

REVIEW OF THE FEDERAL CROP INSURANCE SYSTEM

HEARING BEFORE THE SUBCOMMITTEE ON GENERAL FARM COMMODITIES AND RISK MANAGEMENT OF THE COMMITTEE ON AGRICULTURE HOUSE OF REPRESENTATIVES

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WEDNESDAY, JULY 21, 2004

HOUSE OF REPRESENTATIVES,
SUBCOMMITTEE ON GENERAL FARM COMMODITIES
AND RISK MANAGEMENT,
COMMITTEE ON AGRICULTURE,
Washington, DC.

The subcommittee met, pursuant to call, at 10:02 a.m., in room 1300 of the Longworth House Office Building, Hon. Jerry Moran (chairman of the subcommittee) presiding.

Present: Representatives: Smith, Chocola, Neugebauer, Peterson, Alexander, Pomeroy, Etheridge, Larsen, and Stenholm [ex officio].

Staff present: Craig Jagger, Matt O'Mara, Callista Gingrich, clerk; Howard Conley, and John Riley.

OPENING STATEMENT OF HON. JERRY MORAN, A REPRESENTATIVE IN CONGRESS FROM THE STATE OF KANSAS

Mr. MORAN. The hearing of this subcommittee will now come to order. We are here today to review the Federal Crop Insurance System, and I appreciate very much the witnesses that we have before us. We are here, I think, to discuss a rather lengthy list of items, all with the purpose of trying to find ways to improve the delivery and effectiveness of crop insurance for farmers across America.

Last year, this subcommittee conducted four hearings, two field hearings—one in Ada, Minnesota, one in Lubbock, Texas, and two hearings here in Washington with the purpose of listening to farmers, farm organizations and commodity groups, as to how the crop insurance system could be improved. Following those hearings, we compiled a list of the concerns raised by those various witnesses, which I have shared with our committee members, as well as with USDA and RMA in particular.

Today this is an opportunity that I thought would be useful to subcommittee members, as well as to RMA, in a sense to force RMA to evaluate those items that were raised, and an opportunity for subcommittee members to question the Risk Management Agency about those suggestions, and where RMA was headed, and whether it was possible for RMA to make changes, or whether legislative changes would be required. Certainly not here to poke at the shortfalls of the crop insurance system, but rather we are here to consider ways to improve its effectiveness as a Risk Management tool for producers.

A number of issues on that list from a Kansas perspective, but I think from across the country the topic No. 1 was what to do in the case of multi-year disasters, and I appreciate the Risk Management Agency's forum held in Kansas City, Missouri, in May. I appreciate being a participant in that in which the industry, crop insurance companies, and the academics were invited to discuss how to handle multi-year disasters, and ultimately proposals were requested. As I recall, June 30 was the deadline for those proposals, and I am particularly interested in hearing what RMA has to say about the status of that effort to develop a product or a policy related to multi-year disasters.

I intend that this hearing present an opportunity for substantial back-and-forth between the subcommittee members and our folks from RMA. An updated list of those issues has been circulated to our members, and the testimony by Mr. Davidson has, I think, 25 items in which RMA has addressed. So I appreciate the creation of that document. We now have something that we can wave at each other and say here is what is important, and here is what we are doing, and here is what needs to be done. I would welcome subcommittee members raising issues that are not necessarily on the list that have arisen since our hearings last year.

I conclude my remarks just with a mention of the renegotiations of the SRA. Concerns have been raised by lawmakers and crop insurance companies. I notice, in your testimony, that this is an issue that you at least mention. I am delighted to learn that the companies have all signed the SRA. My concern all along has been the timing and potential delay, and concerns about the lack of competition and loss of companies in further consolidation of the industry.

So although this hearing is not designed to address the issue of SRA negotiations, Mr. Davidson or Mr. Collins, I would not be surprised at what that topic might arise today. I conclude my remarks again by thanking you for your testimony, and what I know is a significant effort to prepare for today's hearing, so I thank RMA for its efforts.

Mr. Peterson, I would recognize you for any of your opening remarks.

OPENING STATEMENT OF HON. COLLIN C. PETERSON, A REPRESENTATIVE IN CONGRESS FROM THE STATE OF MINNESOTA

Mr. PETERSON. Thank you, Mr. Chairman, and thank you for holding this hearing. I know that we have, as you said, had several hearings on the subject of crop insurance, and I think that there is a consensus, at least between myself and yourself, that there are problems with the current system, especially in regard to affordable coverage, multi-year losses, and other key factors that have affected our producers.

I know personally in northwest Minnesota, we, as I have said many times, have experienced multi-year losses, and we are looking at another year where we have got some isolated areas that are in the same problem. We have one area up in the north of my district that over half the crop was not planted again this year because of wet weather. Some of those guys have only had one crop out of the last 10 years, and, of course, this affects the APH and

t-yields, and the system. Even though we have improved it some, it really does not work for folks that are in that situation and we continue to look for ways to try to address that. I think that the preventative planning has been helpful coverage, but there is still a need, in my opinion, for some kind of a predictable disaster assistance program to go along with crop insurance, such as the bill that I have introduced that would give the Secretary the authority to provide disaster payments to counties that have been declared a disaster area by the Secretary, similar to what we do with EMA. I think that would be a helpful situation for folks that are in this type of situation, maybe a cheaper way to deal with it with that kind of a system, as opposed to trying to change the crop insurance system to deal with it.

We also have a number of companies in my area that have been concerned about these SRA's and would like to get in a little bit of discussion about what the final outcome of those agreements were, so once again, thank you, Mr. Chairman, for holding the hearing. I thank the witnesses for being with us today, and I look forward to a productive session. Thanks.

Mr. MORAN. Mr. Peterson, thank you. I do know that you have a great interest in the issue of disaster assistance and how to eliminate the need for ad hoc, and to make the system more certain. And I look forward to working with you to address those issues. Our first panel, and only panel, consists of Dr. Keith Collins, the Chairman of the Federal Crop Insurance Corporation, and the Chief Economist for the U.S. Department of Agriculture, along with Mr. Ross Davidson, who is the Administrator of the Risk Management Agency. Both of you have been before this subcommittee many times. We welcome you back.

Dr. Collins, any knowledge of how many times you have testified before a committee of Congress in your career?

Mr. COLLINS. I don't have enough fingers and toes to keep track, Mr. Chairman.

Mr. MORAN. It is very encouraging to know that our Chief Economist counts by using his fingers and toes. We would welcome your testimony, Dr. Collins.

**STATEMENT OF KEITH COLLINS, CHIEF ECONOMIST, AND
CHAIRMAN, FEDERAL CROP INSURANCE CORPORATION, U.S.
DEPARTMENT OF AGRICULTURE**

Mr. COLLINS. Thank you very much, Mr. Chairman, Mr. Peterson, and members of the subcommittee. Thanks for the opportunity to come up here today and update the subcommittee on the activities of the Board of Directors of the Federal Crop Insurance Corporation, and to join Mr. Davidson in following up on the series of crop insurance issues that the subcommittee has identified.

As you noted, Mr. Chairman, I currently serve as Chair of the Corporation's Board of Directors, and the Board has the responsibility for general management of the corporation. Since the last time we were up here, your last oversight hearing, before the subcommittee a little over a year ago, the Board has held 11 public meetings. We have taken 50 official actions, including approving 15 program expansions and modifications. I could give a lot of examples of that.

I will give a couple. One important one I want to mention is the expansion that we have undertaken with the Adjusted Gross Revenue-Lite, or AGR-Lite, plan of insurance. This policy fills an important void in FCIC's product line because it makes available crop insurance for small to medium-sized producers of livestock and specialty crops, among other commodities. AGR-Lite covers farmers' and ranchers' adjusted gross revenue for the whole farm. It is based on 5 years of Federal income tax data, and it is a simplified version of the Adjusted Gross Revenue plan of insurance. Since its initial approval of sale in Pennsylvania, AGR-Lite has been expanded to 16 other States that are primarily located in New England and mid-Atlantic States and the Pacific Northwestern States.

Another recent Board action was to reinstate the Livestock Risk Protection, or LRP policy, for fed and feeder cattle and the Livestock Gross Margin, or LGM, policy for hogs. LRP was suspended following the finding of BSE in the State of Washington, and LGM was suspended last December following a determination that the contract had serious program integrity issues. RMA has worked successfully over the last 6 months with the owners of these products to identify modifications that have been requested by the Board, and each of the products is expected to be selling again this fall.

Because livestock products are new activities for the FCIC emanating from ARPA, the Board has requested a major review and analysis of each of these livestock programs. We have requested that those analyses be conducted 1 year after the products have returned to the marketplace. Other Board recent Board actions have included expanding the blueberry and pecan pilot programs, approving a sugarbeet stage removal pilot program, and a silage sorghum pilot program, also modifying and expanding group risk income protection plan of insurance.

On the management front, I want to mention that the Board recently completed rewriting the delegations of authority for the corporation for the first time since the early 1990's. The Board worked for over a year with RMA management and the Office of General Counsel to review all statutory responsibilities, and ensure that all are properly delegated for action. The Board also strengthened standards for reimbursement to outside entities for research/development, and maintenance costs for products submitted for approval.

As we look ahead for the next 12 months, the Board's current agenda includes expected action on 15 pilot project evaluation reports, and at least six feasibility and development contracts that are planned for completion during this period. In addition, there are some 65 other pilot evaluations and research and development contracts and partnerships underway under RMA oversight right now. We also expect a number of new products will be submitted to the Board, under section 508(h) of the Act, from the private sector in the coming year.

Regardless of where these products come from, the Board's goal will be to ensure, before approval, that each product is actuarially sound, is marketable to the majority of farmers of the covered commodity, and does not negatively affect program integrity or the delivery system. Increasingly, the Board will have to consider the ef-

fects of its actions on the resources of RMA, particularly in light of the Agency's appropriations falling short of requested and needed levels. The Board is committed to strengthening the Nation's crop insurance and other risk management programs, and the regulatory functions of FCIC, including those conducted by RMA on FCIC's behalf.

That completes my comments. Thank you, Mr. Chairman.

[The prepared statement of Mr. Collins appears at the conclusion of the hearing.]

Mr. MORAN. Thank you, Dr. Collins. Mr. Davidson.

STATEMENT OF ROSS DAVIDSON, ADMINISTRATOR, RISK MANAGEMENT AGENCY, U.S. DEPARTMENT OF AGRICULTURE

Mr. DAVIDSON. Mr. Chairman and members of the subcommittee, I am pleased to appear before you today and report on the progress and plans of the Risk Management Agency. As background, I submit a summary status report on the various aspects of the program for the record. At the outset, I draw your attention to the charts attached to my statement for some perspective on the issues we will discuss today.

The first chart shows indemnities paid for the 2003 crop year by county in the U.S., are currently estimated at about \$3.2 billion. The vast majority of counties receive significant benefit from this program, and we are working to expand the program to new areas, commodities, risks and producers.

The second chart demonstrates some measures of program growth over the past 10 years. In 2004, nearly 3,800 new county crop programs will be added; liability will grow from just over \$40 billion to nearly \$46 billion, and cost reimbursements to the private sector delivery system will continue to increase dramatically.

However, RMA's appropriated operating budget has remained essentially flat for the past 10 years. We are very concerned that without the additional funds requested in the President's budget, RMA will have difficulty in maintaining its current level of services, will not be able to safely sustain additional information systems and program changes required by new product development or changes in existing products.

The third chart shows the amount of time and deliberation that it takes to bring a new product to market, on average, 9 years from concept to full implementation. RMA is working hard to encourage and oversee the responsive and responsible development of new products while expediting the process where feasible.

And the final chart shows the value of and the progress RMA is making in preempting fraud, waste and abuse through the use of data mining, remote sensing and other advanced technologies, and cooperation with FSA, OIG, insurance providers, and States' attorneys and others. We have preempted multiple millions of dollars of improper payments through these and other measures. We constantly balance competing needs to make our products fraud-proof while seeking to provide responsive, useful risk protection to farmers. We still have work to do but are making good progress in our fight against fraud.

RMA has also made significant progress in providing new and existing programs to producers. As I said, in 2004, a record number

of county crop program expansions were approved, including several livestock, revenue assurance, AGR-Lite, and various specialty crop programs. In January 2004, RMA released a statement of objectives for research and development of Risk Management Products for Pasture/Rangeland and Forage, with the goal of serving the vital needs in this area of livestock producers. We expect to award contracts by early August. In addition to that, Mr. Chairman, as you have noted, the multi-year loss issue is being addressed, and we also expect to award contracts in the early fall for those.

Our 2004 Requests for Application for Outreach Education and Research Partnerships for new non-insurance risk management tools seek to deal with many of the more current and compelling risk management issues. We have received nearly 300 proposals for those RFA's, and awards will be made in August and September. Currently, RMA has 31 active pilot programs. The regulations to implement the FCIC Board's decisions on blueberries, pecans and millet have been written and are in various stages of review, comment and clearance. In addition, regulations are in process for significant modifications to various programs, including apples, citrus coverage, processing tomatoes and peanuts.

We have worked hard on fraud deterrence. The 2002 Crop Year Compliance Annual Report to Congress will be delivered very soon. From January through December 2002, RMA estimates that approximately \$125 million was saved by deterring or preventing potentially fraudulent claims through data mining and other related activities, and we have similar savings in 2003. We are optimistic about the benefits of data mining in our and program integrity and delivery compliance efforts, should funding continue beyond 2005.

The 2005 SRA builds on these results by incorporating data mining into the selection of policies that will be reviewed by companies as part of their quality control requirements. As of June 30, 14 companies, representing 100 percent of the Federal Crop Insurance Program, had signed the new 2005 SRA. The Agency continues to receive inquiries from additional insurance companies interested in joining the program. We are currently reviewing two such applications, and expect to receive a third in the near future. We are anxious again to work closely with the companies, associations and other interested parties to collectively strengthen the crop insurance program.

The attached update on issues raised at the subcommittee hearings conducted last year shows that we are making good progress on many points. Our ability to positively address specific requests within preferred timelines is based on the Agency's charge to serve the producer while adhering to principals of program integrity, actuarial and agronomic soundness, legal sufficiency, contractual provisions, fiscal prudence, and, as always, doing what can be done with appropriated Agency resources. RMA will continue to fulfill its mission and produce the best results for American agriculture within that framework.

Again, I thank you for the opportunity to participate in this important oversight hearing, and I look forward to responding to questions.

[The prepared statement of Mr. Davidson appears at the conclusion of the hearing.]

Mr. MORAN. Mr. Davidson, thank you for your testimony. Thank you for the effort of you and your staff in preparing the documents attached to your testimony. I think it can become a very useful tool for both RMA and for our subcommittee's oversight and development of products and solving issues. Would you just further address for me the results of the forum that we had in Kansas City regarding multi-year disaster? What kind of timetable are we on? What kind of proposals did you receive? How do you think things are going?

Mr. DAVIDSON. We have have received a significant number of proposals, Mr. Chairman. Those proposals are currently in the contract evaluation process. We started that July 12 and are continuing it. We anticipate that in early fall, we will be able to award some contracts, but it is a little bit too early to be able to characterize what those are, because they are just in the process of evaluation at this time. But, my Kansas City staff tells me that they are very pleased that there were significant number of proposals that came in over a broad range of ideas.

Mr. MORAN. Suggesting that RMA believes there are proposals out there that can address this issue, that it is something that there is a possibility for addressing the issue, it is nothing that is going to go away?

Mr. DAVIDSON. Well, certainly the issue is critical to us, and everybody talks about it. Since I have come to the program, it has been on everybody's lips, and we do want to do something about it. As you know, some of these proposals may, in fact, require legislative change, some may require funding. There may be some for which we can make some modifications within the existing structure. So the nature of those proposals really remains to be seen, to see what additional help we will need to be able to address the issues.

Mr. MORAN. Dr. Collins, one of the issues you raised in multi-year disaster discussions related to is the weather pattern anomaly. Is it something that is insurable because it occurs on a rare occasion, or is this becoming the standard weather that we face in certain portions of the country? Do you have any additional scientific basis to tell us the answer to that question?

Mr. COLLINS. No, sir. I really do not. I just simply raise it as a point. I think that whatever comes out of this contract work will ultimately come to the Board for approval, if it is something that we can implement under our statute and regulation. If it is something that requires legislative change, it would have to go to Congress, obviously. But, if it comes to the Board, that is a concern that the Board will have. The concern that the Board will have is are we creating something that would create over-insurance?

We do have adjustment mechanisms now, as you know, for multi-year yield losses. We have the 60 percent plug. We have a maximum 10 percent reduction in APH in any one year. We actually have floors on APH, which range from 70 percent all the way up to 90 percent, depending on the product. In each of those cases, when those mechanisms are put in place to help a producer who has had multiple year losses, we raise the premium for the pro-

ducer, so they do not get a higher APH without paying for it. And so I think that that is something that the Board will want to look at. If we start to go to an alternative way to temper the effects of weather on yields over time, are we going to be able to do it in a way that is fiscally responsible? Are we going to have to re-rate the policy as a result of that? And that is where the weather question comes in, I think. And it will be involved in the rating issue.

So, no, I really do not have any information on that, but certainly weather patterns have a big effect on the performance over time, and have to be taken into consideration.

One example I would give is everyone knows about the loss ratios of Federal Crop Insurance Corporation during the 1980 to early 1990 period. We had a loss ratio in excess of 1.5 from 1990 through 1993. And, of course, that was because we had the 1988 drought, the 1993 floods and so on, whereas the loss ratio over the last decade has been about one, because we have had a much better weather pattern for the Nation as a whole, although we have had this continuing problem in some areas like the Northern Plains and in parts of Texas over the last decade.

