United States Department of Agriculture

Federal Crop Insurance Corporation

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DATE: August 5, 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:

<u>Program Issues:</u>

Declining Yield Contracts Awarded – On July 25, 2005, RMA awarded contracts to Agrilogic, Inc. and Science Applications International Corporation (SAIC) to develop new and innovative approaches to mitigate declines in yield guarantees following successive years of low yields.

Multiple years of low yields in some drought affected areas have an impact on the producers' actual production history (APH), which is often used to determine insurance coverage levels. 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, are equitable across insureds with differing average yields and are broadly applicable to all crops and regions.

On August 16, 2005, RMA will host a "kick off" meeting with AgriLogic, Inc. and SAIC in Kansas City, MO. The two contractors will begin their work immediately and will be holding listening sessions to seek input from producers and other interested parties during their research work.

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 well. At this meeting, two proposals are being presented for Board consideration to send for independent expert review. If approved by the Board in late 2005, it is possible that pilot testing could begin as early as summer 2006, provided that 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

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development stage, and RMA is working closely with the contractors as they continue to work through various issues.

Request for Applications (RFA) for Non-insurance Risk Management Tools – On May 11, 2005, RMA published in the Federal Register a Request For Applications (RFA) for partnerships for the development of non-insurance risk management tools. The RFA identified 10 specific objectives that a proposed tool could address, including disease or pest management, reducing the impact of multiple-year losses, assisting producers of forage and rangeland and assisting limited resource or traditionally underserved farmers and ranchers. RMA received 113 proposals addressing one or more of the objectives listed in the RFA. From July 18, to July 22, 2005, a panel consisting of USDA personnel with appropriate technical skills and experience met to evaluate the applications. The panel scored each proposal according to the evaluation criteria published in the RFA, and identified the proposals that will be further eligible for potential consideration and funding.

Good Farming Practices – RMA is currently 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.

Asian Soybean Rust – Disease is an insured cause of loss under the Basic Provisions and Asian Soybean Rust (ASR) is an insurable cause of loss. The current report on the spread of ASR as of August 1, 2005 follows:

Four counties in Georgia have reported rust. The newest finding of rust comes from Colquitt County in sentinel plots. The previous finding was in Decatur County on kudzu and soybean samples. Tift County reported rust on a soybean crop while the Seminole County, Florida find was on volunteer soybeans which have since been destroyed. Eight counties in Florida have now reported soybean rust on kudzu with two reports from soybeans. The first rust find in Mississippi in 2005 occurred from soybean samples collected on July 13, 2005 from a sentinel plot in George County. In Alabama, soybean rust has now been reported on soybeans from a sentinel plot and a commercial soybean field. Intensive scouting is continuing wherever soybeans are grown. ASR has not been found in states north of Mississippi, Alabama, Georgia and Florida.

Mobile teams, in conjunction with state and extension personnel, continue to search for new soybean rust infections in the southeastern U.S. During the current week, they have found just a few isolated infections on kudzu and soybeans close to known source areas. Systematic surveys will continue to be carried out in eastern Mississippi, Alabama, northern Florida, Georgia and South Carolina to define the geographic boundary of disease development.

Hurricane Emily – According to Texas A&M University, Hurricane Emily's sideswipe appears to have been beneficial for southern Texas agriculture. With landfall 75 miles south of Brownsville, the storm brought little more than badly needed rainfall to the area. Crop conditions in Hidalgo County, consist of a few flooded fields. It is impressive how healthy and green irrigated cotton looked a day after the storm. Damage to cotton depends on the stage of growth it was in. In those fields that were defoliated and ready to be picked, some lint strung out of the boll and some on the ground. However, most fields are still green and look very good. Dryland cotton, which had been under severe drought stress, appeared to be the most affected by rains. Most of the Rio Grande Valley vegetables, sorghum, and corn were harvested prior to the storm.

In addition to cotton, citrus and sugarcane were left vulnerable to Hurricane Emily. But both appear to have fared well and should benefit from the needed rainfall. There have been no reports of damage to citrus, and in the mid-valley area, the citrus got 3-4 inches of rainfall. The rainfall totals throughout the Valley seemed to range from 3-9 inches, which is not enough to create standing water that could damage crops. In addition, wind damage also appeared to be sparse. The effects of Hurricane Emily will help the soil profile tremendously and add soil moisture for fall vegetable planting. Additionally, sugarcane, one of the heavier water-consuming crops of the area, appears to have escaped widespread damage. Both citrus and sugarcane are harvested in the fall and winter months and benefit from timely rainfall in their growing cycles.

Despite the generally favorable effects of Hurricane Emily, there have been some specific areas that have incurred damage. According to the July 22, 2005 edition of the Valley Morning Star (Harlingen, TX), Hurricane Emily's damage appeared to be 30 percent of the cotton in Willacy and Cameron counties was lost. According to the Cameron County Farm Service Agency (FSA), 30 percent or $4.7 million was lost. When Hurricane Emily hit, no more than 35 percent of Cameron County's 56,500 acres of cotton was harvested. Of the remaining 60 percent of the crop in the field, about half was lost.

As of July 25, 2005, the liability for all crops for the four counties in the lower Rio Grande Valley of Texas total $178,151,655. It appears indemnities paid will be minimal, as most crops are insured at the 75 percent coverage level and the estimated damage thus far is approximately 30 percent. More accurate information will be available as the cotton harvest advances and insureds start filing notices of loss with the approved insurance providers.

