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S. HRG. 109–509

TO REVIEW THE AGRICULTURAL RISK PROTECTION ACT OF 2000 AND RELATED CROP INSURANCE ISSUES

HEARING

BEFORE THE

COMMITTEE ON AGRICULTURE, NUTRITION, AND FORESTRY UNITED STATES SENATE

ONE HUNDRED NINTH CONGRESS

FIRST SESSION

JUNE 28, 2005

Printed for the use of the
Committee on Agriculture, Nutrition, and Forestry

Available via the World Wide Web: http://www.agriculture.senate.gov

U.S. GOVERNMENT PRINTING OFFICE

22–647 PDF WASHINGTON : 2006

For sale by the Superintendent of Documents, U.S. Government Printing Office
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TO REVIEW THE AGRICULTURAL RISK PROTECTION ACT OF 2000 AND RELATED CROP INSURANCE ISSUES

TUESDAY, JUNE 28, 2005

U.S. SENATE,
COMMITTEE ON AGRICULTURE, NUTRITION, AND FORESTRY,
Washington, DC.

The committee met, pursuant to notice, at 10:10 a.m., in room SR–328A, Russell Senate Office Building, Hon. Saxby Chambliss, [Chairman of the Committee], presiding.

Present or submitting a statement: Senators Chambliss, Lugar, Roberts, Crapo, Grassley, Harkin, Conrad, and Nelson.

STATEMENT OF HON. MIKE CRAPO, A U.S. SENATOR FROM IDAHO

Senator CRAPO [presiding]. The hearing will come to order. As you can see, I am not Senator Chambliss, but he will be here soon and we wanted to get this hearing started so that we can continue and keep on time. It is a very busy morning. I, myself, have three hearings at this exact time and I suspect that is about the way it is with every other Senator this morning, so you will probably see a number of people coming in and going throughout the morning. It is not to indicate a lack of importance of the topic, it is just to indicate how things are starting to hop around here.

This hearing is to review the Agricultural Risk Protection Act of 2000, and I would like to welcome all of our witnesses who are here with us today. I especially want to welcome Ray Buttars, who traveled from Idaho to take part in this hearing. Ray, who is the father of four and is accompanied here by his wife, Melissa, grows wheat and barley and corn and alfalfa and beans while serving as the President of the Idaho Grain Producers Association and as the Chairman of the National Association of Wheat Growers Domestic Policy Committee. Ray, we thank you for being here with us to share your perspective on Federal crop insurance.

All of the other witnesses here deserve a special introduction, too, but since you are not from Idaho, I don't have your biography, so I will just welcome you here and tell you that we do appreciate the attention you give to this important issue.

Farmers and ranchers are at the mercy of Mother Nature, and plant and animal diseases, fluctuating markets, and rising production costs. With all the challenges of farm families that we are faced with, it is essential to ensure that producers have access to

the risk management tools necessary to rebound quickly when disaster strikes.

That is why I was proud to support the enactment of the Agricultural Risk Protection Act. This law has made significant enhancements to the Federal Crop Insurance Program and I commend the Department of Agriculture for the variety of different programs that have been developed and tailored to the particular needs of many diverse commodities.

More producers are utilizing Crop Insurance Programs. Idaho is a great illustration of this. In 1994, Idaho producers signed up for a total of $97 million worth of liability coverage through Risk Management Agency programs. This year is expected to be a record high for coverage in Idaho, with more than $600 million in coverage. This is due in large part to substantial work and dedication of the RMA staff toward educating producers about the availability of products and working with the agriculture community to ensure that the products fit the needs of the farms.

As farm risk management needs change, we must continue to review and adapt our Federal Crop Insurance Programs, and today's review of ARPA and the discussion will help us toward ensuring that farm families have the implements necessary to face whatever might come their way.

Now, as other members of the committee arrive- and I will have to check with the chairman's staff- will they be allowed to make opening statements, or do we want to pass that and get right on with testimony?

All right. We are going to go ahead with testimony and I will let the chairman decide what to do with the statements of other members when they arrive.

So with that, we will start with our first panel. I don't know what Chairman Chambliss does on this, but we would like to restrict your testimony to 5 minutes. We do have three panels today and I know the Senators who are here are going to want to have an opportunity for dialog with you. My experience is that neither I nor anybody else can ever get everything that they want to say into 5 minutes. Your written testimony will be made a part of the record, but we do ask you to try to pay attention to the 5–minute clock, and then when it winds down, wrap up your testimony.

With that, we will start with our first panel, which is Dr. Keith Collins, the Chief Economist of the U.S. Department of Agriculture, and Mr. Ross Davidson, who is the Administrator of the Risk Management Agency. Gentlemen, we will have you go in that order.

Dr. Collins?

STATEMENT OF KEITH COLLINS, CHIEF ECONOMIST, U.S. DEPARTMENT OF AGRICULTURE, WASHINGTON, DC

Mr. COLLINS. Thank you very much, Mr. Chairman. We thank you and Mr. Chambliss for inviting Mr. Davidson and me to participate in today's hearing on the performance of crop insurance under ARPA.

I will briefly discuss the role under ARPA of the Board of Directors of the Federal Crop Insurance Corporation, of which I am the elected Chair. The Board has general management responsibility for FCIC. The primary activities of the Board under ARPA include

approving new products, improving and expanding existing products, establishing priorities for the Federal Crop Insurance Corporation, evaluating the FCIC's products, improving Board operating processes, and dealing with a range of other issues, including premium reduction plans.

The Federal Crop Insurance Program is growing. I think it is getting better every year, and I believe today it is serving the needs of the public well. Acreage in the program and insured liability reached record highs last year and farmers are increasingly turning to crop insurance as more products are being developed and approved for more crops in more regions of the country.

In the 5 years under ARPA, the Board has met 46 times, compared with 28 times in the 5 years prior to enactment of ARPA. The increased activity reflects the submission of private products, as provided under Section 508(h), and the requirement that the Board use independent expert reviewers in its deliberations, as well as the need for the Board to take action with respect to numerous pilot programs and research products.

Under ARPA, over 200 individual independent expert reviews have been conducted on over 40 submitted crop insurance products and program modifications. Examples of some of the products approved include the Livestock Risk Protection pilot plan of insurance for swine, fed cattle, and feeder cattle; the Livestock Gross Margin pilot program for hogs. After BSE and for other reasons, sales were suspended on these products, but changes approved by the Board made possible the reopening of sales last fall. We had a test of these new procedures with the second positive finding last week and the procedures appear to have worked well.

Another Board action significantly expanded Adjusted Gross Income-Lite. First offered in 2003 in Pennsylvania, AGR-Lite has been expanded this year to 17 States. The Board believes AGR-Lite, which covers adjusted gross revenue for the whole farm, can potentially fill an important void by appealing to small- to medium-sized producers, particularly of livestock and specialty crops. Sales have been slow, and the Board is working with the submitter to consider potential changes to improve the product and increase sales.

Some examples of other products approved by the Board during the past year include a silage sorghum pilot program, group risk income protection for grain sorghum, a new pilot group risk plan rangeland program, a new pilot program for sweet potatoes, and permanent programs for mustard, mint, wild rice, and cabbage.

A major issue the Board and RMA continue to face is the provision for a Premium Reduction Plan for producers. Section 508(e)(3) of the Federal Crop Insurance Act requires the FCIC to allow approved insurance providers to offer premium reduction plans if they meet the legal requirements. In 2002, one company, Crop 1, requested Board approval to offer a PRP. In December 2002, the Board established certain standards that such a PRP should meet and directed RMA to develop additional procedures under which Crop 1 and other companies could operate a PRP.

After that, six additional approved insurance providers, representing over 80 percent of the crop insurance business, requested approval for a PRP. Because of the diversity of the plans and the

implementation issues that were raised by their submissions, the Board decided that all stakeholders should have an opportunity to present their views on PRP, so the Board asked RMA to undertake notice and comment rulemaking to establish the framework under which PRPs will be evaluated, approved, regulated, and operated.

The Board created an ad hoc committee that reviewed the proposed rule and has worked with RMA on the development of the final rule. After the final rule is issued, the Board plans to review with the manager of FCIC all the submissions for approval of a PRP.

That concludes my remarks.

Senator CRAPO. Thank you very much, Dr. Collins.

[The prepared statement of Mr. Collins can be found in the appendix on page 48.]

Senator CRAPO. Mr. Davidson?

STATEMENT OF ROSS J. DAVIDSON, JR., ADMINISTRATOR, RISK MANAGEMENT AGENCY, U.S. DEPARTMENT OF AGRICULTURE, WASHINGTON, DC

Mr. DAVIDSON. Thank you, Mr. Chairman and members of the committee. I am pleased to appear before you today to report on the progress and challenges of the Federal Crop Insurance Program, particularly to provide an update with regard to the implementation, successes, and challenges of the Agricultural Risk Protection Act.

In fulfillment of the mandates of ARPA and under the direction of the Federal Crop Insurance Board of Directors, the Risk Management Agency continues to promote an aggressive agenda to bring new and innovative insurance products to the agricultural community, to validate the utility of current insurance products, to ensure outreach to small and limited resource farmers, and to promote equity in risk sharing and to guard against waste, fraud, and abuse within the program.

The program has experienced extraordinary growth in the last quarter-century, particularly after ARPA. Through the private sector delivery system in crop year 2004, RMA provided approximately $47 billion of risk protection to farmers on approximately 370 commodity types covering over 80 percent of planted acreage on about 221 million acres through 22 insurance plans. Attached to my testimony are several charts that I commend to your review that provide further background and highlight the growth of the Federal Crop Insurance Program under ARPA.

In 2004, crop insurance provided approximately $3.1 billion in indemnity payments to farmers and ranchers, including approximately $218 million for the four hurricanes in the Southeast and approximately $337 million for a brief freeze in the upper Midwest. RMA continues to improve and update the terms and conditions of the existing crop insurance policies to improve coverage and the efficacy of those policies as well as to clarify and define insurance protection and the duties and responsibilities of the policy holders and insurance providers, to enhance understanding, use, and integrity of the program.

The new standard reinsurance agreement is now in place and the financial terms of that agreement will be implemented in 2005 and

2006. The regulatory terms are in place currently and we are in the process of implementing those through Manager's Bulletins and other means.

We now have 16 approved insurance providers selling and servicing crop insurance, compared to 14 when the SRA was signed. Since the SRA was signed, three new insurance companies have been approved. We have also been contacted by another major organization, which has indicated it is in the process of preparing an application to join the program.

The 2004 reinsurance year was exceptionally profitable for the companies and the commercial reinsurers, with an estimated $700 million in underwriting gain and a return on retained premium of approximately 22 percent. This compares to $380 million and a return on premium of about 15 percent in 2003. Of course, 2002 was a loss year, with a loss of $46 million for the industry and a minus-two percent return on retained premium.

The administrative and operating expense reimbursement has also risen, from $626 million in 2002 to $734 million in 2003, with an estimated $889 million in 2004. This represents a growth in administrative and operating reimbursement per policy of 45 percent over the past 3 years. At the beginning of ARPA, it was just a little bit over $400 per policy and slightly over $700 per policy for 2004.

Now let me briefly highlight a couple of items. We are in the process of reviewing comments from the proposed rule for premium reduction plans under the Board's direction and are reviewing those with the Office of Management and Budget currently and intend to publish a rule in the near future. The comments have been very helpful and we very much appreciate those comments in guiding the agency to establish a rule that will address the concerns on discrimination and program integrity.

Soybean rust continues to be a concern and we are working diligently to make sure that farmers understand their responsibilities under the program and that farmers will be covered, assuming that they do the right thing by their land.

Multi-year disasters and declining yields have been a concern in this program. We are working now with a couple of potential contractors that we will hopefully award contracts to this week and next week to move along in trying to address declining yields in the program.

With regard to program integrity, we have used a number of innovative tools, part of which were funded by ARPA, particularly data mining. We are very proud of that initiative, and you have a data mining topic on your agenda today. I won't spend more time on that. But we have saved millions of dollars in prevention of fraud, waste, and abuse. We do intend to issue a Manager's Bulletin briefly in the near future on conflict of interest supplementary guidance.

The program is expanding dramatically, Mr. Chairman, including a number of areas, like pasture, forage and rangeland and the nursery program. We are excited about the things that are moving forward and appreciate the support of this committee.

Senator CRAPO. Thank you very much, gentlemen.

[The prepared statement of Mr. Davidson can be found in the appendix on page 57.]

Senator CRAPO. I will begin the questioning and then we will go to Senator Lugar, who has joined us, and Senator, you will also be able to make an opening statement at that time if you would like to.

Dr. Collins, my first question is for you, and let me say, I have appreciated the USDA's willingness to develop a wide variety of risk management products for producers with a wide variety of commodities. One of those that I am interested in is the sheep industry, the proposal for an LRP pilot project for the sheep industry. It is my understanding that there has been some concern about that proposal because of the lack of a commodities exchange upon which forecasts for sheep prices can be effectively evaluated.

I am concerned about that, because I understand that a number of commodities have futures markets and that those markets can be utilized as the basis for insurance programs under the LRP pilot approach, but I don't think the fact that the sheep industry does not have a futures market or a price risk management tool should preclude them from being able to have access to these kinds of programs.

So, first of all, I urge the USDA to work with the sheep industry to help them manage their proposal or modify it, if necessary, so that it can be implemented. But I would like your comments on this issue.

Mr. COLLINS. Sure, Mr. Chairman. This is a difficult issue for the Board. We do have effectively functioning livestock price insurance products for swine, for fed cattle, and for feeder cattle. We have gone down this road, I think, fairly deliberately and have ramped up the coverage over a several-year period.

Senator CRAPO. Let me interrupt you. I have just been called away myself, and I am going to have to leave. My staff is here. You can finish your answer, but the committee is going to be taken over now by Senator Lugar.

Mr. COLLINS. Just to quickly finish the response, Mr. Crapo, the Board of Directors of the Federal Crop Insurance Corporation sent a notice of its intent to disapprove an LRP proposal for sheep that we had received and considered and had sent out for expert review. The reason that we chose to do that was because the insurance guarantee in this product is based on projections. We do not have insurance guarantees in any FCIC product based on model projections. We use insurance guarantees based on projections in a marketplace where a number of buyers and sellers come together and establish a futures price.

It would be quite a change, or quite a departure in our policy to adopt an insurance policy where the coverage is based on a projection from a model. It is on that basis that we issued our notice of intent to disapprove this product. The submitter of the product has indicated to us that they plan to come back with responses to our concerns by the end of calendar year 2005.

So the LRP sheep product is not dead. It is still alive and we will wait and see what the submitter does to respond to the concerns of the Board of Directors.

STATEMENT OF HON. RICHARD LUGAR, A U.S. SENATOR FROM INDIANA

Senator LUGAR [presiding]. Thank you very much. I will raise a couple of questions while we are waiting for our chairman to arrive.

Mention was made by you, Mr. Davidson, of the data mining and this has helped to prevent fraud. Precisely how? When you talk about the data mining situation that you have employed so extensively and successfully, what does this amount to? How do you go about doing this?

Mr. DAVIDSON. Senator, RMA collects information on farming operations, as you know, as part of the insurance and the reinsurance activities of the agency. That information is rich with global information about the general trends in various areas of the country. Data mining is simply an analysis tool. As we analyze that information, we are able to identify anomalous activity, things that are outside the bounds of what would appear to be normal from the information that we have, such as a higher incidence of losses linked with agents, loss adjustors, and particular producers. Trends are identified as we do the analysis.

In and of itself, those anomalous data do not represent that fraud is actually taking place, but they do guide our actions. We refer those anomalous activities over to the FSA State offices as well as to the county offices and there are in many instances, growing season spot checks that take place. That has been very helpful as we look at those trends and those anomalous activities. After those growing season spot checks and after other notifications to farmers that there seems to be something different about their results, we notice a regular decline in those anomalous activities.

Senator LUGAR. So this mining would pick out rapidly diverging trends, big payments and small losses——

Mr. DAVIDSON. Absolutely.

Senator LUGAR [continuing]. Or some agent that seems to be going haywire or whatever.

Mr. DAVIDSON. Yes, and we just use that to inform our investigation process and our oversight process and it has helped dramatically. We also use data mining actually to take to court and prosecute people who have actually defrauded the government, and that has been very helpful.

Senator LUGAR. I suspect during the hearing, the soybean rust problem will bob up in various directions, but you have touched upon it in your opening testimony. Just in a nutshell, what does a soybean farmer need to be thinking about who has not seen soybean rust in his or her State at this point but is apprehensive and wondering, will my crop insurance hold if and when it comes? What are the prudential steps, as simply as possible, so every farmer in America hearing this will know exactly what to do?

Mr. DAVIDSON. Well, in the first place, soybean rust is a devastating disease and can act very rapidly. That is different from most diseases that affect soybeans, and as a result of that, the management practices of farmers, of course, need to adjust to that very rapidly emerging disease.

I want to say up front that our policies cover damage from disease. The farmer is obligated to do the right thing by their crop,

to raise the crop in a way that is sufficient to produce the amount that is guaranteed under the policy. If natural causes or other things preclude the farmer from being able to do that—it has to be a natural risk—then the farmer is covered.

So, basically, the farmer has to pursue good farming practices and document what they have done. We recommend that farmers use consultants, because this is a new and emerging disease, that they document advice that they have used to guide them in caring for their crop. If they do that, and assuming that they take the necessary actions, then they will be covered. But the documentation is a very important thing.

Senator LUGAR. Let me ask the question farmers ask me, and that is if there is a hint that soybean rust has come, must I apply chemicals immediately, in other words, take that prudential step, or at what point am I obligated to have applied the chemicals to have indicated the proper steps?

Mr. DAVIDSON. If a farmer knows that soybean rust is in his area and there are preventative steps that should be taken, we will look at whether or not he took those preventative steps.

Senator LUGAR. Now, who will notify the farmer? I raise this question carefully, because——

Mr. DAVIDSON. Of whether or not the disease is there?

Senator LUGAR. Yes. He says that FEMA is going to have a task force down there at USDA and they haven't had one for 3 weeks on soybean rust, but he had one after we called him because this is very serious, this very step I am talking about now. Who informs the farmer? Is there a flash point in Indiana here people say, "Soybean rust is here," so be on your guard because you have got to begin taking the steps?

Mr. DAVIDSON. I could answer that, but Dr. Collins can answer it better, if you don't mind.

Mr. COLLINS. Mr. Lugar, the answer to that is that there has been a National Soybean Rust Working Group that has developed a system to track soybean rust in the United States. As of the most recent data on that system, soybean rust is present in five counties in Florida on kudzu and in one county, Seminole County in Georgia, on volunteer soybeans. Any farmer in the United States can automatically get e-mailed, an e-mail every time that information is updated by the National Soybean Tracking System. They can find that information on USDA's website or they can personally get an e-mail letting them know every time that information changes.

So there is a system to track soybean rust. It comes from a total of 700 sentinel sites in the United States, 300 sites established by USDA and 400 sites established by the soybean industry through their checkoff program, and there are tens of thousands of people who have been trained to be able to detect soybean rust and report soybean rust. So there has been a tremendous effort going on to make producers aware of the possible progression of soybean rust.

Senator LUGAR. It may be, and I would just say off the top of my head, Senators even on this committee may want in their offices to be issuing these advisories, because the communications system here appears to me to be there, but maybe not apparent to every soybean farmer.

The second thing is if we start applying this chemical, is it going to be like the flu shots last fall, and that is that, suddenly, there is a tremendous demand but there isn't any chemical? What is the situation as far as we can tell now?

Mr. COLLINS. As far as we can tell now, the manufacturers of these chemicals tell us that they believe there are adequate provision of chemicals. We don't know the actual data. It is proprietary information. There are questions about where it is staged in the country. But when we talk to the chemical suppliers, they indicate to us that there are adequate chemicals. There are something on the order of nine active ingredients that have been under expedited procedures approved by EPA or already registered and a total of something like 19 different products. In talking with the chemical companies, they believe that they have adequate supplies.

Senator LUGAR. One final question, and that is that this year, maybe not for the first time, but conspicuously, insurance companies have asked for the ability to discount policies to various policy holders. The House of Representatives took action in its legislation to stop that, prevent that from occurring. The Senate, I gather, hasn't acted yet. What are the policy implications? Is this good, bad, or indifferent, or what should we be thinking about discounts?

Mr. COLLINS. That question has many answers, depending on the level at which you are asking it. If you are asking about the House action, that is one thing. If you are talking more generically about premium discount plans and whether they are a judicious policy or not, there are two——

Senator LUGAR. Try the generic side.

Mr. COLLINS. Under the generic side, OK. I guess I would respond to that generally by saying that the crop insurance industry in the United States is highly regulated, as you know. The Department of Agriculture sets rates. In other lines of insurance, that doesn't happen the way we set rates. The Department of Agriculture pays a reimbursement to the companies to deliver the program. We pay their delivery expenses. There is little opportunity for price competition or cost competition in this industry.

In 1994, legislation was enacted which provided an authority for a company to come to us and ask to be able to offer a discount to producers on their premium if they could show a gain in efficiency of delivering crop insurance that would reduce their expenses below the expense reimbursement we give them. This is not our program. This is not us asking companies to do this. This is companies that come to USDA and they can do this if they want to do this, if they can meet the requirements of the law.

I think the good part about this is it could mean a lower premium for producers. It could mean an increase in participation in crop insurance. It could mean higher levels of buy-up coverage and, therefore, overall coverage for crop insurance. It could mean an increase in the efficiency of delivering crop insurance to producers, that is, squeeze out some cost efficiencies in the delivery system.

On the down side of this, on the other side is that this could potentially be somewhat disruptive to the industry in that it could mean some change. People may do business differently as a result of this. This may cause some dislocations. There have also been issues raised about whether there might be some unfair discrimina-

tion, that is, that the small, the minority, the women, and the limited resource farmers might be neglected at the expense of large producers. There might be some shifting of sales away from high-risk areas to low-risk areas.

These are things that we have been trying to deal with in the development of the final rule. We recognize these as potential adverse consequences of being able to provide a discount to producers and we are trying to mitigate those possible consequences.

Senator LUGAR. Thank you very much for that very thoughtful answer, both the up sides and the down sides. Obviously, in most parts of American life, people are looking for discounts, including farmers. But I appreciate this is controversial and you have weighed judiciously the pros and cons and I thank you.

Senator Harkin?

STATEMENT OF HON. TOM HARKIN, A U.S. SENATOR FROM IOWA, RANKING MEMBER, COMMITTEE ON AGRICULTURE, NUTRITION, AND FORESTRY

Senator HARKIN. Thank you very much, Mr. Chairman. I apologize for being a little bit late with that vote, and everything. I have a statement, but I will just ask that it be made a part of the record.

Senator LUGAR. We will include that in the record.

Senator HARKIN. I appreciate that very much.

[The prepared statement of Senator Harkin can be found in the appendix on page 46.]

Senator HARKIN. I just note that we just passed the fifth anniversary of the enactment of the Agricultural Risk Protection Act last week. I just note again for the record, since 2000, crop insurance participation in terms of acres enrolled has increased by 7 percent and the total crop value covered has increased by more than 33 percent. So farmers are buying more and they are covering more acres, which is exactly what we intended to achieve.

However, in some of these new conflict of interest rules that have come out, I have heard from many of our agents, Mr. Davidson, in Iowa about some of the problems in this in terms of the relationships between crop insurance agents and loss adjustors. I understand under the new conflict of interest rules, a loss adjustor can't even utilize the data and records that an agent has readily available. He instead has to go to an FSA office to obtain them, which in some rural areas in the country can mean a 100–mile trip, just to gather maps and records that are sitting in a file cabinet in the agent's office.

I have heard a lot about this, and my question is, is this level of restriction really necessary to protect against conflicts of interest? Is this in the best interest of the farmer or anyone if it causes a great delay in adjusting and processing their claim? Do you understand what I am talking about?

Mr. DAVIDSON. I do understand the question, Senator, and I appreciate the question, as well. We, as we negotiated the standard reinsurance agreement, implemented a number of changes that were suggested by audits that had identified fraud, waste, and abuse in the program. Many of those instances of fraud, waste, and abuse included collusion among producers, agents, loss adjustors, and particularly the area of collusion between an agent and a loss

adjustor was a great concern for the Office of the Inspector General and for others who had looked at these cases of fraud, waste, and abuse. A number of those cases have actually come to prosecution and have been widely publicized, as well.

And so one of our mandates in negotiating the standard reinsurance agreement was to tighten up on the regulatory framework, to hopefully preclude some of this fraud, waste, and abuse, or at least create a framework in which that could be controlled and mitigated through internal controls.

The agent's involvement in loss adjustment has long been precluded in the standard reinsurance agreement, not recently, but since a long time ago, for good reason. The provisions of the agreement actually say that agents should have no involvement in the loss adjustment process. The more recent guidance that we have provided has given further detail to that and has tightened up because we have found a continuing disregard in some agents' situations of that prohibition.

That having been said, there is a business process that has to be pursued and information is necessary in order for a timely adjustment of the claims. The FSA offices are one source of that information. The farmer himself is a direct source of that information. Agents will often use the information from FSA to help fill out applications and many of them do have that information resident in their files.

At the time of a loss, it is entirely possible, and happens frequently, that something has changed since the sale of the policy. It is the obligation of the loss adjustor, who represents the company, to make sure that he has the most current information, and in some instances we have found, in fact, that the information received from an agent hasn't kept up with that information that may be resident at the FSA office.

That having been said, we have also had instances where agents have, in fact, altered those reports to obtain a more favorable loss adjustment for their producer clients. Those are troubling situations. They are not frequent, but they are troubling.

And so our Compliance Office has felt that it is necessary to, No. 1, give notice to agents when we have said, don't be involved in the loss adjustment process, that that is something that they really do mean, and that the loss adjustor needs to be the one to provide those services and to get the most current information, either directly from the farmer, who has an obligation to maintain that, or from the FSA office.

Senator HARKIN. Mr. Davidson, I appreciate that. It just seems to me, though, that the loss adjustor is representing the company. I mean, why would they then give the report to the agent to modify and change before they send it in? That is true collusion——

Mr. DAVIDSON. Yes, it is——

Senator HARKIN. And I don't know how many cases of that you have, but that is quite adequately covered. I mean, it would seem to me that the loss adjustor, that anyone would do that, the company ought to fire them right away if they ever detect anything like that.

Mr. DAVIDSON. I would agree.

Senator HARKIN. So I think there has to be some internal market forces that would keep them from that kind of collusion. However, to have it so strict that an adjustor can't even call up an agent and say, where is this field? How do I get there to look at it? That they have to go to the FSA office someplace and get a map, and the agent knows exactly where it is, I mean, that is how tight these conflict of interest rules get and I just wonder if that is really in the best interest of anyone.

You have a few cases. You have brought them to prosecution. But does that mean you have to have this wholesale change which really, as I have come to know, can be quite onerous in some cases. I would just leave that.

Mr. DAVIDSON. I appreciate those comments, and we have held up on the——

Senator HARKIN. Let me ask one thing. My time is running out. There have been a number of complaints about marketing practices used by one company, Crop 1——

Mr. DAVIDSON. Yes.

Senator HARKIN [continuing]. Authorized to sell our PRP policies. Your written testimony indicates that these complaints were investigated and changes were made when some complaints were validated. But to my knowledge, no public report of these investigations has ever been provided.

In order to put some of these concerns to rest, I think you should consider releasing at least a summary of the results of those investigations and actions taken to remedy problems when they were detected. Have you contemplated doing anything like that?

Mr. DAVIDSON. We haven't, but I think that is a fair request and we would be willing to do that. I have a full list of those complaints, and we may have to be careful to not disclose confidential business information, but I think we could probably do that.

Senator HARKIN. OK. Thank you very much, Mr. Davidson.

Just one last thing. The written testimony provided by Mr. Brichler and Mr. Nielsen, who will appear on the second panel, indicate that more than 90 percent of the comments submitted on the proposed rule on PRP were negative. Two questions. Is that fairly accurate, and second, if that is correct, doesn't that suggest to you that it would be appropriate to circulate the revised rule for review outside of RMA before finalizing it?

Mr. DAVIDSON. I very much appreciate that question, because that is an important one. Yes, we did receive a number of comments. In fact, we received letters from over 800 people, which represent 1,900 individual comments, or thereabouts, and the preponderance of those comments came in the form of a fairly standardized wording, repetitive, as you might guess, and so it may not be fair to necessarily count them one for one.

But that having been said, there are a number of comments that just simply say, don't implement this rule. We have been advised by our counsel that we don't have the choice of whether or not to administer this law. We have to figure out how to administer it in an appropriate manner. If it can be administered in an appropriate manner without causing damage to the program, then we will do it. If it can't, then we will be the first ones to indicate that we cannot do that.

We have taken into consideration all of the comments. They have been very helpful. Many of those comments have been laced with positives and negatives. Some have said, don't do this, but if you do it, do it this way. That has been very, very helpful. Some have suggested a different way of doing it, or as we had included in the preamble to the rule, some alternative approaches. Comments on those alternative approaches have been very helpful in guiding us.

Some of the issues are that the proposed rule didn't allow variability from State to State, for example. That has become a very common theme throughout the comments. We have paid attention to that very carefully. Some have said, don't make this a discount up front where people have to guess whether or not they can provide—reach these efficiencies. Do it on the back end. That has been very helpful, as well. There are other comments that have been very helpful.

I can't say that we have counted all of those helpful suggestions as negatives because they have been linked with negatives, but we have a substantial number of those helpful suggestions and we have paid a lot of attention to those.