So we have to be able to sort out these weather patterns. I will leave that to the actuaries and the weathermen to figure out.

Mr. MORAN. Mr. Davidson, just a couple of things before my time expires. You mentioned in your testimony in this issue of de-minimis loss—the concern that we are requiring farmers to harvest and determine the yields before crop insurance is able to make an adjustment. You mentioned in your testimony that establishing a de-minimis yield would cause the rates to rise. Could you tell me what you are talking about? And also, I see that my time has expired. Yesterday, I sent you a letter, not that I am expecting a response to it today. I know you are good, but not that good. Dealing with sorghum and the issue of GRP and GRIP and making it more available for sorghum producers, and I look forward to working with you on that issue. But, the de-minimis yield?

Mr. DAVIDSON. De-minimis yield basically is that if you have a very small production on your farm, and the loss adjuster comes out and finds that it is a very small production, the loss adjuster has to assess how much yield there is there in order to be able to assess what the indemnity payment would be. Sometimes that amount is less than what would be economically viable for a producer to actually go out and harvest and bring to market. We frequently get questions about, well, why do you not just zero out something that is a 5 percent or a 10 percent yield and just call it a zero, thereby increasing the indemnity that would be paid. Because it would increase the indemnity that would be paid, we have to reflect in the insurance rate that additional amount of indemnity that would result from zeroing out.

Mr. MORAN. I understand. So it is the difference that I am learning about is it is a difference between adjusting the loss as compared to the indemnity payment?

Mr. DAVIDSON. That is correct.

Mr. MORAN. OK. The gentleman from Minnesota.

Mr. PETERSON. Mr. Chairman, I will defer to the ranking member of the full committee, Mr. Stenholm.

Mr. MORAN. The gentleman from Texas, Mr. Stenholm.

Mr. STENHOLM. Thank you, my friend. RMA use the new process for negotiating the recent SRA. In past rounds, it negotiated with companies as a group. This time, you declared you could not. Can you provide the subcommittee with the background on this?

Mr. DAVIDSON. I would be happy to, Mr. Stenholm. When we first began preparations for the re-negotiation of the SRA this last year, we were advised that the Office of Inspector General and the Office of the Department of Justice, had asked that they be consulted prior to the beginning of those negotiations because of concerns in the prior negotiation that certain areas of anti-trust might have been a concern. We did so.

We consulted with the Department of Justice and we were given counsel with regard to how the negotiations could be conducted on a basis that would be consistent with anti-trust law. We structured the negotiations so that the Agency would not inadvertently or advertently draw the parties of the negotiation into a situation where there may be questions raised by the Justice Department on how the negotiations were conducted. As a result of that, we chose to meet with individual companies in an individual negotiating process. We also listened to trade associations give input on general issues, but not representing individual or multiple companies. And of course, we invited comments from the general public, including many that have an interest in the crop insurance program.

We continued, at the Justice Department's request, to monitor the negotiations, to make sure that we were within the guidelines that we were hearing from them, and throughout the negotiations have continued in that vein. It is a different process than had been conducted previously. While, many may think of that as a dark cloud, with not much of a silver lining, the Agency, actually, has experienced a great benefit, and we believe that individual companies experience great benefit in being able to individually express their concerns to us. We learned a lot more about the impacts of the program on individual companies, and believe that the process, while it is different and more constrained from a group negotiation process, nonetheless provided significant benefits in that area.

Mr. STENHOLM. Can you provide the subcommittee with a written legal opinion explaining why crop insurance companies could not negotiate as an industry with RMA that you have just now described in general?

Mr. DAVIDSON. We requested the written document from the Department of Justice. They declined, but I would suspect that if there were a request from Congress, they might comply.

Mr. STENHOLM. I just made that request, so I would appreciate you carrying that on to Justice.

Mr. DAVIDSON. Yes.

Mr. STENHOLM. In your testimony, you note that the data mining efforts of RMA and the Center for Agriculture Excellence have saved millions of dollars. You also mention that the return on investment is significant, but you do not mention the amount of the investment. How much did we invest in order to get the great results that you mentioned in your opening testimony?

Mr. DAVIDSON. We are just entering into the second to last option year under this contract. A total of \$18 million was originally allocated to this effort. We will have expended virtually all of that by

the end of 2005, leaving another option year without full funding available. But, approximately \$18 million would have been expended by that time period. Some \$14½–15 million has been expended to today.

Mr. STENHOLM. And the estimated savings to the taxpayer with that \$14½ million was what in your testimony?

Mr. DAVIDSON. I do have some detailed data with regard to that. And there are various aspects of this, but we believe, for example, the major savings that came out of this was through a spot check directed by the data mining activity. And we believe that that spot check in 2001 preempted approximately \$72 million of improper payments; in 2002, approximately \$110 million of improper payments; and in 2003, approximately \$81 million of improper payments. For all activities for controlled fraud waste and abuse, including other activities such as the OIG hotline and other activities the total savings for 2001 was \$94 million; for 2002, \$126 million; and for 2003, about \$92 million. So there are significant savings for that kind of an investment.

Mr. STENHOLM. Thank you very much. Thank you, Mr. Chairman.

Mr. MORAN. Thank you, Mr. Stenholm. The gentleman from Indiana, Mr. Chocola.

Mr. CHOCOLA. Thank you, Mr. Chairman. Both of you touched upon livestock risk management programs, and Dr. Collins, I think you mentioned in your testimony that some had been suspended and will be subject to further review. Could you expand on that a little bit, and talk about what you see the future of those programs might be?

Mr. COLLINS. Oh, sure. I would be happy to. The Board of Directors and RMA have both been very concerned about the provision of adequate risk management tools for the livestock industry. It is one of our highest priorities, as we look out to the future. And it is certainly an untapped area for FCIC. The kind of products that we are focusing on are really two-fold: those that address the feed question—not energy feeds like corn, because we have lots of insurance there, but the forage/rangeland and pasture issues. We have very limited coverage in those areas. We have a group risk plan for rangeland now that has about 9 million acres in it. We have something in excess of 500 million acres of rangeland in the United States, including public lands, so very limited coverage. We have a forage policy. Likewise, it has very limited participation in it. So those are tools that need to be improved, and that is one of the major contract efforts that we have underway now, and that, I think, in the very near future, we are going to be awarding contracts to develop new insurance tools for rangeland and pastureland and forage land.

Then, on the other side of the question, there is the animal itself, and what kind of protection we are providing for animals. And there, we are limited by the Agricultural Risk Protection Act. It gives us the authority to enter into new products in that arena, but I think the cap is \$20 million a year in program costs. Under that provision and law, we have had several products submitted to us. We have approved products which are basically derivative kinds of options products. They are price protection products. One of them

is simply a form of an option price for live cattle, fed cattle and hogs. The other one is a spread between the price of the animal you could get in the marketplace and the cost of the feed to produce the animal, corn and soybeans. And we have those products in place. A couple of them were suspended over the past year.

The livestock risk protection, for fed cattle and feeder cattle prices was suspended with the finding of BSE because back when that occurred, futures markets were locked limit down for several days in a row. Meanwhile, options markets plunged. The premium is based on the futures markets, and so we had a disconnect. We had an opportunity for people to be able to buy a product that was likely going to pay an indemnity that we could not rate for, and so that product was suspended, the sales were suspended.

LGM was suspended for a different reason. What we did on that product, it was only sold periodically, and the premium was based on futures prices as of the mid-month, and then we allowed the contract to be sold for the next 2 weeks. Well, what happened is future prices moved during that 2-week period. The rating was inconsistent then with the expected indemnity, and so we had a program vulnerability. It is the same issue that has come up with the mutual fund industry where people were allowed to trade after markets had closed based on the mutual fund prices at the end of the day. The traders then have more information that is imbedded in the price of the product, and they can capitalize on that. So we had to suspend the LGM product as well.

What the Board has done subsequent to that is set up a series of standards that we want those products to meet so that we will not have those kinds of program vulnerabilities. One of the standards is that we now require the product to be purchased from the time the market is closed until 9 o'clock the following morning, so you no longer have this multi-day period in which to buy the product. Second, we put a cap on the daily sales volume of these products of \$1 million a day, and that is a reflection of the fact that we have this \$20 million cap on the program. Third, we do not allow the product to be sold on any day when the rating is based on a futures price that was locked limit down or locked limit up. And the fourth criterion that we have put in place is that depending on the product—we have different rules for different products—we set up some standards under which sale of the product could be suspended in the event of catastrophic events. That last one has not been fully worked out with one of the owners of one of the products. We are going to take that up as an issue at our Board meeting next week, and we hope to resolve that issue next week. We hope to be able to release these products probably within another month or so, and have them for sale some time in the fall.

So that is a thumbnail sketch of the kinds of things we are doing in livestock.

Mr. CHOCOLA. And there will be a 1-year review after these are available?

Mr. COLLINS. Yes. After they come up for sale, then we are going to require a 1-year evaluation. Typically on a pilot, we only do an evaluation after 3 years, but that is our rule for crops, which are harvested only once a year. These are products that are traded frequently, and so we think we are going to have enough market in-

formation to be able to do an adequate review after 1 year of trading.

Mr. CHOCOLA. Thank you, Mr. Chairman.

Mr. MORAN. Thank you, Mr. Chocola. The gentleman from Minnesota, Mr. Peterson.

Mr. PETERSON. Thank you, Mr. Chairman. You may have told me this, but can you tell me why you felt it was necessary to make these cuts? A number of us asked you to develop a budget-neutral program, and I guess you ended up with \$36 million in cuts. What drove that? What was the reason that you felt we needed to do that, or were you told you had to do that?

Mr. DAVIDSON. Well, as I think you are probably aware, for several years prior to the negotiation of this SRA, the administration has sought through legislative changes to find savings within the crop insurance program. That started before I came with a proposal in the President's budget following with a limitation on underwriting gains, for example, another proposal on the limitation on the amount that could be reimbursed to the companies for administrative costs. This year, the administration decided that—and I think it was consistent with what we had heard also from Congress that these kinds of savings should be sought within the bounds of an SRA re-negotiation. And so the choice of the administration was to seek those savings here in the negotiation. We sought to design the savings that were targeted in a way that companies could make adjustments to their own operations and their own financial operations so they could absorb those savings without having a significant adverse impact on the companies, things such as the reinsurance arrangements with third parties.

We believe that the savings were designed in such a way that gave flexibility to companies to have a number of options to make those adjustments. The whole intent was that, if you remember this chart that I have put out, there is a very steep slope of increase of the cost of administering this program, as reflected in the ANO reimbursements in total, as well as on a per-policy basis. 65 percent increase over a 5-year period, and that is a compounded 10 percent annual increase. Now, there was concern that that was a trend that was unhealthy for the program overall. We have continuing concerns that companies need to look very carefully about how they could effectively administer their service in this program at minimal cost. And so this was one of the ways that we were advised that should be pursued, and we pursued it in the best way possible.

Mr. PETERSON. Did you have some kind of data? This Milliman and Roberts model, and apparently you hired them to do some kind of a study for \$1 million?

Mr. DAVIDSON. The Milliman and Roberts model was a model that was developed by this actuarial consulting firm to help us inform the Agency with regard to what the impacts of the various proposals would be, particularly impacts on the underwriting aspects of the program. Some of the changes that were affected had to do with the risk sharing between the insurance companies and the Agency, the amount of assigned risk policies that companies could put into the assigned risk fund and therefore transfer a significant amount of risk to the Agency, and to assess the impact of

those required to relatively sophisticated model that would run that, based upon the current structure of the program and the proposed structure of the program. So that is what the model has been used for.

Mr. PETERSON. And as I think a number of us sent a letter asking for information about what was in that study, and as I understand it, we have never received a response to that or that information.

Mr. DAVIDSON. Well, actually, our response offered to be able to sit down with staff and walk through it verbally and we are still very willing to do that if we can spend some time with your staff on that, we would be happy to do that.

Mr. PETERSON. That is the only way it can be done, you think?

Mr. DAVIDSON. Well, there were some concerns, and there are some FOIA requests for information related to this, and we are still in the deliberations of what can be shared and what cannot be shared under the FOIA, but, we would offer to sit down and go through the model and its structure verbally with staff.

Mr. PETERSON. All right. Well, we will follow up with you on that.

Mr. DAVIDSON. Right.

Mr. PETERSON. I was not aware that that offer had been made.

Mr. DAVIDSON. That was in our letter response, so we were willing to do that.

Mr. PETERSON. Thank you. Thank you, Mr. Chairman.

Mr. MORAN. The gentleman from Texas, Mr. Neugebauer.

Mr. NEUGEBAUER. Mr. Chairman, thank you, and thank you for calling this important meeting. Mr. Davidson, I want to also compliment you and thank you. When my office has called over on specific issues, you all have been very responsive. You have not always given me the answer I wanted to hear, maybe, but you have been very responsive and we appreciate that open dialog that you have provided. As you know, last week I introduced a new piece of legislation that would allow producers to take two existing products and combine them to help them get a higher level of coverage, because, as you recall, when we had our hearing out in Lubbock, we heard testimony from producers, and one of the concerns is that being able to, with the increasing cost of production and inputs, getting the coverage that covered the cost of putting those crops in. And so, we have introduced this concept and we sent that over to your office for review, and I would just like to get your initial feedback on where you think you all are with this program. And since this does take two existing products, our ability to streamline this product and get it on the market for our producers?

Mr. DAVIDSON. I would be happy to respond to that. As we understand the legislation, and we are still studying it to fully comprehend how it would fit within a crop and our existing programs. We understand that the intent is to allow producers to purchase a Group Risk Plan policy in addition to their underlying APH policy, or whatever other policy they may have, as a means of covering their deductible. And the intent is that the summation of both of those would not exceed 100 percent of the indemnity coverage. We have evaluated this to some extent with regard to how it would fit within the current programs. It appears we have both programs in

place, and so it appears that something like this could be implemented relatively efficiently and effectively within the administrative aspects of the program. There are some questions that we have that we would like to continue to talk to your staff about with respect to whether or not there is a possibility that a farmer could end up being over-insured in this program, recognizing that the Group Risk Plan—they cannot affect their indemnity there. I think a very positive element of this. But, from an overall perspective, it appears to be a very good faith effort to try to address a sticky problem.

Mr. NEUGEBAUER. Thank you, and I look forward to working with you on that. I think the importance of this, and I think the importance of the hearing in a lot of the questions you are hearing and the inputs you are hearing back from, is, agriculture is big business now, and we have a good farm bill that was put in place in 2002. I think the one piece of agriculture that seems to be missing is, as I listen to producers, is the fact of managing this very large risk that we are taking in. Certainly, in the past, we have had ad hoc disaster programs where we have had catastrophic events in regions or areas, and, quite honestly, sometimes it takes years for Congress to decide whether that was an event they wanted to act on. Unfortunately, that is way too late for many of our producers, and so I think the ability to transition from politics to just a good business product and having something that producers can rely on if they do have catastrophic-type events happen within the region or county, it is just good business.

Along those same lines, if you will recall from our testimony that we had in Lubbock, was the ability in my area, contrary to some folks belief, we have producers farming thousands of acres. Again, they are managing their risk, and some of those folks are farming dry lands, some of them are farming irrigated, and particularly, when we talk about cotton, as we heard many of our producers say that they wanted some flexibility in managing their risk and their product and their crop mix between their coverage levels that they carry for the dry land, and for the cotton. Can you give me some reflection on where we are? I think the last time we talked, you had it was something that you all were considering and you would look at? I think Plains Cotton Growers and some other groups offered some solutions up at that time. And so I would like to hear some of your thoughts on that.

Mr. DAVIDSON. I am actually drawing a bit of a blank on specifically what you are referring to.

Mr. COLLINS. I can perhaps start this. I know there are a number of issues that we have dealt with, but the particular one you are referring to—you may be referring to how we treat coverage levels or the availability of alternative plans of insurance on optional units.

Mr. NEUGEBAUER. Right.

Mr. COLLINS. You mentioned irrigated and non-irrigated, one of the issues there has been whether we would provide different coverage levels on an optional unit for irrigated acreage versus, say, a basic unit for non-irrigated acreage.

Mr. NEUGEBAUER. Right.

Mr. COLLINS. And I would say that this has been an interest of the Board of Directors of FCIC, and just as a general statement—let me state this because the Board has taken this action: the Board has passed, in last December, a sense of the Board resolution discouraging the Risk Management Agency from offering alternative coverage levels based on practice type or plan of insurance. The reason for the Board action, and it certainly probably pre-dates your interest in the reason for the Board action on that is that the Board has been concerned about the portfolio of products we have right now. For example for cotton, or corn, or soybeans, includes crop revenue coverage, revenue assurance income protection, indexed income protection, available on basic units, optional units, enterprise units, whole-farm units. Different coverage levels now are being asked to go into all of those products.

This does several things. It increases the complexity of the program. It stresses the delivery system. It also puts a burden on agents to understand all of these things. It leads to misconceptions about the programs. It leads to mistakes about the programs. It is difficult for RMA to keep up with the rating of all these different products that are out there. That is part of the delivery system issue. So for that reason, the whole complexity and the burdens it places, including burdens on producers for record keeping, all of the abundance of burdens that it places that derive from complexity, is one reason that the Board has been concerned about that.

