corn and soybeans. The GRIP corn simple average loss ratio is 0.94. The two loss ratios exceeding 1.00 for GRIP corn occurred in 1999 and 2004. The 1999 corn losses were due primarily to significant yield losses in the state of Indiana. The 2004 corn losses were due primarily to a significant decline in price between the expected price in February and the harvest price, i.e. the October daily settlement price for the harvest year's CBOT December corn futures. The expected price was \$2.93 and the harvest price \$1.99. (See attached table)

The GRIP soybean simple average loss ratio was 0.49. Only 2004 showed a loss ratio exceeding 1.00. The 2004 soybean losses also were due primarily to a significant decline in price between the expected price in February and the harvest price. The expected price was \$7.27 and the harvest price i.e. the October daily settlement price for the harvest year's CBOT November soybean futures was \$5.26. (See attached table)

GRP wheat experience has been mostly favorable over the timeframe in which it has been offered. The GRP wheat simple average loss ratio is 0.84, experiencing its highest loss ratios in the 2000, 2002 and 2003 crop years which reflected widespread drought losses in the Midwest. The loss ratio dropped to 0.53 in 2004, with more substantial moisture in most Midwestern states. The liability has steadily increased for most of the GRP crops from 1997 through 2004. (See attached table.)

All currently approved GRIP policies, procedures, rating and pricing methodology will be applicable to the requested GRIP wheat expansion counties. GRIP Wheat Crop Provisions have been completed (see attachment). The GRIP Underwriting Rules and Common Questions and Answers will be updated to address wheat specifically. The current GRP wheat rating and CRC wheat pricing methodology will be used.

Reason For the Action

The GRIP Plan of Insurance has previously been reviewed by RMA and independent expert reviewers. However, since the price discovery periods and markets used in the proposed GRIP Wheat Plan of Insurance were never reviewed under the previous GRIP policies and have not specifically been reviewed under any other plans of insurance, expert review is necessary under current Board internal procedures.

IMPACT ANALYSIS

If the proposed product is sent out for expert review and then eventually approved by the Board, the plan of insurance is expected to have the following impact:

Producers:

- Several years of yield losses and/or low prices have a lesser impact on the producer's revenue stream because the GRIP guarantee is based on the county yield and expected price determined prior to the crop year. If the plan is approved, GRIP may dramatically reduce a producer's revenue variability over time, allowing producers to better plan cash flows.
- GRIP wheat would offer an alternative risk management tool (i.e. revenue coverage for area plans that has not been available to GRP wheat producers). Based on producer feedback, there is significant interest in this product for meeting their risk management needs.

Approved Insurance Providers:

- This product would add to the portfolio of insurance products offered to producers.
- To the extent that producers purchase GRIP, participation increases, and more premium dollars are generated, total Administrative and Operating (A&O) reimbursement would also increase.
- If approved by the Board, this program would be offered under the Standard Reinsurance Agreement (SRA) by all insurance companies reinsured by FCIC and would be carried out in accordance with the provisions of the Act. GRIP policies for corn, soybeans, and grain sorghum are currently reinsured under the Standard Reinsurance Agreement that does provide for a lower A&O reimbursement due to the reduced paperwork involved (19.4 to 22.4) percent for the 2006 crop year.

- Insurance providers may designate policies in various Funds under the Standard Reinsurance Agreement (SRA) consistent with current GRIP policies.
- Approval of GRIP wheat would require only minor modification of participating companies' computer systems.
- If the plan is approved, the work burden for the insurance companies should be minimized because the GRIP plan of insurance does not require loss adjustment.

Reinsurance:

- This product would add to a company's portfolio and would spread the risk over a range of Federally reinsured products.

Stakeholders:

- Approving the GRIP expansion to wheat meets the mandate of the Federal Crop Insurance Corporation (FCIC) to provide reinsurance to reinsured companies to provide additional insurance risk management tools to producers only if the policy complies with all applicable provisions of the Act, the interests of producers are adequately protected, premium rates are actuarially appropriate, and program integrity is protected.
- If GRIP is made available in counties with approved GRP programs, RMA expects approximately 50% of current GRP insureds will switch to GRIP, plus any new sales. For the current expansion request, the additional 2006 GRIP wheat liability is estimated to be \$11,021,000 on 80,000 acres, with a premium of \$1,030,000.

Other Participants

- Lenders have allowed producers to secure operating loans on the basis of having Federal Crop Insurance coverage, including GRP and GRIP policies.

BUDGET CONSIDERATION

Costs to contract for expert reviews are funded under the authority of section 516(b)(2)(A) of the Federal Crop Insurance Act. Under this section, FCIC may use the insurance fund for expert review contracting and other costs specified in the statute, but these costs cannot exceed \$3,500,000 in a given fiscal year. Of the \$3,500,000, approximately \$2,005,190 has not yet been obligated for the current fiscal year. The estimated cost associated with this expert review is \$50,000.

There are no specific budgetary restrictions that would limit the approval of the GRIP Wheat plan of insurance once expert review is completed. GRIP expansion on Information Technology resources is minimal (estimated \$10,000) since the automated systems and actuarial structure for GRP and GRIP currently exists. With minimal changes, GRIP Wheat could be processed by the current Data Acceptance System. Expanding the GRIP program to wheat could readily be accommodated within RMA's existing infrastructure. The impact for work required and associated implementation processes on the various RMA functional units is not envisioned to be outside of normal or reasonable resource requirements, likely less than 1 FTE. For long-term maintenance of this program, the requirements are not considered excessive, and can be absorbed within current staff limits since these requirements have been handled on an ongoing basis during the past several years of the pilot program. Since RMA already provides GRP wheat, and GRIP is built upon the underlying GRP program materials and processing systems, the expansion is not overly labor intensive.

DELEGATION OF AUTHORITY

If the plan of insurance is eventually approved by the Board, the Board could delegate to the Manager of the Corporation authority to make such technical policy changes, as necessary, to make the policy legally sufficient.

FOR OFFICIAL USE ONLY DESIGNATION

This program docket is "For Official Use Only" and the "For Official Use Only" designation will terminate once the Board takes a substantive action regarding this docket, or upon approval of the product in the case of a 508(h) submission.

LEGAL AUTHORITY

The Office of General Counsel will review all final policy materials for legal sufficiency and at this time has identified no legal impediments that would prohibit this matter from going to expert review.

FINAL RESOLUTION

WHEREAS, The Federal Crop Insurance Act (Act) requires the Board to enter into contracts with persons experienced as actuaries and in underwriting for reviews of any policy or plan of insurance, or any related material or modification of a policy or plan of insurance proposed to be offered under the Act, NOW THEREFORE BE IT

RESOLVED, that pursuant to the information contained in Docket No. CI-Group Risk Income Protection (GRIP) Expansion to Wheat-Expert Review - 05-01, Exhibit No. 2793, the Board approves expert review for the Group Risk Income Protection (GRIP) Plan of Insurance for Wheat and directs that 1) the Manager of the Corporation be authorized to take such action as necessary to enter into and execute contracts with the persons or entities on the attached list, or the alternates in case the proposed persons are not available, to review the Group Risk Income Protection (GRIP) Expansion to Wheat, beginning with the 2006 Crop Year, prior to Board action; and 2) use to execute the contracts the attached task order statement of work as modified to reflect any concerns of the Board.

Adopted by the Board of Directors on: June 8, 2005

<u>/Signed/</u>	<u>June 8, 2005</u>
Byron Anderson	Date
Secretary	
Federal Crop Insurance Corporation	

[SEAL]

Approved by:

/Signed/
Keith Collins
Chairman of the Board

June 8, 2005
Date