Senator HARKIN. Thank you very much.

Mr. Chairman, I may not be able to stay for all the hearing. I just want to thank you for making sure we have three people from Iowa here testifying today. I appreciate that.

Senator LUGAR. Thank you, Senator Harkin, for that observation.

[Laughter.]

Senator LUGAR. Another person from Iowa, Senator Grassley, with the understanding of others, Senator Grassley needs to head off to chair another hearing, so I will recognize him at this point.

STATEMENT OF HON. CHARLES GRASSLEY, A U.S. SENATOR FROM IOWA

Senator GRASSLEY. Senator Hatch is filling in for me while I am gone, and I won't ask any questions. I will submit them for the record and I have some documents I want to submit for the record, as well.

Senator LUGAR. They will be placed in the record.

Senator GRASSLEY. I appreciate my colleagues' accommodation and I appreciate your irritation because I have been in the same position myself.

I, first of all, thank you, Senator Lugar, but also Senator Chambliss for holding a timely hearing. When the Agricultural Risk Protection Act was signed into law on June 20, 2000, I was hopeful that by adopting the Agricultural Risk Protection Act, we would increase the affordability of crop insurance, make programs more flexible and responsible for farmers, and improve the public-private partnership that composes the programs' underlying basis.

While the Agricultural Risk Protection Act has clearly improved affordability and flexibility for farmers, I believe that the public-private relationship that we had hoped to create has been undercut by the Risk Management Agency's Administrator. Administrator Davidson knows that I have been critical of many decisions made by RMA under his leadership. From the standard reinsurance agreement negotiation to an evolution of the Premium Reduction Program, from discovery of soybean rust to constituent services, I

have raised numerous questions about the decisions made by the Administrator and his inability to work with or provide service for my constituents.

So what I am going to ask now shouldn't come as any surprise, because I have suggested this in the past. It is for these above reasons that I am calling on Administrator Ross Davidson to resign. I do not believe that there is any way at this point in his tenure as Administrator to improve his image or standing with the companies, agents, and most importantly, farmers that are provided the essential service of mitigating their own risk through participation in the program.

While I could point out specific examples of my dissatisfaction with many issues, in the interest of time, I want to limit my comments to the Premium Reduction Program's proposed rule. The proposed rule requires that the discount made available to farmers may not vary between State, crops, coverage levels, policies, and plans of insurance. Yet anyone involved in crop insurance knows it costs less to provide a crop insurance product in Iowa than it does in Texas because we have less risk. It is not possible, in my opinion, to have non-variable efficiencies in an environment full of variable costs.

RMA's attempt to arbitrarily cap the Premium Reduction Program's benefit based on the State with the highest cost of delivery or risk works against the original intent of the program. Under the proposed rule, the only folks that lose are the ones that have the most to gain, those in low-risk areas like Iowa. If companies don't want to be subject to caps based on States with high risk, the companies must cut the high-risk States out of the program. That won't help us maintain our support in Congress for federally subsidized Crop Insurance Programs.

There is no question that I support lower premiums for farmers when market and regulatory conditions warrant lower premiums. But due to comments made by RMA that I plan to submit for the record, and that is what I have asked to submit, I have no confidence RMA can recognize more major delivery efficiencies in the current marketplace.

For that reason, Mr. Collins, I would call on the U.S. Department of Agriculture to reevaluate the timing of benefit delivery. If the premium reduction were to be delivered in a similar fashion to the USDA's Title I loan or LDPs, that is, if the benefit were delivered as a loan upon purchase of the policy or provided after the crop is harvested when the speculative calculations currently involved in benefit delivery could be eliminated, I would have much more confidence in the Premium Reduction Program.

While I know that neither Mr. Collins nor Administrator Davidson can comment on the content of the final rule, these types of changes could give me confidence that this issue need not be addressed through appropriations or even reconciliation. Anything short of that type of change will most likely result in an amendment similar to Congressman Kingston's being offered on the Senate floor during agricultural appropriations.

So, Mr. Chairman, I need to leave and chair the Medicaid hearing I talked about. I will submit questions. I am surely not leaving because of lack of interest or due to—but only due to time. So I will

look forward to future hearings on this topic and I would suggest to the chairman that he might consider the possibility of holding another hearing in the near future following the release of the Premium Reduction Program final rule.

I thank you.

Senator LUGAR. Thank you very much, Senator Grassley.

[The questions and documents of Senator Grassley follow:]

Senator LUGAR. Do either of you have a comment on Senator Grassley's testimony?

Mr. DAVIDSON. I appreciate the Senator's perspective, and we have had a number of exchanges and we very much appreciate his suggestions on the rule. He made comment on the rule.

As to my resignation, as we all know, I serve at the pleasure of this administration and when I am asked to resign, I will obviously agree to do that. Until that time, I serve at the pleasure.

Senator LUGAR. Thank you.

I will recognize now the Senators in the order that they have come, and that would be Senator Nelson, Senator Roberts, and Senator Conrad. Senator Nelson?

STATEMENT OF HON. BEN NELSON, A U.S. SENATOR FROM NEBRASKA

Senator NELSON. Thank you, Mr. Chairman, Mr. Davidson, Dr. Collins.

Mr. Chairman, you have raised the question of soy rust. That is an issue of considerable importance to the State of Nebraska and I appreciate the fact that you raised that. I react positively to your suggestions as to how we deal with this in an integrated fashion across the country so that farmers are aware of its existence and the locations of the existence as well as how to deal with mitigating against the damage that would otherwise be caused if they didn't take action.

From time to time, we get comments from agents in Nebraska raising questions about the challenges they have in representing companies and providing coverage to the farmers. I think that there has been significant improvement over the years in the awareness of how you go about doing some of the things, but from time to time, there are still fairly substantial challenges that many of them face. I am going to have some of those examples put together and submit them to you to respond rather than take up the time of the committee this morning.

But it does seem to me that coordination and communication can't be overstated when it comes to this area. It is only 5 years old, so it is still evolving. But there are a lot of things that come to light that haven't been dealt with that I think can be dealt with and probably more anticipation of those problems.

I am wondering if you have a working group of agents from around the country that come in and discuss with you on a timely basis the problems and challenges that they are experiencing out in the field, if you have a group that you meet with. It could be ad hoc or it could be formalized. Do you have one?

Mr. DAVIDSON. Yes, we have invited agents to come in and to describe to us the challenges that we have. Occasionally, we will meet with an agent group. I could name names, but you are familiar

with the associations. We are willing to do that. I have also offered to come out to meet with individual agent offices. Frankly, we are trying to finish this proposed rule and that is the next thing on the agenda. We did receive a considerable amount of input from agents in the negotiation of the standard reinsurance agreement, as well. So yes, we are very open to interact with agents specifically and learn what their issues are and try to address those within the context of what our responsibilities in the statute require.

Senator NELSON. The other thing, I am puzzled by excluding agents from having anything to do with the loss experience. I have had a little experience with the insurance business over the years and I know the concerns about collusion and the moral hazards that go along with that. But I would caution against taking a total ban against any kind of agent involvement. Rather, I would recommend you deal with instances when they arise and you deal with them swiftly and painfully for those that collude and take care of it that way rather than push the agency system completely out of the loss adjustment phase when there are losses.

I think you are identifying problems, but the solution seems to be extraordinary unless you are going to tell us that the problems in terms of numbers or amounts are extraordinary. I just don't think the solution fits the problem you are trying to solve if it is total exclusion. I just think in some cases, if you have an agent you don't trust, you don't involve them. But I would hate to see a hard and fast rule that would extend or raise the cost of adjusting.

Mr. DAVIDSON. If I might respond——

Senator NELSON. Yes.

Mr. DAVIDSON [continuing]. The guidance that we have been intending to release and, frankly, haven't released because we wanted to receive this kind of input, makes a number of exceptions to this general rule of agent involvement in loss adjustment.

For example, we have a simplified claims process for small claims and for claims where there is minimal opportunity for collusion because we rely upon third party information for the claims adjustment. In those instances, the agent preclusion from the loss adjustment process is, in fact, exempted.

We have also stated in this guidance that we understand that it is the agent's responsibility to keep the policy holder advised of their opportunities, their benefits, including loss adjustment, and so we would not preclude the agent from having a continuing conversation on that.

When it gets to the exact claim itself and the actual adjustment of the claim, we feel that the loss adjustor is the person to do that and so we have limited the agents' involvement at the time, for example, riding along with the loss adjustor to go out and visit the farm as the claim is being adjusted, holding the tape as the bin is being measured, and things of that nature. We feel that that is—there is too much conflict there and we haven't allowed it.

Senator NELSON. I just never heard of such a thing, to be quite candid. It seems to me you ought to identify the things that—where the problems are and permit them to be involved where the problems aren't. I can't imagine how holding the tape gets in the way or creates a conflict of interest. Perhaps deciding the level of damage or loss to a field, whether it is 25 percent, 30 percent,

whatever it may be that way, might be a conflict. But I am just puzzled by it. I just hope it doesn't add to the cost to exclude agents. Unless your problem is bigger than I understand it to be, I wouldn't understand why——

Mr. DAVIDSON. We would be happy to spend some time with you and go over specific cases where——

Senator NELSON. Maybe that is the best way. I don't want to take up the time of the——

Mr. DAVIDSON [continuing]. The results of the audits from the Office of Inspector General that have driven us to this.

Senator NELSON. Maybe I just don't understand the nature of the problem. I appreciate very much.

Mr. DAVIDSON. We will set up a time to come see you.

Senator NELSON. OK. Thank you. Thank you, Mr. Chairman.

Senator LUGAR. Thank you very much, Senator Nelson.

Senator Roberts?

STATEMENT OF HON. PAT ROBERTS, A U.S. SENATOR FROM KANSAS

Senator ROBERTS. Senator Nelson, I think you understand the problem very well. Mr. Chairman, welcome back.

Senator LUGAR. Thank you.

[Laughter.]

Senator ROBERTS. Temporarily. I realize we are supposed to be in the question and answer session, but I do want to make a quick statement in regard to today's hearing.

First, I want to thank Senator Chambliss for taking the step of holding this oversight hearing. I think it is very important and very timely. We have got an important role to play in overseeing all the programs under our jurisdiction and I am pleased we have this opportunity.

Second, I am pleased we are holding this hearing today because of the advancements we undertook back in 2000 to strengthen the Crop Insurance Program. Chairman Lugar, thank you for your help in this regard, and I also want to thank Senator Chambliss, then Congressman Chambliss, for his role in this, and more especially former Senator Bob Kerrey. We led a rather difficult uphill fight in the Senate and the House in trying to achieve the passage of that Act. It took us nearly 2 years, but we finally got the job done.

I must admit that in terms of producer participation in increased coverage levels, we have been successful beyond our wildest expectations. Crop insurance has become a viable risk management tool for a large number of our producers and I think it is due, at least in part, to our efforts and the good work of people on this committee in 2000.

As most of you know, many parts of Kansas went through a severe drought in 2001 through 2004. I have had more than one producer tell me the only reason they are in business is because of our efforts in 2000. We should all be very proud of that fact.

But Mr. Chairman, despite these successes, I am concerned with what I view as some of the overall management issues with the program. We have seen what I could only term as an adversarial relationship between the agency and the industry. That is not healthy. I understand the need to provide oversight and the proper

use of taxpayer dollars, but I am concerned that actions over the last year and continued efforts to find additional savings in the program are the equivalent of trying to squeeze blood out of a turnip, and that turnip just isn't there. Mr. Chairman, this program will only continue the success of the last few years if industry participants have a financial incentive to continue in the program.

Finally, I remain disappointed with the agency's continued blockage of expanded coverage to producers that want to diversify their operations by planting new crops in their rotations. I have a lengthy question in that regard. If we have a second round, I would like to get into that.

And new research and technology is allowing crops to be viable in expanded growing areas, but the agency seems continuously locked in neutral on expanding coverage and it is harming our producers and their bottom lines.

Mr. Chairman, I am not going to continue, as I intend to address many of these issues in my questions of Mr. Davidson. Again, I can say on the whole, we have been incredibly successful since 2000. I thank you and I thank Senator Chambliss and my colleagues for their continued leadership and oversight of the program.

As to Senator Grassley's comment, Mr. Davidson, I associate myself with his remarks and more especially with the proposed rule. I intend to recommend to Secretary Johanns that we need what I would call new producer and crop insurance-friendly leadership at the USDA. In terms of riding that Crop Insurance Program into a box canyon that I think has been full of regulatory overkill mismanagement, I don't know if you can turn that horse around or not, but that is how I feel about it. So if you serve at the pleasure of the Secretary, it is my view that I am going to advise the Secretary that you resign, as well.

I see that I have a minute and 15 left, but I will let that comment and the deafening silence that will occur, just let it lie there, and I have one more question if, in fact, there would be a second round.

Senator LUGAR. Thank you very much, Senator Roberts.

Are there any comments from the panel?

[No response.]

Senator LUGAR. Very well. I call now on Senator Conrad.

STATEMENT OF HON. KENT CONRAD, A U.S. SENATOR FROM NORTH DAKOTA

Senator CONRAD. I thank the chairman and I thank Chairman Chambliss for holding this hearing, as well.

I think this is a sobering hearing, and I know, Mr. Davidson, it must be tough for you to hear this, but I can tell you, dissatisfaction in your performance is widespread in my State, as well. I was just home. I have been home, I think, seven of the last 10 weekends and your agency is probably the most unpopular Federal agency in my State. There is a feeling that there is a rigidity there, that when problems are brought to the attention of the leadership, that nothing happens.

I could go into a long litany. I just was with several farm group leaders this last trip home. They said they believe you ought to be

replaced and they asked me to deliver that message at this hearing.

To be very succinct about it, the No. 1 complaint that I hear is on quality loss adjustment. In fact, I have just now received a letter from the insurance agents back home, the Professional Insurance Agents Association of our State, and quality loss adjustment topped their list.

I have raised this issue on numerous occasions. I mean, I don't know how many letters I have sent up there, and nothing happens. No progress has been made in better reflecting actual market discounts for quality losses in the Crop Insurance Program. Your own agency commissioned Milliman USA to produce an independent actuarial review of quality adjustment that was completed in 2002. Milliman found existing crop insurance discount schedules to be inadequate when compared to local or regional market discounts in terms of the quality factors considered and discount levels applied.

Milliman recognized that quality issues generally occur on the local or regional level and therefore their impact on producer returns is also concentrated at those levels. This is a fact that RMA continues to ignore.

RMA's response to their own study was to criticize the report's conclusions, fail to propose alternatives, and suggest that everyone in the industry supports the status quo. That is just an unacceptable outcome and has engendered deep resentment in my State.

On the Premium Reduction Program, at least part of the complaint that I heard from Senator Grassley is mirrored in my State and just a serious skepticism about the performance of the agency and about a willingness to adjust.

Finally, also grave dissatisfaction in my State on those who produce both spring wheat and durham wheat in calculating their yields. This, too—I mean, I don't know how many letters I have sent. I don't know how many sessions we have had, and nothing happens. It is just—it has just led to a breakdown of confidence, a breakdown of support, and a growing level of anger and frustration.

I must say, in some ways, I say this with a heavy heart. I don't like to ask for people to leave. I don't like to recommend that they be replaced. I honestly don't. But I have to tell you, I am here representing my State and the people of my State, I mean, I hear this time after time after time, are utterly dissatisfied with the leadership of your agency.

We have just suffered—I have 25 seconds left—we have just suffered another set of weather disasters in my State, a million acres affected, 385,000 acres prevented planting. I don't know what is going on in my State. This is not how things were when I grew up. But 16 inches of rain in 2 days. I just flew over 10 days ago, just unbelievable.

And the way this is all set up, a lot of these people aren't going to get helped. It is perverse. Those with prevented planting are, 385,000 acres. But I have got a million acres affected and a lot of those people are not going to get helped and that is just not right.

With that, Mr. Chairman, I am supposed to be at the same hearing that Senator Grassley has left for. I will submit a series of questions for the record.

And I must say, really, I kind of leave here with a heavy heart. I wish it would never have come to this, but it has. We can either try to avoid unpleasantness or we can face up to things. Senator Grassley and Senator Roberts have faced up to it and I think I have got an obligation to do that, as well.

So with that, I thank the chair.

Senator LUGAR. Thank you very much, Senator Conrad.

[The questions of Senator Conrad follow:]

Senator LUGAR. This is not a time for levity or humor, but I would suggest the energy bill we have been discussing, climate change, for example, global warming, may be hitting your State. As a result, we may sort of couple our talents with energy and agriculture. But in any event, I appreciate your coming and you have a responsibility, as we all have.

Senator Roberts has one more question, and he will be back in a moment. Do you have another question in this round, Senator Harkin? If not, this is a question from Chairman Chambliss.

Mr. Davidson, the financial failure in late 2002 of American Growers, Incorporated, raised questions about the financial strengthens of the crop insurance industry. Can you describe for us the current and projected financial conditions of the crop insurance industry in light of the new standard reinsurance agreement and also the steps that RMA has taken to ensure that we do not have a repeat of the American Growers situation?

Mr. DAVIDSON. I would be pleased to answer that question. In the wake of the failure of American Growers, we spent a considerable amount of time evaluating what kind of financial standards existed within this agency's regulatory structure, what kind of reports we were asking from the companies, and how we collaborated with State insurance departments in the oversight of the financial condition of the companies.

We worked with the Nebraska State Insurance Department in evaluating what took place and why it took place with American Growers. We required within the standard reinsurance agreement additional disclosures and placed upon the companies the obligation to advise us in advance if there were deteriorating circumstances.

This year, we have made continuing strides in asking the companies for additional information with regard to how they view the risks that face them, what they plan to do about those risks if they should emerge. This contingency planning will require additional evolution over time to make it even more effective, linking with the States who are also addressing these issues. There is a Risk Assessment Working Group at the National Association of Insurance Commissioners, for example, that is revising the standards by which an insurance company's financial condition is reviewed to take into account future risks.

I will say that this year, because we have had a very good year, that many of the companies' financial conditions is quite strong. We continue to be concerned about a few companies who have minimal amounts of surplus. Many of those companies participate in substantial amounts of insurance provision under this programing with the assistance of additional reinsurance support. We have a ranking system for each one of those companies in terms

of their financial condition and we review those as we approve them for their annual plans of operation.

I think the industry is relatively strong. A small number of companies are on very close watch, though.

Senator LUGAR. You say relatively strong, but reinsurance that undergirds this.

Mr. DAVIDSON. In a number of instances, if the reinsurance should go away, we would have grave concerns, yes.

Senator LUGAR. Thank you very much.

Senator Roberts?

Senator ROBERTS. Yes. Thank you again, Mr. Chairman.

When we wrote the crop insurance reform bill in 2000, we took a large sum of funding that actually created a T-yield plug to help address the declining—the Acreage Production History—the acronym is APH—caused by multiple years of losses that this continues to be a problem, and your prepared testimony indicates that you are in the negotiating stage of letting a contract to look into the issue.

What I would like to know is when you expect to get moving on this. This has been a priority for over a year. We had a meeting in Kansas City on the topic. I thank you for going to Kansas City. Yet we seem to be getting a lot more talk than action. Can we get a time line from you?

Mr. DAVIDSON. Senator, you are referring to the so-called declining yield?

Senator ROBERTS. Yes, that is correct.

Mr. DAVIDSON. We anticipate awarding a contract at the end of this week and another one at the end of next week, two proposals that seem to have some promise. Both of those proposals, however, will ultimately end up in requiring additional legislative authority as well as funding to fully implement, as we have said in the past.

Senator ROBERTS. We spent a large sum of funding that actually created the T-yield plug to help address the problem. I am not sure what it is in legislation that is needed, but we would sure like to get with you to work that out.

When we wrote ARPA, i.e., the crop insurance reform, one of our priorities in addition to increasing the premium assistance for farmers was to expand coverage for the alternative crops and to make it easier for producers to increase their crop rotation opportunities under the flexibility of the 1996 bill and the 2002 farm bill. One example of this is expansion of sunflowers and canola in Kansas and also in other areas of the high plains, and Congress has pumped a lot of research dollars and investment into these crops.

I have heard from just a lot of producers in Kansas and the Southern plains who would like to raise canola. It mirrors the growing season as winter wheat and thus it could fit well into a planting rotation. We also have seen a lot of data indicating it could provide significant opportunities for cattle grazing. But we have got a roadblock in halting the expansion of these crops and it is in the form of the Risk Management Agency.

Earlier this year, I authored a letter signed by quite a few of my Senate colleagues regarding the proposed expansion of this coverage for these crops. In Kansas, we requested the expansion of crop insurance coverage for sunflowers in 25 counties. We get the

crop insurance in the counties out West where we don't have much rainfall. We asked for the counties east of that where we do get the rainfall. You expanded the coverage to one. Nationwide, you expanded it to 19 counties, half of those being for irrigated purposes only. I don't see the sense on that. In terms of canola, you did not expand coverage to a single county in the United States, not one.

The letter you send in response to our request cited several factors for denying these requests, and specifically, you mentioned the lack of cropping histories and the lack of the crushing facilities. I have a news flash on that one. Most of these producers, or most of the lenders won't let them plant the crops without the insurance coverage, and without the crops being planted, we have been told that the crushing facilities will not be expanded into these areas even though the crushers have an interest in doing so. So it is a catch–22.

Based on the criteria you have established, you are making it impossible for these crops to continue to grow, expand, and become part of the producers' normal cropping rotation. It is my understanding that in the past, written agreements could be provided to allow producers to begin to grow an alternative crop, but the RMA now requires at least 3 years of growing the crop in a county before a written agreement will be granted. Now, how are we supposed to get this history if we can't insure the crop through a written agreement in most of these counties?

Additionally, I don't know why the rule was changed to require the new 3–year history. I just don't think this is acceptable myself. I know Senator Chambliss and others have really worked very hard in this regard, only to find that we have sort of run into a roadblock on this issue. This also involves many other members of the committee, and the House committee moved heaven and earth in 2000 to improve this program.

But this decision on canola is just one more example to me of an agency that is saying no when they should be saying, let us work on it and see how we can work this out. I think, to a great extent, that is a lawyer decision and it has failed to serve our producers when it comes to expanding coverage to these alternative crops. We used to be known as the "Wheat State." That is not true anymore because of the flexibility we had in the 1996 Act and the 2002 program and we would like to continue that progress.

So if you are going to make guidelines that make no sense and which make it impossible to make the program work for producers, I just don't understand this position. So if you would like to respond to that, why, feel perfectly free.

Mr. DAVIDSON. I would be happy to. The challenge that we have in this program is that the one standard that we have to follow is that our programs are actuarially appropriate, that there is enough information to be able to provide insurance rates that are actuarially appropriate. Where there has been no production history, there is no information and that creates a conundrum for us. We have a very difficult time identifying data that can be used to determine actuarial appropriateness when there is no production.

We strongly support the idea of innovation in the crop insurance, or in crops, and recognize that that is very important. We have found that the actuarial appropriate requirement is a barrier to ex-

panding in many areas. I will say that we have added over 11,000 county crop programs since the beginning of this administration and have shown a willingness to expand as rapidly as can be done under the actuarial requirements of the program.

We did respond in our letter that through the Noninsured Assistance Program, producers can receive coverage through FSA. In some instances, we did confirm that banks will accept that as collateral and that that is a way for farmers to begin to develop their experience. When an individual farmer has enough experience, and three points of data is a minimal amount of data to be able to say what any kind of a rate should be, then we can establish rates and provide a written agreement. Then when there is sufficient information in the county, when we can expand it beyond that.

So there is kind of a continuation here that you provided in the statute. Where there has been no experience, NAP is available to farmers, and hopefully that is acceptable as collateral to bankers. With NAP, they can develop their experience and can progress to a written agreement, and we are willing to provide written agreements as well as we can within the bounds of statutory actuarial soundness requirements. Then beyond that, as there is adequate experience in a county, we are willing and have shown the willingness to expand to the county for the full program. So that is a continuation, or a continuous path that a farmer can follow to get coverage.

Senator ROBERTS. It is the 3–year business that bothers me, because when we passed that law, we didn't have that in there, and then you changed that to the 3–year history.

But here is what I am talking about. If you look at a map here on the 2006 expansion and existing sunflower counties in regards to my State, this is where you are covered. The green area is where we asked and the one county here is where the coverage has been expanded. The thing that doesn't make any sense to me is that here is—from about here on is where you have most of the moisture in terms of being actuarially sound, and I don't understand why it takes 3 years to wrestle with the paperwork to get that done. But at any rate, we will continue to work with the agency to see if we can't make some progress.

I am way over time and I appreciate the patience of the chairman. Welcome back, Mr. Chairman.

Mr. DAVIDSON. Senator, if I might, it might be useful for us to have a further conversation about the kind of flexibility that we would need statutorily to give us the ability to both meet the actuarial sound standard as well as expand.

Senator ROBERTS. Well, I am—it took us 2 years to pass that Act. We had to go uphill and downhill and around Grandmother's house and in about six different pastures to get it done, and many strong differences of opinion. Out in the West part of my State, we used to have five or 6 percent of people sign up for crop insurance, and as the former chairman can testify, they would indicate why on earth would you want to sign up for crop insurance when you get a disaster payment every year? So the whole design was to address the disaster payment situation.

We tried to give a lot of flexibility in that Act, and now all I am hearing now is that we have to go back and do more legislation.

If we do more legislation on crop insurance, you open up Pandora's box, and it wouldn't be Pandora's. If you need it, we will try to get it. Mr. Chairman, that would be called a technical correction as opposed to "son of ARPA." But as you can see, I am not very happy about this whole situation.

Anyway, thank you very much for coming, and that is about it.

STATEMENT OF HON. SAXBY CHAMBLISS, A U.S. SENATOR FROM GEORGIA, CHAIRMAN, COMMITTEE ON AGRICULTURE, NUTRITION, AND FORESTRY

The CHAIRMAN [presiding]. First of all, let me apologize to our witnesses for running behind here. We have had some other crisis we have been trying to address. To my colleagues, thank you all for pinch-hitting for me here.

Without being here, though, Mr. Davidson, Dr. Collins, it is apparent to me just from talking to my colleagues over the last several months that there is a lot of frustration relative to what is going on in the Crop Insurance Program. We passed the bill that Senator Roberts referred to back in 2000 that we thought was going to solve a lot of problems, and apparently the more we get into it, the more problems we are observing. I hope we can resolve this and make this a smoother program without additional legislation. If we need to, we have got to.

I just have a couple of questions. Dr. Collins, in November 2004, the FCIC Board of Directors adopted a resolution directing FCIC to publish a proposed and final rule regarding Premium Reduction Plans of Insurance. What led the Board to adopt this resolution and why had the rulemaking process not been fully exercised prior to the initial availability of PRP?

Mr. COLLINS. Mr. Chairman, the Board first considered PRP in the fall of 2002. At that time, the Board considered rulemaking, but only briefly. We spoke with the Department's General Counsel. At that time, the General Counsel advised us that PRP was provided for in the standard reinsurance agreement and that PRP could be implemented without rulemaking. It could be implemented under procedures—it could be implemented straightforward under the SRA, or it could be implemented with additional procedures developed by the Board or RMA.

In December of 2002, the Board adopted a resolution that authorized the approval of PRP subject to, I think it was nine different conditions. There was one company that was approved under those conditions, and those conditions were later expanded by a Manager's Bulletin issued by Mr. Davidson. One company was approved under those procedures for two successive years.

It, however, was in the late summer or early fall of 2004 when we received six additional applications for PRP that we first became more troubled by the procedures that were in place. The six additional applications raised many new issues that hadn't been contemplated by the Board or by RMA. There was a diversity of approaches submitted by the six companies on how a PRP should be operated.

So in October of 2004, the Board passed a resolution seeking an Advance Notice of Proposed Rulemaking, an ANPR, to find out what the public thought, find out what additional analysis we could

get together to evaluate a PRP. We knew it was becoming controversial at that point. We were hearing from agents. We were hearing from companies. We were hearing from the public. We were hearing from producers. We felt that it would be important to get in a formalized way that input.

So at that point, we were only contemplating receiving comments and revising our existing procedures. We also sent out PRP to five independent expert reviewers under contract to get their evaluation.

Come November, the next month, the month that you started with, we had thought about it some more and thought, well, just going out and asking for public comment is probably not going to be enough. We ought to follow APA, the Administrative Procedures Act, and do a formalized approach to this because of the possible repercussions of this to the industry. So it was at that point that the Board of Directors adopted the resolution that you just mentioned and indicated that FCIC would proceed with notice and comment rulemaking, and that is the process we are in right now.

The CHAIRMAN. Mr. Davidson, when do you expect that final rule on PRP to be published?

Mr. DAVIDSON. When the Board passed its resolution, it directed us to have something available so that companies could apply for the 2006 reinsurance year that begins July 1. We anticipate publishing a rule in the very near future.

The CHAIRMAN. On the next panel we are going to hear in greater detail from the industry about PRP. Can Crop 1 operate in 2006 without premium discounts if it so chooses?

Mr. DAVIDSON. They haven't applied to us to do so.

The CHAIRMAN. They haven't applied for what exactly?

Mr. DAVIDSON. They have applied to do business this next year under PRP. That is the mode of business that they have done. Any company that applies will have to adhere to the new rule as it comes out. That will probably require some adjustment on anybody's part, but particularly, I would say, on Crop 1's part.

The CHAIRMAN. Senator Lugar, do you have any other questions?