The second reason that the Board has been concerned about it is it obviously will increase indemnities over time. I mean, that is why producers want it. They want to be able to tailor their risk management plan to the particular idiosyncrasies of their operation, which from a producer point-of-view, it is probably a good idea. They want to tailor their risk management plan. From a corporation point-of-view, it will increase the indemnities over time. It creates the possibility of adverse selection across the different types of plans of insurance. You will pick out and increase your insurance where you expect the greatest loss to occur. And it can also lead to moral hazard issues.

So I think, based on the financial implications of this, based on the complexity issues, the Board has been concerned about different coverage levels on optional units of the same crop in the same county. I think the idea is that if you have a crop, and you have produced it in that county you are getting an income out of that crop. You could have situation where your income off of most of your crop is very, very high, so that your net farm income for the year is above normal for cotton, and then we may be making an indemnity payment on one piece of your operation because you have been able to carve out a product just for that piece of the operation. I think we have to ask the question is that the way we want a broad safety net program that is designed for catastrophic events to work? Should someone get an indemnity payment on cotton in a county when their income from that crop is otherwise above average?

So I have raised a bunch of issues here and it is that discussion that the Board had about this issue, going back to last December, and we raised a caution to RMA about proceeding down this route. So that is the best I can tell you about that.

Maybe Mr. Davidson would want to amplify or clarify—

Mr. DAVIDSON. We listen to our Board of Directors.

Mr. NEUGEBAUER. I know my time has expired, Mr. Chairman. I will be brief here. I think the thing that we have to recognize is even though those are the same commodities, the cost of producing that commodity from a dry-land standpoint and an irrigated standpoint are different. And while the revenue issue is anticipated, the costs are real, and I think we, in all due respect to your Board of Directors, what I hear is a lot of reasons why we should not do it. But what I would like to do is hopefully sit down and have some dialogue about what are some of the issues that your Board is concerned about, and what are some of the ways that we can address those?

I think that some of the producer groups have offered up some solution as to some of the issues that you have brought forward. And, certainly, most of the commodity groups that I have talked to are interested in making sure that the abuse part of it is addressed in the issue, but not to the detriment of not allowing programs to come onto the market just because we are trying to reduce the 1 percent of the folks that may be abusing that process. So I hope that we can continue that dialogue.

Mr. COLLINS. That is good response, Mr. Neugebauer, and I think the Board's charge on this is very broad, and we would certainly be willing to take a look at aspects of this.

Mr. NEUGEBAUER. Thank you very much.

Mr. MORAN. The gentleman from North Dakota, Mr. Pomeroy.

Mr. POMEROY. Thank you, Mr. Chairman. What is going to come next, but I am going to start by saying I have the highest regard for you, the chairman, and the highest regard for the Administrator. Having said that, I am concerned about the process and the product of this SRA re-negotiation.

The process: I would like to have had this hearing earlier. I know the chairman and I have a healthy disagreement about how this might have unfolded. You did not want us to be party to the negotiations and for very good reason. That is not a legislative undertaking. I am frustrated that oversight occurs after it is all done and, hell, we cannot do any good or bad at this point. It is done. So that is not oversight to me, and I am feeling frustrated about that.

I am also feeling frustrated about the process. I mean, I do not understand, with McKieran-Ferguson on the books, this anti-trust objection, as of 8 years of insurance regulation, I have not encountered that view in this way that would suddenly change completely the way SRA's have been negotiated in the past. I would go along with the request that we want the document from DOJ. If it was just somebody opining that is—we ought to know that, but if there is a document, we want to see that.

We also want the Milliman and Roberts document. It is one thing to get this presented orally, but we are not talking about classified information here, to my knowledge. And I think it is time now that we take a look at what was the basis—what was guiding the Department's actions through these negotiations. So I specifically reiterate the request for the document. If we cannot have the document, I want a reason why we cannot have the document.

You cite the rising cost of the program. I cite this as a success of legislative effort to get the risk protection out to farmers that they require, so that we do not have to be as dependent upon disaster programs, which, if you lay against this chart, have also had a very substantial budget effect.

Mr. DAVIDSON. I would agree with that.

Mr. POMEROY. This chart encompasses two legislative acts specifically designed to, first of all, in 1993, broaden participation, and then with ARPA, increase the insured values so there is more protection.

Mr. DAVIDSON. Yes.

Mr. POMEROY. And so, my opinion, this shows the committee's done some pretty good work at getting meaningful protection out to farmers. Now what I had in mind when I offered the amendment to ARPA that we would have an SRA negotiation, was that the Administrator would take a pretty good look at what was on the books thereby way of a reinsurance agreement. Those have to be evaluated, I believe, on a periodic basis, just to make sure that it is appropriate, we are not being overly generous, that it is working right.

I believe this budget-driven approach that you speak of, to try and take as much savings out of the program as could be gotten, really is a different approach entirely. That is not about the Technical Reinsurance Deal, that is an effort by the administration to administratively, without legislative input, change the terms of the deal that was contemplated with the ARPA legislation. And this public/private partnership has got some delicacy to it. And I think that, again, a budget-driven approach as opposed to an evaluation of how the insurance markets are working, is one that endangers the public/private partnership, and may change delivery of the service on the ground, and may change the ability of us to keep the support for crop insurance going forward, so I did not like that changed approach.

Now, I have got some questions at the end of this tirade. One further comment. The fact that companies are now signing up, I do not take that as validation of the end product. To me, what choice do they have? It is like the Jack Benny, "your money or your life?" He responds, "I am thinking." It is like that. It is a take the risk of this deal or leave the business, and that is obviously not much of a choice to take the risk. But I do think, from what I have heard from, not just the insurance sector but also the banking sector, that there is great concern we are going to have a significant reduction, in terms of players in the field.

I believe that, even with RMA, the more established the company, the more favorable your proposal looks. I just do worry about it, in the end, anti-competitive effects of the program. Specifically, question: we have got an awful lot of preventive planning acres in North Dakota, about 2½ million acres, and you have determined that ARPA prohibits allowing any grazing or haying of prevent planned land. Is there basis in statute for that, Mr. Administrator, or is that your administrative interpretation?

Mr. DAVIDSON. No, it is not an administrative interpretation. There is a basis in statute. When ARPA was passed, there were a couple of provisions that dealt with double cropping as well as pre-

venting planting, and there was provided in the legislation that there would be a reduced indemnity if a second crop was raised after a successful first crop where double cropping was not a typical part of the agricultural practice. Particularly with prevented planting, there was a specific statute, and I would be happy to give you the cite later on, if you would like it. And I think, in fact, the letter—

Mr. POMEROY. I remember the discussion. I did not contemplate grazing, for example, something that might grow on land as a second crop.

Mr. DAVIDSON. The challenge is is that if a second crop is harvested for value, and harvesting includes whatever method that may be, be it grazing or otherwise, then that produces an economic value, and within the bounds of the statute itself, the law itself, it would require us to reduce the indemnity on the first payment, the preventive planning payment, down to 35 percent. So while we did implement regulations to bring that to fruition last year, and the basic provisions, this is the first year that this is impacting is because those regulations have just come out. The regulations followed the statute and did not add anything or detract anything from the statute, and it is really the statute that has created the constraint on us at this point in time. Whether that was intended or not, that is the effect, according to our counsel.

Mr. POMEROY. Prevent plant is very important coverage, very easily abused, I believe, and yet critical, and so I favor the restriction on double cropping. I think that the interpretation of grazing as an alternative crop on land that previously grew soy beans, for example, is a bit of a stretch. But, I will take a look at the underlying statute.

Mr. MORAN. As the gentleman from North Dakota knows, I hold him in high regard, but his time has expired. The gentleman from Washington, Mr. Larsen.

Mr. LARSEN. Thank you, Mr. Chairman, for the opportunity to be here today and have a chance to ask some questions at the hearing. I want to first thank RMA, and also Mr. Collins, representing the FCIC for helping with the expansion of AGR-Lite in Washington State, and the Pacific Northwest generally, but certainly to my State, where we have more opportunities under AGR-Lite to get products offered to the specialty crop farmers that are scattered throughout the State, so I want to thank you for that.

I want to ask about apples—you were asked the apple question last time you were here, if I am not mistaken, but present apple crop insurance policy stipulates that damaged apples are not covered by the base policy, as long as those apples were as good or better than juice-grade. Juice-grade tend to be low-grade apples, and under current economic conditions, do not have a lot of market value. So the many F farmers have great distinction needs to get back to more reasonable level of their lost income. So I know there is a proposal to give growers producing apples designating it for the fresh market, the option to purchase coverage for U.S. fancy grade, which is a higher specification grade. Can you let me know where that effort is, and do you have any thoughts, or are you thinking about how that model might be applied to berries or stone

fruits that have similar issues between low-grade and higher-grade?

Mr. DAVIDSON. Let me first say that all of the issues related to the apple policy have been vetted extensively, as you are probably aware, not only with apple growers in your State, but throughout the Nation over an extended period of time, and all of those considerations have been folded into a proposed regulation that will be published shortly. We have gone through the comments and it is in the process, so I am pretty much limited in what I can say specifically about that, because it is in a regulatory process. But I can just say that those issues will be addressed in the regulation.

Mr. LARSEN. Can you give us the anticipated date of publishing of the regulation?

Mr. DAVIDSON. Imminent.

Mr. LARSEN. OK.

Mr. DAVIDSON. Then, you asked also about the application of that model to stone fruit, and I guess we would probably need to spend a little bit more time, but certainly there are concerns that I have noted as I have gone through my 26 listening sessions of the past year-and-a-half throughout the Nation, of concerns about quality, and reflecting prices that are appropriate for the quality of the fruit and its intended use.

Mr. LARSEN. Yes.

Mr. DAVIDSON. And so certainly that is very germane to other stone fruit—probably needs to be addressed.

Mr. LARSEN. Somebody will take a look at what the regulations says, then, and see where we can go from there.

Mr. DAVIDSON. Yes, we would entertain any suggestions from grower groups.

Mr. LARSEN. OK. That would be useful for us to fall upon here to begin to provide some more options. Folks maybe do not have them. Regarding seed potatoes, and you may have addressed this in the question about cotton. I think, generally, it is the principles applied on the cotton question may be applied here with seed potatoes. We got one of the certified seed counties in the country in my district, and farmers, like those who produce seed potatoes, are constantly moving and leasing new fields, which makes the current unit regulation difficult.

If you have a two 500-acre farms where the only difference is that one of the farms is a road devaluing the field in half while the other is undivided. Why does the one with a road need a different risk management program than the one with the undivided field, and what thoughts you have prevent fraud, but also give the farmers some flexibility they need to cover the crops they need to plant on a unit. Any thoughts there?

Mr. COLLINS. You are looking at me, Mr. Davidson.

Mr. DAVIDSON. I would be happy to address that, but, Mr. Chairman, you have given me some guidance on units so maybe you would be the best to address it.

Mr. COLLINS. It is a difficult question to answer, and it is a concern that we have had as we look broadly across all of our policies.

Mr. LARSEN. Yes.

Mr. COLLINS. The Board, I believe, feels that when the product is a commodity—that is, it is all planted at one time, produced one

way with similar cultural practices, marketed the same way, we like to see that under one unit. We do not like to see the proliferation of units. Units should exist when the crops are fundamentally different. You have got two different units because maybe it is different varieties of wheat planted at different times of the year, a Spring wheat, a Winter wheat, or it is Durham wheat and other Spring wheat which have different quality characteristics, or is irrigated versus non-irrigated, which are subject to different perils.

So it is a difference in perils or a difference in the characteristics of the crop that justifies different units. When it is the same crop, seed potatoes on 1,000 acres, and whether it has a road or not a road, I personally would prefer to see that as one unit. Now, that does not answer your question why does it exist that way.

Mr. DAVIDSON. We do recognize, I believe, units where there is significantly different topography and things of that nature that in—particularly in your State, you might find—

Mr. COLLINS. Where the perils may be different.

Mr. DAVIDSON. Right. Where the perils are different, yes.

Mr. LARSEN. Well, I will do some follow-up with—

Mr. COLLINS. Yes. It is an issue we are struggling with. It is an issue that, as we have approved new products, we have paid close attention to the unit structure. It does not mean we have gone back and looked at all of our existing hundreds of products and the unit structure of all of them, but I am telling you sort of the thinking now of the Board about what we do with these kinds of actions we take in the future.

Mr. LARSEN. I will just follow up with some details on this with you, and you have always been very cooperative in helping out my office and listening to our concerns. I shall look forward to continuing to work with you on that.

Mr. DAVIDSON. We will work with you with our regional office as well.

Mr. LARSEN. Yes.

Mr. DAVIDSON. I think you have good working relations with them.

Mr. LARSEN. They are great out there.

Mr. DAVIDSON. Yes.

Mr. LARSEN. They are doing a great job. Thanks.

Mr. DAVIDSON. Thank you.

Mr. LARSEN. Thank you, Mr. Chairman.

Mr. MORAN. Thank you, Mr. Larsen. The gentleman from North Carolina, Mr. Etheridge.

Mr. ETHERIDGE. Thank you, Mr. Chairman. Mr. Davidson, I read with interest your testimony, particularly in the section regarding the new sweet potato pilot insurance program because we have quite a bit in my district, and, obviously—in fact, that would—in my interest. And our farmers are quite interested in the new pilot program, as you can appreciate, and particularly pleased to see that you are talking about expanding the number of participating counties, since we have some of the higher producing exposures in our area. My question is three-fold.

Number 1, how long will this expert review take? No. 2, when can we expect the FCIC Board to be voting on the proposal, if you know that at this point. And, finally, should the expert review

panel find there are problems with where we are, will there be enough time to correct those adjustments that need to be made in time to insure that the program is in place for the 2004–05 crop year?

Mr. DAVIDSON. I have been advised that the expert review is due to come back to the agency and to the Board of Directors on the 20th of August, that there will be a meeting of the Board of Directors at the first week of September where those will be considered. It is our intent, if all goes well, to be able to have that available for the 2005 crop year.

Mr. ETHERIDGE. Thank you.

Mr. DAVIDSON. Now, if all does not go well, we will have to see what it is that is making something not go well to—

Mr. ETHERIDGE. Yes, and I believe that is a concern. If there are some issues that need to be resolve, obviously, that would be great because you have got a lot of folks out there who have a lot of exposure that they would like to take advantage of having insurance.

Mr. DAVIDSON. I will say that, as the Board deliberated this, the proposal that came back did not include some of the counties that currently exist where we have had particular concerns about losses. But the Board ultimately agreed that we should continue to include those counties to give them a chance, and to see whether or not these provisions actually work to make a program viable in the face of some of the difficulties that we had in those counties, and so hopefully we are going to be able to make this work.

Mr. ETHERIDGE. Good. Thank you, sir. My next question deals with crop insurance for peanuts, as you can appreciate the area is—

Mr. DAVIDSON. Yes.

Mr. ETHERIDGE. And we have talked at previous hearings, and thank you for your help on that, but our ability to insure peanuts at contract prices, and you are familiar with that?

Mr. DAVIDSON. Yes.

Mr. ETHERIDGE. It is a real challenge, and your testimony did not address this point, but I know that RMA's notice incumbent period that ended in June will also show units for peanuts. I also saw comments regarding insured peanuts at contract prices, and I appreciate your spending time in working on the issue because I think this is a big issue. Can you share with us your thoughts on the process where we are, and is it possible that RMA could have something approved, or maybe in place, as we work toward the 2005 crop year?

Mr. DAVIDSON. We intend to have this rule effective for 2005. We are still in the regulation process, or in the rule-making process, and so I cannot talk specifically about details, but we did receive a number of comments with respect to the contract price issue, and to unit issues as well, if I remember correctly, which were two big issues and hopefully we will be able to address those positively.

Mr. ETHERIDGE. OK. I notice the gentleman from Texas wanted me to yield on that because I—

Mr. STENHOLM. If you would yield on that.

Mr. ETHERIDGE. OK.

Mr. STENHOLM. Along that same line, are you considering establishing price election for peanuts as one of the options, in a manner

similar to the methodology used by USDA and other programs, based by reviewing the average price during the market year, or do you have any current thinking on that aspect of setting the price option?

Mr. DAVIDSON. I am not aware that we are, Mr. Stenholm, but I would be happy to check into that and get back to you. I may be limited in what I can say until the rule-making process is over, you understand, but I will get back to you and say what I can say.

Mr. STENHOLM. Thank you.

Mr. ETHERIDGE. One final thing. Let me give you one more specific before my time runs out. In the Raleigh office, which handles our region, and they have been very helpful, there is an issue that deals specifically with our State, and maybe some other, maybe Virginia, but when farmers do have a disaster, at the end of the year, especially in tobacco, there are—they are not allowed to move those pounds to someone else who may need it, and I think it is specific to our area. Is there anything being done to look at that, because I think that is a real issue? Assuming things move through this Congress and this buyout, it might not be an issue after this year, but it has historically been a problem over the last couple years, and I think that is something that still needs attention, if we can.

Mr. DAVIDSON. I would be happy to look further into that. I did receive a report knowing that you would ask this question, and a number of the issues here relate to concerns over program integrity that would have to be dealt with, and I think probably we can just talk with you.

Mr. ETHERIDGE. We would like to because I do not think it is a big issue, but for some folks it is, and normally it is in an isolated area. If we can provide the kind of security we would need for it, and also help some farmers who really do get hurt unintentionally.

Mr. DAVIDSON. We would be happy to have further conversations.

Mr. ETHERIDGE. Thank you, sir. Thank you, Mr. Chairman. I yield.

Mr. MORAN. Mr. Etheridge, thank you. We are going to have a very, I hope, brief round of second questions, and I recognize Mr. Neugebauer.