Illinois Drought – Precipitation in Illinois from March 1, to July 21, 2005 ranks as the fifth driest since 1900. The northern half of the state has suffered the greatest impact of the current drought conditions, receiving only 50 percent of normal rainfall. According to the July 26, 2005 U.S. Drought Map, 58 counties of Illinois' 102 counties are facing extreme drought conditions (D3), which is an increase of 10 counties over the previous week's report. A large number of counties in the rest of the state are facing moderate to severe levels of drought. Much of the southern third of the state has been less impacted by the drought, due in part to the beneficial rains received from the remnants of hurricane Dennis.

Major insured crops grown in the areas impacted by the extreme drought are corn and soybeans. The July 24, 2005 Illinois crop report from NASS showed 56 percent of corn acreage and 33 percent of soybean acreage was rated either poor or very poor. Acreage reports for the 2005 crop year have just recently been filed for spring planted crops. Thus, the estimated losses were based on 2004 crop year data.

Drought losses have already occurred in some areas as some fields of corn have failed to pollinate due to hot and dry weather. Other fields have suffered delays in their normal growth cycle due to the drought conditions. The soybean crop has been affected to a lesser extent, but yield reductions due to drought conditions are expected. Since soybeans have only started to bloom and set pods, it is difficult to estimate the extent of losses at this time. Many corn fields in the northern part of the state failed to pollinate eliminating any yield potential. The dry weather this summer will likely make aflatoxin a potential harvest threat. Adequate rainfall for the rest of the growing season will provide only limited help with the corn crop. However, the adequate rainfall may help the soybean crop reach near average yields.

The following loss estimates were developed from the County Emergency Board Damage Assessment reports for all Illinois counties, information received from the Illinois Department of Agriculture and other USDA agencies, and information gathered by the RMA Springfield Regional Office.

Policies breakdown:	CAT	16,174	12%
	BUY-UP	117,373	88%
	Total	133,547	

Overall Average Coverage Level: 70%

Estimated Liability:	$ 3.9 Billion
-Corn Losses:	$ 238,618,746
-Soybean Losses	$ 53,656,736
Current Loss Estimate:	$ 292,275,482

Quality Adjustment for Sunflower Seed Dark Roast in 2006 – RMA has committed to elected representatives and sunflower growers to provide quality adjustment discounts for sunflowers affected by dark roast, as stated in Board Memorandum No. 608. RMA personnel worked closely with the National Sunflower Association to develop appropriate quality adjustment for sunseed dark roast that will be applicable for the 2006 and succeeding crop years. In addition, RMA ties its quality adjustment factors to the FSA loan discounts. Beginning in 2005, FSA began offering loan discounts for dark roast. However, this announcement came after RMA had already filed the 2005 actuarial documents. Dark roast is particularly problematic for confectionary sunseed growers. Buyers of confectionary sunflower seeds have very low tolerance for dark roast, usually less than one percent, since Sclerotinia damaged seeds when roasted turn dark in color and taste rancid or bitter.

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. RMA and OGC will begin discussions and deliberations the week of August 8, 2005 to prepare for proposed rule publication. Implementation could take two to three years.

Nursery Crop Provisions – The Nursery final rule was completed and was published in the Federal Register on June 28, 2005, allowing RMA to release the policy and actuarial material to be effective for the 2006 crop year.

Subpart V General Administrative Regulations; Submission of Policies, Provisions of Policies, and Rates of Premium – The final rule incorporating a Sense of the Board regarding disclosure of business relationships and marketability of products submitted under Section 508(h) has been updated based on final comments, signed by the Administrator and forwarded to the Federal Register for publication.

<u>Program Highlights/Announcements:</u>

E-Written Agreement Project Update – The RMA Electronic Written Agreement project (eWA) is currently in the requirements definition phase of development. RMA is conducting this project as directed by the USDA Office of the Chief Information Officer (OCIO). The eWA Technical Team continues to gather requirements and document the IT environment and business processes for this project. The user requirements obtained during these meetings will become part of the overall System Requirements Specification (SRS), which is a primary resource for designing the eWA System. During the next few months, the eWA Technical Team will finalize the SRS document for sign-off by stakeholders, signifying the start of the Design phase.

<u>Compliance:</u>

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's approved policies and procedures. RMA is in the process of completing Operations Reviews on four insurance providers in FY 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. RMA will report 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 is assisting 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. 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.

Wentworth serviced a large book of business of over 400 crop insurance policies in Nebraska and South Dakota. Based on complaints received from the FSA, RMA began investigating the appearance of fraudulent activities of Wentworth for the 2000, 2001 and 2002 crop years. Based upon the 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. Also, there were 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, over a period of several years, had inflated APH databases, incorrect insurance premiums and had received overpaid indemnities.

RMA identified some producers as being complicit in obtaining inflated coverage and indemnities to which they were not entitled. In addition, USDA is addressing certain civil actions that are taking place along with the ongoing investigation. In response to a Temporary Restraining Order (TRO) filed by some Wentworth producers, RMA reached an agreement to address a TRO by staying related 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.

The U.S. Attorney in charge of the civil side of this case sent a letter to the plaintiff's attorneys in May indicating how RMA would address the TRO agreement. RMA then sent letters to the companies indicating what was required to maintain reinsurance on these policies. Companies are making the required changes, while RMA continues to address the producers' complaint. The Kansas City Compliance Office, OGC and Department of Justice met with the plaintiffs' attorneys on June 22, 2005 to provide samples and explanations of the problems identified with their clients' APH records. The parties agreed to a stay until August 31, 2005. Shortly thereafter, and on July 26, 2005, RMA received a copy of a letter from the plaintiffs' attorneys to their clients indicating that they had seen the evidence and that the government was in a position to prove what it had asserted from the beginning. RMA continues to be optimistic about a reasonable conclusion to this matter in the near future.