Senator LUGAR. No, Mr. Chairman.

The CHAIRMAN. All right, gentlemen. There will be some additional questions that will be submitted to you in writing and we would ask that you respond to those as quickly as possible, if you will, please.

The CHAIRMAN. We will move now to our next panel. We have Ron Brichler, the Chairman of the American Association of Crop Insurers; Mr. Norm Nielsen, Independent Insurance Agents and Brokers of America, and Mr. Billy Rose, CEO of Crop 1.

Gentlemen, welcome. Thank you. I have been advised by staff that we will certainly take any statement you want to submit for the record, but if you will please limit your opening comments to 3 minutes, it will just allow us to move a little bit quicker.

Mr. Brichler, we will start with you.

STATEMENT OF RON BRICHLER, AMERICAN ASSOCIATION OF CROP INSURERS, CINCINNATI, OHIO

Mr. BRICHLER. Thank you, Mr. Chairman. Members of the committee, in spite of all the progress that we have made in recent

years, and despite the tremendous boost the program was given by the passage of ARPA in 2000, the Crop Insurance Program is now at great risk. Three initiatives taken by RMA could destroy in a few years the progress we have made over the last 25.

These RMA initiatives are as follows: Pursuing a premium reduction plan that will discriminate against small and limited resource farmers and create chaos in the marketplace; two, promulgating regulations that make the Crop Insurance Program more costly and nearly impossible for the traditional companies and agencies to deliver; three, misusing data of a taxpayer-funded industry analysis to force cuts in the delivery system that will, if allowed to continue, adversely impact the delivery system that took 25 years to build.

On the first threat, RMA asserts that the law requires they implement a PRP rule this year. We disagree. If they cannot devise a rule that prevents discrimination against small farmers that meets all of RMA's other requirements, limitations, and procedures, RMA should not issue a final rule. Strangely, RMA has chosen to ignore the mandatory provisions of the 2000 ARPA law and instead are forcing implementation of the outdated provisions of the 1994 law, which is not mandatory.

RMA verbally stated that they are going forward with a PRP program even prior to closure of the comment period. They are choosing to ignore 93 percent of the 805 comments which are opposed to the PRP rule and program. We have supplied our own analysis of these comments as our Appendix A.

We predict the following outcomes will be the inevitable result of a PRP program authorized by RMA's proposed rule. Companies and agents will be forced to neglect the small family farmers and concentrate on competing for the largest and most profitable accounts. Companies will be forced to withdraw from States because it will not be profitable to compete in those States. Service to farmers, both through risk management counseling and claims adjusting, will rapidly decline.

RMA continues to increase the regulatory burden of the program in an attempt to limit fraud. No one in the crop insurance industry condones fraud, and fraud identification and control is improving. However, currently, the greatest threat to the integrity of the program is the attempt of RMA to force down reimbursements to companies and their agency force to a level that makes it impossible to properly service the business.

By its very nature and purpose, the Federal Crop Insurance Program is complex. The photograph before you represents roughly about half of the pages of notices and guidelines and regulations that companies and agents must understand and adhere to. Doing the job right requires true public-private partnership and one that is not resource-starved.

The third threat concerns RMA's deceptive and misuse of certain data. In an unsigned briefing paper delivered by the RMA to the House Appropriations Committee on May 13, RMA stated, quote, "The allegation that PRP is being offered only to large farmers and not small farmers is untrue. In 2004, approximately two-thirds of the policies sold by Crop 1 were for 250 acres or less," close quote. This is a deceptive use of statistics.

RMA's definition of a crop policy is one crop in one county. With this definition, very few farmers would have only one policy. A farmer frequently has multiple county crop policies for the same crop, and most farmers have more than one crop. In any event, our research shows that other companies report that, on average, the size of policies being transferred from their companies to the premium discounter company is twice as large as their average policy.

Another instance of misuse of data involves a study produced under contract with RMA by Milliman USA. Although the study is a highly technical analysis of rates of return involving several scenarios and economic assumptions about the crop insurance industry, RMA has publicly referenced certain statements in the study without making the complete study available for independent review. RMA skewed the study by picking a period in which crop insurance had a loss in only one of 13 years rather than a more representative period of 1988 to 2002, when crop insurance experienced a loss in three of 15 years. Both the private industry and Congress have tried unsuccessfully to obtain the complete study.

I am sorry for going over, Mr. Chairman. There is a lot to say in 5 minutes. Thank you for your time.

The CHAIRMAN. Thank you.

[The prepared statement of Mr. Brichler can be found in the appendix on page 76.]

The CHAIRMAN. Mr. Nielsen?

STATEMENT OF NORMAN A. NIELSEN, ON BEHALF OF THE INDEPENDENT INSURANCE AGENTS AND BROKERS OF AMERICA, PRESTON, IOWA

Mr. NIELSEN. Good morning and thank you, Mr. Chairman, for holding this important hearing. My name is Norm Nielsen from Eastern Iowa. In the interest of time, I am going to let the record stand as for my formal introduction.

I have been a Main Street agent for 20–plus years, through the good years and bad while RMA has slowly evolved through seven administrations. However, I have never seen it in the state it is in now. I am particularly bothered by the persistent undermining of the agent's role, which adds value to this program.

Recently, through an unfair and arbitrarily drafted conflict of interest provision, RMA designed rules severely reducing the agent's involvement in loss adjustment. It is unrealistic to expect the agent to remain silent while their client faces a loss. There are always questions that only the agent can answer, but RMA's policy levies a $10,000 fine against us.

Not as Senators, but as policy holders, I ask you, does this really make sense? Agents have built this program into the successful story it is today, and to be treated like second-class citizens is unconscionable.

The Big I opposes PRPs. This does not mean that we are against competition. In fact, we embrace competition as an important check and balance to the industry. Competition drives the agent network. We compete against each other, which makes us strive to offer better service. However, PRPs actually undermine the competitive playing field by putting cost of service over quality of service.

Speaking of competition, RMA's decision to allow one company to continue to offer PRPs after the FCIC Board suspended the program pending rulemaking created a government-sponsored monopoly for the 2005 year. This is RMA's idea of promoting competition in the industry?

The Big I believes that PRPs have no role in the industry that relies so heavily on agents. We believe that PRPs promote discrimination against limited resource and high-risk farmers, contrary to the Federal Crop Insurance Act. In order to understand why PRPs are bad for the program, we need to understand what the agent does.

Unlike property-casualty, a crop agent has to gather data, compute APH, determine optional units, review plans of insurance, quote 247 options, do risk management, enter data into the company's computer, and most of this done by March 15. I charge RMA to show me a delivery system that reduces the agent's role without reducing the quality of service to our farmers.

PRPs require the provider to demonstrate that a true efficiency will be achieved, not merely cost savings. Mr. Chairman, agents are the efficiencies. RMA can admonish all forms of discrimination, but condemning it and actually preventing it are mutually exclusive. RMA can neither enforce—does not have an enforcement mechanism to prevent such abuse nor the resources to create one.

There are also forms of covert discrimination. For example, an agent's book of business full of lucrative accounts, they will want you. If it is full of small and high-risk accounts, they will pass over you. There is a term that we call this and that is called cherry-picking. If only the profitable customers are skimmed off the top, who will service the small farmers?

Mr. Chairman, companies have realized significant reductions in the Federal reimbursement over the last 11 years and the quality of service to the nation's agriculture producers has remained static. Unfortunately, that will not be the case under PRPs.

In conclusion, Mr. Chairman, there are too many unanswered questions to allow the program to go forward. The most pragmatic solution is to suspend PRPs until a third party, preferably the GAO, can conduct a comprehensive oversight investigation. I implore the Congress to have the USDA suspend this program and initiate one immediately.

Thank you for the opportunity to testify and I would be pleased to entertain any questions you may have.

The CHAIRMAN. Thank you, Mr. Nielsen.

[The prepared statement of Mr. Nielsen can be found in the appendix on page 107.]

The CHAIRMAN. Mr. Rose?

STATEMENT OF BILLY ROSE, PRESIDENT AND CHIEF EXECUTIVE OFFICER, CROP 1 INSURANCE, URBANDALE, IOWA

Mr. ROSE. Chairman Chambliss, Senator Lugar, and members of the committee, my name is Billy Rose. I am the President of Crop 1 Insurance out of Des Moines, Iowa. We are the first company approved by USDA's Risk Management Agency to offer farmers a savings of up to 10 percent of their Federal Crop Insurance premiums.

Since I only have a few minutes, let us cut to the chase. The issue comes down to priorities for you and for the crop insurance industry. Is it more important to offer farmers a price break on crop insurance and help them control their costs, or is it more important to maintain the status quo of an industry undermining its own stability through bidding wars over agent commissions?

Here is how a PRP works. If an insurance company meets certain operating expense criteria, a premium savings can be passed on to the farmer. But some companies and agents want to kill PRP. This is bad Federal policy and very bad for the American farmer. To kill PRP sends a simple message: Insurance company profits and agent commission checks are more important than helping farmers save money.

Occidental Fire and Casualty Insurance of North Carolina and its managing general agent, Crop 1, in order to make PRP broadly available, have appointed over 400 independent agents in 15 States and we have written over 16,000 crop policies. Since the inception and approval of our program, we have saved the American farmer out of our pocket over $4 million, no cost to the American taxpayer.

Farmers embrace PRP. They want to save money. They want to reduce risk by purchasing higher levels of coverage. Our book of business shows just the opposite of these allegations. Our farmers are taking the savings and buying higher levels of coverage, and we service all farmers.

Attacks on PRP and its provider are really about competition amongst crop insurance companies. If PRP disappears, reduced competition allows large insurance companies and agents to retain the higher profits and market share.

This industry is controlled by two insurance companies that have over 50 percent market share. Don't forget, crop insurance companies don't set the premium price. They recruit other firms' agents by offering higher commissions, leading to the loss of companies that can't afford the bidding war. This is one of the factors that led to the collapse of American Growers, a $40 million bill to the American taxpayer.

Crop 1 now has evidence that other companies today are offering our agents in excess of 20 percent commission if they will move their farmers away from Crop 1. To date, our agents have resisted this predatory attempt to undermine the PRP agent delivery force.

We feel it is time to stop talking to the insurance companies and agents and begin talking to farmers, the beneficiaries of reduced premium crop insurance. Occidental, Crop 1, and our agents are eager to support any legitimate effort to make PRP, with the obvious farmer benefits, a better program.

I would like to, Mr. Chairman, set the record straight on some of the distortion and attacks that I have heard here today against Crop 1. First, it is a government-sponsored monopoly. The fact is, Crop 1 is simply the first company to sell PRP as approved by RMA. Six other companies have applied and weren't approved.

Fact—or, excuse me, myth is that we are cherry-picking and we only operate in the most profitable States and we only service large farmers. As I mentioned before, we are in 15 States. Our plan of operations for 2006 goes to 21 States. We include States like Texas, North Dakota, South Dakota, some of the highest-risk States.

In fact, when you break down our book of business and you look at the facts, not the rumors, 60 percent of our policy holders are comprised of 500 acres or less. In fact, one of those Iowa farmers is with us today, Christine Ferguson. She comes from a century farm in Iowa, a couple hundred acres. Any farmer that wants a savings who can contact us through our agent or through our direct 800 number, we make sure that we get them hooked up with a local agent and they get the savings.

Another myth is that farmers' service will suffer with PRP. Approximately 94 percent of PRP policy holders renewed their policy last year. Over 95 percent of PRP policy holders who had a claim renewed their policy. I contend you go to a good restaurant, you have a good meal, you go back and you tell your friends. If you have a bad meal, you don't go back and you tell your friends that, too. Well, our service record shows that the farmers want to go back. They want the savings and they are telling their friends about it.

One of the last myths is that Crop 1 is operating without proper RMA oversight. USDA's Chief Economist that was here today, Dr. Keith Collins, calls Crop 1 the most scrutinized crop insurance company in his memory. Crop 1 has been audited, reviewed, reaudited throughout its 3 years of operation. I ask, could other firms selling crop insurance at government-set rates withstand the same scrutiny?

Thank you, Mr. Chairman. I look forward to your questions.

The CHAIRMAN. Thank you, Mr. Rose.

[The prepared statement of Mr. Rose can be found in the appendix on page 125.]

The CHAIRMAN. Mr. Rose, I do disagree with your written statement and testimony that says, and I quote, "to accept such an amendment regarding PRP in the appropriations process tells farmers Congress cares more about insurance company profits and agent commission checks than about helping farmers save money," close quote.

Just like everybody on this committee, I am a staunch supporter of the American farmer and I worked with others in the industry to modify the appropriations amendment so that producers' outstanding PRP policies will be honored and your company will be able to continue servicing these policies. I have been very clear that my position on this PRP amendment is not anti-Crop 1, and I will be clear today that my position is not anti-farmer. It is my firm belief that based on the proposed rule, USDA needs to thoroughly and carefully consider all issues as it moves forward in drafting the final rule.

Mr. BRICHLER AND MR. Nielsen, some may view your pursuit of the moratorium on the PRP rule in the appropriations process as an attempt to put Crop 1 out of business. Is that what you seek to achieve?

Mr. NIELSEN. Mr. Chairman, that is furthest from the truth. All we are asking for is an independent GAO audit. Let us get all the facts on the table.

Mr. Rose was in the Insurance Department in Iowa 2 years ago with a marketing plan that stated, I am going after the $5,000 ac-

count. Let us just get it to the public. RMA has not given this to us.

Mr. BRICHLER. Mr. Chairman, we are not trying to put Crop 1 out of business. They can continue to provide crop insurance without a premium discount program. All they have to do is file under that method. So what Mr. Davidson refused to answer before is they may file under a PRP, but they aren't required to file PRP, so they can remain in business if they like.

Second, many of the insurance companies have always asked for just an even playing field in administrating the PRP rules. Many of us met with Mr. Davidson in his office and asked questions relating to what type of expenses qualify under the PRP rules, what happens to startup costs. All these types of questions were asked and we didn't get any action from the administration on making sure that the playing field remained even.

There are different business models from different companies. Some companies rely on underwriting gain. Some rely only on the administrative and operating expense reimbursement. I don't think the elimination of PRP eliminates either one of those two business models.

The CHAIRMAN. Mr. Rose, I understand your company is currently approved to sell PRP policies only. If a moratorium in the appropriations process is achieved or PRP policies are not approved to be sold in the 2006 reinsurance year, will your company request approval to sell non-PRP policies?

Mr. ROSE. We have already filed our 2006 plan that includes PRP. The 2006 crop year starts in a matter of days. Texas, the Southern crops, will be kicking off, and then we roll right up into Kansas and the winter wheat crops.

To change midstream would create havoc, confusion, and great expense. We spent over $3 million creating an IT system of which we are able to analyze the farmers' options and we provide it to our agents so they can do it quicker, say within an hour, which used to take us 10 hours to do a complete analysis. All our systems would have to be overhauled. It would be a serious setback, sir.

The CHAIRMAN. So I am not sure what your answer is, though.

Mr. ROSE. We feel this is a good program and the program should continue forward. We want the facts to come out. We support any further investigations. We are very proud. We play by the rules. We think it would just be a tragedy if this program were to be overturned and we could no longer offer it. We have not gone to that stage of saying, we can't offer the program anymore, so I don't have a concise answer for you, sir.

The CHAIRMAN. OK. Mr. Brichler, Mr. Nielsen, if Crop 1 sought approval to sell non-PRP policies, would you support having competition on a level playing field in the industry?

Mr. NIELSEN. We always support. I represent 22 companies in my shop and I have two Crop companies, so I can't say anything but support it.

The CHAIRMAN. OK. Mr. Nielsen, your written statement directs pretty harsh criticism at RMA. Do you have any recommendations for improvement?

Mr. NIELSEN. Well, I kind of think Senator Grassley said it all early on. But I think what we really need is communications. When

the SRA was being negotiated, we were not there. We weren't asked. We were never given any kind of input into what will the agents and the farmers really buy? We need to be at that table to give the input because we are on the first line of communicating with the producer and that information needs to be fed back up to the RMA.

The CHAIRMAN. Senator Lugar?

Senator LUGAR. Thank you, Mr. Chairman.

The issues this morning are extremely complex and it is difficult in this short hearing, and you have done a yeoman's job in short statements to sort of make it concise. But let me just ask this question from the standpoint—I suppose perhaps Senator Grassley and I may be the only two customers for crop insurance on this committee. So in terms of conflict of interest, we have indicated earlier on, and certainly I am. I buy crop insurance every year.

We have 604 acres, just 200 acres in soybeans, 200–and-some acres in corn, so we would qualify in one of the classifications of either the small people under 250 or 500 or whatever this involved. We are in Indiana.

One of the questions that Senator Grassley raised this morning, if I heard him correctly, was that Iowa is a low-risk State. He suggested there were other States that have higher risk, without categorizing all of them. There are some farming situations even within Iowa, I suppose, or in Indiana that are lower-risk than others.

So philosophically, there is a problem here. I suppose, depending on how you sort of look at economics generally, if, in fact, the purpose of the Risk Management Agency, the crop insurance, is to try to take a look at every State, every farmer with the thought that the most efficient situations in the lowest-cost States get a better deal and those that are higher-risk get much worse terms, this might fit the normal circumstances, or at least one set of circumstances.

On the other hand, the argument that I think is being made inferentially is that if we get down that road, essentially, before long, the higher-risk States will be forgotten or their situations will be less cared for. Ditto for the smaller farmers in the higher-risk States almost beyond the pale at this point. Therefore, perhaps in a democracy, you say you can't cherry-pick. You can't pick and choose among these people. Essentially, if you are going to have one crop insurance system, it is one crop insurance system, and therefore you cover everybody, same premiums, and you are mandated if you are a company to cover a State and every one of these situations unless somebody is in fraud and abuse.

I suppose there have been arguments this may state too broadly the parameters, the question, but along these arguments, not only in crop insurance and agriculture but in other kinds of social policy insurance or other general situations, nondiscriminatory. So it is an interesting issue.

If, for example, to take the Lugar farm, and we have just, say, 200 acres in soybeans for the sake of an argument this morning, and we appear to be a pretty low-risk State in Indiana. I don't know where we rank along with Iowa and so forth in terms of low-risk situations. We are probably not among the most risky. Senator Conrad has mentioned this morning his State, and I have heard

Senator Conrad, I think for the last 15 years describe weather disasters that hit almost every month, not just every year. So it is a tough situation, we understand.

But what I am trying to fathom is, and I would ask you, Mr. Brichler, to begin with, as the industry takes a look at this, as you are reading this, what is all of this to be about? If we are philosophically trying to design a crop insurance program for America, should it deal with the efficient and the inefficient the same, States likewise, or what is the marketing aspect as you look at it?

Mr. BRICHLER. Well, I think, Senator, that maybe this body actually addresses the type of concern that you are posing to me better than most in that you build coalitions every day in order to get one common piece of legislation passed.

If you look at corn in Iowa, for instance, and its likeliness of loss versus that same corn plant in North Dakota or cotton in the Southeast, each one of those particular crops are going to have a different set of loss factors, some better, some worse. What we are trying to do is build a program that brings all crops, all people that want insurance into the process. In some cases, we are going to have to insure crops that don't make an APH each year on an actuarially sound basis in order to maintain 50 State support for this program, which I think is important. I don't think our lending institutions would provide operating loans to our farmers without the Crop Insurance Program as a backstop.

Senator LUGAR. Well, that is an honest answer. Coalition building does happen all the time. It is an interesting insurance concept as well as a political one, I suspect. But what is your take on this, Mr. Nielsen?

Mr. NIELSEN. Coming from Iowa, we can say that we have some of the best loss ratios historically over a number of years. But coming from where I live along the Mississippi corridor, we have claims when nobody else has. When the Mississippi comes out of its banks, we have claims. We need a program that is there always for all farmers. Our Southern Iowa farmers get droughted out at times. We need it to be available.

So to say that we have a program out here that fits everyone's needs, yes, we do presently. Everybody can get insurance. That is all we are asking. Provide the protection for the producer.

You start cherry-picking this and then companies—I mean, it is not a dirty word. They are supposed to make money, OK. With that, they are going to have to make some tough decisions of where they are going to be involved in the marketplace. We just cannot have that for the producers.

Senator LUGAR. Let me just mention parenthetically, and the chairman has already testified or others have, ideally, crop insurance would then cover 50 States and all the marginal situations. But as some of us could point out, almost each year, there are hues and cries for additional disaster insurance. We had the program, but folks come then and say, well, the weather was especially bad here, or in five States, we just simply were blown out of the water, crop insurance or not, and if you pressed them, they would say, well, not all of our farmers can buy crop insurance at this point. They haven't discovered it yet. They found it too expensive.

It was less expensive to come to the Federal Government and coalition build for another $4 or $5, $10 billion of disaster insurance on top of the crop insurance. Now, that is not your fault, the insurance situation. It is our fault, I suppose in whatever the political rallies may be in here. But this is just my observation, sort of year after year of this.

There is another second cut for those that somehow or other felt that they either didn't want to buy the crop insurance and the Lord will provide, namely the Congress if you didn't have it.

What is your answer to all of this, Mr. Rose? You are obviously offering differentials, 10 percent discount. You mentioned some farmers in Iowa for this type of thing. What is your take on the philosophy?

Mr. ROSE. Very good questions. I think it is important that we are aware that the current industry is operating anywhere from five to 15 percent above their expense reimbursement, looking at it from the insurance company. So we are speculating on an underwriting game. So Indiana is a very good State. If I am going to be eight points underwater as an insurance company, I want to operate in the highly profitable States.

The beauty about PRP is you must operate within the expense reimbursement, the 22 percent, which has allowed us to be in North Dakota since day one, to go down to Texas and write 4,000 policies, because in a worst-case situation, when farmers need the savings and they have drought, you know, now they can get the benefit of the savings, good for the farmer, now is it good for the American taxpayer? We are operating within the budget, so if we have a complete wipe-out in one State or all States, and our plans are to go nationwide, that we would—we are at break even. That just makes practical business sense.

And that is why I look at the PRP model and I go, sure, it can be refined. There is no perfect program. But this is good for the farmer, it is good for the taxpayer, and it is good for the program.

Senator LUGAR. Thank you. Thank you, Mr. Chairman.

The CHAIRMAN. Gentlemen, thank you very much for being here today. We appreciate your testimony and response to our questions.

The CHAIRMAN. Our last panel today is composed of Dr. Bert Little, Associate Vice President for Research, Tarleton State University in Stevenville, Texas; Dr. Bruce Babcock, Director, Center for Agricultural and Rural Development, Iowa State University in Ames, Iowa; Mr. Mike Clemens, Wimbledon, North Dakota, on behalf of the American Soybean Association, the National Sunflower Association, and U.S. Canola Association; and Mr. Ray Buttars, National Association of Wheat Growers, Weston, Idaho.

Gentlemen, thank you for being here today. Thank you for your patience. Dr. Little, we will start with you and we will come right down the row. Again, we will take your full statement for the record. If you could limit your opening comments to 3 minutes, it would be very much appreciated.

Dr. Little?

STATEMENT OF BERT LITTLE, ASSOCIATE VICE PRESIDENT FOR RESEARCH, AND PROFESSOR OF COMPUTER SCIENCE AND MATHEMATICS, TARLETON STATE UNIVERSITY, STEVENVILLE, TEXAS

Mr. LITTLE. Thank you, Senator Chambliss. My name is Bert Little. I am Associate Vice President for Research at Tarleton State University, which is a member of the Texas A&M University System. I am a professor of computer science and of mathematics. I have been doing research for over 27 years on the Federal dime and the Fed has always been happy with my research, which I am glad to report.

I am here to bring to you the results of another program of research that w conducted at the Center for Agribusiness Excellence. It was sponsored under Subtitle B, Section 515(j) of ARPA, basically to establish an information management system under which we could do data mining which would improve the integrity of the crop insurance system and effect savings and reduce fraud, waste, and abuse.

I am bringing to you three messages today. The first message is that this program has been a success. The second one is, if this program goes away, the savings that we have been able to achieve will ultimately go away. Then third, I would like to raise a yellow flag, and that yellow flag is that the House gave us money to continue on for one more year and the Senate Appropriations Committee did not put money in there.

Basically, what we have been able to do under my point one is to be able to effect savings that are on the average of $100 million a year. Over the past 4 years, we have effected savings in excess of $350 million.

No. 2, if the program does not continue, such savings will disappear and anything that we have been able to do to increase the integrity of the program will go away.

No. 3, we do have 1 year of funding on the House side, not on the Senate side, and the interesting quagmire that the Risk Management Agency finds itself in is that although the authorization for the funding ends this year, the requirement for this kind of research to reduce fraud, waste, and abuse does not disappear.

I have tried to keep my statement brief and I will yield my 57 seconds.

The CHAIRMAN. It is well received, I assure you, Dr. Little——

[Laughter.]

The CHAIRMAN [continuing]. The appropriations process is not over, so that will be duly noted, that you yielded back a minute as we move into that process.

[Laughter.]

The CHAIRMAN. I also note that you have as your Washington representative Mr. Ken Ackerman, who is former RMA administrator under the previous administration, a gentleman that I had the privilege of working with on many, many difficult issues, and Ken, it is good to see you.

[The prepared statement of Mr. Little can be found in the appendix on page 161.]

The CHAIRMAN. Dr. Babcock?

STATEMENT OF BRUCE A. BABCOCK, DIRECTOR, CENTER FOR AGRICULTURAL AND RURAL DEVELOPMENT, IOWA STATE UNIVERSITY, AMES, IOWA

Mr. BABCOCK. Thank you, Mr. Chairman, for the opportunity to participate in today's hearing and to review ARPA's livestock insurance provisions. ARPA authorized the RMA to insure livestock and it set up a mechanism to induce the private sector to create new insurance products.

My view of the rationale for expanded Federal involvement in the livestock sector is to increase the economic viability of independent livestock producers by providing them with efficient risk management tools that allow them to manage their risk independently of packers.

Producers of hogs, fed cattle, and feeder cattle in 19 States can now insure against unexpected declines in the price of their production with Livestock Risk Protection, or LRP. Hog producers in Iowa can insure against unexpected declines in the average margin over feed costs with LGM, or Livestock Gross Margin.

Now, the extent to which small to medium-sized livestock producers will actually use these new insurance products remains to be seen, however. This year, no State has more than 3 percent of its livestock insured under either product.

There are a number of reasons for this low participation. History has shown that it takes time for farmers, their agents, and the companies to become knowledgeable about and comfortable with new products. In addition, both LGM and LRP were pulled from the market in December of 2003 following discovery of BSE in the U.S. Following substantial program modifications, sales of both resumed in October of 2004. This withdrawal hurt sales momentum for both products, but this type of learning by doing is what pilot insurance programs are really all about.

Market research showed that livestock producers list risk management as a top concern. However, recent experience with crop insurance shows that most crop farmers will not buy high levels of insurance without large premium subsidies. But extending these large premium subsidies to the livestock sector to encourage participation would be counterproductive because livestock supplies are much more responsive to subsidies than are crop supplies. Large premium subsidies would lead to supply expansion and a resulting drop in market prices, exactly the event that the insurance products are designed to protect against.

Over the next three to 5 years, we should learn whether independent livestock producers find that Federal livestock products are important to their operations. By then a large proportion of the nation's producers will have access to Federal insurance and agents and companies will have had time to learn how to sell the products and manage their risk.

If it turns out that a significant number of producers want to purchase this kind of insurance, Congress will need to revisit the $20 million limitation on annual expenditures that is included in ARPA.

In summary, ARPA is a success with regards to livestock insurance. It set up a successful mechanism to encourage the private sector to develop innovative products and it gave RMA authority

and the financial means to offer reinsurance and support for the products.

As an aside, I must say that in my experience, RMA has done a very good job working with the private companies in making, implementing this part of ARPA.

So that is it.

The CHAIRMAN. It is noted you didn't yield back any time——

[Laughter.]

Mr. BABCOCK. But I was only 9 seconds over.

The CHAIRMAN. We won't charge you for that, I promise you.

[The prepared statement of Mr. Babcock can be found in the appendix on page 166.]

The CHAIRMAN. Mr. Clemens?

STATEMENT OF MIKE CLEMENS, WIMBLEDON, NORTH DAKOTA, ON BEHALF OF THE AMERICAN SOYBEAN ASSOCIATION, NATIONAL SUNFLOWER ASSOCIATION, AND U.S. CANOLA ASSOCIATION

Mr. CLEMENS. Mr. Chairman and members of the committee, I am a producer from Wimbledon, North Dakota. I am Mike Clemens. I grow wheat, corn, sunflowers, and soybeans, and I am also Chairman of the National Sunflower Association.

While the immediate concern for each oilseed and association varies, as farmers, we support a strong National Crop Insurance Program that ensures all producers can obtain affordable coverage. I will briefly discuss the major issues for each oilseed commodity that I represent here today.

First, under soybeans, finding effective policies to address soybean rust is a top priority for the American Soybean Association. Soybean producers are significant customers of the Crop Insurance Program. Last year, 77 percent of the total soybean acres were insured, or 58 million acres out of the 75 million acres. However, while participation numbers for soybeans are impressive, there are a wide range and regional variations in the type of policies farmers buy toward this program.

For example, consider the different position of a soybean farmer from Iowa and a soybean farmer from Arkansas is likely to find himself in if both suffer a 40 percent yield loss from soybean rust. In Iowa, the State with the most soybean acres, 94 percent of the acres in 2004 were covered with buy-up policies at the level of 75 percent. In Arkansas, the Southern State with the most soybean acres, only 46 percent of the acres were covered with a buy-up policy. In fact, only about two-thirds of Arkansas growers bought crop insurance at all, and of these, more than half bought CAT policies. For those growers, a 40 percent yield loss would not even be covered if soybean rust were to happen.