Mr. NEUGEBAUER. Thank you, Mr. Chairman. I want to talk about something that we had briefly talked about a couple of weeks ago, and that is the deferral period for non-emerged cotton. And we got the 15-day white planting day, and then we have got the 8-day deferral period. I continue to hear from producers that if you are going to—those that have planted before the late planning date and have non-emerged cotton, feel like they are being penalized and asked to wait an extended period of time for them to make an optional planting decision for, say, grain sorghum or something like that. And one of the things we talked about whether there was opportunity for fraud in there or someone that planned to run up to the late planting date and their crop would be adjusted based on the fact that they had crop failure when, in fact, that crop had not been on the ground—

Mr. DAVIDSON. Just the next day.

Mr. NEUGEBAUER. Yes. So now we know what some of the issues are. What are some of the things that we can work together on to

look at that, because it is a real issue, because the way we are making some of those folks wait now, some of those folks are waiting past the late planning period for, say, an alternate crop like grain sorghum?

Mr. DAVIDSON. Well, this has been an issue that I personally have dealt with from the time that I got here because it was raised fairly shortly after I got into the Agency, and we tried to—at the time, I think there was a 15-day, or something like that, deferral period. We worked with the Extension Service in that area to try to obtain all of the agronomic data that could be obtained on how long it takes to raise a cotton crop, number of fee units, et cetera, the latest—or the earliest frost dates, and things of that nature.

The fundamental principle in this regard is, is that once the farmer plants the crop, it is their obligation to raise it to fruition. To do what they can to raise it to fruition. Recognizing that in that area, seed can stay in the ground, and you can have rain, and with a very nominal amount of rain, the crop can come up and start being established. So we tried to gear this timeframe to what the agronomics said is appropriate for raising a crop in the area, and frankly, went out as far as we could go for the timeframes. If there is a continuing concern, things that can be discussed are the late planting date an appropriate date, things of that nature, and maybe we can open that question up. There has been reluctance on the part of the growers to open that issue in the past, but we would be happy to entertain that. And if there is additional data, if there are new varieties, or some kind of a genetically changed seed or something like that that has a different agronomic characteristics, we would be happy to look at that as well.

Mr. NEUGEBAUER. I think we have been working with your office on providing some additional information, and also, I think that some of the producers are willing, maybe, to have some discussion about the late planting date and seeing if we can come up with a date that is kind of the date—and talk about whether the deferral period, then, is relevant in that period of time.

Mr. DAVIDSON. Yes.

Mr. NEUGEBAUER. One quick question, Mr. Chairman, and I will move on. I know you have made some changes in relation to grain sorghum and grain sorghum silage, and I believe you have got a pilot program currently going on, and the price election for those two is certainly an issue. Grain sorghum prices, which is a good thing, are up, and what we are hearing from some of our producers is that they are wanting to make sure that they have some of the same parity that we have in the corn program, because in some cases, they feel like that they are being pushed to plant corn, because of the price selection process, and not really reflecting some of the increased prices in the grain sorghums. Particularly in my area, that is very important because it takes, certainly, a lot more water for the corn in many cases than it does the grain sorghum. So we do not want to be having a farm policy or insurance policy, I guess, that would be encouraging producers to move to a crop just because of the insurance coverage available. What are some of the ways that you are going to be working on to make sure that price selection for grain sorghum is reflective?

Mr. DAVIDSON. Well, we have been addressing this for quite a while, and did make what I thought was a positive move last year, to try to ensure that the price selection process was reflective of what the current market is. And rather than look at a long-term trend, we looked at a more current trend of what the price relationship between grain sorghum and corn is. Of course, if we had a futures market for grain sorghum, that would be perfect. We do not. We have to do some kind of a derivative pricing arrangement. We do rely upon the World Boards Price Determinations for that relationship, and so from the Agency perspective, we have probably gone about as far as could be expected there. We are required to have price selections that are reflective of the market, so we try to get as close to the market as possible, recognizing that it is not always available to help us do that. But Dr. Collins, in his other capacities, might be able to respond to that as well.

Mr. COLLINS. I think that Mr. Davidson summarized it pretty well. This is an action that the Board took, the Board directed RMA on how to establish the price selection for sorghum. For a long time, because there is no futures market for sorghum, particularly on the revenue products, sorghum was established at 95 percent of the price of corn. In fact, the long-term ratio of sorghum to corn prices is more like 92 percent, so there was a benefit there for some time, it seems to me. But, then, in 2002 and 2003, we saw the average corn price equal the average sorghum price for the Nation as a whole, and that raised concerns with the sorghum producers. They visited with us. I personally met with them. Mr. Davidson met with them. And what we decided to do is instead of using a long-term actuarially-based kind of relationship, we tried to take into account recent market events. So we have a price forecasting committee within USDA for sorghum that has been long-standing. They have been existing for some time. They are comprised of representatives from my office, the Agriculture Marketing Service, the Farm Service Agency, Economic Research Service, the Foreign Agricultural Service, and, in January, they project forward the price of corn and the price of sorghum. For example, this January, they would have predicted—forecasted the price of corn and sorghum for the 2004 crop, and the ratio that they project is now the ratio that we use in the sorghum claim of insurance.

It turned out that their projected ratio for the 2004 crop was 95.9 percent, and that did not please some people because the market had been 100 percent the last couple of years. Nevertheless, if you look back over the last 23 years of data, there has only been 2 of out of the 23 years when prices were equal. Sorghum has always less. And then if you look at the recent prices reported by the National Agricultural Statistics Service for the last couple of months, sorghum is running about 94 percent of corn. So this is not an easy issue.

Mr. NEUGEBAUER. Right.

Mr. COLLINS. But we have tried to be sensitive. We have gone to a new method, which we hope, in future years, will allow sorghum to reflect a price that is equal to corn, or less than corn, or above corn, depending upon the relative market conditions.

The second part to your questions is, more broadly, besides the price election. The package of programs. Is it better structured for

corn as opposed to sorghum and therefore maybe cause people to go into corn as opposed to sorghum? And that is an issue that we are trying to deal with with the consolidation of all of our products. As you may know, we now own all the revenue products. We own the APH product, and we have a process going on now to build one product out of APH, CRC, RA and IP, and in that way, I think you will see something that puts sorghum on a more equal footing with corn. Then we still have the question that Mr. Moran opened with, with respect to GRP and GRIP, and can those be made available for sorghum? GRP is available for sorghum already, it is just not bought by sorghum producers. It is available in almost every county in Kansas, and many other counties, and I think we sold 9 policies in 2003. But, there has been a lot more interest in it over the last year. But people want—not GRP, they want GRIP, G-R-I-P, the income protection plan. And then the question there is, can we put something in place for sorghum, and I think our plan is to look at that. I do not know that we can get in place for 2005, but certainly for 2006, and I will defer to Mr. Davidson because it is going to be his determination on whether he has got the resources to be able to get this done in time for 2005.

Mr. DAVIDSON. 2005 would be stretching it at this point because of the lateness of the year, but we certainly believe that we can do something for 2006.

Mr. MORAN. The gentleman's time is expired. Gentleman from Minnesota, Mr. Peterson.

Mr. PETERSON. Mr. Chairman, a couple parochial things. Has there been a request made to you to do a pilot program for COPIA? Do you know what that is?

Mr. DAVIDSON. Well, I think we actually had a phone conversation about this product a while back.

Mr. PETERSON. Have they sent anything?

Mr. DAVIDSON. I am not aware of having received a request for a pilot program for that product or that commodity, no.

Mr. PETERSON. Does that have to come from a company, or how does that work?

Mr. DAVIDSON. Could be with a grower group.

Mr. PETERSON. Well, see, they do not have a grower group.

Mr. DAVIDSON. Or a group of producers in the area. They do not have to have an organized—

Mr. PETERSON. Yes, but this is a crop that was developed in an ARS station in Morrison. They have not commercially started growing it yet. One of the issues is that they do not have crop insurance, but anyway—

Mr. DAVIDSON. There may be some opportunities, for example, AGR-Lite, if they are a diversified farming operation, or they are starting up a new crop. That might be a way of getting coverage. Certainly, we would have to look at the agronomics of the crop itself and be able to establish rates and things of that nature.

Mr. PETERSON. Well, I will have to get a hold of them and get that in the works. But, the other part of the question is that this card here, is this right? That if we start on this company right now, it is going to take 9 years before we actually get a product?

Mr. DAVIDSON. Well, I guess we could both address that.

Mr. COLLINS. Yes. Let me just make a comment about that. That chart—I was interested to see Mr. Davidson's testimony contain that chart may be unduly pessimistic. But, it may be reflective in some areas. This is a chart that basically—

Mr. DAVIDSON. Actually, it is reflective of our experience.

Mr. COLLINS. It is reflective of the RMA product development process, the full cycle, including regulation. Some of this stuff up front may not happen that way. I mean, as Mr. Davidson just said on the product you were talking about—we might get a private company submit a product to us where a lot of this work has already been done, and then we can approve that product in fairly short order, after the expert review process, and go right into a pilot. Now, after 3 years after the pilot is evaluated, if the pilot is performing well, it is entirely possible that we can scale it up at that point to a much larger client base, even before we have gone through a regulation. There is no limitation in law in the size of our pilots.

For example, when we did the blueberry and the pecan pilots, we scaled those up after the 3 years. After we had a successful pilot experience, we scaled those up to a lot of producers. Now, you have to have the rate information available to be able to scale it up, but it is entirely possible that a private sector submitter could come to us with a product. We could approve it within 6 months, have a pilot going the next year, and 3 years later be scaling a successful pilot up to a broader client base. So that would be the shorter end of this. But, this is an accurate chart.

Mr. DAVIDSON. It is an accurate chart, and I guess it really depends upon whether it is the initial stages of this are accomplished in the private sector, or whether the initial stages are contracted by RMA. In either case, it takes some time to go from idea to a package that is ready to be presented to the Board of Directors of the FCIC. And whether a private sector party on their own could take a shorter period of time, I guess. It would depend upon the product. But, the product has to come to the Board of Directors complete and ready to be reviewed, and if it does not, then it gets kicked back and may take even more time.

Mr. PETERSON. One last thing. The barley people were in to see me a month ago. They had some concerns about the coverage between malting and feed barley. Has that been resolved, do you know?

Mr. DAVIDSON. We are in discussions with them to deal with those issues, I am told.

Mr. PETERSON. And that is that going to get resolved satisfactorily?

Mr. DAVIDSON. We think we will be able to come to some resolution, yes.

Mr. PETERSON. Thank you. Thanks, Mr. Chairman.

Mr. MORAN. Mr. Stenholm, do you have any additional questions?

Mr. STENHOLM. Yes, regarding the data warehousing question, what is your current plan for continuing the contractual arrangement continuing the process that you have been in now? What are the current plants?

Mr. DAVIDSON. Are you talking about the comprehensive management information system that was asked for by the farm bill? We are in the middle of the first contract year on that, and the last report that I have received is that we have just finished all of the planning stages and are just getting into part of the implementation side, so there is no plan to discontinue that at all. We plan to take it all the way to the fruition. We think it is a good idea. We are working with the Farm Service Agency and with the contractor to do that, as well as with our Office of Chief Information Officer.

Mr. STENHOLM. And, specifically, the data mining aspects of it that you have mentioned have been so successful with a pretty minimal cost, there is no intent not to continue in that direction?

Mr. DAVIDSON. Well, as you know, the funding expires on that coming up in a year-and-a-half and we are concerned about that, but that that is something that we will—

Mr. STENHOLM. Do you have a recommendation that you will make to the Congress regarding that?

Mr. DAVIDSON. I am probably not at liberty to tell you what we would recommend in the President's budget, but data mining is a very important part of our ongoing program.

Mr. STENHOLM. Finally on the whole question of declining APH's, you mentioned in your testimony that you received some contract proposals. When do you expect awards to be made, and do you have an impression as to what kind of methods are the most promising in those contractual proposals that have been submitted to you?

Mr. DAVIDSON. I am sorry, on which one?

Mr. STENHOLM. On the APH's.

Mr. DAVIDSON. On the multi-year declining—

Mr. STENHOLM. Multi-year—

Mr. DAVIDSON. It is really too early to be able to tell. We are just starting to evaluate the proposals, and I have not had a report on that.

Mr. STENHOLM. Nothing has kind of caught your attention as you—

Mr. DAVIDSON. Not yet. I have not had any report on what the various proposals are.

Mr. STENHOLM. Thank you, Mr. Chairman.

Mr. MORAN. Thank you, Mr. Stenholm. Dr. Collins, Mr. Davidson, thank you very much for spending your morning with us. Without objection, the record of today's hearing will remain open for 10 days to receive additional material and supplementary written responses from witnesses, any question posed by a member of the subcommittee. This hearing of the Subcommittee on General Farm Commodities and Risk Management is now adjourned.

[Whereupon, at 11:32 a.m., the subcommittee was adjourned.]

[Material submitted for inclusion in the record follows:]

STATEMENT OF KEITH COLLINS

Mr. Chairman and members of the subcommittee, thank you for the opportunity to be at today's hearing on crop insurance and risk management issues for U.S. agriculture. I currently serve as Chairman of the Board of Directors of the Federal Crop Insurance Corporation. Your invitation requested responses of the Department of Agriculture to 25 issues related to crop insurance. The witness statement of Mr. Ross Davidson, Administrator of the Risk Management Agency, provides detailed re-

sponses to those issues. My brief remarks today are intended to provide an update on the activities of the Board since the subcommittee's last hearing on May 22, 2003, the Board's actions in relation to issues raised for today's hearing.

Since the last hearing, the Board has held 11 meetings and taken 50 official actions. Among these actions, the Board sent 11 proposals for new insurance products and changes to existing insurance products submitted by the private sector under section 508(h) of the Federal Crop Insurance Act (Act) to actuarial and underwriting experts for review. The Board also evaluated other products developed under contracts managed by RMA.

Based upon the analysis and recommendations of these expert reviewers, recommendations from RMA staff, and the judgment of the Board, 15 program expansions and modifications were approved. Included in these actions were major expansions to the Adjusted Gross Revenue-Lite (AGR-Lite) plan of insurance, modifications and expansions of the Livestock Risk Protection (LRP) and the Livestock Gross Margin (LGM) plans of insurance for livestock, expansions of the blueberry and pecan pilot programs, and modifications and expansion of the Group Risk Income Protection plan. The Board also approved two new pilot programs, a sugarbeet stage removal program and a silage sorghum program. One pilot program, Cost of Production, was disapproved due to actuarial and underwriting issues discovered during the expert review process. Four other new product submissions were withdrawn by the submitters, after various issues were discovered during the expert review process.

In addition to adding to and improving the portfolio of FCIC's risk management products, the Board has sought to improve the governance of FCIC by completing the first major restructuring of the delegations of authority for FCIC since the early 1990's. In an era where boards of directors are under increased scrutiny by their shareholders for management oversight, we are pleased to be able to report to the subcommittee that the Board, in concert with the RMA management team and the Office of General Counsel, has conducted an exhaustive review of all statutory responsibilities and ensured they are properly delegated for action.

The revised delegations reflect all of the amendments to the Federal Crop Insurance Act since the early 1990's, including the Federal Crop Insurance Reform Act of 1994, the Agricultural Risk Protection Act of 2000 (ARPA) and the Farm Security and Rural Investment Act of 2002 (2002 farm bill), and provides explicit guidance to FCIC on those activities delegated to the Manager and those reserved to the Board. This set of delegations will increase the efficiency and effectiveness of the operations of the FCIC by allowing Manager Davidson to deal directly on routine matters and bring only those issues reserved by law, or the judgment of the Board, to the Board for action.

In other official actions, the Board gave guidance to the Manager through a series of Sense of the Board resolutions on issues such as standards for reimbursement to outside entities for research and development costs and maintenance costs for submitted products under Section 508(h) of the Act, the suspension of sales for the LGM plan of insurance, and whether producers should be able to elect coverage levels by plan of insurance and practice. The Board also evaluated and authorized the reimbursement of research and development and maintenance costs to submitters of five 508(h) submitted insurance products.

LIVESTOCK RISK PROTECTION PROGRAMS

An issue of concern to the subcommittee has been the suspension of the two livestock insurance plans at the end of 2003. On December 17, 2003, the Board passed a Sense of the Board resolution that recommended that RMA suspend sales of LGM insurance for swine based on findings that the plan presented excessive risks to the FCIC. In response, RMA suspended sales on January 13, 2004. On December 24, 2003, RMA announced that applications for Specific Coverage Endorsements for Fed Cattle and Feeder Cattle under the LRP Insurance Policy were temporarily suspended following the discovery of a cow infected with bovine spongiform encephalopathy (BSE) in the State of Washington.

On April 6, the Board voted to permit reinstatement of LRP for fed and feeder cattle, and LGM for swine under certain conditions. RMA has worked with the owners of these products to implement certain modifications requested by the Board and each of the programs will be reissued this fall.

The Board is committed to providing the maximum possible continuity of livestock price risk protection to producers upon implementation of changes necessary to ensure actuarial, underwriting, and program integrity of the LRP and LGM products.

Because of the problems inherent in the livestock programs and the general public interest in determining the appropriate role of insurance and other risk manage-

ment tools for livestock, the Board has requested that a review and analysis of each of the livestock programs be conducted one year after they have returned to the marketplace. Typically, crop pilot programs are reviewed after 3 years, but the continual nature of the sales cycles for these livestock programs should provide sufficient data to permit a useful review after 1 more year of experience.