In Georgia, soybean farmers are in a similar situation. Only 71 percent of the soybean acres are insured at all, and fully 38 percent of all policies are at the CAT level.

Soybean farmers have real concerns that despite our best efforts to protect ourselves through the Crop Insurance Program, losses due to soybean rust will not be adequately covered and disaster assistance will be necessary. The criteria for paying indemnities due to soybean rust seem terribly subjective to farmers. There is no cer-

tainty as to when to spray, how many times to spray, whether it is too early, too late, and the list just constantly goes on with the producer to identify that.

The Soybean Growers Association strongly believes losses due to soybean rust should be covered through the Crop Insurance Program.

And moving quickly into sunflowers and canola, the major concern is the inability to expand crop insurance coverage availability in a timely manner. Historically, farmers have used written agreements designed to offer coverage in a county where the crop insurance is not in place for a certain crop to help make the transition into growing a new crop. This also helped RMA compile enough experience to extend crop insurance policies into that county.

However, under current RMA rules, 3 years of production history are now required before a producer can get a written agreement. In most cases, this prohibits producers from even trying an alternative crop, since lenders routinely require their borrowers to buy insurance every year, and to let a producer go along without crop insurance for 3 years can be devastating.

We understand the need for actuarial soundness. However, we believe the cropping history of a producer's similar insurable crops could gauge his or her ability to grow these new crops. Therefore, we ask the committee to consider amending the crop insurance statute to allow the use of similar commodities to establish cropping history for written agreements.

For instance, FDA's mandated trans fat labeling becomes effective January 1 of 2006 and consumers are searching for this healthy oil that is not available to the market at the levels we would like to see now. Producers need the flexibility to plant for these markets to capitalize on markets that are in front of us right now.

Everybody likes baseball, but just think of confection sunflower seeds. You won't be able to eat the seeds at the ballgame because the producers in Kansas can't grow enough sunflowers.

Thank you.

The CHAIRMAN. Thank you, Mr. Clemens.

[The prepared statement of Mr. Clemens can be found in the appendix on page 171.]

The CHAIRMAN. Mr. Buttars?

STATEMENT OF RAY BUTTARS, CHAIRMAN, DOMESTIC POLICY COMMITTEE, NATIONAL ASSOCIATION OF WHEAT GROWERS, WESTON, IDAHO

Mr. BUTTARS. Thank you, Mr. Chairman, Senator Lugar, and in absentia, the rest of the members of the committee. My name is Ray Buttars and I grow wheat in the great State of Idaho. I am pleased to be here on behalf of the National Association of Wheat Growers and offer our thoughts on the Federal Crop Insurance Program.

Crop insurance is a critical risk management tool, and like any other important tool on the farm, it needs periodic maintenance and sharpening. The sharpening we recommend is identified in the following four improvements.

First, coverage levels. The higher levels of coverage currently available are not affordable. Even with the existing premium support, most farmers can afford only 65 or 70 percent coverage. With fuel and fertilizer costs being double of just a crop or two ago, it is easy to understand that production costs usually exceed 90 percent of the average crop value. At 70 percent coverage, a farmer loses 3 years of potential profit before any claim is paid.

Higher coverage is critical. However, it must also be affordable. NAWG has requested that group risk plans be made available to wheat growers. These policies are more affordable, but will work only for a portion of farmers because counties in the wheat belt tend to be large and have multiple climates. Greater premium support for 75 to 85 percent levels appear to be the only real solution for making these higher levels affordable.

Second, risk management accounts. We have developed a concept we call risk management accounts. These accounts would provide a mechanism for Federal and private partnership to address the most glaring hole in the Crop Insurance Program, which is the uninsurable portion of a farmer's crop. Presently, this initial deductible is far greater than the slim margins we work with. Recent ad hoc programs have tried to address this. We believe the time is right for a proactive solution.

These accounts would be available to farmers who buy crop insurance policies and would be linked to the value of the crops insured. Further details are attached to my testimony.

Third, APH, or Actual Production History. The nation's wheat growers know all too well the effects of prolonged drought. Over the last several years, much of the nation's wheat belt has suffered from extensive drought and, therefore, loss of crop. Each year of crop failure reduces a farmer's APH, eroding the safety net provided by crop insurance. In my written testimony, you will find two suggestions to offset this erosion.

Finally, minimum harvestable value. Many times, the residual value of a damaged crop is less than the cost of gathering or harvesting the remaining crop. Determining the point at which a crop is not worth harvesting and the actuarial cost of this option should be very simple. We suggest that farmers be allowed to purchase optional coverage to insure the unharvestable residual and recommend that this option be assignable to a custom harvester.

Mr. Chairman, members of the committee, Senator Lugar, we sincerely thank you for this opportunity. I would be glad to respond to any questions you have and the NAWG leaders, staff, and I look forward to working with you to sharpen the risk management tools available to the American farmer. Thank you.

The CHAIRMAN. Thank you very much.

[The prepared statement of Mr. Buttars can be found in the appendix on page 175.]

The CHAIRMAN. Dr. Little, you answered part of this, but I want to go a little bit further. As you know, mandatory funding for data mining expires after fiscal year 2005, as you stated. Also in your testimony, you state that your data is currently protected by an RMA firewall. What happens to this data if funding expires and is unavailable after October 1, 2005?

Mr. LITTLE. The hardware and software are property of USDA and we would pack it up and take it to Kansas City.

The CHAIRMAN. Mr. Clemens, your testimony highlights regional differences in levels of insurance coverage. Do you have any thoughts about how to encourage producers to purchase higher levels of insurance coverage?

Mr. CLEMENS. It seems in where I am from, North Dakota, that the agents do an excellent job of providing information to the growers to outline all the options that are to them out there as far as different levels of coverage and what policy they have. Just more of an educational thing, possibly, could be more in place.

And also, there are certain areas that don't think that they ever have a crop less. Well, they may never have a crop less—North Dakota, it seems like you have heard in the room here several times today that North Dakota has a crop loss every minute of the day, it seems like, and these other States, with soybean rust coming in now, it might not be as often, but it is going to be as huge loss to the producers. So maybe they just get complacent to think that they never have a loss and that is why they buy that lower coverage.

The CHAIRMAN. Are we far enough into the season yet to know what percentage of our soybean growers are going to experience a problem with rust?

Mr. CLEMENS. Earlier testimony, I believe there was only one county in Florida that is identified. It is really pretty early in the season. You know, a spray will only last 2 weeks and it costs $15 per application, so a farmer could go broke just blindly applying a fungicide to his crop every 2 weeks to prevent the rust, and when you see it, it is going to be too late. Really, we are just starting to get into the timeframe when it is really getting crucial.

The CHAIRMAN. Mr. Clemens, Mr. Buttars, do you as producer organizations have any views to share on the data mining?

Mr. CLEMENS. We just support whatever RMA has already put in place, the firewalls that are in there to see what is going on in local communities. Other than that, really none.

Mr. BUTTARS. Mr. Chairman, the Association of Wheat Growers has not taken a formal position on this. We support the absolute need for the preservation of the integrity of the Crop Insurance Program, as one of you has expressed. We also, though, nonetheless would want to assure that availability was always maintained and that profiling was not a pursuit of the program.

The CHAIRMAN. Mr. Buttars, I appreciate your thinking about ways to improve the Crop Insurance Program, but as you probably know, statutory improvements to the Crop Insurance Program cost money. Do you have any cost estimates on the proposals that you have mentioned in your testimony?

Mr. BUTTARS. We have simple estimates, but they are only simple. We would look forward to the opportunity to working with your committee, with FAPRI or whoever else we need to. The staff at NAWG and the rest of our group are eager to get an actuarially sound and FAPRI or OMB-supported estimate of these suggestions.

The CHAIRMAN. Mr. Babcock, your written testimony suggests, on the one hand, that there may be a public policy rationale for Federal livestock insurance, but on the other hand warns that large

premium subsidies could lead to a significant expansion in livestock supply and a resulting drop in market prices for livestock. Could you explain or elaborate a little bit on this, please, sir?

Mr. BABCOCK. Sure. The public policy rationale, in my view, is that small to medium livestock producers can't really go to the Chicago Board of Trade and Chicago Mercantile Exchange and efficiently buy futures and options because the contract sizes are so large that they do not, what should I say, aren't customizable to an individual producer's operation and that the LRP and LGM insurance plans basically take those futures and options and customize them to make them work for small to medium livestock producers.

The large producers can go to the commodity exchanges and use those for their price insurance. The only alternative for small to medium producers is to go to—and they have done it over the last 10 years—is go to the packing houses and the packers and processors in the big companies that will offer them different risk management tools like window contracts or forward contracts on their production, but then that raises a question about how independent those producers are relative to the packers, and so that the LRP and LGM give them an alternative to packers for their risk management purposes.

So that, to me, is a public policy reason why maybe the Federal Government should support the insurance products. But on the other hand, that support needs to be a bit limited because the livestock sector, especially hogs and poultry and things that have a shorter biological cycle can take a price subsidy or a subsidy for their insurance and what that will do is encourage them to expand, because if you pay for the risk reduction, they will take more risk and they will expand their markets. Our experience with the livestock commodity groups is that they don't want that kind of intervention because they are afraid of what it will do to market price.

So on the one hand, there is a reason for being involved, but on the other hand, I think we need to make sure we limit the large premium subsidies on—be careful that we don't take all the risk out of producing livestock.

The CHAIRMAN. Senator Lugar?

Senator LUGAR. Thank you, Mr. Chairman.

Mr. Clemens, I was interested in your analysis of the soybean situation in these ways. I think you mentioned that there could be a very great difference in what happens with soybean rust in the South, and you cited Arkansas, which is pretty Southern as opposed to Iowa or Indiana, where the spores might take a while longer to get there, but a very different set of circumstances under the crop insurance coverage.

That is, as I understand you are saying in Arkansas, maybe 40–some percent had greater coverage of 75 percent to 85 percent levels, whereas maybe in Iowa, it was 77 percent or thereabouts. So this is totally disproportionate in this particular crisis to what is likely to be the problem.

As I understand, the spores thrive in the South, could even exist in the South even if they die in the North during winter and so forth, and yet we sort of know as this situation is being set up there is a real problem here because the losses may not be to the

point where you even get any coverage at all and you sort of miss out altogether.

So then there will clearly be a hue and cry in the event that the rust problem really is a big one this year that the program didn't work, that the coverage is inadequate. In essence, you can almost see it coming just by definition unless we have no problem at all, in which case, why, this was a false alarm.

I raised questions with the first panel to start out with this morning because I am alarmed about this. I have a feeling that this could be a very bad surprise. I am assured, for example, in my State that there are 20 plots somewhere that are going to detect the first spore that gets there. In other words, this will be an alert. I hope that is right. I am not sure I know where the 20 plots are and who will report what happens on those 20 plots.

And as you have pointed out, if you apply the chemicals then at that point, the efficacy of the chemicals may have a duration of a week, two, three, how many times you do this to qualify for the crop insurance payments at the end of the trail, which I am still trying to pin down with those over at USDA to give us more definition. I am not satisfied that we sort of know if in a conventional way you plant the crop and nature moves on, you are OK.

You are representing the soybean people. Let me just ask, have you encouraged soybean farmers generally because of this rust to go for the 85 percent coverage? In other words, this would appear to be the most prudent thing they could do. Or do you take Mr. Buttars' testimony on wheat? He has said so many wheat farmers have such a small margin with regard to the total expenses and with other things rising that although they might like to have the 85, the best they can do is the minimum situation, but then they may misfire altogether. So he is calling for a new program that offers some possibility to people moving up into this.

What is your overall comment, given all of these sort of nondescript points that I have made?

Mr. CLEMENS. First off, the data I supplied to you was 2004 and it was the history——

Senator LUGAR. Two-thousand-and-four, OK.

Mr. CLEMENS. Two-thousand-and-four data. We don't have the data for 2005.

Senator LUGAR. OK.

Mr. CLEMENS. There hasn't been any effort by the Soybean Association to really get growers involved and know what could be coming down the road. I am not really sure, because I represent the National Sunflower Association, I am not on the American Soybean Board, but as a producer, I grow soybeans on my farm and I have had notices sent to me, not necessarily about buying up coverage, but how to look for the rust. A nice pamphlet was sent out to me. Unfortunately, everything in that pamphlet once I read it, it was already too late for me to spray my crop.

There is going to be a real problem as far as if this rust does show up and we say one of these 20 fields shows it. There isn't enough airplanes, sprayers, and chemical in the country probably to treat all these acres and it is going to be just a panic.

I think back to back in the 1980's when they had wheat midge predicted in North Dakota coming in. There were traps set out and

everything to monitor it and the big scare was put in. A lot of producers couldn't forward-price their crops because they didn't know if they were going to have a crop and it never materialized.

So this rust is really going to—it is a new thing, new kid on the block, so we are going to have to see how it is going to work out for us. We know the history in South America is very devastating.

Senator LUGAR. Well, I appreciate what you are saying. I am concerned about it because, as I have already pointed out, I have a parochial interest, 200 acres of beans out there. I am watching them. But I don't have any confidence at all in what is occurring as I watch either USDA's crop insurance or what have you on this. There is almost a wistful hope that somehow, we are going to miss what happened. But as you are suggesting, if we don't, then there will really be hell to pay. Everybody will be flying in every direction as to why there was no foresight, no vision, and so forth.

At least, Mr. Chairman, on this committee, there was vision. We kept raising the alarm every time we had a hearing, hoping somebody understands that. I appreciate all the thoughts about clear signals and communications and what have you, but, you know, I am in a position to hear all these things and I don't hear very much of it. So I am worried about the average farmer in Indiana who isn't sitting in a Senate office, going to hearings, talking to USDA, visiting with my friend, Chuck Connor. You know, where do you gain some confidence in all this?

Let me just ask a question of you, Mr. Buttars. Even if a wheat farmers pressed in terms of margin, wouldn't your advice still be to go to the 85 percent? In other words, I can't imagine—our margin is not that great in Indiana on corn or beans, for that matter, but I can't imagine starting off a crop year without the highest amount of insurance anybody is going to provide, and particularly given the fact there is a large Federal support to it. This is not the actuarial cost of all of this.

Mr. BUTTARS. You ask a very good question and that question, while I don't know the answer for soybeans, I do know from personal experience that as I pursue the higher levels of coverage, the premium cost is just about dollar for dollar for the insured benefit. In explaining crop insurance to an intern that works for our Association yesterday, we discussed the concept, well, now if her car payment is $300 a year, or, excuse me, a month, and her insurance were $300 a month, she said, why not just buy a second car, because she doesn't need the coverage because she can bear that risk already. If the cost of that additional coverage is equal to the premium, or to the benefit, why buy the coverage?

Senator LUGAR. So here, I would guess that maybe our calculations are different. At least, my own calculation is why I buy this, actually pay the premiums, or theoretically discussing it this morning is that there is real value in doing that. One year, why, White River came up in September and came across 150 acres of bottom land. There was no predictability about that situation whatsoever, but I was awfully glad we had the insurance and it saved our situation, even granted a 5–year average. It doesn't precisely cover that crop.

But in any event, this is why the value of people like Dr. Little and Dr. Babcock are very important, some economists in here to

advise some of the rest of us as to whether there is value or not. Now, if there isn't, why, we need to hear that, likewise, from the academic community who are non-imbibers, non-soybean farmers, insurance premium payers.

I think there is substance in what you are advocating, Mr. Buttars. What I am trying to get at is, before we get into that, to try to gauge the value of what additional appropriations might be involved and what benefits come from that, which I hope the adequate research will support before we bite into that.

Thank you, Mr. Chairman.

The CHAIRMAN. Gentlemen, thank you all very much for your participation. This has been a very informative hearing with testimony and the answering of questions by all of our panelists.

The record will remain open for 5 days, if anyone has any additional comments or statements to insert.

Thank you, and this hearing is concluded.

[Whereupon, at 12:36 p.m., the committee was adjourned.]

APPENDIX

JUNE 28, 2005

Statement of Senator Tom Harkin(Ranking Democratic Member)
Crop Insurance Hearing
Senate Committee on Agriculture, Nutrition, and Forestry
June 28, 2005

Thank you, Mr. Chairman, for holding today's hearing on the very important topic of the federal crop insurance program. We passed the fifth anniversary of the enactment of the Agricultural Risk Protection Act last week, on June 22, so this is a good time to take a look at how it has improved the program. Crop insurance is a crucial component of the farm income safety net.

Since 2000, crop insurance participation in terms of acres enrolled has increased by 7 percent, and total crop value covered has increased by more than 33 percent. With the higher premium subsidies provided in ARPA, farmers are both covering more acres and buying higher levels of coverage for acres that were already insured, which is what we intending to achieve. ARPA also invested resources in developing new products for crops for which either no policies exist or for which existing policies were deemed inadequate by producers of those crops. The Act also relaxed the restriction on providing insurance coverage for livestock operations, for which several pilot projects have been approved.

I expect that many of the witnesses will raise the issue of the proposed rule for the Premium Reduction Plan. The Federal Register notice for that proposed rule generated several hundred comments. I understand that the majority of the comments were negative, raising concerns both about the adequacy of the proposed rule and the capacity of RMA to oversee how companies and agents market these discounted policies, in order to reduce the temptation for agents to focus on larger, more profitable operations while neglecting small- and medium-sized farms.

I share those concerns, and believe that RMA should delay implementing this rule until stakeholders have an opportunity to provide input on the revised version of the rule before it goes into effect. A delay would also permit an independent analysis of the potential impact on the crop insurance program and the resources needed to monitor marketing practices.

I also have concerns about the proposed changes to the conflict of interest rules which govern relationships between crop insurance agents and loss adjusters. Many agents from Iowa and elsewhere have objected to requirements which bar any contact between agents and adjusters, even something as routine and non-controversial as providing maps or directions to the farm where the crop loss occurred. While I understand the need for effective conflict of interest rules, some of these proposed changes seem more likely to create confusion and delay in processing farmers' claims without really reducing wasteful or abusive practices.

I would like to note that three of today's witnesses hail from Iowa, and I would like to acknowledge their participation in this hearing. In order of appearance, we have Mr. Norman Nielsen from Preston, Iowa, representing the Independent Insurance Agents and Brokers of America, Mr. Billy Rose, CEO of Crop1, located in Des Moines, Iowa, and Dr. Bruce Babcock, Director of the Center for Agricultural and Rural Development at Iowa State University in Ames. Welcome, gentlemen, and thank you for testifying.

I believe that over the last several years, Congress, USDA, crop insurance companies, and agents have combined to provide a greatly improved federal crop insurance program. Certainly, Iowa farmers have embraced the program, insuring their crops to the tune of more than $5 billion in protection last year. Before we tinker with that success, let's take a long, hard look at these matters. Thank you again, Mr. Chairman.

STATEMENT OF KEITH COLLINS
CHIEF ECONOMIST, U.S. DEPARTMENT OF AGRICULTURE
BEFORE THE U.S. SENATE COMMITTEE ON AGRICULTURE, NUTRITION, AND FORESTRY

June 28, 2005

Mr. Chairman and Members of the Committee, thank you for the opportunity to discuss implementation of the Agricultural Risk Protection Act (ARPA) of 2000. I serve as Chairperson of the Board of Directors (Board) of the Federal Crop Insurance Corporation (FCIC), which has general management responsibility for FCIC. My remarks today will focus on the general activities of the Board since the passage of ARPA. Mr. Davidson, Manager of FCIC, and Administrator of the Risk Management Agency (RMA) will provide programmatic details on FCIC activities under ARPA.

Under ARPA, the Federal crop insurance program has been strengthened and expanded. The cost of the program has grown, reflecting increased premium subsidies and participation. In the past five years, the number of acres insured through the program rose from 206.5 million in 2000 to 221 million in 2004. During that period, liability rose from $34.4 billion to $46.6 billion, as more farmers saw the value of the crop insurance safety net, entered the program and purchased higher coverage levels and as more products were developed and approved for more crops in more locations. The program now offers 22 insurance plans in all 50 states plus Puerto Rico. Actuarial performance has also been excellent, with loss ratios, that is, indemnities paid divided by total premiums, steadily improving over time. This past year also saw record-high underwriting gains and administrative and operating expense reimbursements for the approved insurance providers, and new companies have entered the business.

FCIC Board Process under ARPA

ARPA also made many changes to the functions and responsibilities of the FCIC. Significant changes include: restructuring the Board and its process for approving new insurance products; expanding pilot programs to include livestock, a sector of agriculture specifically excluded in the past; emphasizing service to underserved states, underserved crops, and underserved producers; outsourcing the internal research and development of crop insurance products; increasing risk management and crop insurance education and expanding the role and use of new technology, such as data mining, to increase program compliance.

Under ARPA, the number of private sector Board members has increased. The Board is composed of 10 members: the Corporation Manager, as an ex officio non-voting member; two Under Secretaries of Agriculture, one responsible for the Federal crop insurance program; the USDA's Chief Economist; one crop insurance professional; one member experienced in reinsurance or the regulation of insurance; and four active producers who are policyholders from different geographic areas of the United States representing a cross-section of agricultural commodities, including at least one specialty crop producer. Currently, nine of the 10 positions are filled.

The Board has met 46 times since enactment of ARPA in June 2000, compared to 28 times from 1995 through 2000. Since ARPA, the Board has taken 196 official actions. The intense activity reflects the increased submission of private products under section 508(h) of the Federal Crop Insurance Act (Act), the requirement that the Board use independent expert reviewers to assist in the decision making of the Board and the need for the Board to take action with respect to numerous pilot programs and research results.

Section 508(h) of the Act authorizes the reimbursement of certain costs associated with the development and submission of products from persons outside FCIC. This incentive, along with the expansion of allowable commodities, such as livestock, has led to an increase in the number of private submissions. The legislation also requires FCIC to make determinations on submissions to the Board by issuing a notice of intent to disapprove a product not later than 90 days and approve or disapprove a product not later than 120 days after receipt of a complete submission.

ARPA also requires the Board to contract with independent actuarial and underwriting experts for the independent review of policies, plans of insurance, and related materials prior to the Board giving approval for such products. In making its decisions, the Board must take the results of the expert reviews into consideration before its determination of approval or disapproval. Since the enactment of ARPA, over 200 individual independent expert reviews have been conducted on over 41 submitted crop insurance products and program modifications. The Board currently has 43 expert reviewers under contract.

Recent Board Actions

The Board has approved many new risk management products since the enactment of ARPA. I will summarize only some of our most recent actions. An inventory of all Board actions under ARPA is attached to this statement. During the past year, two actions taken by the Board involved resolving issues of concern related to outstanding livestock products. The Livestock Risk Protection (LRP) pilot plan of insurance for fed and feeder cattle and the Livestock Gross Margin (LGM) pilot policy for swine. In early 2004, the Board withdrew these products, pending review and modification, following cessation of sales of LRP cattle as a result of the discovery of a BSE infected cow in Washington State in December 2003 and due to other

issues related to LGM. RMA successfully worked with the owners of both of these products to identify modifications requested by the Board, making it possible for the Board to re-open sales of the improved plans of insurance beginning September 30, 2004. The modifications made to the livestock insurance plans included procedures for the suspension of sales of the product in cases of catastrophic events or highly volatile futures market prices and other procedures to minimize adverse selection by insureds.

The Board remains concerned over the marketability and the appropriateness of these products as a long-term offering of FCIC. Consequently, the Board will soon contract for an evaluation of the performance of the livestock pilots.

During the past year, the Board also approved the significant expansion of a relatively new product, Adjusted Gross Income-Lite (AGR-Lite). AGR-Lite was developed by the Pennsylvania Department of Agriculture and first offered in 2003 in Pennsylvania. In the two years following its introduction, AGR-Lite was expanded to 16 states (including Pennsylvania), and for 2006 will be available in a total of 18 states. There appear to be additional states currently working with Pennsylvania to request that AGR-Lite be expanded into their states.

AGR-Lite covers the adjusted gross revenue from the whole farm based on five years of Federal tax return data and expected farm income for the current year. It is a simplified version of the Adjusted Gross Revenue (AGR) pilot plan of insurance and uses the AGR Handbook and rating methodology. AGR-Lite can potentially fill an important void in FCIC's product line by appealing to small-to-medium size producers of livestock and specialty crops. AGR-Lite, as a new plan of insurance, has had limited participation and continues to undergo revisions for improvement. In 2004, there were 96 policies sold, and for 2005, there are 148 policies earning premium with an average of three agricultural commodities covered per policy.

AGR-Lite has a $250,000 liability limit and that is most likely one reason for the somewhat limited participation, including participation by producers with livestock. The liability limitation exists as an eligibility requirement because of the relationship between the cyclical nature of livestock prices and the AGR/AGR-Lite rating method. RMA currently has a contractor working to determine the most effective and actuarially sound methods to use in rating various types of livestock under the AGR plan of insurance. Other reasons the participation level is low may be related to the learning curve of a financial product as compared to a production agriculture type of insurance product, as well as the cost of delivery. On April 28, 2005, the Board sent for expert review a series of potential modifications of AGR-Lite designed to improve the product and increase participation.

Answers to some of the questions surrounding the limited participation may also be forthcoming soon, as RMA entered into a contract for a formal evaluation of the AGR pilot program last summer. This in-depth evaluation will review all aspects of the AGR pilot program including a review of listening sessions with both producers and approved insurance providers, underwriting, actuarial analysis, tax issues, and reinsurance. The evaluation is scheduled to be completed in early December 2005 after which the Board will place AGR under consideration for continuation, continuation with modifications, or termination.

Some other recent actions include authorizing implementation of a Silage Sorghum Pilot plan of insurance for two counties in Colorado and 37 counties in Kansas; approving Group Risk Income Protection (GRIP) plan of insurance for grain sorghum, for all states and counties currently approved for the Group Risk Plan (GRP) and expanding LRP to Montana. Many actions have been taken regarding pilot programs over the past year including terminating the pilot program for crambe and the Pilot Coverage Enhancement Option (CEO) following the 2005

crop year in most states. Pilot programs for mustard, mint, wild rice, and cabbage were evaluated by the Board, determined to be successful and then converted to permanent programs. The Board approved for continuation pilot programs for strawberries, fresh market beans, California citrus, cherries, and clams. The Board terminated the existing Pilot Group Risk Plan Rangeland Program but replaced it with a new Pilot Group Risk Plan Rangeland Program, which has a more accurate index for the 2005 and succeeding crop years. Similarly, the Board terminated the existing Sweet Potato Pilot program and approved for 2005 a new program to address the high loss ratios and program integrity vulnerabilities of the prior pilot. The Board disapproved a proposed LRP program for lamb. The Board has several proposed programs pending for action including: LGM for cattle, various changes in AGR-Lite, a nursery crop price endorsement pilot program, a Florida fruit tree pilot program, and a long-term revenue program for dry peas and lentils. A large number of additional programs and products are expected to be addressed by the Board during the remainder of 2005, ranging from good experience discounts to new pasture, range and forage products.

Improving Processes and Setting Priorities

In order for the Board to better manage its expanded responsibilities under the Act as amended by ARPA, the Board has created a Governance Committee and an Audit and Finance Committee. The Governance Committee recently completed, and the Board approved, the first restatement in over a decade of the delegations of authorities from the Board to the Manager of FCIC. It also established information requirements regarding marketability and maintenance costs for proposed new products so they may be better assessed regarding their value to producers and their actuarial appropriateness. The Audit and Finance Committee focuses its

attention on the many audits of RMA conducted by the Office of Inspector General or the Government Accountability Office and RMA's actions in response to those audits.

Under ARPA, the Board has focused on providing RMA with direction in its efforts to improve the risk management capacity of farmers and ranchers. In order to ensure that FCIC's resources are used most effectively to meet the needs of producers and the industry, the Board authorized studies examining FCIC's current and future products, including an analysis of the FCIC product portfolio, with specific attention on coverage overlap and gaps. That portfolio review helped the Board establish broad priorities for FCIC.

These general objectives include: putting equal emphasis on new product development and improving existing products; increasing evaluation of market impacts, market penetration and delivery costs of proposed products; emphasizing group and whole farm products; improving oversight, evaluation and performance of pilot programs; treating internally developed products in the approval process consistent with the treatment of private sector submitted products; placing highest priority on developing range, forage and pasture risk management products; removing redundant programs, such as combining various revenue products into one policy; strengthen and expand the pool of expert reviewers and contracting vehicles; requiring periodic reports from RMA on all aspects of its operations; involving the Board early in the process for contracting for evaluations, feasibility and development studies and program issues.

As part of that portfolio review, the Board contracted for the development of an analytical tool to help measure the performance of existing products and identify changes that would improve their usefulness. That analysis tool, which encompasses over 70 questions, is now being integrated into the business processes of RMA. It will be used by RMA to assess existing policies and can be used by new product developers and contracted evaluators. We

believe this tool will also help the Board and RMA assess the large number of pilot programs and feasibility studies that are in the pipeline.

The Board's Role in PRP

A major issue that the Board addressed during the past year and an interest expressed for this hearing is Section 508(e)(3) of the Act, which provides for the possibility of a crop insurance premium reduction for producers. The issue of a Premium Reduction Plan (PRP) has led to considerable debate, divergent opinions, and much deliberation by the Board. Issues regarding the legality and equity of such a plan have arisen. To address all the issues, in November 2004, the Board directed the FCIC to proceed with the notice and comment rulemaking process in this matter as expeditiously as possible. Let me briefly provide the context in which the issue arose for the Board.

Section 508(e)(3) requires the FCIC to allow approved insurance providers to offer a premium reduction plan if they meet the requirements of the law. In 2002, one company, Crop 1, requested Board approval to offer a PRP. By Board resolution in December 2002, the Board established certain standards that such a PRP should meet. The Board also directed RMA to develop more detailed procedures by which that particular company could operate a PRP and by which others could also apply to operate such plans. Since then, several other approved insurance providers, representing over 80 percent of the crop insurance business have requested approval to offer a PRP of their own particular design, including substantial variations from the single plan approved in accordance with Board-established procedures. However, those plans have presented significant implementation and regulatory issues for RMA that were not contemplated by the existing procedures. The Board decided that all stakeholders, including the producers who stand to benefit from such plans, should have an opportunity to present their

views. Accordingly, RMA is proceeding with notice and comment rulemaking to establish a comprehensive framework by which such plans will be evaluated, approved, regulated and operated. The comment period for the proposed rule ended on April 25, 2005. RMA will consider all comments received so that the regulation will allow them to administer Section 508(e)(3) of the Act equitably and to the benefit of all producers, large and small, while maintaining the integrity of the Federal crop insurance program and the strength of its delivery system.

During this rulemaking process, the Board has provided its counsel to RMA on a range of PRP-related issues. The Board created an ad hoc committee that reviewed the proposed rule and will continue to serve as a sounding board for RMA during the development of the regulation. After the rule is issued, the Board will review with the manager of FCIC all submissions for approval of a PRP.

The Board is fulfilling and will continue to fulfill, its statutory responsibilities, including the provision of oversight, guidance and direction to FCIC and RMA. At each meeting, the Board reviews different aspects of RMA's activities in the discharge of the Board's general management responsibilities. Each Board member is pleased to have the opportunity to serve and we all work diligently to ensure the effectiveness and efficiency of the nation's crop insurance program.

That completes my remarks.

Statement by Ross J. Davidson, Jr.
Administrator
Risk Management Agency
United States Department of Agriculture
Before the Senate Committee on Agriculture, Nutrition and Forestry
Tuesday, June 28, 2005

Mr. Chairman and members of the Committee, I am pleased to appear before you today to report on the progress and challenges of the Federal crop insurance program and particularly to provide an update on our successes and challenges in implementing the Agricultural Risk Protection Act of 2000 (ARPA). In fulfillment of the mandates of ARPA, and under the direction of the Federal Crop Insurance Corporation (FCIC) Board of Directors (Board), the Risk Management Agency (RMA) continues to promote an aggressive agenda to bring new and innovative insurance products to the agricultural community, to validate the utility of current insurance products, to ensure outreach to small and limited resource farmers, to promote equity in risk sharing and to guard against waste, fraud and abuse within the program.

This year we mark a major milestone for the crop insurance program. Twenty-five years ago, the Federal Crop Insurance Act of 1980 became law, creating the unique partnership between private insurance companies and the Federal government within the crop insurance program.

The program has experienced extraordinary growth in the last quarter century. Through the private sector delivery system in crop year 2004, RMA provided approximately $46.7 billion of protection to farmers on approximately 370 commodities covering over 80% of planted acreage in the United States. This coverage was offered through 22 plans of insurance and approximately one and a quarter million policies that insured about 221 million acres. Attached to my testimony are several charts that provide further background and highlight the growth of the Federal crop insurance program under ARPA.

In 2004, crop insurance provided approximately $3.1 billion in indemnity payments to farmers and ranchers, including approximately $218 million for the four hurricanes in the Southeast and approximately $337 million for a brief freeze in the upper Midwest.

The roles of crop insurance and the Risk Management Agency have evolved over the years, but our mission remains the same – to promote, support and regulate sound risk management solutions to preserve and strengthen the economic stability of America's agriculture producers. RMA continues to improve and update the terms and conditions of existing crop insurance policies to improve coverage and efficacy of the policies, as well as to clarify and define insurance protection and the duties and responsibilities of the policyholder and insurance providers to enhance understanding, use and the integrity of the program.

The new Standard Reinsurance Agreement (SRA) is now in place, effective for the 2005 crop year. Key changes included a lowering of the percentage rate of Administrative & Operating (A&O) expense reimbursement and a rebalancing of the risk sharing between the government and the private sector, which will be implemented over the 2005 and 2006 reinsurance years. In addition, RMA enhanced the reporting and monitoring of SRA holders and related parties with respect to financial solvency and program integrity. To complement that enhancement, RMA has strengthened formal ties with state insurance regulators and the National Association of Insurance Commissioners (NAIC).

We now have 16 approved insurance providers selling and servicing crop insurance, compared to 14 when the 2005 SRA was signed. Most of these companies have requested authorization to increase the amount of premium they write and the number of states they intend to serve.

Since the SRA was signed, three new insurance companies have been approved. They are Austin Mutual and its Managing General Agent (MGA), Crop USA; the Westfield Insurance Company with its MGA, John Deere Risk Protection, Inc.; and Stonington Insurance Company with its MGA, Agro National LLC. RMA has also been contacted by another major organization, which has indicated it is in the process of preparing an application to join the program.

The 2004 reinsurance year was exceptionally profitable for the companies and their commercial reinsurers, with an estimated $700 million in underwriting gain and a return on retained premium of approximately 22 percent. In 2003, companies had an underwriting gain of $380 million, with a return on retained premium of about 15 percent. In 2002, companies had an underwriting loss of $46 million, with a -2 percent return on retained premium. A&O reimbursement has also risen from $626 million in 2002 to $734 million in 2003, with an estimated $889 million in 2004. This represents a growth in A&O reimbursement per policy of 45% over the past three years.

Now I would like to provide an update to the Subcommittee on the following key issues.

RMA Program Issues

- **Premium Reduction Plans**
- **Soybean Rust**
- **Multi-year Disasters/Declining Yields**
- **Program Integrity**
- **Misreporting and Penalties**
- **Conflict of Interest**
- **Pasture, Rangeland, Forage and Hay Initiatives**
- **Program Expansion and Market Penetration**
- **Nursery Final Rule**

Premium Reduction Plans (PRP)

In 1994, Congress added Section 508(e)(3) of the Federal Crop Insurance Act, which allows approved insurance providers to offer premium discounts to farmers corresponding to demonstrated efficiencies in delivering crop insurance below the A&O expense reimbursement.

The Act requires that the PRPs be subject to the rules, limitations and procedures established by the FCIC.

The Board established procedures for allowing approved insurance providers to offer PRP in early 2003 in response to the application made by Converium Insurance Companies (Converium) and its Managing General Agency, Crop1. Converium was approved to offer a PRP under those procedures, which were available to all companies. RMA then closely monitored Converium and Crop1's implementation of their approved PRP, including investigating complaints received from competing agents and insurance providers.

In the few instances that it was found an adjustment was needed, RMA required Crop1 to adjust its approach in the marketplace to ensure compliance with the rules, limitations and procedures of the crop insurance program in general, and those specific PRP procedures established by the Board. This included the requirement that Crop1 make insurance available to all farmers in the states in which the company sells and services crop insurance. Farmers who purchased insurance using the PRP plan expressed appreciation for the lower premiums and consistently reported good service. Additionally, Crop1 has a very good record of compliance with the administrative requirements of reporting policy information, remitting payments to FCIC and resolving discrepancies. As with all insurance providers in the program, we continue to assess compliance with the requirements of the program and follow up on consumer and competitor complaints as we become aware of them and take corrective action where warranted.

In 2004, a number of additional insurance providers requested RMA's approval to offer their own PRP. Implementation issues were raised by these new submissions that were not contemplated when the procedures were drafted. In light of this and other issues that have been raised regarding the effect of PRP on the crop insurance delivery system, the Board adopted a resolution on November 19, 2004 to promulgate a regulation to address these issues.

The proposed rule for PRP was published in the Federal Register on February 24, 2005, with a 60-day comment period. The comment period ended on April 25, 2005. RMA has received approximately 800 separate mailings and 1,900 comments pertaining to the PRP proposed rule.

Generally, the comments received have expressed concerns about the potential for PRP to reduce agents' commissions and the effect this would have on the agent force and service to producers, particularly small, minority and limited resource producers. Several comments have expressed concerns that PRP will result in larger, lower-risk producers being targeted for the discount, while smaller producers would not be offered the discount. However, RMA has also received comments supporting PRP, stating that Crop1's Premium Discount Plan has allowed producers to purchase higher coverage levels. Briefings on PRP for both the Senate and House Agriculture Committee staffs were also held recently to provide a summary of the comments and answer questions about the process.

These comments have been very helpful to RMA in evaluating the benefits, challenges and appropriate measures to take to administer a PRP in light of the statutory language and consistent with the long term integrity and viability of the crop insurance program. The regulatory process

will document RMA's evaluation and consideration of the comments and the resultant changes to the proposed rule.

At the direction and under close oversight of the FCIC Board, the rulemaking process continues to move along in a timely manner.

Soybean Rust

Asian soybean rust (*Phakopsora pachyrhizi*) is a fungal disease that can quickly defoliate plants and reduce pod set, pod fill, seed quality and yield.

To ensure that farmers know their rights and responsibilities under the soybean policy, RMA has augmented the information that insurance providers are required to provide to farmers through their agents. RMA's communications encourage insured producers concerned about the impact of Asian soybean rust to use good farming practices by seeking and following recommendations of agricultural experts to control soybean rust. RMA recommends that insured producers document the advice received and actions taken to combat this disease and contact their agents on matters related to their insurance policies. Insurance providers have been asked to distribute this information to all soybean policyholders. Further, on May 26, 2005, RMA met with commodity groups and crop insurance providers, their associations and agent organizations to discuss several issues, including RMA's Manager's Bulletin on clarification of good farming practices.

Additionally, RMA is continually gathering up-to-date information and data regarding the spread and appropriate management of soybean rust. RMA participates in the National Soybean Rust Working Group's bi-monthly teleconference and U.S. Department of Agriculture Soybean Rust Working Group. In addition, RMA monitors and participates as necessary in discussions among State and Federal agriculture agencies regarding preventative and control measures. RMA holds a bi-weekly conference call with all RMA Regional Office Directors to discuss their direct contact with local State and Federal agriculture officials to obtain any updated information or developments in the spread and control of the disease.

Multi-year Disasters/Declining Yields

For most FCIC insurance plans, an individual insured's yield guarantee – approved Actual Production History (APH) yield – is principally based on a simple average of four to ten years of actual yields. Producers and others, including Members of Congress, have suggested that insureds are underserved when guarantees decline following successive years of poor growing conditions. The reduction in guarantee can adversely affect the viability of future crop insurance coverage and discourage continued participation in the program.

Multi-year crop losses do create a problem, but the solution is complex and potentially costly. Last spring, RMA solicited proposals for Alternative Methods for Mitigating Declines in Approved Yields Due to Successive Years of Low Yields. RMA goals were to seek proposals for new or modified approaches to establishing approved APH yields that are 1) less subject to decreases during successive years of low yields as compared to current procedures; 2) equitable across policyholders with differing average yields; 3) broadly applicable to all crops and regions;

4) affordable to policyholders; 5) feasible and cost-effective for RMA and insurance providers; and 5) actuarially sound.

Contract proposals have been received and evaluated and RMA recently entered negotiations for two contracts to begin the necessary research and development of alternative methods. The details of those proposals are not publicly releasable at this time, but we will release them as soon as contract negotiations are complete. Any proposal effectively addressing this issue may require additional funding and possibly new statutory authority.

Program Integrity

Additional efforts have been dedicated to integrating data mining projects; exploring avenues to expedite the increase in sanctions requests; and continuing to improve the Compliance case management and tracking system. 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.

RMA is making significant progress in preempting fraud, waste and abuse through the use of these tools. We have preempted millions of dollars' worth of improper payments and RMA continues to identify ways to reduce fraud. RMA has used data mining to identify anomalous results in the crop insurance program and, with the assistance of Farm Service Agency (FSA) offices, conducts growing season spot checks to ascertain the cause of the results. These spot checks based on data mining have resulted in a significant reduction in anomalous claims for certain situations.

RMA saved approximately $125 million in 2002 by deterring or preventing potentially fraudulent claims through data mining and other related activities. Additional savings of approximately $93 million were realized for 2003. We are optimistic about the long-term benefits of data mining in our compliance efforts and elsewhere should Congress continue funding beyond 2005.

Recent activity in this area identified policies where a comparison of past claims and APH data indicated that claim production data was not used to establish the APH as required by regulation. The Compliance Offices have completed their assessment of the accuracy and validation of this information. On October 10, 2004, Compliance notified the insurance providers that as a result of data mining, RMA had identified potential debt on approximately 14,000 policy units. The notification also contained a request to hold policy records for these units beyond the three-year record retention requirement, if applicable. Although the request did not immediately require the insurance providers to review these policies, several insurance providers have initiated reviews to determine the extent of the problem and preclude potentially incorrect payments on crop year 2004 claims. Some of these providers have already notified RMA of certain procedures that account for the discrepancies, confirming the fact that data mining results identify anomalous data, but still require review to determine whether an error exists for the policy.

The return on investment using data mining is significant. For example, RMA believes that over $320 million in estimated savings for the last four years is attributable to the data mining spot-check process.

RMA Compliance managers have been concentrating on the mission-critical tasks of evaluating and improving new processes to prevent and deter waste, fraud and abuse in the crop insurance program. Significant effort is dedicated to building and adapting the reporting and tracking feedback systems to complement and integrate the oversight mandates established by ARPA. During 2004, Compliance initiated operation reviews of several insurance providers to capture a program error rate and to assess insurance provider activities under the SRA. The Office of Management and Budget and the USDA Office of Chief Financial Officer agree that a quantifiable program error rate is a key measure in assessing program compliance and integrity.

While RMA and FSA have preempted tens of millions of dollars of improper payments through these and other measures, RMA is 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.

Misreporting and Penalties

A recently publicized dispute between some Nebraska producers and the Federal crop insurance program highlights the potential problems associated with certifications and correcting multiple years of discrepancies in reported information. The RMA Central Regional Compliance Office is assisting the Office of Inspector General (OIG) in a criminal/civil investigation of a crop insurance agency. The OIG initiated the investigation as a result of RMA reviews that identified the appearance of fraud, waste and abuse in the crop insurance policies serviced by the agency. Currently, the U.S. Attorney's office and OIG are in charge of the matter, with RMA and the impacted insurance providers assisting to bring this matter to a close as soon as possible.

The agency serviced a large book of business of over 400 crop insurance policies in Nebraska and South Dakota. Based on complaints received from FSA, RMA began investigating the appearance of fraudulent activities of the insurance agency for the 2000, 2001 and 2002 crop years.

RMA found significant misrepresentations of the production and acreages covering several years in crop policies serviced by the agency. The misrepresentations included several cases where producers certified having planted crops they never grew or had not grown in several years and where producers certified having an insurable interest in crops in which they had no such interest. There were also instances of inflation or deletion of production histories involving multiple crop units and years, which had the effect of inflating the producers' guarantees. As a result, the producers had inflated APH databases, incorrect insurance premiums and received overpaid indemnities, many occurring over a period of several years.

In November 2002, the insurance provider that the agency was affiliated with, American Growers Insurance Company (Growers), was placed under supervision by the State of Nebraska. The policies written by the agency for Growers were then assumed by various companies

beginning with the 2003 crop year. By the time OIG released RMA to begin corrective action relative to the incorrect policy certifications, the former agency policies had been placed with 14 different insurance providers.

In August of 2004, RMA sent letters to the insurance providers notifying them that the RMA reviews had found significant errors in former agency policies and that they needed to have the producers recertify their APH records and make corrections to the 2003 and 2004 data as appropriate. The intent was to provide information to the insurance providers so they could begin correcting policies, even though the OIG investigation was ongoing.

Some producers who believe the insurance providers' corrections were unfair have filed suit against USDA and RMA. This current legal action is the result of insurance providers correcting yields that producers could not support with their records. RMA received enough feedback to recognize that the instructions given in August needed to be revisited to ensure consistent treatment of these producers. On March 11, 2005, RMA placed a hold on the insurance providers implementing those previous instructions so that RMA could clarify the instructions to ensure producers were not adversely impacted because the procedures may have been misunderstood. RMA also ensured that all the affected producers will be eligible for 2005 crop insurance.

On May 25, 2005, RMA sent out further instructions to the insurance providers in compliance with an agreement to ensure that the corrections made in this case were fair and equitable. However, policyholders' coverage may still be affected by their ability to prove their yields under the revised guidelines issued by RMA to the insurance providers as a condition of reinsurance. This in turn may result in: 1) changes to policyholders' 2005 crop year liability and premium; 2) corrected premium and indemnities from prior years; and 3) repayment of any prior indemnities to which the producers were not entitled. Producers in all cases will have the ability to dispute the insurance provider findings under the terms of their crop insurance policy.

Conflict of Interest Supplementary Guidance

RMA is preparing to issue a Manager's Bulletin to supplement an Informational Memorandum it issued in March, which contains further guidance to assist approved insurance providers to implement changes to the new SRA regarding conflict of interest reporting and prohibited conduct. RMA's supplemental guidance would promote program integrity and ensure adequate internal controls based on the identification of certain problems in past audits and investigations of fraud, waste, and abuse in the program. RMA's guidance will recognize the agent's role in advising producers on their benefits and responsibilities with regard to their crop insurance policies.

On May 26, 2005, RMA met with commodity groups and crop insurance providers, their associations and agent organizations to discuss the draft Manager's Bulletin. Additionally, RMA has briefed congressional staff on this issue and has received helpful comments from them, industry, producer groups and the FCIC Board. We appreciate the feedback and assistance in addressing these compliance issues.

Pasture, Rangeland, Forage and Hay Initiatives
RMA previously awarded four contracts for research and development of new and potentially innovative crop insurance programs for pasture, rangeland, forage and hay. We are pleased to report that positive progress continues on each of these four contracts. RMA expects that at least two proposals may be ready for the Board to consider for independent expert review as early as August 2005. If approved by the Board, pilot testing could begin in 2006.

Program Expansion and Market Penetration
As Dr. Collins has testified, RMA and the FCIC Board have proceeded expeditiously with the review and approval of new plans of insurance as outlined by ARPA. RMA and the Board have reviewed priorities and schedules for product development and have determined that, barring any significant unforeseen hurdles, within the next 5 years a risk management product will be available to cover approximately 98 percent of the commercial value of U.S. crops. That is not to say that the task of having effective and useful products will be complete. Traditional APH products have been around for years and we are still finding ways to make them more effective and useful for producers. In addition, products to efficiently address risk management needs for livestock, specialty crops, pasture, rangeland, forage and hay, as well as to deal effectively with extended periods of drought are in their infancy and will need significant maturation over time.

Since the adoption of ARPA, RMA has aggressively expanded availability of existing crop insurance programs to producers. From 2001 to date, we have added 11,215 county crop programs to those available to farmers. In addition, the FCIC Board has reviewed and approved seven new private sector products under section 508(h) of the Act, converted six pilot programs to permanent status and recently approved three new pilot plans of insurance, with several more new pilot programs pending independent expert review and Board action in FY 2005 and 2006. Currently, over 25 programs or program options are in various stages of piloting. RMA expects that most of these pilot programs will continue to be modified and fine tuned over the next several years to meet marketplace demands and needs.

Possibly the greatest challenge and litmus test of the effectiveness of crop insurance is whether it is bought and used by farmers and ranchers, and whether the coverage they elect is sufficient to cover the risk of major loss. These factors are also important to the private sector delivery system and capital (reinsurance) markets acceptance of our products in determining whether products are attractive enough to the private sector to promote and support them.

Producer awareness, appreciation, proper selection and use of risk management products are important. RMA has used the authority and funding provided in ARPA to expand and enhance education and outreach activities in partnership with community based organizations, universities, extension service and others. It is believed that these efforts in combination with local and federal agencies and the efforts of the private sector have contributed to the strong record of expansion of the program since the passage of ARPA.

Nursery Final Rule
On June 20, 2005, RMA received word that the Office of Management and Budget had cleared the Nursery final rule. In general, the rule is designed to better meet the risk management needs

of nursery producers and to encourage nursery producers to choose higher levels of coverage. The rule is scheduled to be published in the Federal Register by June 30, 2005, effective for the 2006 crop year.

Conclusion

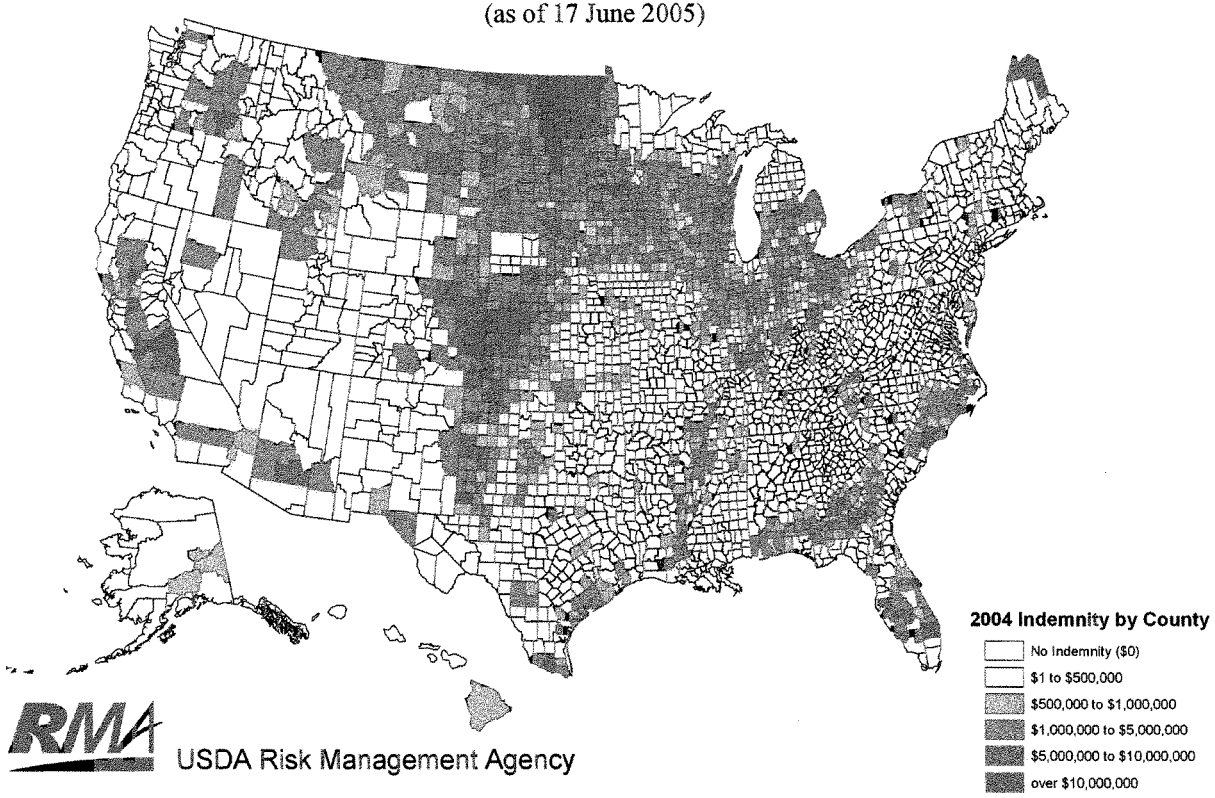
RMA continues to evaluate and provide new products and to promote the adoption of crop insurance as a risk management tool so that the government can further reduce the need for ad-hoc disaster payments to the agriculture

The growth and effectiveness of the crop insurance program is dependent on a reliable delivery system, insurance products that meet the needs of producers, investment in information technology to ensure the delivery system is timely, accurate and dependable, and adequate funding to support compliance and program integrity, product evaluation, maintenance and administration, and new product development.

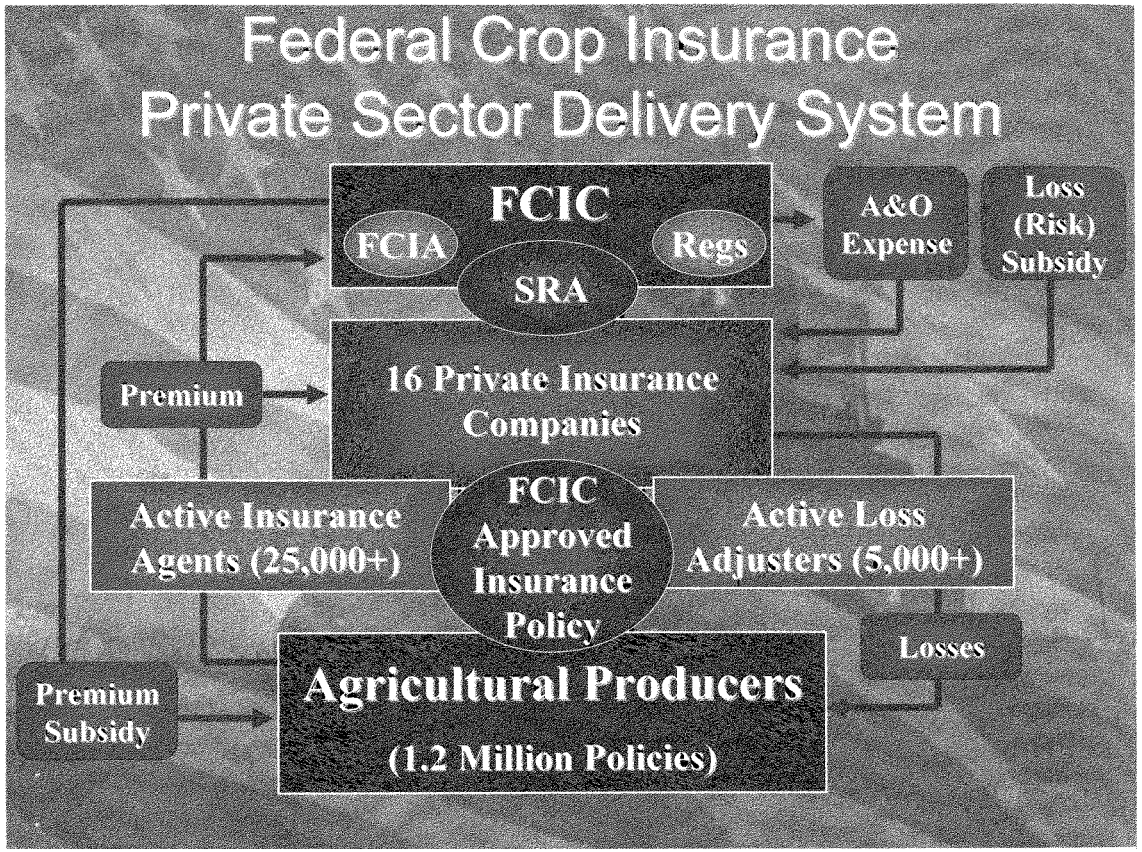
Again, thank you for the opportunity to participate in this important oversight hearing. I look forward to responding to questions on these issues.