2005 STANDARD REINSURANCE AGREEMENT

In 1991, the Board delegated to RMA the responsibility to renegotiate the SRA on its behalf. This delegation of authority still remains in effect. RMA completed renegotiation of the 2005 Standard Reinsurance Agreement (SRA), and all 14 currently reinsured companies signed the Agreement by the start of the 2005 reinsurance year on July 1, 2004. Throughout the negotiating process, RMA and administration officials provided the Board with regular updates. The Board provided guidance and opinions when appropriate in order to aid RMA in the negotiation process. The renegotiation of the SRA was very complex, requiring a balancing of the interests of crop insurance policyholders, reinsured companies and agents, and American taxpayers.

AGR-LITE

AGR-Lite is a whole-farm risk management product owned by the Pennsylvania Department of Agriculture. On August 1, 2003, the Board voted to expand the program to reach all counties in Connecticut, Delaware, Maine, Massachusetts, New Hampshire, Vermont, and Rhode Island, and selected counties in Maryland, New Jersey, New York, and West Virginia, in addition to Pennsylvania. Additional modifications were also approved for the program in all states, including Pennsylvania. These modifications qualify more livestock and organic and small-to-medium size producers in these states than are currently available for coverage under FCIC's Adjusted Gross Revenue plan of insurance. On May 6, 2004, the Board approved availability of AGR-Lite in all counties in Alaska, Idaho, North Carolina, Oregon, and Washington, beginning in the 2005 crop year. AGR-Lite now is available in 17 States and covers farmers' and ranchers' adjusted gross revenue from the whole farm based on five years of Federal tax return data.

The Board recognizes that there is great interest in expanding this program to additional states. Since AGR-Lite is a program owned and maintained by the Pennsylvania Department of Agriculture, expansion to additional states requires the Pennsylvania Department of Agriculture to submit a request to the Board with the appropriate ratings data and other required information. Those interested in making AGR-Lite available in their State should contact and work with the Pennsylvania Department of Agriculture. The Pennsylvania Department of Agriculture supplies interested parties with the requirements for expansion and has worked with many states in accomplishing expansion to their areas.

APPROVAL OF NEW PRODUCTS

The Board retains the authority for approval of all pilot programs developed by FCIC under contract, as well as those policies or plans of insurance submitted to FCIC under the authority of section 508(h) of the Act. The Board spends a large portion of its time in the review and analysis of these products to determine whether the interests of producers are protected and the products are actuarially sound. In addition to the actions taken over the past year, the Board expects a considerable amount of such activity in the future. Contract awards for research and development of new pasture and rangeland risk management tools are nearing completion, and a solicitation for proposed solutions to the declining yield issue has been released. RMA is also overseeing contract research and development on over 20 additional commodities to determine whether new insurance programs are feasible in areas including specialty crops, livestock, and aquaculture, with a focus on underserved areas and crops.

The normal cycle for a pilot program is a lengthy process that can take several years for complete development into a permanent program. The cycle includes development, pilot testing, and evaluation, followed by the rule making process in the Federal Register. In addition to the products developed under contract for FCIC, the Board accepts product submissions from outside entities at the beginning of each quarter. We anticipate that innovative products submitted under section 508(h) of the Act will continue to come to FCIC from the private sector in the coming years. Regardless of the source of the proposed product, the Board is responsible for ensuring before approval that each product is actuarially sound, is marketable to the ma-

jority of farmers of the covered commodity, and does not negatively affect program integrity or the delivery system.

The Board is fulfilling, and will continue to fulfill, its statutory responsibilities, including the provision of oversight, guidance and direction to FCIC. The Board is committed to strengthening the Nation's crop insurance and other risk management programs and the regulatory functions of FCIC, including those conducted by RMA on FCIC's behalf. All of the Board members are pleased to have the opportunity to serve American agriculture and all are working diligently to ensure this crucial part of the farm safety net functions as efficiently and as effectively as possible.

That completes my remarks. Thank you.



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Statement by Ross J. Davidson, Jr.
Administrator
Risk Management Agency
United States Department of Agriculture
Before the House Agriculture Subcommittee on
General Farm Commodities and Risk Management
Wednesday, July 21, 2004

Mr. Chairman and members of the Subcommittee, I am pleased to appear before you today to report on the progress and plans of the Risk Management Agency (RMA) to address various comments you received from the public hearings held by the Subcommittee last year. As background for my presentation and anticipated response to questions from the Subcommittee, I am submitting a summary status report on various aspects of the Federal crop insurance program.

At the outset I draw your attention to the charts attached to my statement. They provide perspective for some of the major elements of the Federal crop insurance program.

The first chart shows the indemnities paid for 2003 by county in the U.S. As of July 12, 2004, the total indemnities paid for the 2003 crop year are \$3.2 billion. The chart shows that almost every county has received significant benefit from this program and we are working to expand the program to new areas, commodities, producers and risks.

The second chart demonstrates some of that effort as measured by the growth in the program over the past ten years. The total number of county crop programs available to farmers and the total amount of liability covered by Federal Crop Insurance Corporation (FCIC) products has continued to increase dramatically. In 2004 we anticipate a record growth in both of these measures with nearly 3,800 new county crop programs being added and liability growing from just over \$40 billion to over \$46 billion. The chart also shows that anticipated cost reimbursements to the private sector delivery system are expected to continue to increase dramatically, reflecting the underlying growth of the program. In the face of this program growth RMA's operating budget has remained essentially flat for the past ten years. Without the additional funds requested in the President's budget, RMA will have difficulty in maintaining its current level of services.

The third chart shows the amount of time and deliberation that it takes to bring a new product to market -- on average nine years from concept to full implementation. RMA is working hard to encourage and oversee the responsive and responsible development of a

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broad range of new products while expediting the process where feasible. I will highlight some of our progress later in my statement.

The final chart shows the value of and the progress RMA is making in preempting fraud, waste and abuse through the use of data mining, remote sensing and other advanced technologies, monitoring and growing season spot checks and other activities conducted in cooperation with the Farm Service Agency (FSA), The Office of Inspector General (OIG), Insurance Providers, States' Attorneys and others. We have preempted tens of millions of dollars of improper payments through these and other measures and we are constantly identifying ways to balance competing needs to make our products fraud proof while seeking to provide responsive, useful risk protection to farmers. We still have work to do and improvements to make but we are making good progress in our fight against fraud.

Now I would like to address some broad program issues before I give you a status report on the specific product issues raised in the 2003 hearings of the Subcommittee.

RMA Program Issues

Expansion of County Crop Programs

FCIC, through RMA, has made significant progress in providing new and existing programs to producers. In 2004 a record number of county crop program expansions (nearly 3,800) including several livestock, revenue assurance, AGR-lite and various programs, will be approved. We are also reviewing county crop programs that have not had any use in the past few years for possible elimination.

Research and Development for Risk Management Products for Pasture/Rangeland and Forage

In January 2004, RMA released a Statement of Objectives for research and development of Risk Management Products for Pasture/Rangeland and Forage, with the goal of serving the vital needs in this area of livestock producers. RMA's goal was to obtain proposals which: (1) provide improvements to existing crop insurance programs specific to pasture, rangeland and forage; and/or (2) research and development of new, and potentially innovative crop insurance programs for pasture/rangeland, forage and hay. In March, RMA held a pre-proposal conference with potential vendors. RMA received 12 contract proposals. The Forage, Pasture/Rangeland TET members are coming to closure and expect to award contracts by early August. RMA is providing \$3 million in funding for these projects, and may provide more depending on the number and quality of submissions that meet program objectives.

New Outreach, Education, and Research Partnerships for 2004

The Request for Application (RFA) for the Community Outreach & Assistance and Education Partnership programs and Research Partnerships for new non-insurance risk management tools were published in the Federal Register on May 24, 2004. The RFA sought proposals to deal with many of the more current and compelling risk management issues, including multi-year losses, forage and rangeland, terrorism, limited resource and underserved areas. The last day for applicants to submit proposals was July 8, 2004. RMA Regional Offices, other USDA agencies, universities and other partners aided in the distribution of the notice to potential applicants. We have received nearly 300 proposals that will be reviewed and rated in July. Awards will be made in August and September.

American Growers Update

Despite a very successful effort to ensure that all farmers were paid timely and their policies were transferred to new companies, there are still some major components of the American Growers disposition that must be resolved. Pending a final decision on how to close out Growers, the State of Nebraska has continued to oversee the company in rehabilitation. In completing the 2002 crop year activities under Nebraska's rehabilitation and monitoring by RMA, Growers paid claims on nearly 82,000 policies for about \$743.7M on a premium volume of \$580M (as of 06/21/04). RMA is working to resolve few remaining open claims for the 2002 and prior crop years. The USDA, OIG and the General Accounting Office (GAO) has completed their respective audits of the American Growers failure. GAO has released their report and RMA is preparing a formal response to the findings. We have not received the OIG discussion draft. OIG has not indicated when it will be provided to RMA for comment.

The current cost to the Federal government for the failure of Grower's currently stands at approximately \$40.7M 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 final disposition of Growers is completed by the State of Nebraska.

Information Technology Budget Situation

The President's Budget, as submitted to Congress, includes RMA's FY 2005 request of \$91.6 million for Administrative and Operating Expenses representing an increase of about \$20.6 million from FY 2004. This budget supports increases for information technology (IT) initiatives of \$15.5 million.

These IT funds are targeted toward infrastructure improvements and enhancement of the corporate operating systems necessary to support growth in the program as new products are developed and existing products are improved and offered for sale. Due to rapid growth in the program, it has been difficult to maintain adequate funding for RMA's information technology system. This IT infrastructure supports the crop insurance program's business operations at the national and local levels, supports risk management products to producers nationwide and is the basis for payments to private companies reinsured by FCIC. RMA is using system and database designs originally developed in 1994. There have been few hardware and software upgrades and business process analysis and re-engineering of the entire business delivery system are needed to support current and future program growth. The IT systems do not meet the minimum requirements mandated by the USDA Office of the Chief Information Officer due to advanced age and architecture. Without adequate funding of IT requirements, the Agency will not be able to safely sustain additional changes required by new product development or changes in existing products. Future program expansion will increase the risk of system failure and possible inability to handle day-to-day processing of applications and indemnity payments on the existing portfolios of business.

Prevented Planting Request

Under new requirements in the Federal Crop Insurance (FCIA) originating with the Agricultural Risk Protection Act of 2000 (ARPA) to address fraud, waste and abuse issues, producers cannot plant a second crop for harvest (including haying or grazing within the same crop year) before November 1, (harvest date as set forth in an RMA Manager's Bulletin) without losing 65 percent of their prevented planting payments. These rules to implement ARPA requirements were first published and became operative for the 2004 crop year. In response to a recent prevented planting situation affecting growers in North Dakota, RMA engaged in extensive legal review and determined that it cannot allow farmers to hay and graze prevented planting acres and waive the statutorily required reduction in the prevented planting payment without legislation to the Federal Crop Insurance Act; to do otherwise, violates FCIA, policy provisions of contract change dates and financial and contractual terms within the Standard Reinsurance Agreement.

RMA believes prevented planting payments are consistent with estimates of pre-plant budget costs incurred by North Dakota farmers. Such payments were set at 60 percent of the production guarantee to fully cover pre-planting budget costs. In addition, an option was provided to purchase additional coverage up to 70 percent of the production guarantee. To the extent that North Dakota producers elected this policy option (in the past three years, 82 percent did so), the prevented planting payment should more than compensate for the costs farmers incurred prior to planting.

The Agency also reviewed a request to change the earliest date for grazing land on which prevented planting payments were received without a reduction in the prevented planting

payment from November 1, to an earlier date. Unfortunately the request could not be granted without subjecting the program to increased litigation risk.

Pilot Programs Status

Currently, RMA has 31 pilot programs, including: Adjusted Gross Revenue (AGR), Apple Pilot Quality Option, avocado Actual Production History (APH), avocado revenue, avocado/mango tree, cabbage, cherry, citrus dollar (navel oranges only), Coverage Enhancement Option, crambe, cultivated clams, cultivated wild rice, Florida fruit trees, forage seed, fresh market snap beans, Income Protection Plan of Insurance (IP), livestock (swine) gross margin, livestock risk protection (swine/cattle), mint, mustard, Onion Pilot Stage Removal Option, pecans, processing chile peppers, processing cucumbers, rangeland Group Risk Protection, raspberry/blackberry, strawberries, sweet potatoes, and winter squash/pumpkins.

The FCIC Board approved the expansion of the millet pilot program and its conversion from a pilot program to permanent status for the 2003 crop year. The FCIC Board also approved expansion of the pecan-revenue pilot program to be offered in eighty-two counties for the 2003 crop year and subsequently approved the program to permanent status for the 2004 crop year. Additionally, the FCIC Board approved conversion of the blueberry pilot program to permanent status effective beginning with the 2004 crop year.

The regulations necessary to implement the FCIC Board's decisions on blueberries, pecans, peanuts and millet have been written and are in various stages of review and clearance

Livestock Risk Program (LRP) and Livestock Gross Margin (LGM) Suspensions and Next Steps

Upon the discovery of Bovine Spongiform Encephalopathy (BSE) in the State of Washington late last year, FCIC suspended the sales of LRP cattle policies to new policyholders. When originally developed, the LRP premium structure was based on the relatively stable futures market prices, which existed prior to the discovery of BSE in Washington State. However, the discovery of BSE destabilized the futures market resulting in large price swings and increased the probability that a producer could purchase insurance with the expectation of receiving an indemnity. The crop insurance program is statutorily required to operate on an actuarially sound basis. The volatility present in the market after the discovery of BSE caused the rates to be inadequate and the product to no longer be actuarially sound. The Board believes RMA acted quickly and responsibly to protect the integrity of the crop insurance program. At present, RMA is actively evaluating the rating structure and other design components of the program that may be affected by the BSE development. Sales will be restored when it is determined by the Board that LRP is operating in an actuarially sound manner and will serve the best interests of the producers.

On December 17, 2003, the Board discontinued new sales of the LGM Swine. The FCIC Board determined that the contract terms of LGM Swine presented excess risk for FCIC. Coverage price is determined two weeks prior to sales closing. Because LGM coverage prices are determined using the Chicago Mercantile Exchange and the Chicago Board of Trade, insurance holders may speculate as price on either exchange drops (hogs) or rises (corn and soybeans meal) and purchase LGM; RMA refers to this phenomena as stale pricing. While this strategy is sound, (buy low, sell high) for speculative purposes, LGM is a risk management tool and reinsured by FCIC; this strategy is not appropriate for insurance purposes. As directed by the FCIC Board, RMA is working with the submitter of LGM to address concerns regarding the program for subsequent insurance periods. Current policyholders of this plan of insurance are not affected by the discontinuance.

At the FCIC Board's April 6, meeting, it formally withdrew both the LRP and LGM products from reinsurance eligibility upon review and revision. RMA expects that these products could be available for livestock producers as early as this fall.

Compliance Activities

Our compliance function workload has increased substantially due to the expansion of the Federal crop insurance program and the implementation of ARPA. In order to deal with the increased referral activity, RMA has sought to manage the increase in workload by emphasizing the use of data mining, remote sensing, Geospatial Information technologies and other computer-based resources. During the period from January 2002 through December 2002, RMA estimates that approximately \$125 million was saved by deterring or preventing potentially fraudulent claims through data mining and other related activities. Similar savings were realized for 2003, of approximately \$93 million, as we expanded data mining capabilities. We are optimistic about the long-term benefits of data mining in our compliance efforts and elsewhere should funding continue beyond 2005. The return on investment using this tool is significant.

Annual Report to Congress - The 2002 Crop Year Compliance Annual Report to Congress is in the final stages of Departmental clearance and we expect it to be delivered to Congress very soon. The report shows continuing gains against waste, fraud and abuse from the use of data mining and remote sensing to identify anomalous producers within the policyholder base. The SRA for 2005 will build 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.

Sanctions, Appeals, and Litigation - A recent analysis showed that RMA has steadily increased the number of fines, debarments, disqualifications, and suspensions against persons found to have violated program rules from seven in 1999, to 31 for the first six months of 2004.

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And Oversees All Programs Authorized Under
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Monitoring Tools - In 2004, we continue to develop data management and integration tools to effectively evaluate, track and improve program compliance integrity and to reduce the potential for erroneous payments. The need for the authority to regulate certain insurance provider business activities associated with the Federal crop insurance program and the ability to perform timely and effective reviews of insurance providers became apparent in 2002 with the failure of the American Growers. The President's FY 2005 Budget request for RMA includes \$1.0 million for monitoring and evaluating the reinsured companies. Improving RMA's ability to monitor the reinsured companies will provide the means to perform the necessary analysis and pursue any needed corrective actions to reduce the likelihood and cost of future failures.

Recent progress in the compliance area has been concentrated on the mission-critical tasks of evaluating and improving new processes established to prevent and deter waste, fraud and abuse. In addition, extensive progress has been made in building and adapting RMA's compliance investigation caseload reporting, tracking, and feedback systems to meet the requirements that were mandated by ARPA.

RMA, FSA, OIG, U.S. Attorneys' offices throughout the nation, and the insurance providers continue to work together to improve program compliance and integrity of the Federal crop insurance program by: fine tuning the RMA/FSA data reconciliation and matching process; evaluating and amending the procedures for referring potential crop insurance errors or abuse between FSA and RMA; creating an anti-fraud and distance learning training package to complete the requirements of ARPA; and detecting, prosecuting and sanctioning perpetrators of crop insurance fraud. We also have dedicated additional efforts to integrating data mining analysis into all Agency functions to assist in preemption of fraud through effective underwriting and product design; exploring ways to expedite increasing sanctions requests; and establishing a fraud investigation case management and issue tracking system.