Crop Year 2004 Indemnity Map

(as of 17 June 2005)



RMA USDA Risk Management Agency


Federal Crop Insurance
Private Sector Delivery System
FCIC
FCIA
Regs
SRA
A&O Expense
Loss (Risk) Subsidy
Premium
16 Private Insurance Companies
Active Insurance Agents (25,000+)
FCIC Approved Insurance Policy
Active Loss Adjusters (5,000+)
Losses
Premium Subsidy
Agricultural Producers
(1.2 Million Policies)

Federal Crop Insurance Program Status

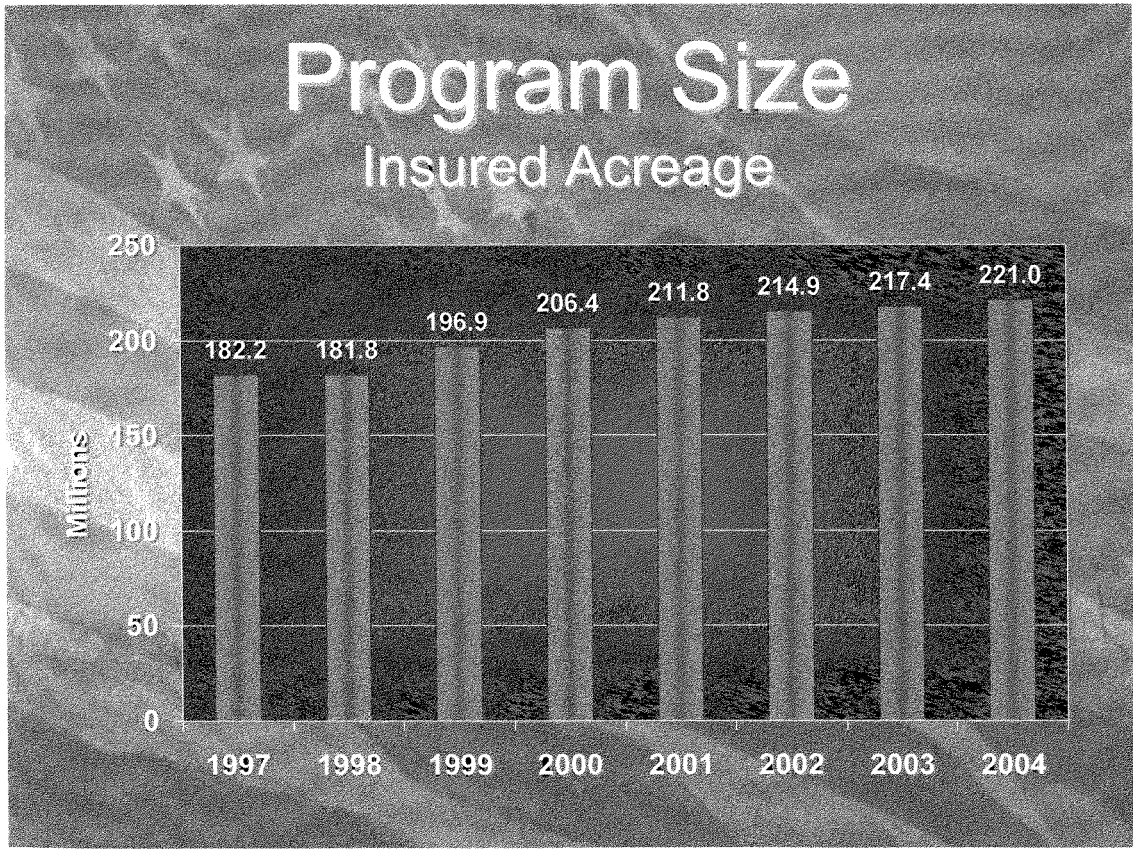
$46+ Billion Coverage	221 Million Acres	350+ Commodities

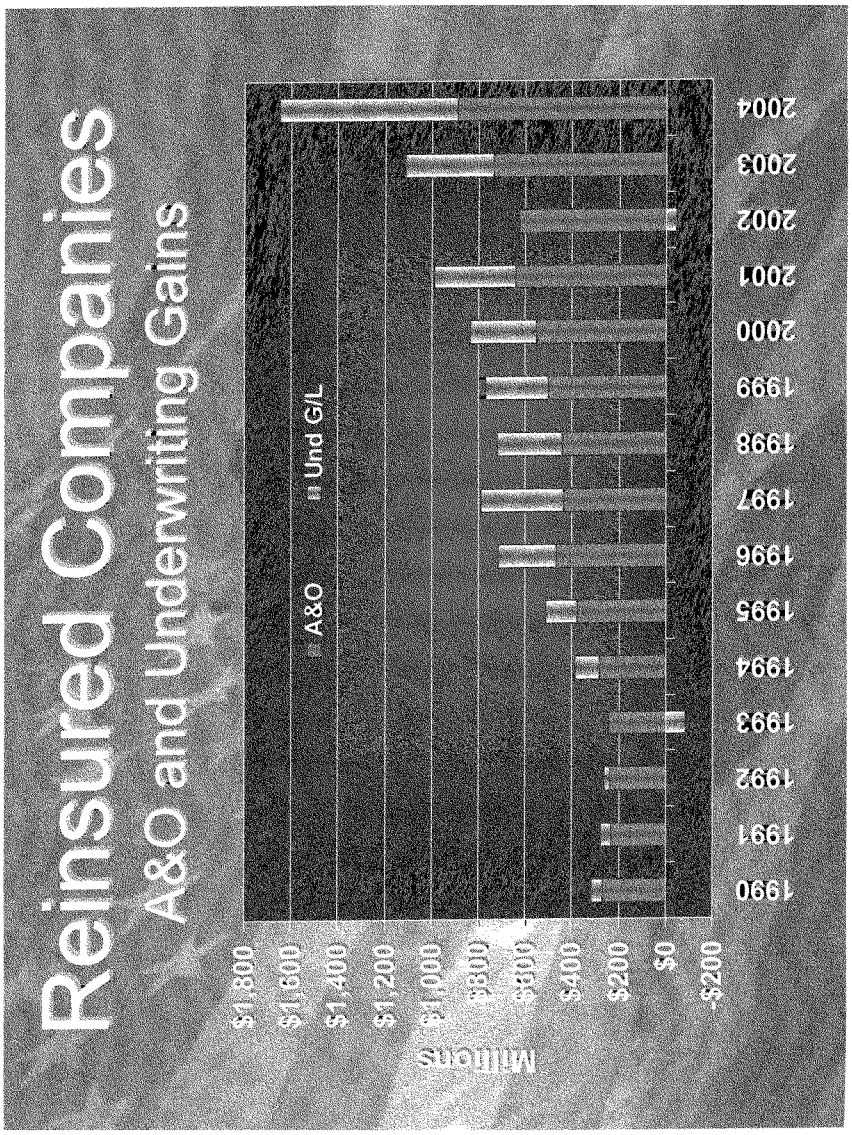
22 Existing Crop Insurance Plans	
Actual Production History (APH)	Group Risk Protection Income Protection (GRIP)
Adjusted Gross Revenue (AGR)	Income Protection (IP)
Adjusted Gross Revenue Lite (AGR-Lite)	Indexed Income Protection (IIP)
Aquaculture Dollar	Livestock Gross Margin (LGM)
Avocado Revenue Coverage	Livestock Risk Protection (LRP)
Crop Revenue Coverage (CRC)	Pecan Revenue
Dollar Amount of Insurance	Revenue Assurance (RA)
Fixed Dollar	Tobacco - Guaranteed Production
Grower Yield Certification (GYC)	Tobacco - Quota
Grower Yield Certification Span (GYC Span)	Tree Based Dollar Amount of Insurance
Group Risk Plan (GRP)	Yield Based Dollar Amount of Insurance

Program Size

Insurance Coverage by Crop Nationwide

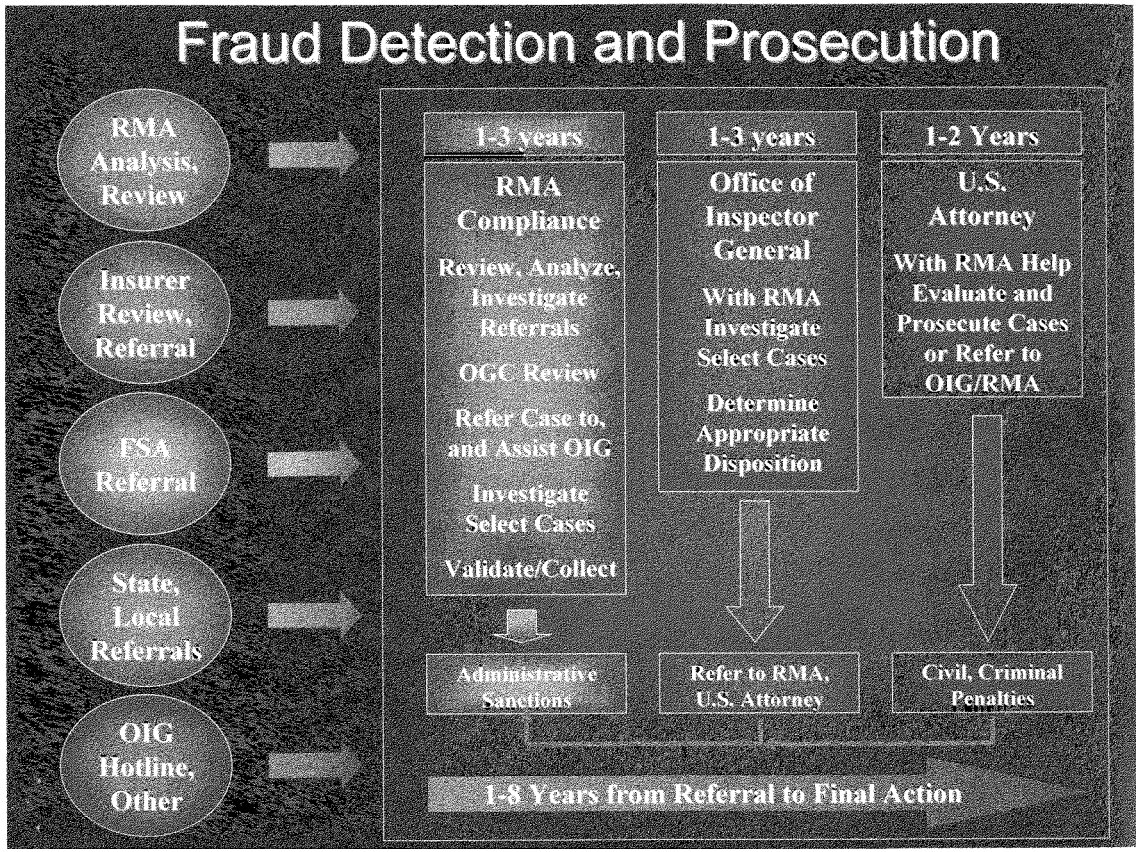
TOP TEN CROPS	($ in Billions)
CORN	16
SOYBEANS	10
WHEAT	4
NURSERY	4
COTTON	3
CITRUS TREES	1
POTATOES	.9
TOBACCO	.9
CITRUS	.7
SUGAR BEETS	.6

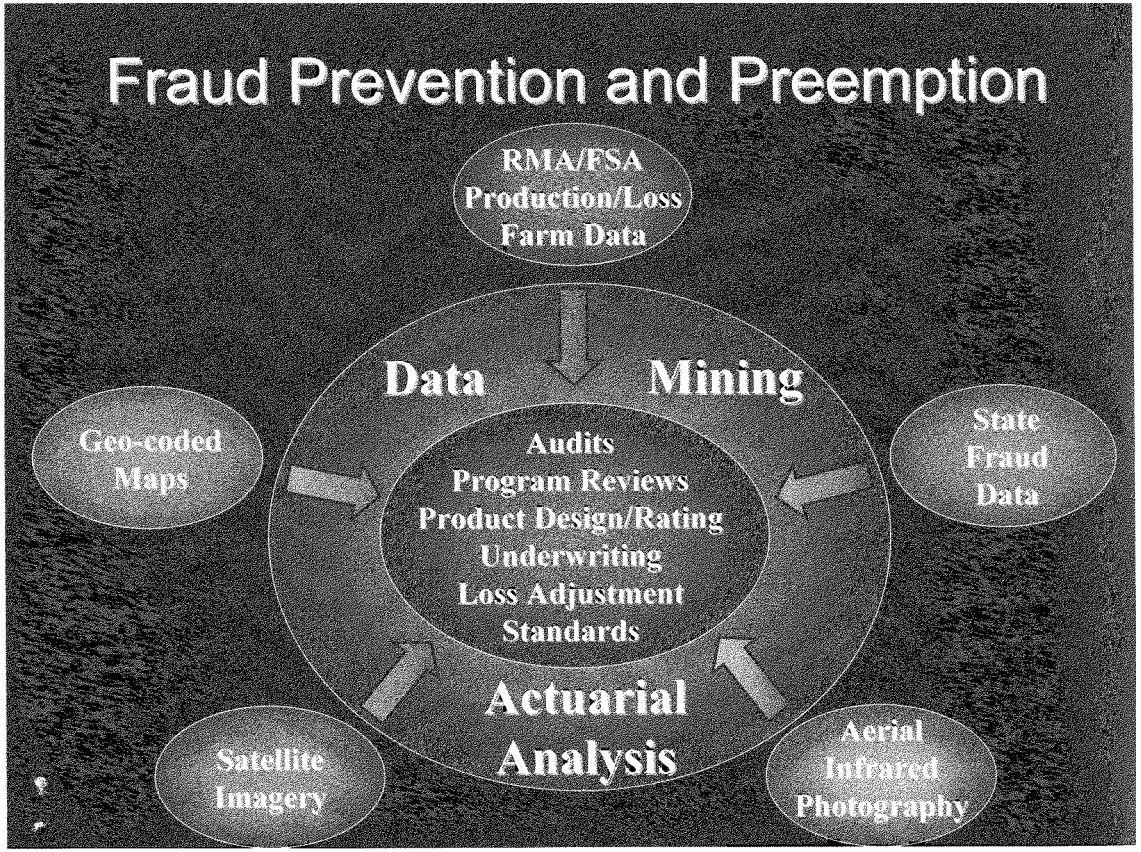

Program Size
Insured Acreage
Millions
250
200
150
100
50
0
182.2
181.8
196.9
206.4
211.8
214.9
217.4
221.0
1997
1998
1999
2000
2001
2002
2003
2004


Reinsured Companies
A&O and Underwriting Gains
A&O
Und G/L
Millions
$1,800
$1,600
$1,400
$1,200
$1,000
$800
$600
$400
$200
$0
-$200
1990
1991
1992
1993
1994
1995
1996
1997
1998
1999
2000
2001
2002
2003
2004

Reinsured Companies
A&O Reimbursement Per Policy
Dollars per Policy
$800
$700
$600
$500
$400
$300
$200
$100
$0
1990
1991
1992
1993
1994
1995
1996
1997
1998
1999
2000
2001
2002
2003
2004

Reinsurance Summary
Underwriting Gains & Losses
FCIC Gain/Loss
Company Gain/Loss
Millions
1,500
1,000
500
0
-500
-1,000
-1,500
1990
1991
1992
1993
1994
1995
1996
1997
1998
1999
2000
2001
2002
2003
2004


Fraud Detection and Prosecution
RMA Analysis, Review
Insurer Review, Referral
FSA Referral
State, Local Referrals
OIG Hotline, Other
1-3 years
RMA Compliance
Review, Analyze, Investigate Referrals
OGC Review
Refer Case to, and Assist OIG
Investigate Select Cases
Validate/Collect
1-3 years
Office of Inspector General
With RMA Investigate Select Cases
Determine Appropriate Disposition
1-2 Years
U.S. Attorney
With RMA Help Evaluate and Prosecute Cases or Refer to OIG/RMA
Administrative Sanctions
Refer to RMA, U.S. Attorney
Civil, Criminal Penalties
1-8 Years from Referral to Final Action


Fraud Prevention and Preemption
RMA/FSA
Production/Loss
Farm Data
Data
Mining
Geo-coded
Maps
Audits
Program Reviews
Product Design/Rating
Underwriting
Loss Adjustment
Standards
State
Fraud
Data
Actuarial
Analysis
Satellite
Imagery
Aerial
Infrared
Photography

TESTIMONY

By

RON BRICHLER

CHAIRMAN

AMERICAN ASSOCIATION OF CROP INSURERS

To

SENATE COMMITTEE ON

AGRICULTURE, NUTRITION AND FORESTRY

Washington, D.C.

June 28, 2005

Good morning Mr. Chairman and Members of the Senate Committee on Agriculture, Nutrition and Forestry. My name is Ron Brichler, and I am president of Great American Insurance Company, Crop Insurance Division, headquartered in Cincinnati, Ohio. I appear here today in my capacity as Chairman of the American Association of Crop Insurers (AACI), which is the only national organization which represents all segments of the private sector delivery system for Federal Crop Insurance. AACI represents the reinsured companies, managing general agencies, private reinsurers, and the nationwide agent force that delivers the crop insurance program to farmers.

On behalf of the Board of Directors and members of AACI, I want to thank you for scheduling this hearing. It comes at a very critical time for the federal crop insurance program. Although the program has grown considerably and enjoys broad based support among farmers, ranchers and growers, as well as lenders, for providing improved risk management, the federal regulator, the Risk Management Administration (RMA), is about to engage in a fundamental change of policy that has not been authorized by Congress. It is embarking on this new policy contrary to established law and precedents of 25 years of the crop insurance program, 93 percent of the comments of its own rule-making process, and the objections of Congress as expressed in the Agriculture Appropriations Bill recently passed by the House of Representatives.

The new policy I am speaking of is the new rule that RMA is rushing to implement a national premium reduction program (PRP). RMA insists on doing this although:

1) the overwhelming opposition of over 93 percent of the 805 comments it received in its rule making process;
2) their inability to answer some of the very basic questions raised in these comments;
3) the very serious questions that have been raised about the discriminatory administration of their current PRP program that is limited to one start-up company;
4) their lack of resources to supervise the program they are rushing to put in place; and
5) the fact that they are not required by law to issue a final rule.

If RMA would objectively analyze the comments they have received in their rule-making process, they would realize their course of action would significantly impact the crop insurance program. Because we were concerned whether RMA would provide either Congress or the FCIC Board with a complete summary of these comments, we have provided our own summary and analysis, which we have included as Appendix A. Based on our experience in the business and the comments received by RMA, we predict the following outcomes will be the inevitable results of a PRP program that would be authorized by RMA's proposed rule as published in the Federal Register:

1) **Companies and agents will be forced to neglect the small family farmers and concentrate on competing for the largest and most profitable accounts**. Thus, the principle of serving all farmers without discrimination as to size and location will be inoperable.
2) **Companies will be forced to withdraw from some states, because it will not be profitable to compete in those states**. We have just two companies that write in every state now. The loss of one or both of these companies from any farm state would have serious consequences for the availability of crop insurance to farmers in those states. Again, the concept of universal availability of crop insurance to all farmers will be fatally compromised.
3) **The service to farmers, both true risk management counseling and claims adjusting, will rapidly decline**. Inferior claims adjustment will increase fraud and abuse to the extent that government will pay out millions more dollars than it should.
4) **It will be easy for the critics of farm program spending to argue for the elimination of a crop insurance program that no longer serves the family farmer.**

The Federal Crop Insurance Program Is a Success

With the RMA management consciously adopting policies that are certain to degrade the program, one might assume that it is not a very successful or popular program—a program that is not working for American farmers. Nothing could be further from the truth.

While congressional support for the federal crop insurance program historically has been strong and consistent, the Committee is to be specially commended for development and adoption of the Agricultural Risk Protection Act (ARPA) of 2000. ARPA provisions were designed to encourage farmers to buy higher coverage in decisions regarding risk protection and management. We believe ARPA is proving to be a success story and the Committee should be proud of this effort on behalf of all farmers, ranchers and growers.

USDA's crop insurance program participation data as reported by RMA confirms our belief regarding the value and contribution of ARPA to building a quality risk protection and management program for American farmers. For the first time, total premium was reported to have reached the four billion dollar mark in 2004, slightly exceeding $4.1 billion. The average annual total premium for the four years since the passage of ARPA is reported to be more than 50 percent larger than the same statistic for the four preceding years. Net acres insured in 2004 are reported to have exceeded 221 million. Annually, the RMA data indicate that net acres insured have averaged more than 13 percent greater since ARPA than for the four-year period leading up to it.

The Federal Crop Insurance Program is the Envy of the World

It has taken decades to have the federal crop insurance program attain the current levels of participation and benefit for American farmers. And, while certainly there is room and opportunity to continue improving the program, today it stands second to none as a world-class agriculture risk management tool. Nations such as France are moving to develop their own program after having observed ours. Furthermore, it is noteworthy to acknowledge that a WTO panel publicly indicated the U.S. crop insurance program did not suppress world commodity prices. This revelation becomes yet another reason the Committee should be proud and protective of the federal crop insurance program that it has helped create.

A lot of people have contributed to the development and evolution of the modern crop insurance program, however, no effort has been greater than that made by Congress and members of this Committee. On behalf of the AACI membership and the farmers, ranchers and growers we serve, I want to take this opportunity to thank you for your support of a quality risk management program. Given the natural and global market elements they work and live with every day that are beyond their control, America's farmers, ranchers and growers deserve the predictability and protection of the risk management program you have provided.

The Federal Crop Insurance Program Now At Risk

In spite of all the progress made in recent years and despite the tremendous boost the program was given by the passage of ARPA in 2000, the crop insurance program is now at great risk. **Three initiatives taken by RMA could undermine in a few years all the gains made over the last 25 years.** Thus, they represent threats to the program and, thereby, to America's farmers, ranchers and growers.

These RMA initiatives are:

1. Pursuing a PRP that will discriminate against small and limited-resource farmers and create chaos in the marketplace.

2. Promulgating regulations that make the crop insurance program more costly and nearly impossible for the traditional companies and agencies to deliver.

3. Misusing data of a taxpayer-funded industry analysis to force cuts in the delivery system that will, if continued, adversely impact the delivery system that took 25 years to build.

The Mission of Pursuing PRP. Since December 2002, RMA has been on a mission to force premium discounting on the Crop Insurance Delivery System. They have used an outdated section of the crop insurance law enacted in 1994 when reimbursement for delivering crop insurance was almost 32 percent of premium, to impose premium discounting on an industry that is now reimbursed at a rate of only 21 percent. They have taken this section of the law, Section 508(e)(3) of the Federal Crop Insurance Act (Act), and read it in a vacuum, without considering all other provisions of law. They have brushed aside complaints, including those received as a part of their rulemaking process, that the sole premium discount provider is discriminating against small farmers. They are ignoring their own regulations, which require that a company that offers insurance in a State must offer it to all eligible farmers in that State. They are ignoring their own Standard Reinsurance Agreement, which requires that companies do extensive training of both agents and loss adjusters. They are ignoring the weight of over 93 percent of the comments in their rule making process.

RMA asserts that the law requires they implement a PRP rule this year. We disagree. If they cannot devise a rule that prevents discrimination against small farmers and meets all of RMA's other requirements, limitations and procedures, RMA should not issue a final rule. Nor does the law require that they do so. The outdated provisions in a section of a 1994 law have been supplanted by a provision of ARPA enacted in 2000 that requires a carefully tailored pilot program for reductions in rates. Unlike the 1994 law, the 2000 law requires that a pilot program be implemented in 2002. Strangely, RMA has chosen to ignore the 2000 law, which is mandatory, and say that it is required to implement the outdated 1994 provision of law which is not mandatory. The contrasting provisions of the two statutes are included as Appendix B of this statement.

In the comments filed by AACI's counsel during RMA's rulemaking process the following major points were made.

1. RMA ignored the history and purpose of the crop insurance program in approving and operating the current premium discount program.

2. The approval of a premium discounter's application in 2002 was contrary to established law and regulations.

3. RMA approved the original premium-discounting program with no protections against discrimination and without adequate disclosure to the Board, including no disclosure of a pending 1999 regulation that would have prevented discrimination.

4. RMA never took any action when the original basis of its premium discount approval (direct sales of crop insurance on the internet) proved to be false and is compounding this negligence in going forward with the proposed rule.

5. RMA has repeatedly ignored industry complaints about the discriminatory and predatory nature of the current premium discount program.

6. The proposed rule's impact is inherently discriminatory and could subject USDA and the industry to massive class action lawsuits.

7. RMA sought to rush forward with a national premium-discounting program in 2004 and suspended its efforts only when forced by the FCIC Board to conduct a notice and comment rulemaking process.

8. RMA does not have the resources to prevent predatory and discriminatory practices under a PRP program. Thus it would create chaos in the marketplace.

9. RMA has already made a decision that it will go forward with its PRP program regardless of the comments received in the rulemaking process, thereby rendering the process meaningless. [In fact, 805 comments were submitted, of which over 93 percent indicated opposition to the PRP rule and program. See Appendix A for AACI's analysis of the comments.]

We wish to emphasize this last point. Public statements by RMA management indicate they are not taking the rulemaking process seriously, in our opinion. In a meeting with the industry on April 19, a high ranking RMA official stated that the agency would, in fact, implement a rule allowing premium discounting for the 2006 reinsurance year. Since this statement was made before the comment period was closed, it evidences a clear intent to ignore the comments that would be made in the rule-making process. Therefore, we appeal to Congress to direct RMA to halt PRP until there can be a thorough analysis of the program.

Furthermore, we are led to believe that RMA did not properly disclose facts, legal precedents, and prior proposed rules to the FCIC Board during consideration of the initial premium discounting proposal. We believe there were enough irregularities in this process to warrant an investigation as to the role of RMA management in the premium discounting approval and oversight process.

In our efforts to demonstrate why a premium discounting program will force crop insurance agencies to discriminate against small farmers or go out of business, we have tried to get RMA to focus on the actual books of crop insurance agencies. They have refused to do so.

Therefore, we have attached as Appendix C data from the Sherry Wegner Agency in Glasscock, Texas. It shows that the agency's average cost of serving a federal crop insurance policy is approximately $300. It is undisputed in the industry that it is just as expensive to service a small policy as a large one. The Wegner Agency has provided a printout of the actual policies sold by the Agency, with the names of policyholders deleted for privacy reasons. If you will focus on the next to last column on the page, you will find the actual commission paid to the Agency. This data demonstrates that many of the commissions paid are substantially below $300. In fact, 58 percent of them are less than $300.

In the interest of full disclosure, it should be pointed out that some farmers have multiple policies. However, the size of the smaller policies indicates that many of the farmers insured by the Wegner Agency are indeed small farmers. The Wegner Agency remains profitable because it has some larger policies. Clearly, if a premium discounter is allowed to cherry pick the larger and more profitable policies of the Wegner Agency, the Agency will no longer be able to serve small farmers. It would go out of business. It is this business reality that we have never been able to get RMA to address. We appeal to Congress to help RMA understand it.

RMA's response to our concerns about discrimination may be that the proposed rule does have some language that prohibits discrimination. However, we believe that RMA has already demonstrated its unwillingness to enforce this new language by its record of allowing discrimination under the current premium-discounting program. Moreover, as several comments on the proposed rule have pointed out, RMA does not have the extensive resources that would be required to enforce such a rule in order to avoid offering discounted premiums to any but the largest farmers. The only way that this kind of evasion can be avoided is for RMA to have a large market conduct enforcement division. **Congress should demand to know where the resources to enforce the new rule are going to come from.**

Just as important, no rule can trump the laws of economics. No rule can address the simple statement of reality demonstrated by the data provided by the Wegner Agency. A premium-discounting program will make crop insurance unavailable to thousands of the nation's small farmers.

RMA is imposing additional burdens on the private sector.

To implement the Federal Crop Insurance Act – which includes provisions to help control, reduce and eliminate fraud, waste, and abuse – RMA, working with the authority granted by the FCIC, has developed and finalized certain critical changes to the Basic Provisions for the 2005 crop insurance year. In addition, RMA has made other regulatory changes in the new Standard Reinsurance Agreement (SRA) that was adopted in 2004. However, in many instances, this additional paperwork and regulatory burdens are making the program more expensive and nearly impossible to deliver, especially in a manner that has been most beneficial to farmers.

While no one condones fraud, waste, and abuse, some of the regulations adopted by RMA are excessively rigid and can result in punitive damages. For example, some of the changes do not adequately allow for or accommodate common, unintended mistakes and errors of data entry by either farmers or agents and companies, even when there is no adverse pattern of practice. Nonetheless, under the new provisions, these everyday innocent clerical mistakes would result in substantial penalties at claim filing. The implementation and administration of these regulations, especially after the changes made in 2004, are reaching the point of being overly burdensome and wasteful. Industry resources, both human and capital, are already stressed as a result of the increasing complexity of the insurance program of crop and livestock enterprise risk management.

Additionally, the changes establish a discriminatory relationship between USDA agencies regarding the treatment of farmers. For example, reporting errors in the Farm Service Agency (FSA) records, when discovered, are simply corrected. However, reporting errors in RMA records are not correctable in some instances and penalties can be assessed. This development is occurring in spite of the fact that ARPA called for greater cooperation in reporting and recordkeeping consistency between the two agencies.

No one in the crop insurance industry condones fraud. However fraud identification and control is improving. This committee supported legislation that has assigned greater attention and resources to researching and ending fraud. RMA and the administration have acted aggressively with emphasis on data mining and other means to identify and punish instances of fraud. While, in all likelihood, all fraud has not been stamped out, the general environment is greatly improved and continues to get better. Currently the greatest threat to the integrity of the program is the attempt of RMA to force down reimbursements to the companies and their agent force to a level that makes it impossible to properly service the business.

Our concern in AACI is that RMA has instituted so many rules and regulations because of the fraudulent acts of a few that the honest producers and agents are overwhelmed with procedures and vulnerable to severe penalties. RMA's response to every problem is to pile a new requirement on top of the mountain of existing regulations.

We believe RMA is not uniformly applying regulations.

While continuing to pile more regulatory burdens and hardships on the companies and agents that have faithfully delivered the program for decades, they have another standard for the sole premium discounter. Nothing is more basic than the extensive requirement for training agents and adjusters. However, RMA appears to have excused the premium discounter from this requirement. By going to the premium discounter's website, it is apparent that the premium discounter does not even have one loss adjuster in 8 of the 15 states in which it is selling crop insurance.

We in the crop insurance business know that sales are the easy part of the business and the difficult and burdensome part of the business is the service part. That is why several companies have been forced to leave the business. The companies who are successful have invested millions of dollars in improving back office operations as well as in agent and adjuster training. As you can imagine, we are upset when RMA allows a company to offer premium discounts without bearing the expense of servicing the businesses.

RMA's continuing efforts to act as cheerleader rather than regulator for the premium discounter is especially disturbing. In an unsigned briefing paper delivered by the RMA to the House Appropriations Committee on May 13, RMA stated "The allegation that PRP is being offered only to large farmers and not small farmers is untrue. In 2004, approximately 2/3rds of the policies sold by Crop1 were for 250 acres or less." **This is a deceptive use of statistics.** A policy is not a farmer. Very few farmers have one policy. A farmer frequently has multiple county crop policies for the same crop and most farmers have more than one crop. One of the largest national crop insurance companies, who has a long tradition of serving farmers of all sizes in every state in which it does business, has indicated that 89 percent of its policies averaged 136 acres. Also, the RMA statement is contrary to all anecdotal evidence and the statements of 56 commenters in the PRP rulemaking process.

In any event, other companies report that, on average, the size of policies being transferred from their companies to the premium discounter's company is twice as large as their average policy.

Misusing Data to Push RMA's Agenda. Applying this methodology RMA made unwarranted cuts in compensation in the 2005 SRA based on a misuse of certain data from an analysis of the crop insurance industry.