Basic Provisions - During FY 2003, RMA published ARPA mandated revisions to the Common Crop Insurance Policy (Basic Provisions). RMA proposed many changes to the Basic Provisions, including changes mandated by ARPA or requested by OIG, as well as changes related to program integrity and administrative issues. Due to the large number of comments received, and in order to implement the changes mandated by ARPA for the 2004 crop year, RMA chose to implement the proposed changes in two separate regulations.

The first final rule was published in the Federal Register on June 25, 2003. It contained all of the proposed changes mandated by ARPA and a change requested by OIG for an earlier notice of loss for prevented planting. The final rule that addresses the changes proposed in the Basic Provisions dealing with administrative and program integrity issues is in final clearance. RMA has asked for expedited review of this rule in time to implement for the major portion of the 2005 crop year.

MAGNUM Management System – RMA has recently enhanced its tools used in managing, tracking and determining the status of investigations (reviews) conducted by Regional Compliance Offices by adapting an “off the shelf” case management software product to fit RMA’s compliance data requirements. With this new system (MAGNUM), anyone within the risk compliance organization who has authority can track all investigative cases; determine, view, and analyze information contained within each case file; report related financial data; report case status; report and analyze case determinations; and report and track administrative and judicial actions and results. Weekly, quarterly, annual and ad hoc reports to the Regional Directors, Deputy Administrator for Compliance, Administrator and Secretary, along with information for the ARPA, section 121 report can now be generated by compliance personnel in a timely manner. After completing training sessions in each Regional Office and Headquarters during the summer of 2003, the system became operational. By December of 2003, all cases in the previous system were migrated to MAGNUM. To date, there have been 2,750 cases opened within MAGNUM.

As users become more proficient in using MAGNUM they will detect more efficient means to process data and identify additional data requirements. RMA compliance has established a mechanism for capturing, assessing and implementing these improvements.

SRA Update – RMA released the final draft of the Standard Reinsurance Agreement (SRA) to the insurance companies for signature on June 10, and to the public on June 15. This final draft is the culmination of 45 individual meetings with companies and insurance industry associations, and reflects their comments, concerns, and suggestions as well as those of Members of Congress, commodity groups and the general public. Input from such a wide range of parties was unprecedented and proved very helpful in the development of the various drafts and final agreement. Changes from the third draft included responses to concerns over high-risk areas, cooperatives and affiliate oversight. RMA reviewed technical changes with some industry lawyers on June 15. Each insurance company intending to write new business for the 2005 reinsurance year was required to submit a signed copy of the SRA to RMA no later than close of business June 30, 2004, to allow agents and eligible producers to pursue an orderly transfer of business to an alternative insurance company.

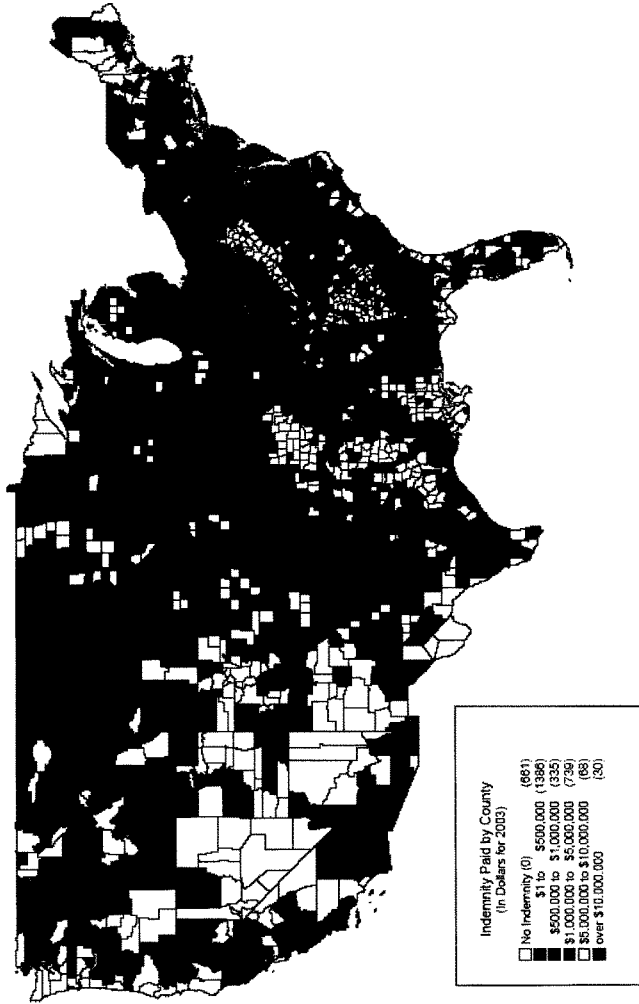
As of June 30, 14 companies representing 100 percent of the Federal crop insurance program had signed the 2005 SRA in time for the 2005 Reinsurance Year that begins July 1, 2004. The Agency continues to receive inquiries from additional insurance companies interested in joining the program in 2005 and has received applications from two such applicants for review. RMA is pleased by this positive response and looks forward to working closely with the insurance companies to continue to advance the crop insurance program and meet the risk management needs of America's agricultural producers.

We are anxious to again work closely with the companies, associations and other interested parties so we can collectively strengthen the crop insurance program and address a wide range of issues; some of which will be discussed today.

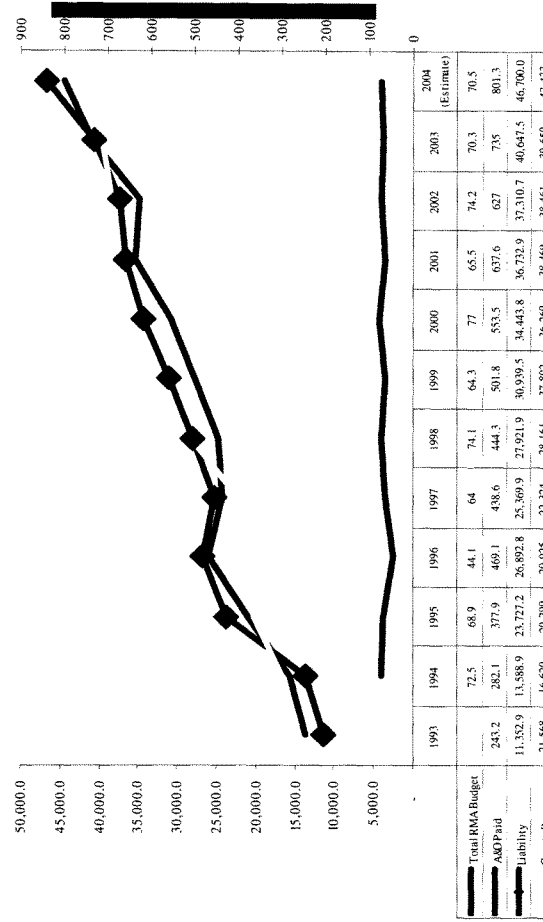
First Operations Review Nearly Complete - RMA is nearing completion of the first Operations Review of an SRA holder. These reviews will compliment ongoing financial examinations of our SRA holders and will also provide the necessary data over time to establish a program error rate that has been sought by the USDA, OIG. The Office of Management and Budget will also use the review results as reported by RMA to satisfy the statutory requirements of the Improper Payments Act. The reviews will assess insurance providers' adherence to the SRA, quality control guidelines, and RMA approved policies and procedures. RMA Compliance will revise the review process and the procedures and prepare a schedule to review all companies over the next 36 months. The next operations review is scheduled in the near future.

Finally, attached to my testimony is a specific update on issues raised at the Subcommittee hearings conducted last year. Again, thank you for the opportunity to participate in this important oversight hearing. I look forward to responding to questions on these issues. Thank you.

2003 RMA Crop Indemnities (As of 03/01/2004)



RMA Program Growth and Expenditures

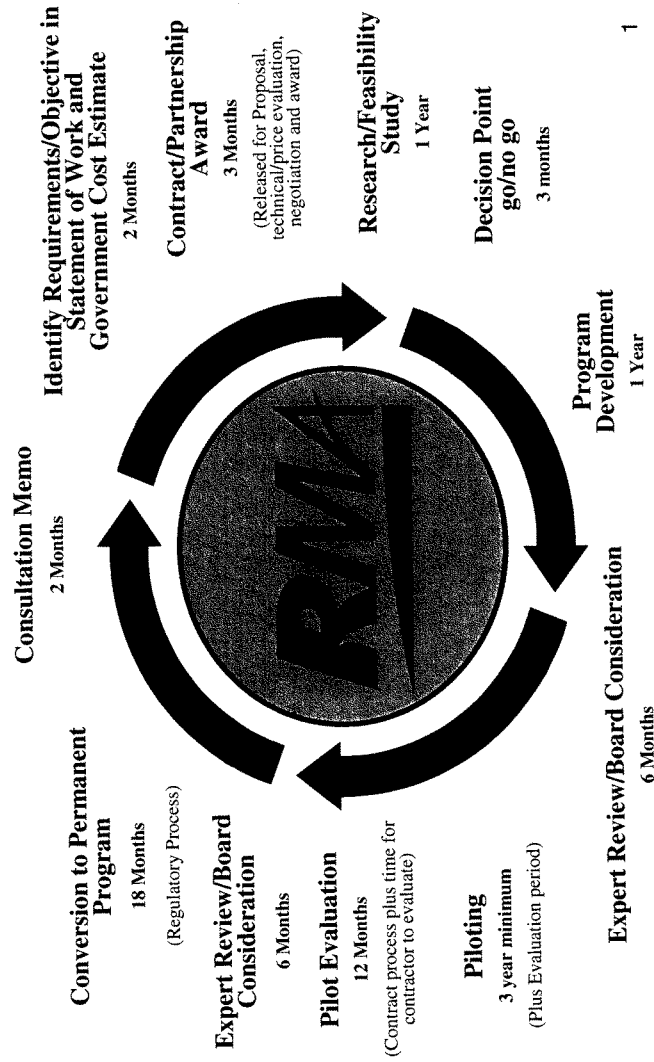


Reinsurance Year (Liability/County Programs) Fiscal Year (Budget)

Source: USDA Risk Management Agency, 2004

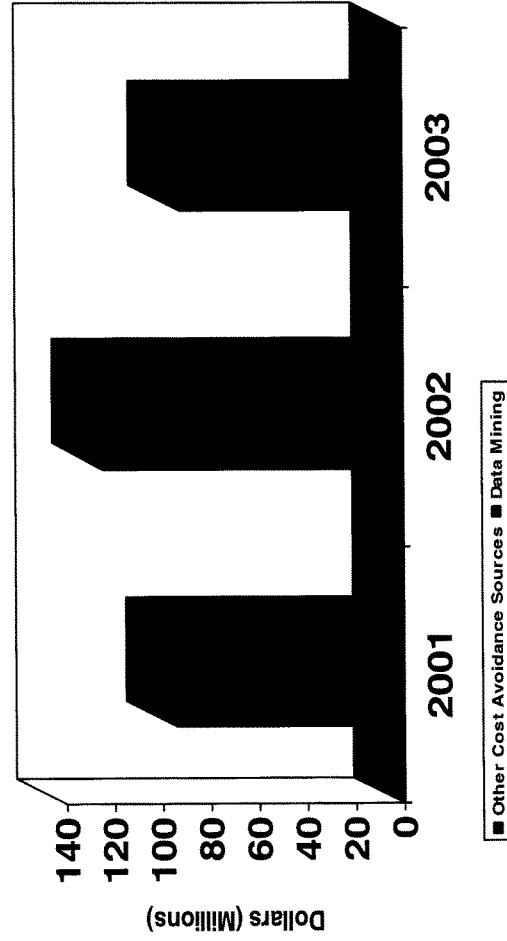
Estimated Timeline and Process for Developing a New Product

(Approximately 9 Years)



Prevention Saves Taxpayers Millions

RMA's data mining efforts, producer notification, and field spot checks dramatically reduce losses.



Source: USDA-Risk Management Agency, 2004

**Subcommittee on General Farm Commodities
and Risk Management**

**Issues from 2003 public hearings
Risk Management Agency**

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1. Multi-year losses – declining coverage and increasing cost

The most frequent and consistent concern heard from producers.

RMA Response:

RMA is somewhat limited by the Federal Crop Insurance Act (Act) in its ability to address

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the issue of declining yields. The Act mandates that a yield for a crop be based on a producer's APH yield for that crop to determine the amount of the insurance guarantee.

RMA has implemented yield adjustments as required by ARPA that may be elected by insureds. Yield adjustments allow an insured to substitute 60 percent of the applicable Transitional Yield (T-Yield) for actual yields that are less than 60 percent of the T-Yield. Yield substitutions may increase effective coverage levels, but may also lead to over-insurance and be detrimental to the actuarial soundness of the program. Additionally, the current yield substitution may not treat producers in an equitable manner, as it tends to assist those producers whose average yield is near or lower than the T-Yield while not providing any or effective relief for those producers with yields that tend to be above the T-Yield.

Alternative Methods for Mitigating Declines in Approved Yields Due to Successive Years of Low Yields - In March 2004, RMA released a Statement of Objectives to develop new or revised methods for mitigating declines in an insured's approved yield following successive years of low yield. RMA's goal is to obtain proposals for: (1) research and development of new and innovative approaches to mitigating declines in yield guarantees following successive years of low yield, or provide improvements to existing procedures; and/or (2) research and development of new and innovative procedures for determination of approved APH yields. In May, RMA held a pre-proposal conference, featuring Chairman Moran as our kick-off speaker, to assist interested parties to better understand RMA's objectives in soliciting proposals to develop new or revised methods for mitigating declines in an insured's approved yields. Contract Proposals were due June 30, 2004. RMA formed a TET to begin contract proposal evaluations during the week of July 12.

Through this approach, RMA will seek proposals for new or modified approaches to establishing approved APH yields that are less subject to decreases during successive years of low yields as compared to current procedures; and that are equitable across policy holders with differing average yields; and broadly applicable to all crops and regions; affordable to policy holders; feasible and cost-effective for RMA and reinsured companies; and is actuarially sound.

2. Approval of expansion of Adjusted Gross Revenue (AGR)/AGR-Lite

In August, the FCIC Board of Directors (Board) expanded AGR-Lite to additional counties and states. More states have requested these programs.

RMA Response:

AGR-Lite is based on the AGR product. It uses the same rates/rating methodology.

AGR is a pilot program developed and administered by RMA. The FCIC Board concluded last summer that further expansion of AGR should not be considered unless the pilot evaluation that will be completed by mid 2005 concludes the program is performing satisfactorily.

RMA has recently awarded a contract for an independent evaluation of AGR. The evaluation is an in-depth review of the program's performance during the pilot phase, including producer's acceptance, actuarial and underwriting performance, etc.

The AGR evaluation will assist in determining whether AGR is a viable product for the future, should be modified or can continue on a permanent basis. AGR is available in 216 counties and 14 independent cities in 18 states. The evaluation results should be finalized mid-2005.

Three years of experience is typically required for the evaluation of pilot programs. The AGR evaluation will include experience from the 2001-2003 crop years, and part of 2004.

An average of approximately four commodities are insured per AGR/AGR-Lite insurance policy. Extensive actuarial and underwriting work, to identify all commodities grown in the area and to quantify premium rates for these commodities, is performed when setting up the AGR or AGR-Lite plan of insurance in a county. RMA has issued a contract to research alternative and simpler methods of setting up the AGR/AGR-Lite actuarial and underwriting structures in new areas.

AGR Insurance Sales for 2002/2004

Year	#Policies	Liability	Premium	Indemnity
2002	748	\$244,797,134	\$8,966,153	\$10,831,181
2003	942	\$318,849,592	\$12,150,804	\$3,754,298*
2004**	827	\$302,325,672	\$12,851,440	*

*Indemnity either reported to date but not complete or not available until fall.

**Data may not be complete at this time.

AGR-Lite is a plan of insurance approved under section 508(h) of the FCIC and owned by the Pennsylvania Department of Agriculture (PDA). It was first approved for the 2003 crop year in Pennsylvania. On August 1, 2003, the FCIC Board approved expansion of AGR-Lite to 11 northeast states for the 2004 crop year. On May 6, 2004, the Board approved AGR-Lite expansion for the 2005 crop year into Alaska, Idaho, North Carolina, Oregon and Washington, provided that actuarially appropriate premium rates, as approved by the Manager of FCIC, are provided by the Pennsylvania Department of Agriculture, Washington State University Extension Western Center for Risk Management Education and the North Carolina Department of Agriculture.

AGR-Lite Insurance Sales for 2003/2004

Year	#Policies	Liability	Premium	Indemnity
2003	73	\$2,667,218	\$130,753	*
2004**	88	\$3,286,326	\$175,820	*

*Indemnity either reported to date but not complete or not available until fall.

**Data may not be complete at this time.

Since the PDA currently owns AGR-Lite any expansion requests would need to be coordinated through them and if no AGR rates are available in an area slated for expansion, actuarial work must also be performed by the submitter with premium rates developed and provided. Due to AGR-Lite

being based on AGR, the final recommendation and any changes recommended by the AGR evaluation will also likely pertain to AGR-Lite.

3. Authority to cover pest-related quarantines

An option for such coverage is needed even if it requires additional premium.