At the time that RMA released its proposed new SRA, we were told that it was based in part on a study done by Milliman USA under a RMA contract.

On March 3, 2005, RMA Administrator, Ross Davidson, appearing before the House Agriculture Appropriations Subcommittee said the Milliman work concluded the industry

received an "average rate of return of 15.8 percent over the years 1989-2002 when the average reasonable rate of return was only 14.0 percent."

Both the private industry and Congress have tried unsuccessfully to obtain this study. The private sector filed a request under the Freedom of Information Act (FOIA) on April 27, 2004. Members of the House Agriculture Committee, Mr. Peterson and Mr. Pomeroy, requested a copy of the study in a hearing held on July 21, 2004.

Nearly a year later, we still do not have the complete study. We received only part of three of the 28 Milliman reports. In the reports we received, there were serious deletions. We had stipulated that private confidential business information should be redacted. However, we do not believe wholesale deletions of entire sections of 140 pages are appropriate. We have appealed RMA's actions, but our efforts have been stonewalled.

We ask that this Committee join us in demanding that RMA cease the suppression of this information for which it paid over a million dollars in taxpayer money.

Upon reading the partial report that RMA finally released to us, it becomes abundantly clear the authors repeatedly qualified a key statement referenced at the March 3, 2005 hearing by the RMA Administrator. The following quotes from the November 11, 2002 Milliman USA report to RMA on Historic Rate of Return Analysis are noteworthy as well as instructive:

> "Thus, while MPCI insurers have earned a return somewhat in excess of the cost of capital, the returns are somewhat volatile as evidenced by the fact that in the single catastrophe year, the overall rate of return was -15.6% (negative 15.6%). In fact, we would caution against drawing any strong conclusions on the adequacy or excessiveness of the historical returns based on a sample of thirteen years of data, in light of the fact that only one of those years is a catastrophe year. Had there been a second catastrophe year in the sample similar in magnitude to 1993, the average return over the period would have been below 14%." [Pages 4-5]

> "We caution that actual returns could deviate significantly from the expected returns because of unexpected events. Therefore, a better measurement of whether providers have been reasonably compensated is by comparing mean values over the sample period, and by observing the pattern of difference between actual and reasonable rate of return. ... As can be seen in the table (Table 13, Page 37), the actual rate of return is 1.8% larger than the reasonable rate of return for all years, however, the standard deviation of the difference is 10.2%. **Given the magnitude of the standard deviation, the difference does not appear to be statistically significant.** **(Emphasis added)** In addition, as noted earlier, this result is quite sensitive to the occurrence of catastrophe years in the sample period. **For example, if there had been a second catastrophe year equivalent to 1993 in this sample period, the historical return would have been below 13.7%."** **(Emphasis added)** [Pages 37-38]

> "As with most lines of insurance that have a significant catastrophe exposure, insurers expect to earn significant profits in non-catastrophe years and significant losses in years with catastrophes. As a result, average returns over relatively short sample periods are not necessarily indicative of the long-term pattern of returns. Given the experience in multi peril crop insurance over the past 13 years, we would suggest that the historical returns reported herein would tend to overstate long term returns if the frequency of catastrophes is greater than one in thirteen years, and understate such returns if the frequency is lower than one in thirteen." [Page 38]

In fact, the years selected for the study, 1989-2001, were carefully picked. If the years 1988 and 2002 had been included, the result would have been vastly different. For 1988, a major drought year, the loss ratio was 2.41, the largest in the history of the program. And 2002 was a major loss year with a loss ratio of 1.39. Thus, RMA skewed the result of their study by picking a period in which crop insurance has a loss in only 1 of 13 years (1989-2001), rather than a more representative period of 1988-2002, when crop insurance experienced a loss in three of fifteen years.

Another subject that is important in any profit analysis is the expense side of the equation. The November 11, 2002 Milliman USA report addressed this subject also. Below are several important expense related statements from that report.

> "...the FCIC (Federal Crop Insurance Corporation) compensates insurers for the cost of selling and servicing the coverage through the payment of an administrative and operating (A&O) subsidy. This A&O subsidy is intended to cover all costs associated with the sale and servicing of crop insurance policies, excluding, of course, losses. This raises at least two important issues as regards profitability analysis. First, depending on the level of the A&O subsidy relative to actual incurred expenses, there may be a profit or a loss to insurance providers attributable to the subsidy itself. Second, when evaluating crop insurance expense ratios relative to expenses for other lines of insurance, it is imperative to adjust the ratios to put them on a comparable basis." [Page 10]

> "First, and perhaps most important, the GAO concluded that an expense reimbursement equal to 24 percent of premium would be reasonable in light of their audit of actual company expenses. Currently, the SRA (Standard Reinsurance Agreement) provides for an A&O subsidy ranging from 21 to 24.5 percent of premium, depending on the fund and plan of insurance. As a consequence, assuming expenses as a percent of premium have remained constant over time, the current A&O subsidy would not be viewed as excessive, regardless of the historical levels of the subsidy." [Page 12]

> "Second, we found several of the GAO conclusions and recommendations inconsistent with the objective of delivering multi peril crop insurance through the

private sector. For example, expenses related to acquiring a competitor's book of business, or paying incentive compensation to employees, are parts of the cost of doing business in the private sector. If crop insurance is to be delivered though this mechanism, then insurers will have to compete for resources to support crop insurance on the same terms as would any other business activity." [Page 12]

"Finally, the GAO statement that the expense reimbursement could be reduced in the future because crop prices and premiums will increase must be considered in light of several facts. First, a substantial share of insurer expenses is directly dependent on premium. Agent commissions, which represent a significant portion of expenses (more than half according to the GAO report), are usually a fixed percentage of premiums. As to other expenses, a substantial portion of these are related to employment costs, which tend to increase faster than the general level of prices. Finally, premium increases may reflect expected loss increases, which in turn might result in higher loss adjustment expenses. This is especially true for the introduction of new types of coverage such as revenue assurance. Thus, it is unclear whether increases in the average premium per policy would be sufficient to offset the cost increases associated with higher expenses for labor costs." [Pages 12-13]

"In contrast to the GAO report's suggestion that the A&O subsidy has exceeded actual expenses, there are data from insurer annual statements that indicate the opposite – that is, that the expense reimbursement has fallen short of actual expenses. These data are available for MPCI for all years from 1992 to the present, from the statutory financial reports insurers file with regulators." [Page 13]

We believe research of this nature is very important and can be useful in developing improved insights and understandings of the crop insurance industry. However, taking information out of context and attempting to have interrelated findings stand-alone helps create and perpetuate misconceptions—in this instance about the rate of return in the crop insurance industry.

We Need the Committee's Help to Restore Progress in the Crop Insurance Program

Over the 25 years of this program, we have had to overcome serious obstacles and setbacks to achieve the current program. However, during this time RMA management worked cooperatively with the industry to improve the program. Now, we in the private sector feel that we are always trying to fight off new RMA program changes that would seriously undermine the program. Thus, we are going backward rather than forward for the first time in the modern program's history. We ask the Committee's help in restoring forward momentum to the crop insurance program. In the case of the PRP Program that means conducting an independent analysis to determine whether the provision should repealed. Therefore, we request that this committee write a letter to the Secretary of Agriculture urging a delay in the implementation of the PRP rule until an independent analysis can be done by the Government Accountability Office.

Appendix A

American Association of Crop Insurers (AACI) Analysis of Public Comments on Proposed PRP Rule

In response to the Federal Register notice and request of February 24, 2005, Vol. 70, No. 36, page 9001, submitted by the Federal Crop Insurance Corporation (FCIC) to amend the General Administrative Regulations (7CFR part 400, subpart V), the Risk Management Agency (RMA) received 805 public comments. Twenty-eight states and the District of Columbia are represented by the comments received. These comments have come from the full spectrum of the crop insurance industry, including companies, local agencies, agents, farmers, local banks, as well as industry associations. In analyzing these comments, AACI found that **93 percent of all comments received expressed opposition to the implementation of the proposed rule, the Premium Reduction Plan as a whole or both.**

Table 1 shows the distribution of comments among key participants—agents, farmers, companies and others. Agents accounted for 75 percent of all comments, of which 95 percent were opposed to the rule, PRP or both. The second largest category of participants were farmers accounting for 12 percent of the total comments, of these participants 81 percent expressed opposition to the proposed rule, the PRP program or both. Table 2 shows the comments submitted by individuals in the states in which the single PRP provider is licensed. These 14 states accounted for 69 percent of all comments, of which 95 percent were opposed to the proposed rule, the PRP program or both. Table 3 shows the breakdown of comments submitted for all states. The state which had the largest number of participants was Kansas with 147 comments, 18 percent of all comments received. Table 4 shows the distribution for Kansas participants by participant category and by position on the rule.

The most frequent reason given for opposing the new rule is that it would lead to discrimination against small, minority and limited resource producers in the industry and "cherry-picking" of the larger farm accounts. The reduction in agent commissions (which has been a part of the existing PRP provider's business plan) raised a great deal of concern as well. Many agents stated that should PRP be expanded to the entire industry, they would no longer be able to sell and service crop insurance due to the necessary reduction in commissions. Indeed some of the very companies that provide coverage nationally point out that with the implementation of this rule they would likely be forced to pull out of some high risk states. This sentiment was expressed by the only two companies that service policies nationally.

Fifty-six of the participants opposed to the expansion of PRP detailed instances of discrimination by the industry's only PRP discount provider, Crop1. Many farmers and agents wrote that only the largest producers in their area were being marketed to by the PRP discount provider.

Several of the commentors raised operational questions about the rule and about RMA's ability to enforce it. A selection of these questions is listed below and are grouped alphabetically by author.

Greg Burger, President Farmers Crop Insurance Alliance
"RMA is proposing that the PRP be instituted for all premium written by the carrier regardless of crop or state location. Some companies only write in the Midwest where the underwriting gain has been good. In states where the results have been less favorable, sometimes the only reason to write there is for the A&O subsidy. A company may consider withdrawing from such states to keep rates competitive in profitable states. Is RMA concerned that the few companies writing in a number of these unpopular states might withdraw to file a PRP to compete in the profitable Midwest?"

"The RMA is requiring that the company not reduce its service to the insureds. How will RMA audit to determine that service is remaining constant to their producers? Does RMA have standards of service developed?"

Senator Chuck Grassley (R-IA)
"Finally, on page 90060 in the preamble RMA states, "Further, the workload on RMA and approved insurance providers to identify cost allocations and determine whether the projected cost savings from efficiencies are reasonable and correspond to the premium reduction in the state would be enormous." Yet your response to my second question states: "Therefore, in accordance with sections 400.716(h) and 400.719(a)(6) of the proposed rule, RMA would track the expense performance of the approved insurance provider at the state level to ensure that costs are reduced in each state by an amount that is at least equal to the premium reduction." I disagree that sections 400.716(h) and 400.719(a)(6) say anything about a state level accounting requirement. Yet it is clear from your response that RMA intends to enforce an "enormous" expense on the industry.

How RMA chooses to administer the program is critical. Yet, it is clear to me that RMA does not conceptually understand how to do this. Moreover it appears RMA wishes to foist huge expenses on the industry. Therefore I urge RMA to take more time and fully understand what it is proposing before it issues a final rule. Your staff has indicated that it intends to publish a final rule by the end of June. I do not understand your staff's urgency. Consider the comments carefully and proceed cautiously, if at all."

Senator Tom Harkin (D-IA), Ranking Democratic Member, Senate Committee on Agriculture, Nutrition and Forestry
"As written, the proposed rule requires that companies offer the PRP product with the same level of discount to farmers in all states that they serve, but they do not appear to preclude companies from dropping states entirely if they determine they cannot operate profitably in those states under the reduced A&O reimbursement of PRP products. I would expect little or no impact on the coverage provided to farmers in my state of Iowa, at least for major crops, where nearly all companies now operate profitably because of

historically low loss ratios. However, there are currently 12 states which are served by three or fewer crop insurance companies. Cost-reduction pressures could result in several additional states with higher loss ratios being dropped by existing companies, thus jeopardizing the quality of the service they now receive and undermining the national character of crop insurance, which is essential for its future."

Steve Harms, President, Rain & Hail LLC
"Section 400.720(e) – This item indicates that all producers insured by the provider will "automatically receive" the premium reduction contained in the approved PRP plan. This language does not go far enough to ensure discrimination does not take place. Independent agents frequently write for multiple companies. What conduct is expected of an agent that writes for a PRP company and a non-PRP company? Should said agent offer PRP only to select customers? What if an agent writes for a PRP company with a 1% discount and one with a 4% discount – which plan of insurance should said agent offer to customers? RMA should define agent rules of engagement for both of these circumstances. Otherwise, discrimination among farmers will darkly tarnish the Federal crop insurance program."

"Section 400.717 – We support the statutory requirement which states that the discount must correspond to the efficiency. RMA has added the phrase "correspond to the location" to its proposed requirements. In the preamble, RMA goes to great lengths to say it would be challenged by state level accounting to determine the efficiency and the corresponding discount. We agree RMA does not have the financial or technical resources to make these determinations. However, we submit that by adding the phrase "to the location", RMA is in effect requiring state level accounting. How else will RMA be able to determine if the efficiency and discount correspond "to the location?"

L. Charles Landgraf, Counsel, Independent Insurance Agents and Brokers of America
"Reduced agent compensation could increase instances of novice agents engaging in practices such as illegal rebating and tying arrangements. Because state licensing requirements vary substantially from state to state, agribusiness firms that sell seeds and equipment could easily enter the business of crop insurance in some states. These firms have sources of profit other than agent commissions and could thereby help AIPs offer crop insurance for lower premiums by servicing policies for less compensation than the current agent workforce. However, these firms lack the experience and skill of agents in the current delivery system and have incentives to bundle lower premiums with other goods and services. As a result, producers could become vulnerable to illegal rebates and tying arrangements.

The proposed rules contain no mechanisms to detect and prevent these anti-consumer practices under PRPs. Creation of an enforcement office would be necessary to monitor anti-consumer practices and address producer complaints. The RMA, however, does not have the resources to establish such an office."

Ben Latham, President, Producers Ag Insurance Group
"Producers Ag feels that little or no study has been done to anticipate what effects widespread adoption of PRP might have on the public/private partnership that has been so successful in reducing farmers' reliance on ad hoc relief. RMA admits in the proposed rule on Page 9005that, "diverse plans raised issues or problems that had not previously been considered by RMA…" We feel strongly that before RMA drastically changes such a successful program that exhaustive research should be undertaken so RNA is not surprised again. The timeline RMA has set forth for publishing a new PRP rule is woefully short and much more thoughtful study and back-and-forth dialogue should take place."

Mike Miller, President, Heartland Crop Insurance, Inc.
"Heartland could be in favor of an alternative process where an Insurance Provider is required to prove an ability to operate under the A&O for no less than a year prior to having a premium reduction plan in place. This plan would then be based off actual versus projected efficiencies. There are too many variables involved in accurately predicting the amount of savings proposed in a premium reduction plan. The Financial Reserve Plan in the proposed rule would not account for any major misrepresentation in a premium discount plan and is not enough deterrence for Insurance Providers not hitting their intended saving percentages. If such a plan is necessary, the Insurance Provider should be accountable for the entire amount of the proposed premium savings and be willing to provide access to those additional funds."

"We feel RMA has underestimated the amount of resources necessary to properly regulate the Insurance Providers who have accepted premium reduction plans. The lack of regulation on the current premium reduction plan in place gives us cause for concern and we would like to see a more detailed outline of how RMA plans on improving its oversight capabilities."

Daniel N. Rosenstein, Counsel, Rural Community Insurance Services ("RCIS")
"The Proposed Rule is silent as to the meaning of the term "portion." A portion is vague, nonspecific amount that is "a part of the whole." Webster's Third Internatl. Dictionary at 1789 (Rev. Ed. 1993). Thus a "portion" may vary from one percent to 99 percent. May 99 percent of RCIS savings be predicated on reduced compensation? If not, what "portion" of savings may be associated with "a reduction in compensation"?"

Steven C. Rutledge, President, Farmers Mutual Hail Insurance Company of Iowa
"In reviewing the contents that are required for a revised Plan of Operations, the proposal stipulates that the approved insurance provider must certify that a copy of its marketing strategy be sent to all State Departments of Insurance where it does business. In addition, the approved insurance provider is to provide RMA with a copy of any responses that it

receives back from the states. If one or more states would deny the marketing strategy as proposed by an approved insurance provider, would this denial eliminate the approved provider's ability to offer a premium reduction plan since the premium reduction plan is to be offered in all states where the approved insurance provider is doing business?"

Sam Scheef, President, ARMtech Insurance Services, Inc.
"1. The procedural determination of what is to be allowed as A&O income, and what must be accounted for as an A&O expense, raises several questions. Any departure from the practice of allowing only A&O income from FCIC to be considered when determining an "efficiency" for purposes of PRP would contradict legislation and create opportunities for abuse. Allowing any A&O expenses to be excluded from consideration when determining the discount would open the door to creative accounting schemes detrimental to the stability of the Approved Insurance Provider (AIP) and the delivery system overall as well as RMA's ability to regulate the system.

The FR Release (p. 9005) quotes section 508(e)(3) of the Act to the effect that "the approved insurance provider must provide sufficient documentation to demonstrate that not only can the approved insurance provider operate within its administrative and operating expense reimbursement, but it can also reduce its costs to a level below the amount received from the RMA for administrative and operating expense reimbursement." Thus ceding commissions or any other form of income should not be allowed as A&O income for the purpose of qualifying for a premium reduction plan. If it allows AIPs to consider any other forms of income beyond FCIC-paid expense reimbursement in qualifying for a PRP, FCIC would open the door to situations where no real efficiency exists and would invite reinsurance schemes designed to artificially inflate an AIP's ceding commission in order to provide sufficient 'income' for the AIP to demonstrate an efficiency.

2. Reporting requirements likewise are flawed. For instance, in describing the requirements for semi-annual reports, the FR Release (p. 9005) states that it must contain "the average number of acres insured under all policies by State before and after implementation of the premium reduction plan." This could create inaccuracies where a producer has policies in different counties. At a minimum, the requirement should be restated to include "the average number of acres on a crop, county, and entity basis insured under all policies by State before and after implementation of the premium reduction plan," and should also require premium growth by crop in each state. In addition, these semi-annual reports should be made available to the public."

Thomas P. Zacharias, Executive Vice President, National Crop Insurance Services
"In response to the PRP proposal, we submit that the industry needs greater incentives, not fewer, to operate in the less profitable states. While several the members of the industry have been willing to make a commitment to serve all farmers, regardless of their risk, in the states in which they operate, the opportunity for some companies to use the PRP program to compete for good business in the more profitable states may create financial strains that undermine the industry's ability to maintain its commitment to

universal availability. RMA and FCIC need to consider the impact of the PRP proposal on the industry, and also consider what can be done to improve the incentives for all members of the industry to participate in the less profitable states and to accept a fair share of the less desirable business in the states where they currently operate. This is not a simple task. We request that RMA and FCIC engage in further study of the operation of the program as a whole in order to determine what actions or incentives will best serve the public policy goals of the corporation and help to ensure the long term stability of the industry."

Table 1: Public Comments on Proposed PRP Rule, Distribution by Category and Position.

Category			Position on Rule					
			Pro		Con		NA	
Group	Number	Percent	Number	Percent	Number	Percent	Number	Percent
Farmers	97	12	16	16	81	84	0	0
Agents	603	75	25	4	574	95	4	1
Companies	9	1	1	11	8	89	0	0
Other*	63	8	1	2	60	95	2	3
No ID #	33	4	2	6	27	82	4	12
TOTAL Number	**805**	**100**	**45**	**6**	**750**	**93**	**10**	**1**

* Other includes trade associations, agent organizations, members of congress and local banks.

no ID includes comments with insufficient information to determine a category.

Table 2: Public Comments on Proposed PRP Rule, Distribution by PRP States* and Position.

PRP States			Position on Rule					
			Pro		Con		Not Specified	
Name	Number	Percent of Total	Number	Percent	Number	Percent	Number	Percent
ID	5	1	0	0	5	100	0	0
IL	32	4	0	0	31	97	1	3
IN	12	1	3	25	9	75	0	0
IA	83	10	9	11	73	88	1	1
KS	147	18	3	2	144	98	0	0
MI	11	1	0	0	11	100	0	0
MN	50	6	3	6	47	94	0	0
MO	5	1	0	0	4	80	1	20
NE	61	8	3	5	58	95	0	0
ND	83	10	0	0	81	100	2	2
OH	3	0	1	33	2	67	0	0
SD	26	3	0	0	26	100	0	0
TX	21	3	3	14	18	90	0	0
WA	1	0	0	0	1	100	0	0
WI	14	2	0	0	14	100	0	0
TOTAL	**554**	**69**	**25**	**5**	**524**	**94**	**5**	**1**

*** PRP States are those in which the single approved PRP provider is licensed.**

Table 3: Public Comments on Proposed PRP Rule, Distribution by State and Position.

State			Position on Rule					
			Pro		Con		Not Specified	
Name	Number	Percent of Total	Number	Percent	Number	Percent	Number	Percent
AR	1	0	0	0	1	100	0	0
CA	1	0	0	0	1	100	0	0
CO	2	0	0	0	2	100	0	0
DC	7	1	0	0	6	86	1	14
FL	2	0	0	0	2	100	0	0
GA	2	0	0	0	2	100	0	0
ID	5	1	0	0	5	100	0	0
IL	32	4	0	0	31	97	1	3
IN	12	1	3	25	9	75	0	0
IA	83	10	9	11	73	88	1	1
KS	147	18	3	2	144	98	0	0
KY	2	0	0	0	2	100	0	0
LA	7	1	0	0	7	100	0	0
ME	2	0	0	0	2	100	0	0
MI	11	1	0	0	11	100	0	0
MN	50	6	3	6	47	94	0	0
MS	1	0	0	0	1	100	0	0
MO	5	1	0	0	4	80	1	20
MT	2	0	0	0	2	100	0	0
NE	61	8	3	5	58	95	0	0
NJ	1	0	0	0	1	100	0	0
NC	1	0	0	0	1	100	0	0
ND	83	10	0	0	81	98	2	2
OH	3	0	1	33	2	67	0	0
OK	1	0	0	0	1	100	0	0
SD	26	3	0	0	26	100	0	0
TX	21	3	3	14	18	86	0	0
VA	3	0	0	0	3	100	0	0
WA	1	0	0	0	1	100	0	0
WI	14	2	0	0	14	100	0	0
None Specified	216	27	20	9	192	89	4	2
TOTAL	**805**	**100**	**45**	**6**	**750**	**93**	**10**	**1**

Table 4: Public Comments on Proposed PRP Rule, Distribution for Kansas, by Category and Position.

Category			Position on Rule			
			Pro		Con	
Group	Number	Percent	Number	Percent	Number	Percent
Farmers	54	37	2	4	52	96
Agents	88	60	1	1	87	99
Companies	0	0	0	0	0	0
Other	5	3	0	2	5	100
TOTAL	**147**	**100**	**3**	**2**	**144**	**98**

Appendix B

Two Authorities for Premium Discount

7 U.S.C. 1501 et seq., Chapter 36 Sec. 1508(e)(3) of the Federal Crop Insurance Act as Amended

[P.L. 103-354 Federal Crop Insurance Reform and Department of Agriculture Reorganization Act of 1994]

(3) Premium reduction

If an approved insurance provider determines that the provider may provide insurance more efficiently than the expense reimbursement amount established by the Corporation, the approved insurance provider may reduce, subject to the approval of the Corporation, the premium charged the insured by an amount corresponding to the efficiency. The approved insurance provider shall apply to the Corporation for authority to reduce the premium before making such a reduction, and the reduction shall be subject to the rules, limitations, and procedures established by the Corporation.

7 U.S.C. 1501 et seq., Chapter 36 Sec. 1523(d)(1) of the Federal Crop Insurance Act as Amended

[P.L. 106 – 224 Agricultural Risk Protection Act of 2000 (ARPA)]

(d) Premium rate reduction pilot program

(1) Purpose
The purpose of the pilot program established under this subsection is to determine whether approved insurance providers will compete to market policies or plans of insurance with reduced rates of premium, in a manner that maintains the financial soundness of approved insurance providers and is consistent with the integrity of the Federal crop insurance program.

(2) Establishment
(A) In general
Beginning with the 2002 crop year, the Corporation shall establish a pilot program under which approved insurance providers may propose for approval by the Board policies or plans of insurance with reduced rates of premium -
(i) for one or more agricultural commodities; and

(ii) within a limited geographic area, as proposed by the approved insurance provider and approved by the Board.

(B) Determination by Board

The Board shall approve a policy or plan of insurance proposed under this subsection that involves a premium reduction if the Board determines that –

(i) the interests of producers are adequately protected within the pilot area;

(ii) rates of premium are actuarially appropriate, as determined by the Board;

(iii) the size of the proposed pilot area is adequate;

(iv) the proposed policy or plan of insurance would not unfairly discriminate among producers within the proposed pilot area;

(v) if the proposed policy or plan of insurance were available in a geographic area larger than the proposed pilot area, the proposed policy or plan of insurance would –

(I) not have a significant adverse impact on crop insurance delivery system;

(II) not result in a reduction of program integrity;

(III) be actuarially appropriate; and

(IV) not place an additional financial burden on the Federal Government; and

(vi) the proposed policy or plan of insurance meets other requirements of this chapter determined appropriate by the Board

(C) Time limitations and procedures

The time limitations and procedures of the Board established under section 1508(h) of this title shall apply to the proposal admitted under this subsection.