RMA Response:

A contract was awarded in September 2003, to develop a quarantine program for producers to mitigate losses arising from an inability to sell their particular agricultural commodity when that commodity is subject to a legally imposed quarantine.

The contract directed the development of an endorsement to the basic provisions for the following currently insured crops:

- Wheat in Arizona, California and Texas
- All citrus in Arizona, Texas and Florida
- Avocados in California and Florida

The contract also directed the development of a stand-alone quarantine insurance policy for quarantines due to multiple perils covering the following crops and states:

- Eleven counties in California for the quarantine pilot program: Fresno, Kern, Imperial, Los Angeles, Orange, Riverside, San Bernardino, San Diego, Santa Barbara, Tulare, and Ventura, for multiple disease and insect perils for all insured and non-insured fruits, vegetables and other specialty crops, unless data collected during the development process indicates that the crop should not be covered.
- Quarantine coverage is being developed as an endorsement to the basic policy for San Luis Obispo and all other California counties not named above. RMA is aware of the concern for quarantine coverage for San Luis Obispo and may consider San Luis Obispo as an additional county for the stand-alone quarantine policy when it goes forward to the FCIC Board.
- The target date to send this proposal to the FCIC Board for consideration and expert review is fall 2005. The target year for implementation is crop year 2006.

4. Inadequate time between release of product information and sales closing date

A witness at the July hearing requested a minimum of four months to review policy changes and new material, prior to the sales closing date for that crop policy.

How can RMA/FCIC better manage the process to ensure adequate time is provided to industry?

RMA Response:

RMA has little flexibility in changing sales closing dates, especially for spring planted crops because section 508 (f) (2) (B) of the FICA statutorily set sales closing dates for spring crops that are 30 days earlier than they were for the 1994 crop year. For example, the sales closing dates for corn range from January 31 (south Texas) to March 15 (Midwest and Northern States). Sales closing dates are established early enough in the crop year to minimize adverse selection to the program.

RMA does file all actuarial material by the contract change date which generally should give adequate time for sales (for example for Spring seeded crops with Sales Closing Dates ranging from January 31 to March 15, the actuarial filing is generally issued in October of the previous year (e.g. October 2004 for the 2005 crop year sales). For fall seeded crops with a September 30, Sales Closing Date the actuarial filing is generally released in May, well in advance of the June 30, Contract Change Date.

RMA notes that one of the concerns raised to the Subcommittee regarding the sales closing date was with respect to the nursery crop insurance program. RMA plans to propose changes to the nursery crop insurance program including a change that may help alleviate this concern.

5. Streamline approval process for private product submission

Testimony from the July and October hearings reflects frustration that the FCIC Board has not approved more expansion of specialty crop products. The four page checklist which must accompany 508(h) submissions is viewed as particularly burdensome and a hindrance to private sector product development.

RMA Response:

RMA developed an interim rule (subpart V) for submitting private products under section 508(h) of the FCIA. The regulation outlines the contents that must be contained in a private product submission to ensure that submitted products are complete and of sufficient quality for expert review. This also helps in expediting the review process.

It is important to note that the 508(h) process is a process defined by legislation designed to allow a private entity to create an actual insurance product that will be implemented and sold if it is approved. Therefore, the submission is not just a concept, but also a fully developed product capable of being implemented. RMA does not view these requirements as a hindrance but rather as appropriate regulations to ensure that the integrity of submissions and to provide submitters with a defined listing to assure them the greatest chance of success.

All new product 508(h) submissions go through an external and internal review process. Review by five external reviewers (required by the FCIA) is contracted out and involves substantial costs. In order to enable a meaningful review, it is imperative that each submission contains all of the

components pertaining to underwriting, actuarial soundness, and marketability. Additionally, all components must be provided to allow the submission to be implemented if it is approved. Without all of the components listed on the checklist, key issues with the potential for negatively affecting the best interests of producers, actuarial soundness and markets/prices could be missed in the review process and, for those submissions that are approved, timely implementation would not be possible if all components were not included.

6. Establish a minimum loss standard

When the cost of harvesting a loss-affected field exceeds the appraised salvage value (the cost of harvest is more than the remaining crop is worth), that field should be given an effective appraisal of zero, indicating a 100 percent loss.

RMA Response:

A crop insurance policy does not require producers to harvest a crop when, in the producer's opinion it would not be economically feasible to do so. The producer, however, does retain the right to harvest the crop if they wish.

RMA has been asked to implement a "de-minimis yield" in the past. RMA has declined because the risk associated with implementing such a procedure would require an increase in rates. Producers with minimal yields can ask for a field appraisal of their crops in order to determine how much production will apply to their insurance guarantee. If the amount of appraised production is less than the cost of harvesting, most producers will accept the appraisal and receive a release on their crop. Under the insurance contract, producers who accept a field appraisal agree to put the fields to another use without harvesting. If the producer subsequently decides to harvest after they have agreed to destroy the crop, they must notify their insurance company and report the production.

The production to count for claim purposes is used for subsequent year APH calculations. A de-minimis yield that would be an effective appraisal of zero would also have to be considered in how RMA would treat such for future year APH calculations.

7. Additional producer education

At all hearings, a desire for more education and information about insurance options was expressed. Suggestions included more information available on the RMA website in an easy-to-locate format, additional agent training and agency outreach sessions directly targeted to producers.

How are funds being used to facilitate producer education?

RMA Response:

One of RMA's strategic goals is to ensure that its customers are aware of the numerous risk management solutions available. This goal is supported by sections 524(a)(2) and 522(d)(3)(F) of the FCIA. Section 524(a)(2) authorizes funding for the establishment of crop insurance education and information programs in States that have historically been underserved by the Federal crop insurance program. Fifteen states were designated as "underserved." They are Connecticut, Delaware, Maine, Maryland, Massachusetts, Nevada, New Hampshire, New Jersey, New York, Pennsylvania, Rhode Island, Utah, Vermont, West Virginia and Wyoming (collectively referred to as "Targeted States"). The goal of this program is to ensure that farmers and ranchers in the Targeted States are sufficiently informed of, and therefore can take full advantage of existing and emerging crop insurance products. Section 522(d)(3)(F) authorizes FCIC funding for risk management training and informational efforts for agricultural producers through the formation of partnerships with public and private organizations. With respect to such partnerships, priority is to be given to reaching producers of certain commodities, referred to as Priority Commodities, which include agricultural commodities covered by 7 U.S.C. 7333, specialty crops, and underserved commodities.

To ensure that we are meeting the requirements of the FCIC and that goals are being met, RMA has implemented and oversees two agricultural producer education programs.

1. The commodity partnerships for our risk management education partnership agreement program. The purpose of this program is to deliver training and information in managing production, marketing, and financial risk to U.S. agricultural producers of specialty crops and underserved commodities.
2. The crop insurance education in targeted states cooperative agreement program. The purpose of this program is to assist RMA in delivering crop insurance training and

information to agricultural producers in fifteen states that have been underserved with respect to crop insurance.

State governments, universities, for profit and nonprofit organizations are eligible to apply for funding. Applications are submitted in response to a request for applications notice, which is published annually in the Federal Register and posted on the RMA website. A limited number of one-year cooperative agreements and partnership agreements are awarded to applicants based on the recommendations of a review panel. Both programs have similarities, but also key differences. The differences stem from important features of each program's authorizing legislation.

8. Review of rating structure

Witnesses at all hearings from July to October raised concerns about different areas of the country paying the same rate, and/or producers in the same area paying different rates for similar products and coverage. Data mining information could simplify rating, monitor and reinforce good farming

practices. Individual experience rating was suggested, providing a discount for a “no loss” producer similar to a “good driver discount” in auto insurance.

RMA Response:

Premium rates are set at the county level based on experience data from the county. Losses incurred in one state do not increase the premium rate paid by insureds in other states. RMA does not determine premium rates by utilizing a “national catastrophic rate load”, a common practice utilized by some lines of property casualty insurance programs (e.g. auto, fire, natural disaster), since this would result in insured’s in areas without significant losses being forced to pay higher premium rates as a result of losses incurred elsewhere in the nation. For most crops, RMA adjusts each insured’s premium commensurate with their individual APH yield.

Some pilot programs may have similar rates over wider areas due to limited data availability. In this case, unique county level rates emerge over time as experience data are accumulated and incorporated.

RMA reviews and updates rates at least every five years, but in most cases every two or three years, to ensure that the most recent insurance experience is included. Each year, RMA reviews and analyzes crop and state level loss experience data to determine when updates are necessary. RMA continues to enhance its rating process by focusing on crops and areas with the highest loss ratios in an effort to reinforce actuarial soundness.

RMA has contracted for a study to determine the best mechanism to offer a good experience discount for those who remain in the program and who have generally good insurance experience relative to producers of the same commodity in the same area. The

feasibility study mandated by ARPA has been completed and the current contract will propose the best method for development and implementation by RMA.

9. Accuracy of T-yields

Multiple witnesses believe there is a discrepancy between the T-yields assigned and actual National Agriculture Statistics Service (NASS) yields. By definition, the T-yield is based on the NASS 10-year county average. RMA should review T-yields and make adjustments if needed.

RMA Response:

In general, T-yields are based on the NASS 10-year county average when representative NASS data are available. In cases where NASS data are deficient, Regional Offices recommend T-yields based on additional information (e.g., RMA insured experience) and unique knowledge of the crop or growing area due to Regional Office expertise. RMA reviews and updates T-Yields at least every five years, but in most cases every two or three years, at the same time rates are updated to ensure that the most recent yield information is included.

It should be noted that apparent discrepancies can be the result of a time lag in data availability. NASS county yields are calculated late enough and insurance documents must be published far enough in advance that the base of data used to compute T-yields can lag behind two years. NASS completes end-of-year county estimate surveys (November and December of each year) and releases county estimates to RMA the following spring. For example, 2003 county estimates were released in spring 2004 in time for inclusion in the 2005 crop year filing.

RMA has contracted a study to determine the optimal method for establishing T-yields. In any case, it is in RMA's best interest to ensure that current T-yields are accurate and appropriate. To that end, RMA is always willing to review specific examples of questionable T-yields and, if necessary and appropriate, take immediate corrective action.

10. Review prevented planting provisions

Several program crop producers expressed concerns about prevented planting, particularly for irrigated production. It was suggested that the requirement of 20 percent or 20 acres be prevented from planting to qualify, be lowered to a threshold of 5 percent or five acres.

RMA Response:

The 20 percent/20-acre limitation was added to the prevented planting provisions because past RMA reviews revealed that prevented planting payments were being made for small

areas within a unit that historically were not planted for various reasons. It was felt that it would be better for the producer to absorb a small loss in order to keep rates at a minimum.

Lowering the 20-acre or 20 percent requirement to a lesser amount of acres or percentage of acres was discussed during various prevented planting forums held in 2003 (forums were composed of representatives from companies, grower groups, RMA, Cooperative State Research, Education and Extension Service and four other crop insurance interest groups). Besides the group discussing changes that would result in coverage that is more meaningful for producers, there were also discussions of ways to curb the abuse of the prevented planting provisions that had been occurring. After much discussion changing the current 20 acre or 20 percent threshold was determined to not be in the best interest of the program, because prevented planting payments on very small acreage amounts could lead to yearly payments on very small areas such as pot holes that routinely are not planted, could create less incentive for producers to try and plant and would also result in an increased rate for prevented planting coverage and administrative costs to the program.

RMA will be proposing a number of changes intended to improve prevented planting provisions based on the prevented planting workgroup's recommendations. The focus of these changes will be to provide simplification, increase certainty for the insured producers and insurance providers, provide meaningful coverage in the event of prevented planting, maintain actuarial soundness and reduce program abuse. These changes are currently in the regulatory process and a proposed rule for public comment will be issued with the expectation of implementation for the 2006 crop year.

11. Streamlining revenue products

Since the policies are nearly duplicative, it was recommended that the products be combined for efficiency and easier administration.

RMA Response:

RMA is currently undertaking an initiative to combine the base APH product with the Crop Revenue Coverage (CRC), Revenue Assurance (RA), and IP policies. RMA also plans to combine the GRP with Income Protection (GRIP) and GRIP-HRO products into a single policy in the future. The FCIC Board has also taken a proactive approach when reviewing new insurance products to avoid creating redundancy with existing insurance products. The combinations of these products will reduce confusion, reduce paper-work, eliminate multiple rating structures and will afford producers the choice of electing just yield protection or both yield and price protection. RMA is making every effort to have the combination of APH, CRC, RA and IP completed for the 2006 crop year and plans to follow with the GRP, GRIP and GRIP-HRO combination for the 2007 crop year.

12. Review of RMA quality loss adjustment procedures for program crops

Crop insurance evaluates quality losses differently than local elevators. Ideally, crop insurance should have the same standards and reflect the exact quality discounts assessed at the elevator.

RMA Response:

Section 107 of ARPA required a review of current quality adjustment loss procedures in order to develop procedures that more accurately reflect local quality discounts, stating; "The Corporation shall contract with a qualified person to review the quality loss adjustment procedures of the Corporation so that the procedures more accurately reflect local quality discounts that are applied to agricultural commodities insured under this title. Based on the review, the Corporation shall make adjustments in the procedures, taking into consideration the actuarial soundness of the adjustment and the prevention of fraud, waste, and abuse."

ARPA also stipulated that for cotton; "...the Corporation shall offer producers the option of purchasing quality loss adjustment coverage on a basis that is smaller than a unit ..."

A contract was awarded to Milliman USA, Inc. to do this research. The final report was completed on July 9, 2002.

Study Recommendations - Grain Quality Adjustment (QA):

The study recommended developing regional discount schedules to be maintained by RMA's Regional Offices. This approach would be national in scope and uniform for all crops. However, Milliman grants that this would result in higher maintenance costs. The study also recommends the

use of Olympic averages when the discounts fall off the charts. Local transactions may deviate substantially from recommended discounts. In such cases, quality discounts would be based on an Olympic Average (discard the high and low bid) of five separate local buying points. Thus, either the insured producer or loss adjuster would be required to travel to, wait in line at and receive bids from five different grain elevators. While this may better prevent fraud, waste and abuse and be reflective of the local market price, RMA does not believe this is in the best interests of the producer, grain industry, crop insurance industry or the taxpayers as it would increase administrative costs, could be subject to third party influences if the grain elevators provided lower prices if they knew the bids were for crop insurance purposes and therefore in the end would not be fully reflective of the true local market.

Study Recommendation - Cotton Quality Adjustment (QA) on a Basis Smaller Than a Unit:

The study's risk analysis measured the relative frequency and severity differential between cotton quality loss adjustment on a unit basis and quality loss adjustment on a per-bale basis. Cotton is generally marketed on a per-bale basis. The primary difference between quality loss adjustment on a unit basis and quality loss adjustment on a per-bale basis is that under the per-bale coverage, quality deficiencies are paid for each bale regardless of whether there is a yield loss. The report states this alternate coverage would result in an approximate 10 percent increase in loss costs. The percentage difference is the highest at the lowest coverage level.

The report did not specifically recommend for or against implementing cotton quality adjustment on a per-bale basis, but "strongly recommend RMA implement any coverage changes on a pilot basis, monitor results, and make adjustments accordingly."

RMA has since been contacted by the National Cotton Council and has been having ongoing discussions with them to seek alternatives to improve quality adjustment for cotton. The National Cotton Council did not recommend implementing the study results but rather preferred to explore options and then discuss them with RMA. That process is ongoing.

Industry Comments:

On August 8, 2003, RMA posted the report on its website and requested that producers, producer groups, universities, extension offices and private insurance companies review the study and offer ideas and recommendations for improving the QA procedure. Any recommendations must result in a QA process that is:

1. Reflective of local markets.
2. Easy to administer within current staffing levels.
3. Not subjected to price manipulation, fraud, waste and abuse.

The review of the quality adjustment loss procedure required by ARPA has been completed. After review of the studies recommendations by RMA, the insurance industry and grower associations,

there is no uniform support for changing the current procedure to the study's recommendations. The comments received offered no clear solutions to the concerns raised over the current quality adjustment loss procedure. Based on the study results and feedback received, RMA will continue to use and update the current quality loss provisions.

RMA uses a ten-year average of the FSA loan discounts as compared to the national average loan rate to determine current quality adjustment factors. Due to contract change

dates and actuarial filing schedules there is a two-year lag in the data RMA uses. For example, RMA uses the 2003 FSA loan discounts for the 2005 crop year.

13. Development of GRP coverage

More emphasis on GRP delivery was suggested. Hail coverage should also be added.

RMA Response:

Without more specific information regarding what is meant by GRP delivery, RMA is not able to fully assess the request and its potential. An insurance company has submitted a product that combines GRP with the Income Protection Program to also provide area based revenue protection, and at its October 29, 2003 Board meeting the FCIC Board approved a Harvest Revenue Option feature for the GRIP policy effective for the 2004 crop year.

GRP and GRIP policies are county based and therefore can cover losses due to hail, but often times a hailstorm will not affect the entire county or significantly reduce the county yield. In this case, individual farms that suffer hail losses may not be paid for the loss under a county-based program. In high hail-risk areas, agents typically sell private hail (individual) coverage to supplement the GRP or GRIP coverage. It would seem inappropriate for RMA to add individual hail coverage to the area-based GRP and GRIP products, in light of the broad, general availability of private hail.

The GRIP plan of insurance was a privately developed product submitted to the FCIC Board under Section 508(h) of the Federal Crop Insurance Act. The developers of this product submitted the GRIP plan of insurance for approval for corn and soybeans only. There are other crops insured under GRP, including grain sorghum; however, they were not submitted for Board approval by the private developer.

The developer of the GRIP plan of insurance has since turned the product over to RMA beginning with the 2004 crop year. RMA has only recently received information that there is an interest in expanding the GRIP plan of insurance to other crops such as cotton, grain sorghum and wheat. RMA is assessing the viability of developing GRIP provisions for these crops, and if approved, could be made available pending approval by the FCIC Board. RMA is assessing whether given current resources and timing it can provide GRIP for grain sorghum as early as the 2005 crop year if approved by the Board

RMA recently met with the National Grain Sorghum Producers Association to discuss expansion of the GRP and GRIP plans of insurance for grain sorghum.

Currently, grain sorghum coverage is available under the APH yield, CRC, GRP and IP plans of insurance. However, grain sorghum is not available under GRIP, RA and a pilot Indexed Income Protection (IIP) plan of insurance.

RMA is currently in the process of combining the APH, CRC, RA and IP plans of insurance into a single policy to eliminate redundancies and simplify the crop insurance program. When combined, it is anticipated that grain sorghum producers will have the same coverage choices as corn and soybean producers; however, this change will not be effective until at least the 2006 crop year.

The area plans of insurance (GRP and GRIP) accounted for 2.8 percent (\$1.14 Billion) of the total amount of crop insurance in force (\$40.6 billion) for the 2003 crop year. Area plans covered approximately 5.7 percent of all insured acreage.

14. Optional Units for Continuous Crop and Summer Fallow

Optional units can be established for irrigated vs. non-irrigated. Why can't producers establish optional units for continuous crop and summer fallow? And, how can this be changed? Is this viable, even if the premium rises?

RMA Response:

Optional units are generally established by crop within a section. For some crops, the insurance policy allows additional unit division. For example, irrigated and non-irrigated wheat in the same section can qualify for separate optional units provided separate records of acreage and production are provided for each practice. Irrigated/non-irrigated unit division is provided based on the significant differences in the production perils between these two practices. In addition, some policies also allow unit division based on different crop types. For example, non-irrigated durum and spring wheat in the same section can qualify for separate optional units; however, they are very different wheat types with different quality standards and end uses. Where provided for in the actuarial documents, separate units are also provided for initially planted winter wheat and initially planted spring wheat. Again, this method of unit division is based on significant differences in production perils, quality standards, etc. and is not based on a difference of whether land had laid idle (summer fallowed) or had been continuously cropped.

In addition to the above, when establishing the basis for providing additional breakdown for optional units, consideration must also be given to program integrity and administrative burden. That is, will there be an increased opportunity for shifting production to create or increase losses, increased moral hazard and ultimately resulting in increased rates. Conversely, would providing optional units put additional burden on insured producers and the delivery system for maintaining separate production reporting and record keeping beyond what would traditionally be done given the harvesting and marketing of the crop.

The wheat crop insurance policy does not allow for optional unit division for summer fallow acreage and continuous cropping acreage. The same is true for other crop insurance policies. For example, corn planted on land that had been fallow the previous year and corn

planted on acreage that was in a continuous corn/soybean rotation would not qualify for separate units. In most cases, provided the same crop type is planted, crops grown under both practices would be planted together, harvested together, marketed together, etc. In contrast, different crop types such as durum wheat and spring wheat would not be planted, harvested or marketed together.

The issue of providing additional optional units has been an issue considered by the FCIC Board on different occasions, and the Board has conveyed a sense to RMA that it should not consider providing additional optional units but rather should focus on programs or strategies with fewer optional units.

15. Crop-Specific Issues

A. Apple: Status of Revised Apple Policy

Comments from the July and October hearings:

- Cover all common weather-related damage
- Damaged apples, juice grade or better, are not covered – need option to purchase coverage for a higher quality value
- Expand policy to cover late season varieties
- Base production averages for coverage calculation on county, rather than state, data.
- Allow optional units for non-contiguous units separated by clearly discernible boundaries (e.g., public right-of-ways or roads).

RMA Response:

The proposed rule was published in the Federal Register on March 29. The public comment period ended on April 28, 2004, and RMA is responding to the comments received in the final rule that is to be effective for the 2005 crop year. The contract change date is August 31, 2004, for the 2005 crop year. RMA is working to have the final rule published in time for implementation for the 2005 crop year. RMA regrets that it cannot comment on specific changes to be made in the final rule due to the fact that the regulatory process has not been completed, but we are seeking to be responsive to the comments received consistent with program integrity, actuarial soundness and market responsiveness.

B. Policy Change for Citrus

Citrus canker coverage is not part of the current citrus fruit policy.

RMA Response:

A draft proposed rule that will seek to address this issue is in RMA's internal concurrence process. It is unlikely the final rule can be completed and implemented prior to the 2006 actuarial filing date (12/31/04). RMA plans to have the proposed rule published in the Federal Register by September 15, 2004. Until the rule is finalized, RMA cannot discuss its details.

Under the current Pilot Florida Citrus Fruit Tree crop provisions, Asiatic Citrus Canker (ACC) coverage is an insured cause of loss. A quarantine zone is established in a county when there is a positive find by either the Florida Department of Agriculture and Consumer Services Division of Plant Industry (DPI) or the U.S. Department of Agriculture's Animal and Plant Health Inspection Service. New applicants for insurance and carryover insured's who did not have ACC coverage the previous year must obtain an acceptable ACC Underwriting Certification from DPI to be eligible for ACC coverage. Insured's have ACC coverage once they obtain a "clean" certificate stating that ACC is not present in their groves. Losses are calculated on a "first tree" basis (spot loss) without the standard percent of damage requirement. When DPI determines there is a positive find, those trees and the trees within a specific radius (up to a 1900 foot radius at this time) are destroyed and an indemnity can be determined. Provided an insured does not request a higher coverage level or add acreage, they maintain their ACC coverage on the remaining trees for subsequent crop years.

C. Policy Changes for Nursery Stock

Comments from the July 10, hearing:

- Use growers' wholesale price list as the basis for coverage valuation, eliminating use of the current FCIC-printed wholesale price for valuation purposes.
- Provide coverage for plants grown in containers smaller than three inches in diameter.
- Separate policies for field-grown and containerized plants.
- Year-round sales, subject to a 30-day waiting period to begin coverage.

RMA Response:

A proposed rule is in the final stages of review and should be published in the Federal Register in the near future. The final rule is targeted to be effective for the 2006 or 2007 crop year depending on the timing of Departmental clearance and the number of issues raised during the public comment period.

D. Expansion of Georgia Blueberry Pilot Program

Blueberries are produced in 12 counties, but coverage is available only in three pilot counties. (7/10 hearing)

RMA Response:

The FCIC Board approved the conversion from pilot program to permanent status effective

beginning with the 2005 crop year. Due to the length of the regulatory process, the FCIC Board approved expansion of the blueberry pilot program for the 2004 crop year, to

selected counties in Michigan, Oregon and Washington. For the 2005 crop year, the program is available in selected counties in 11 States.

The proposed rule for the Blueberry Crop Provisions was published on July 30, 2003. Responses to public comments regarding the proposed rule were incorporated into the final rule. To be effective for the 2005 crop year the final rule must be published in the Federal Register by the August 31, 2004, contract change date.

E. Price Election for Georgia Peaches

Review use of localized pricing instead of NASS.

RMA Response:

RMA has held numerous discussions on this issue, which also involves how South Carolina peach price elections compare to Georgia price elections. In particular, discussions with major South Carolina peach growers and Senator Graham and his staff have occurred.

RMA peach price elections are established based on the five-year average of State NASS peach prices, less post-production costs, to arrive at the on-tree price that producers can expect to receive. Although not always the case, in recent years, these NASS data supported higher price elections in Georgia than South Carolina.

South Carolina producers argue they sell into the same market as many Georgia producers, yet current Georgia peach price elections remain slightly higher than South Carolina peach price elections. NASS data continue to support the slightly higher Georgia price elections. The NASS data for both Georgia and South Carolina are based on statistically defensible sampling procedures and survey response rates, and thus provide a compelling argument that the current price differential between Georgia and South Carolina is appropriate.

RMA is currently unable to develop defensible price elections at levels other than what NASS data provide for. Certain Agricultural Marketing Service data are available at specified buying points below the State level, but these data are 'spot market' price quotes and do not include volume or quality information. The problem of a lack of independently verifiable price and volume data at the local level is unlikely to be resolved.

F. Written Agreements for Vegetables in Georgia

Regional Offices differ in their interpretation of the guidelines for written agreements, used to insure crops in counties where an insurance program is not available. RMA should work with all Regional Offices to clarify more uniform guidelines.

RMA Response:

Underwriting procedures used to administer written agreements are contained in the Written Agreement Handbook and intended to provide uniform standards used by the Regional Offices to process written agreement requests.

The Written Agreement Handbook is currently under consideration and review by the FCIC Board and a panel of six expert reviewers.

Depending on the outcome of this review and directions from the FCIC Board, final written agreement procedures will be issued.

In developing these final procedures, RMA will seek to clarify the conditions under which written agreements for crops in counties without programs, including vegetables, are considered. However, it should be recognized that growing practices and conditions, and thus, conditions of insurability might vary from one state or county to another. As a result, RMA, through its Regional Offices, must maintain the latitude to evaluate each request and determine if a sound insurance offer through a written agreement can be made.

G. Quality Issues for Malting Barley

At the Minnesota field hearing, concern was expressed about RMA using a different standard than the industry to determine quality loss due to pre-harvest sprouting. There is also a discrepancy between RMA's protein percentage and the maximum allowed by industry in accordance with the Grain Inspection, Packers and Stockyards Administration (GIPSA) standards.

RMA Response:

RMA is aware of recent identified discrepancies between RMA's quality standards and the industry standards. Sprout damage is covered in the policy as insurable (1 percent). The recent directive by GIPSA establishes "injured-by-sprout" (pre-harvest sprouting) as a new official criteria, that is intended to provide additional information only and has no bearing on the assigned grade. Sprout Damage (a grading factor) is a visual test of the kernel that identifies obvious sprout damage. Injury-by-sprout identifies pre-sprouting (before it breaks the covering of the seed). A legal review determined that placing injury-by-sprout in the crop insurance policy, as a quality standard must be done through publication in the Federal Register as a proposed rule. The Injury-by-sprout addition may require a rate review, because current rates do not reflect this industry grading change. Protein levels will be reviewed and updated to reflect industry standards and RMA may propose adding acceptable Mycotoxin (Vomitoxin, etc) levels to the policy.

RMA is also concerned about recent reports of questionable practice of grain companies buying malting barley – as feed barley – then reselling as malting barley. Another concern is brewers providing growing contracts to producers that do not have a consistent history of growing malting barley.

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RMA has a very good working relationship with the National Barley Growers Association and has recently has attended several meetings to discuss proposed changes to the Barley insurance program. Most recently in June of 2004, an RMA representative attended the National Barley Growers annual meeting in Washington, D.C. to discuss proposed changes.

The contract change date for malting barley is June 30. Any changes will be proposed in the APH, CRC, RA, IP combination initiative. The earliest any changes can be made is for the 2006 crop year.

H. Cotton Issues

Four items were raised in September and December:

1. A credible quality loss provision should be implemented on a bale-by-bale basis with a reasonable threshold of loss.
2. Non-emerged, drought-affected dryland cottons should be allowed to be released in a timely manner, and appraisal dates should be clear and consistent prior to the time by which insurance decisions must be made.
3. Boll count appraisal methods currently used by RMA are outdated and unscientific. Producers have submitted a recommendation for a revised method, but no revision has been implemented.
4. Producers in the Northern Texas Panhandle counties should be eligible to purchase cotton coverage.

RMA Response:

1. RMA quality adjustment is currently performed on a bale-by-bale basis. Each bale's quantity may be adjusted due to the quality adjustment issues affecting that bale. For example, a 600-pound bale of poor quality cotton may equate to 300 pounds of good cotton. Cotton bales are aggregated on a unit basis – the same basis on which the insurance is purchased – and if the adjusted quantity is less than the guarantee, an indemnity is due. This allows the producer to purchase the amount of insurance, which best fits their needs without adversely affecting rates or other producers. RMA contracted a study on the specific issue of offering cotton quality adjustment on a bale-by-bale basis that is not aggregated to the unit level.

Recommendations from Contracted Study (An Independent Actuarial Review of Quality Adjustment 5.6.3 Section 107 of ARPA) Regarding Cotton Quality Adjustment (QA) on a Basis Smaller Than a Unit:

The study's risk analysis measured the relative frequency and severity differential

between cotton quality loss adjustment on a unit basis and quality loss adjustment on a per-bale basis. Cotton is generally marketed on a per-bale basis. The primary difference between quality loss adjustment on a unit basis and quality loss adjustment on a per-bale basis is that under the per-bale coverage, quality deficiencies are paid for each bale regardless of whether there is a yield loss. The report states this alternate coverage would result in an approximate 10 percent increase in loss costs. The percentage difference is the highest at the lowest coverage level.

The report did not specifically recommend for or against implementing cotton quality adjustment on a per-bale basis, but “strongly recommend RMA implement any coverage changes on a pilot basis, monitor results, and make adjustments accordingly.”

RMA has since been contacted by the National Cotton Council and has been having ongoing discussions with them to seek alternatives to improve quality adjustment for cotton. The National Cotton Council did not recommend implementing the study results but rather preferred to explore options and then discuss them with RMA. This process is ongoing.

- 2 RMA has taken considerable efforts in an attempt to address this issue and find a viable solution without adversely affecting the crop insurance program regarding the eight-day deferral period. RMA used information from the Texas Cooperative Extension and Texas A&M to confirm it takes an average of 5-13 days (RMA uses 8 days) for seeds to emerge after planting. Using data from the same sources, RMA has also confirmed there are sufficient heat units in an average year to produce a crop planted before the final planting date or during the late planting period. While RMA was unable to accommodate a change for the 2004 crop year, RMA will continue to work with the National Cotton Council, the Plains Cotton Growers and other interested groups to try to find a long term solution that meets the needs of producers without creating opportunity for fraud, waste and abuse. Some considerations may be adjusting the final planting date or shortening the late planting period. The final planting dates and the late planting periods are on the Special Provision of Insurance that are provided to insureds as well as posted on the Internet.
- 3 The current boll count appraisal method was based on a dated study. Producers submitted a change recommendation based upon a very limited area (19 counties) for one year. RMA insures cotton from California to Georgia and from Texas to Virginia. RMA has prepared a contract to study the appraisal methods for mature cotton that will span multiple years in all major cotton growing areas, using prevailing farming practices, and the major cotton varieties. RMA will announce and release the study's results once the final contracted deliverable is accepted.
- 4 Cotton is insurable in several Northern Texas Panhandle counties such as Hartley, Moore, and Sherman. Additional counties are being proposed for 2005. In addition, if a producer in a county without a cotton program can prove harvested production for three years, they may qualify for a written agreement.

I. Sorghum Issues

Equalize the CRC price election to reflect current market price relationship with corn

RMA Response:

RMA establishes price elections for the APH plan of insurance, including those for corn and grain sorghum, relying heavily on projections from USDA's World Agricultural Supply and Demand Estimates (WASDE). APH price elections utilize the legislated commodity loan rate as the price

floor for the crop. In recent years of low prices, the APH market price election has been established at the loan rate for corn and grain sorghum.

The CRC product is a market-based product. However, since grain sorghum is not traded on exchanges such as the Chicago Board of Trade, there is no futures market price discovery mechanism available. Thus, until the 2004 crop year, the base and harvest prices for CRC grain sorghum had been set at 95 percent of the CRC corn base and harvest price from the Chicago Board of Trade -- based on fundamental analysis of the historic market price relationship between corn and grain sorghum.

At the request of the National Grain Sorghum Producers Association (NGSPA), RMA revisited the CRC grain sorghum pricing methodology. As a result, on October 29, 2003, the FCIC Board approved a change in the formula used to determine the CRC grain sorghum price election to make it more reflective of the most recent expected market price relationship between corn and grain sorghum. The relationship is now based on the harvest year's USDA January estimate of corn and grain sorghum prices as determined by the World Board. This change reflects the best possible estimate, nearest the sales closing date, for what the relationship of corn and grain sorghum will be for the harvest year. This approach provides flexibility for grain sorghum to potentially be equal to, or greater or less than the corn price depending on the estimate of the potential market given USDA's rigorous analysis and price forecasts. RMA implemented this new methodology for the 2004 crop year, resulting in a 2004 CRC grain sorghum price set at 95.9 percent of corn.

NGSPA has asked that RMA make further changes to the calculation of the price percentage relationship between grain sorghum and corn. However, the pricing data currently used by USDA does not support such a change.

J. Coverage for Silage Sorghum

Insurance coverage is needed for sorghum silage, similar to the current policy for corn silage. The NGSPA requested that RMA provide insurance coverage for dual-purpose grain sorghum varieties that are grown for harvest as silage. Under the current grain sorghum insurance program, grain sorghum grown for silage purposes is not eligible for insurance.

RMA Response:

The FCIC Board voted on May 6, 2004, to approve a Pilot Program to provide crop insurance coverage for Sorghum Silage. This was developed through a development contract granted to Watts and Associates. Grain sorghum varieties grown for harvest as silage will be eligible for coverage under the new pilot program beginning in the 2005 crop year and continuing through the 2008 crop year for two counties in Colorado and 37 counties in Kansas. RMA will finalize the policy terms and conditions and anticipates release of such with the 2005 crop year actuarial filing for grain sorghum in early October 2004. The sales closing date will be March 15, 2005, for the 2005 crop year.