Appendix C

SHERRY WEGNER AGENCY/GLASSCOCK BRANCH

CROP YEAR 2004

TOTAL MPCI SALES	$1,297,332.00
TOTAL MPCI COMMISSION	$154,047.28
TOTAL GROSS EXPENSE	$135,327.00
Less expenses not related to MPCI Sales & Service	-85,837.47
NET COST OF MPCI SERVICE	$49,489.59

NUMBER OF MPCI POLICIES = 165

AVERAGE COST OF SERVICING AN MPCI POLICY

49,489.59 / 165= $299.93

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For FCIC Accounting Cutoff: March 11, 2005
Sherry Wegner Agency - Glasscock (481490)

Details for Sherry Wegner Agency - Glasscock (481490)

CROP
Hail

MPCI

Policy	County	Crop/Plan	Comm Rate	Base Prem	Prod Prem	Fees	Int	Paymts/ Loss Cr	Total Comm	-Due- Comm	Advance
		COTTON	14.00	1,280	1,280	0	0.00	1,280.00	179.20	179.20	0.00
		COTTON	14.00	361	361	0	0.00	361.00	50.54	50.54	0.00
		COTTON	14.00	800	800	0	0.00	800.00	112.00	112.00	0.00
		COTTON	14.00	532	532	0	0.00	532.00	74.48	74.48	0.00
		COTTON	14.00	231	231	0	0.00	231.00	32.34	32.34	0.00
		COTTON	14.00	851	851	0	0.00	851.00	119.14	119.14	0.00
		COTTON	15.00	360	360	0	0.00	360.00	54.00	54.00	0.00
		COTTON	15.00	702	702	0	0.00	702.00	105.30	105.30	0.00
		COTTON	15.00	720	720	0	0.00	720.00	108.00	108.00	0.00
		COTTON	14.00	361	361	0	0.00	361.00	50.54	50.54	0.00
		COTTON	14.00	120	120	0	0.00	120.00	16.80	16.80	0.00
		COTTON	14.00	120	120	0	0.00	120.00	16.80	16.80	0.00
		COTTON	14.00	360	360	0	0.00	360.00	50.40	50.40	0.00
		COTTON	14.00	972	972	0	0.00	972.00	136.08	136.08	0.00
		COTTON	14.00	162	162	0	0.00	162.00	22.68	22.68	0.00
		COTTON	14.00	14,136	14,136	0	0.00	14,136.00	1,979.04	1,979.04	0.00
		COTTON	14.00	96	96	0	0.00	96.00	13.44	13.44	0.00
		COTTON	14.00	396	396	0	0.00	396.00	55.44	55.44	0.00
		COTTON	14.00	552	552	0	0.00	552.00	77.28	77.28	0.00
		COTTON	14.00	810	810	0	0.00	810.00	113.40	113.40	0.00
		COTTON	14.00	90	90	0	0.00	90.00	12.60	12.60	0.00
		WHEAT-CRC	12.00	903	370	30	0.00	400.00	108.36	108.36	0.00
		WHEAT-CRC	12.00	6,333	2,596	30	1.53	2,627.53	759.96	759.96	0.00
		WHEAT-CRC	12.00	20,421	8,372	30	0.00	8,402.00	2,450.52	2,450.52	0.00
		WHEAT-APH	14.00	340	122	30	0.00	152.00	47.60	47.60	0.00
		WHEAT-APH	14.00	1,687	607	30	0.00	637.00	236.18	236.18	0.00
		WHEAT-APH	14.00	1,552	559	30	7.36	596.36	217.28	217.28	0.00
		WHEAT-APH	14.00	91	33	30	0.00	63.00	12.74	12.74	0.00
		WHEAT-APH	14.00	291	105	30	0.29	135.29	40.74	40.74	0.00
		WHEAT-CRC	12.00	2,268	816	30	0.00	846.00	272.16	272.16	0.00
		WHEAT-APH	14.00	342	123	30	0.00	153.00	47.88	47.88	0.00
		WHEAT-APH	14.00	41	15	30	0.56	45.56	5.74	5.74	0.00
		WHEAT-CRC	12.00	1,816	745	30	0.00	775.00	217.92	217.92	0.00
		WHEAT-APH	14.00	1,509	543	30	0.00	573.00	211.26	211.26	0.00
		COTTN-CRC	12.00	8,694	2,869	30	0.00	2,899.00	1,043.28	1,043.28	0.00
		COTTN-CRC	12.00	936	309	30	0.00	339.00	112.32	112.32	0.00
		COTTN-CRC	12.00	10,757	3,550	30	0.00	3,580.00	1,290.84	1,290.84	0.00
		COTTN-CRC	12.00	2,352	776	30	20.16	826.16	282.24	282.24	0.00
		GSORG-CRC	12.00	855	283	30	11.73	324.73	102.60	102.60	0.00
		COTTN-CRC	12.00	5,319	1,915	30	24.31	1,969.31	638.28	638.28	0.00
		COTTN-CRC	12.00	20,675	7,443	30	0.00	7,473.00	2,481.00	2,481.00	0.00
		COTTN-CRC	12.00	51,274	18,459	30	52.31	18,541.31	6,152.88	6,152.88	0.00
		COTTN-CRC	12.00	6,892	2,481	30	0.00	2,511.00	827.04	827.04	0.00
		COTTN-CRC	12.00	2,373	783	30	0.00	813.00	284.76	284.76	0.00
		COTTN-CRC	12.00	1,785	642	30	0.00	672.00	214.20	214.20	0.00
		COTTN-CRC	12.00	1,785	642	30	0.00	672.00	214.20	214.20	0.00
		COTTN-CRC	12.00	2,394	790	30	30.75	850.75	287.28	287.28	0.00
		COTTN-CRC	12.00	1,677	553	30	0.00	583.00	201.24	201.24	0.00
		GSORG-CRC	12.00	545	179	30	0.00	209.00	65.40	65.40	0.00
		COTTN-CRC	12.00	4,452	1,603	30	0.00	1,633.00	534.24	534.24	0.00
		COTTN-CRC	12.00	432	143	30	0.00	173.00	51.84	51.84	0.00
		COTTN-CRC	12.00	49	16	30	0.00	46.00	5.88	5.88	0.00

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For FCIC Accounting Cutoff: March 11, 2005

Sherry Wegner Agency - Glasscock (481490)

Details for Sherry Wegner Agency - Glasscock (481490)

Policy	County	Crop/Plan	Comm Rate	Base Prem	Prod Prem	Fees	Int	Paymts/ Loss Cr	Total Comm	-Due- Comm	Advance
		GSORG-CRC	12.00	24	8	30	0.00	38.00	2.88	2.88	0.00
		COTTN-CRC	12.00	99	33	30	0.00	63.00	11.88	11.88	0.00
		GSORG-CRC	12.00	115	38	30	0.00	68.00	13.80	13.80	0.00
		COTTN-CRC	12.00	27,225	8,984	30	0.00	9,014.00	3,267.00	3,267.00	0.00
		COTTN-CRC	12.00	1,858	613	30	0.00	643.00	222.96	222.96	0.00
		COTTN-CRC	12.00	675	223	30	0.00	253.00	81.00	81.00	0.00
		COTTN-CRC	12.00	1,329	545	30	0.00	575.00	159.48	159.48	0.00
		COTTN-CRC	12.00	3,756	1,240	30	15.88	1,285.88	450.72	450.72	0.00
		GSORG-CRC	12.00	56	18	30	1.20	49.20	6.72	6.72	0.00
		COTTN-CRC	12.00	2,619	865	30	22.38	917.38	314.28	314.28	0.00
		GSORG-CRC	12.00	76	25	30	2.07	57.07	9.12	9.12	0.00
		COTTN-CRC	12.00	4,240	1,399	30	0.00	1,429.00	508.80	508.80	0.00
		COTTN-CRC	12.00	17,383	5,737	30	72.09	5,839.09	2,085.96	2,085.96	0.00
		GSORG-CRC	12.00	332	110	30	3.50	143.50	39.84	39.84	0.00
		COTTN-CRC	12.00	4,767	1,716	30	0.00	1,746.00	572.04	572.04	0.00
		COTTN-CRC	12.00	1,314	434	30	0.00	464.00	157.68	157.68	0.00
		COTTN-CRC	12.00	1,314	434	30	0.00	464.00	157.68	157.68	0.00
		COTTN-CRC	12.00	1,942	641	30	0.00	671.00	233.04	233.04	0.00
		COTTN-CRC	12.00	9,267	3,336	30	0.00	3,366.00	1,112.04	1,112.04	0.00
		COTTN-CRC	12.00	199	66	30	0.00	96.00	23.88	23.88	0.00
		GSORG-CRC	12.00	93	31	30	0.00	61.00	11.16	11.16	0.00
		COTTN-CRC	12.00	2,806	1,010	30	0.00	1,040.00	336.72	336.72	0.00
		COTTN-CRC	12.00	1,269	419	30	0.00	449.00	152.28	152.28	0.00
		COTTN-CRC	12.00	702	232	30	0.00	262.00	84.24	84.24	0.00
		COTTN-CRC	12.00	17,018	6,126	30	76.95	6,232.95	2,042.16	2,042.16	0.00
		COTTN-CRC	12.00	3,057	1,100	30	28.26	1,158.26	366.84	366.84	0.00
		COTTN-CRC	12.00	10,310	3,712	30	93.56	3,835.56	1,237.20	1,237.20	0.00
		COTTN-CRC	12.00	2,195	790	30	20.50	840.50	263.40	263.40	0.00
		COTTN-CRC	12.00	3,166	1,045	30	0.00	1,075.00	379.92	379.92	0.00
		COTTN-CRC	12.00	52,134	17,203	30	0.00	17,233.00	6,256.08	6,256.08	0.00
		COTTN-CRC	12.00	16,651	5,495	30	0.00	5,525.00	1,998.12	1,998.12	0.00
		COTTN-APH	5.00	4,514	0	100	3.75	103.75	225.70	225.70	0.00
		COTTN-CRC	12.00	24,143	7,968	30	0.00	7,998.00	2,897.16	2,897.16	0.00
		GSORG-CRC	12.00	518	171	30	0.00	201.00	62.16	62.16	0.00
		COTTN-APH	5.00	511	0	100	0.00	100.00	25.55	25.55	0.00
		GSORG-CRC	12.00	86	28	30	0.00	58.00	10.32	10.32	0.00
		COTTN-CRC	12.00	14,813	5,333	30	0.00	5,363.00	1,777.56	1,777.56	0.00
		COTTN-CRC	12.00	21,648	7,793	30	0.00	7,823.00	2,597.76	2,597.76	0.00
		COTTN-CRC	12.00	107	35	30	0.00	65.00	12.84	12.84	0.00
		COTTN-CRC	12.00	3,392	1,221	30	0.00	1,251.00	407.04	407.04	0.00
		COTTN-CRC	12.00	6,129	2,206	30	0.00	2,236.00	735.48	735.48	0.00
		COTTN-CRC	12.00	13,433	4,836	30	0.00	4,866.00	1,611.96	1,611.96	0.00
		COTTN-CRC	12.00	1,404	463	30	6.16	499.16	168.48	168.48	0.00
		GSORG-CRC	12.00	69	23	30	1.32	54.32	8.28	8.28	0.00
		COTTN-CRC	12.00	7,061	2,330	30	0.00	2,360.00	847.32	847.32	0.00
		COTTN-CRC	12.00	468	155	30	2.31	187.31	56.16	56.16	0.00
		GSORG-CRC	12.00	23	8	30	0.96	38.96	2.76	2.76	0.00
		COTTN-CRC	12.00	44,548	14,700	30	0.00	14,730.00	5,345.76	5,345.76	0.00
		GSORG-CRC	12.00	189	62	30	0.00	92.00	22.68	22.68	0.00
		COTTN-APH	5.00	8,475	0	100	0.00	100.00	423.75	423.75	0.00
		GSORG-APH	5.00	37	0	100	0.00	100.00	1.85	1.85	0.00
		COTTN-CRC	12.00	407	134	30	0.00	164.00	48.84	48.84	0.00

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Sherry Wegner Agency - Glasscock (481490)

Details for Sherry Wegner Agency - Glasscock (481490)

Policy	County	Crop/Plan	Comm Rate	Base Prem	Prod Prem	Fees	Int	Paymts/ Loss Cr	Total Comm	-Due- Comm	Advance
		COTTN-CRC	12.00	407	134	30	0.00	164.00	48.84	48.84	0.00
		COTTN-CRC	12.00	435	156	30	0.00	186.00	52.20	52.20	0.00
		COTTN-CRC	12.00	3,193	1,149	30	0.00	1,179.00	383.16	383.16	0.00
		COTTN-CRC	12.00	435	156	30	4.66	190.66	52.20	52.20	0.00
		COTTN-CRC	12.00	58,566	21,084	30	0.00	21,114.00	7,027.92	7,027.92	0.00
		COTTN-CRC	12.00	14,093	4,652	30	0.00	4,682.00	1,691.16	1,691.16	0.00
		COTTN-CRC	12.00	14,354	4,738	30	0.00	4,768.00	1,722.48	1,722.48	0.00
		COTTN-CRC	12.00	3,261	1,174	30	0.00	1,204.00	391.32	391.32	0.00
	R	COTTN-CRC	12.00	8,301	2,739	30	138.44	2,907.44	996.12	996.12	0.00
		COTTN-CRC	12.00	761	274	30	0.00	304.00	91.32	91.32	0.00
		COTTN-CRC	12.00	36,393	12,009	30	0.00	12,039.00	4,367.16	4,367.16	0.00
		COTTN-CRC	12.00	1,210	399	30	0.00	429.00	145.20	145.20	0.00
		COTTN-CRC	12.00	435	156	30	0.00	186.00	52.20	52.20	0.00
		COTTN-APH	5.00	16,677	0	100	0.00	100.00	833.85	833.85	0.00
	Y	COTTN-CRC	12.00	72,558	29,749	30	0.00	29,779.00	8,706.96	8,706.96	0.00
		COTTN-CRC	12.00	2,902	958	30	0.00	988.00	348.24	348.24	0.00
		COTTN-CRC	12.00	2,861	944	30	0.00	974.00	343.32	343.32	0.00
		COTTN-CRC	12.00	2,727	900	30	0.00	930.00	327.24	327.24	0.00
		COTTN-CRC	12.00	23,957	7,906	30	0.00	7,936.00	2,874.84	2,874.84	0.00
		COTTN-CRC	12.00	7,905	2,608	30	0.00	2,638.00	948.60	948.60	0.00
		COTTN-CRC	12.00	34,330	11,329	30	0.00	11,359.00	4,119.60	4,119.60	0.00
		COTTN-CRC	12.00	37	12	30	0.00	42.00	4.44	4.44	0.00
		COTTN-CRC	12.00	4,683	1,920	30	0.00	1,950.00	561.96	561.96	0.00
		GSORG-CRC	12.00	144	52	30	0.00	82.00	17.28	17.28	0.00
	M	COTTN-CRC	12.00	41,805	17,138	30	214.60	17,382.60	5,016.60	5,016.60	0.00
		COTTN-CRC	12.00	64	26	30	0.00	56.00	7.68	7.68	0.00
		COTTN-CRC	12.00	37	12	30	0.00	42.00	4.44	4.44	0.00
	X	COTTN-CRC	12.00	7,725	2,549	30	0.00	2,579.00	927.00	927.00	0.00
		COTTN-CRC	12.00	37	12	30	0.00	42.00	4.44	4.44	0.00
	C	COTTN-CRC	12.00	1,693	559	30	0.00	589.00	203.16	203.16	0.00
		GSORG-CRC	12.00	114	38	30	0.00	68.00	13.68	13.68	0.00
		COTTN-APH	5.00	1,525	0	100	0.00	100.00	76.25	76.25	0.00
		COTTN-APH	5.00	2,107	0	100	0.00	100.00	105.35	105.35	0.00
		COTTN-CRC	12.00	28,048	9,255	30	232.12	9,517.12	3,365.76	3,365.76	0.00
		GSORG-CRC	12.00	642	212	30	9.09	251.09	77.04	77.04	0.00
		COTTN-CRC	12.00	28,686	9,467	30	0.00	9,497.00	3,442.32	3,442.32	0.00
		COTTN-CRC	12.00	1,723	620	30	17.43	667.43	206.76	206.76	0.00
		COTTN-CRC	12.00	11,509	3,797	30	0.00	3,827.00	1,381.08	1,381.08	0.00
		COTTN-CRC	12.00	5,617	1,853	30	0.00	1,883.00	674.04	674.04	0.00
		GSORG-CRC	12.00	63	21	30	0.00	51.00	7.56	7.56	0.00
		COTTN-CRC	12.00	3,011	994	30	0.00	1,024.00	361.32	361.32	0.00
		COTTN-CRC	12.00	2,000	720	30	0.00	750.00	240.00	240.00	0.00
		COTTN-APH	5.00	4,883	0	100	0.00	100.00	244.15	244.15	0.00
		COTTN-CRC	12.00	35,229	12,682	30	0.00	12,712.00	4,227.48	4,227.48	0.00
		COTTN-CRC	12.00	68,182	27,955	30	0.00	27,985.00	8,181.84	8,181.84	0.00
		WHEAT-APH	14.00	4	2	30	0.00	32.00	0.56	0.56	0.00
		WHEAT-APH	14.00	4	2	30	0.00	32.00	0.56	0.56	0.00
		WHEAT-APH	14.00	754	272	30	0.00	302.00	105.56	105.56	0.00
		WHEAT-APH	14.00	45	16	30	0.00	46.00	6.30	6.30	0.00
		WHEAT-CRC	12.00	52	21	30	0.00	51.00	6.24	6.24	0.00
		WHEAT-APH	14.00	3,521	1,268	30	0.00	1,298.00	492.94	492.94	0.00
		WHEAT-APH	14.00	224	81	30	0.00	111.00	31.36	31.36	0.00

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Sherry Wegner Agency - Glasscock (481490)

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Details for Sherry Wegner Agency - Glasscock (481490)

Policy	County	Crop/Plan	Comm Rate	Base Prem	Prod Prem	Fees	Int	Paymts/ Loss Cr	Total Comm	-Due- Comm	Advance
		WHEAT-CRC	12.00	794	326	30	0.00	356.00	95.28	95.28	0.00
		WHEAT-CRC	12.00	850	306	30	0.00	336.00	102.00	102.00	0.00
		WHEAT-APH	14.00	224	81	30	0.00	111.00	31.36	31.36	0.00
		WHEAT-APH	14.00	4	2	30	0.00	32.00	0.56	0.56	0.00
		WHEAT-APH	14.00	224	81	30	0.00	111.00	31.36	31.36	0.00
		WHEAT-APH	14.00	2,484	894	30	0.00	924.00	347.76	347.76	0.00
		WHEAT-APH	14.00	8,373	3,014	30	0.00	3,044.00	1,172.22	1,172.22	0.00
		WHEAT-APH	14.00	16,403	5,905	30	0.00	5,935.00	2,296.42	2,296.42	0.00
		WHEAT-APH	14.00	177	64	30	0.00	94.00	24.78	24.78	0.00
		WHEAT-APH	14.00	2,278	934	30	0.00	964.00	318.92	318.92	0.00
		WHEAT-APH	14.00	171	62	30	0.00	92.00	23.94	23.94	0.00
		WHEAT-APH	14.00	328	135	30	0.00	165.00	45.92	45.92	0.00
		WHEAT-APH	14.00	1,699	561	30	0.00	591.00	237.86	237.86	0.00
		WHEAT-APH	14.00	4,410	1,808	30	0.00	1,838.00	617.40	617.40	0.00
		WHEAT-CRC	12.00	2,381	977	30	0.00	1,007.00	285.72	285.72	0.00
		WHEAT-APH	14.00	8,084	3,314	30	4.51	3,348.51	1,131.76	1,131.76	0.00
		WHEAT-APH	14.00	28	10	30	0.00	40.00	3.92	3.92	0.00
		WHEAT-APH	14.00	34	12	30	0.00	42.00	4.76	4.76	0.00
		WHEAT-APH	14.00	61	20	30	0.00	50.00	8.54	8.54	0.00
		WHEAT-APH	14.00	508	167	30	0.00	197.00	71.12	71.12	0.00
		COTTN-CRC	12.00	7,405	2,444	30	61.86	2,535.86	888.60	888.60	0.00
		COTTN-CRC	12.00	8,411	2,776	30	70.16	2,876.16	1,009.32	1,009.32	0.00
		COTTN-CRC	12.00	57	19	30	0.00	49.00	6.84	6.84	0.00
		GSORG-CRC	12.00	18	6	30	0.00	36.00	2.16	2.16	0.00
		COTTN-APH	5.00	559	0	100	0.00	100.00	27.95	27.95	0.00
		COTTN-CRC	12.00	8,760	3,592	30	90.56	3,712.56	1,051.20	1,051.20	0.00
		COTTN-CRC	12.00	144,997	52,198	30	0.00	52,228.00	17,399.64	17,399.64	0.00
		COTTN-CRC	12.00	7,235	2,605	30	0.00	2,635.00	868.20	868.20	0.00
		COTTN-CRC	12.00	7,235	2,605	30	0.00	2,635.00	868.20	868.20	0.00
		COTTN-CRC	12.00	2,405	865	30	0.00	895.00	288.60	288.60	0.00
		REV:		1,202,149	429,277	3,750	1,326.85	434,353.85	144,257.88	144,257.88	0.00
		MPCI:		55,895	20,612	930	12.72	21,764.72	7,825.30	7,825.30	0.00
		CAT:		39,288	0	900	3.75	903.75	1,964.40	1,964.40	0.00

Independent Insurance Agents *Brokers of America, Inc.*

TESTIMONY OF NORMAN A. NIELSEN ON BEHALF OF THE INDEPENDENT INSURANCE AGENTS & BROKERS OF AMERICA BEFORE THE SENATE COMMITTEE ON AGRICULTURE, NUTRITION & FORESTRY

June 28, 2005

Good morning. Thank you Chairman Chambliss, Ranking Member Harkin and Members of the Committee for the opportunity to present the views and recommendations of the Independent Insurance Agents & Brokers of America (IIABA) on issues regarding the Federal Crop Insurance Program (FCIP). We appreciate the interest you have shown and the initiative you have taken by calling this very important hearing.

My name is Norman (Norm) Nielsen, and I am President of Associated Insurance Counselors, Inc. in Preston, Iowa. I am also the National Chairman of IIABA's Crop Insurance Task Force. IIABA is the nation's oldest and largest national trade association of independent insurance agents, and represents a network of more than 300,000 agents and agency employees nationwide. IIABA members are small businesses that offer customers a choice of policies from a variety of insurance companies. Independent agents

offer all lines of insurance – property, casualty, life, health, employee benefit plans and retirement products.

I have been a Main Street insurance agent for over two decades. I have witnessed banner years for agriculture and I have been on the front lines for our nation's agriculture producers during some of the worst harvesting seasons in recent history, both as an agent and as an agriculture lender. I have represented this industry while the Risk Management Agency (RMA) has evolved through seven Administrations and I have never seen it in the disrepair it is in now. I am particularly bothered by the RMA's persistent undermining of the agent's role and overall value to the Program. Working together we have built this program into the success story it is today, and to be treated like second-class citizens is surprising and very disappointing. It is beyond the scope of imagination how time has actually worsened the Agency's ability to oversee this vital risk management tool, but somehow it has. With your indulgence, I will discuss some of the recent policy decisions made by the current management of RMA that has brought the program to the state it is in today, and me before the Committee.

<u>Premium Reduction Plans</u>

Section 508(e)3 of the Federal Crop Insurance Act establishes the opportunity for companies demonstrating an ability to offer crop insurance more

efficiently than the rate of the Administrative and Operating (A&O) cost reimbursement the chance to reduce the premium charged by an amount corresponding with that efficiency. In plain English, if a company can establish a true "efficiency" that reduces the delivery cost of crop insurance while maintaining the same quality of service, that savings can then be passed onto the farmer in the form of a policy discount. There is no mistaking the fact that on the surface, a discount in crop insurance for our nation's agriculture producers sounds appealing, and could possibly increase program participation. However, as with any attempt to bring a new product to the marketplace, especially such a broad initiative as introducing price competition, you must conduct a careful analysis to determine its feasibility, and that the governing agency has the capacity to effectively implement and enforce it. IIABA believes that RMA is negligent on all counts.

IIABA is a staunch opponent of the Premium Reduction Plan (PRP). This is not to say that we are against competition; to the contrary, we believe competition provides an important check-and-balance for our industry. To underscore this point, we as independent agents are constantly competing against one another, which ensures that we are constantly striving to provide the best possible service to our customers. Competition is healthy when handled properly. However, we believe PRPs actually undermine the competitive playing field by putting cost of service over quality of service.

IIABA believes that PRPs have absolutely no role in a marketplace that relies so heavily on the expertise of its agent network, and that the proliferation of this program will result in serious unintended consequences for our nation's farmers. Moreover, we believe that PRPs promote unfair discrimination against limited resource farmers, as well as farmers in areas traditionally classified as high risk, which flies in the face of Congress's intent when they created the Federal Crop Insurance Program – to provide all eligible farmers in the United States with crop insurance. In order to understand why PRPs are bad for the Federal Crop Insurance Program, you need to understand the role the agent plays in the delivery system.

Unlike the typical property-casualty product, an agent's responsibilities for crop insurance require a much more hands-on approach, which invariably increases the threshold for errors and omissions (E&O) exposure. On average, with advance meeting preparation, travel, and meeting time, an agent spends approximately 7 hours on a policy during the sales window alone. In Iowa, a transaction begins with the agent quoting the 247 different plans of insurance and then explaining production reporting and supporting record requirements to the farmer. He explains different date requirements by crop and by coverage for application, the actual production history (APH), the acreage report, the farmer's options and claims. He completes APH-

related forms for the farmer, calculates preliminary yields, reviews production early to determine if there is a revenue loss, reviews the APH form for completeness and accuracy, and forwards the signed form and any applicable worksheets to the company. The agent then must review approved APH from the company to ensure accuracy, explain approved APH yields to the farmer, and provide him with a copy. This is just the beginning. I haven't even discussed procedures for Preventive Planting, Yield Adjustment, Unit Division changes, Power of Attorney requirements, or any of the other technical policy provisions. Everything I have just listed goes into writing the policy – I haven't factored in what transpires should the farmer experience a loss. I challenge the RMA to show you a delivery system that reduces the role of the crop insurance agent without reducing the quality of service our nation's farmers have grown to expect for the last 25 years. Some of the witnesses before you today would like you to believe that "innovative software" can reduce or replace the indispensable role of the agent without compromising delivery standards; however, the devil is always in the details.

The Federal Crop Insurance Act, as amended, authorizes the FCIC to establish rules, limitations, and procedures for approving applications by insurance providers to reduce crop insurance premiums. To be eligible for the reduction, however, the Act requires that provider demonstrate that a

true "efficiency" will be achieved, not merely that a cost has been cut below the expense reimbursement amounts established by the FCIC. Unfortunately, the easiest "efficiency" a company can realize is a reduction in the role of the agent in the delivery process, thereby confusing cost-cutting with the efficiency required to be demonstrated under the Act. As a result, PRPs undermine the quality of the crop insurance delivery system, contrary to the standards established by Congress.

In 1980, Congress transitioned the federal crop insurance program from a program administered solely by federal employees to a private-sector/government partnership project. In mandating this transition, Congress recognized that "the sales talents and experience of the private sector commissioned agents . . . are essential to fulfilling the goal of nationwide, generally accepted all-risk insurance protection." As a result of this demonstrated talent, Congress rested upon the agents' shoulders the "large burden of program delivery" and "providing full service to the client" including, but not limited to, sales. Independent agents, including IIABA members, have proved instrumental in achieving the program's goal of helping farmers make well-informed risk assessments and choices about the coverage that they purchase. These agents are knowledgeable about the technicalities of the crop insurance program and skilled at assisting farmers with concerns that directly impact their coverage, such as unit structures and

yield guarantee weaknesses. They also have the training and experience necessary to encourage participation of small, limited resource and minority producers, as required under the Standard Reinsurance Agreement (SRA).

Discrimination

Since approval of a pilot PRP in 2003, IIABA and its members have been concerned about the effect of such programs on the delivery system and preventing discrimination against small, limited resource and minority producers. It is easy for RMA to admonish all forms of discrimination; in fact, there are a number of areas in the preamble of RMA's proposed rules where the Agency goes to great lengths to illustrate the prohibition against such behavior. However, condemning discrimination and actually having the means to police it are completely different issues. Although the proposed rules provide that RMA may not approve PRPs that result in a reduction of services to policyholders or PRPs that are unfairly discriminatory, the rules contain no enforcement mechanism to prevent disruption to the balance of agents and services to policyholders in the current crop insurance delivery system or to detect and prevent covert discrimination against small, limited resource and minority producers.

There is one company offering a PRP in 2005. Unfortunately, we have heard of wide-spread patterns of abuse and discrimination being practiced by this

company, all happening under the nose of RMA's Office of Compliance. If this is occurring with only one company offering a PRP, it is simply unrealistic to expect RMA's current oversight infrastructure to properly monitor and regulate discriminatory practices, especially if the number of companies offering a PRP grows in the 2006 reinsurance year.

There are also forms of covert discrimination available for companies to employ. For example, the agent network for the delivery of PRP will undoubtedly be driven by the size of an agency's book of business. While an agent is required to offer all products offered by the company(s) for whom they write, the companies have the opportunity to decide which agents they wish to employ. The obvious litmus test for this decision-making process will be the size of the agency's book of business. Therefore, those whose book is comprised of accounts from smaller farming enterprises will be passed over for those with the larger, more profitable accounts. If RMA allows this to proceed, the end result will be cherry-picking by the companies to the detriment of small farmers. No agency can survive by servicing only small farmers. Therefore, if only the best and most profitable customers are skimmed off the top, the result will undermine the intent of the law that governs the crop insurance program, a program that is based on serving all farmers of all sizes, without discrimination against smaller farms. Sadly,

IIABA members have suffered from this tactic over the last year courtesy of the one PRP company in the marketplace.

Given RMA's current budget structure and cuts in agriculture spending in FY 2006, it is unrealistic to expect that a "shift of resources," as RMA proposes, will provide the necessary changes to their Office of Compliance in order to ensure order in PRP distribution. Nothing short of a "PRP Compliance Office" will come even close to providing the proper enforcement mechanism, and RMA does not have the financial resources to establish one. Proper compliance will require regulation all the way down to the agent level, and RMA lacks both the resources and the regulatory authority to achieve this goal.

In keeping with Congress's intent, independent agents currently assist producers, particularly small, limited resource and minority producers, with deadlines for reporting, screening information, quality control, risk assessment and determining the necessary amount of coverage. By doing so, agents then make up the difference by writing coverage for larger farming enterprises. If additional PRPs are approved, many independent agents, who receive at most only fair compensation under the current delivery system, would likely stop delivering crop insurance. Companies would likely consolidate their business among a smaller workforce of agents. The smaller

delivery system resulting from PRPs would be unable to provide the same amount of individualized service, which would violate the PRP statute requiring no reduction in the quality of service to policyholders. As a result, Congress's goal of providing producer education through the crop insurance delivery system would be defeated and farmers would likely experience negative financial consequences from ill-informed risk assessment and coverage decisions.

Additional PRP Observations

When section 508(e)3 of the Federal Crop Insurance Act was established, its purpose was to create a vehicle for reducing the federal subsidy paid to the companies which offset policy costs to the farmer while at the same time, mandating that quality of service to the policyholder is not compromised. It is also important to note that when 508(e)3 was established, the A&O subsidy was several percentage points higher than it is today, making it easier to operate efficiently below the federal reimbursement. When RMA renegotiated the SRA in 2004, among other provisions was an additional reduction in federal subsidies paid to the companies. Therefore, there is a degree to which RMA has already created the savings anticipated in 1994 when Congress passed section 508(e)3. Therefore, the empirical evidence exists that the FCIP burden on the American taxpayer has continued to decline, while the quality of service to our nation's agriculture producers has

remained static. This will not be the case under a PRP scenario. Proliferation of PRPs will be the equivalent of throwing the baby out with the bathwater, and will create numerous draconian consequences for an agriculture system our nation depends on, many of which will come to fruition well after the train has left the station.

Rulemaking Process for PRPs

In November of 2004, the Federal Crop Insurance Corporation (FCIC) Board passed a resolution suspending PRPs until a notice and comment rulemaking process can be completed. The FCIC Board should be commended for this prudent action. Prior to the resolution, RMA had approved one company and was prepared to approve several additional company applications to participate in a program lacking a proper set of rules in place to govern its distribution, despite scores of industry complaints regarding the discriminatory nature the program's delivery system lends itself to. Furthermore, we call into question the motives of RMA when they authorized the one company to continue to offer a PRP after the Board's resolution passed. The company continues to market a PRP in several states without any safeguards against predatory sales tactics, and the lack of foresight demonstrated by this decision has created a government –sponsored monopoly for the 2005 reinsurance year. Yet what is particularly singular about this decision -- when compared to RMA's alleged effort to police fraud,

waste and abuse within the industry – is that prohibiting all PRP sales until the completion of the rulemaking process should have been paramount. However, despite conventional wisdom, the Agency decided to turn a blind eye to their irrational decision and instead focus on areas within the industry historically portrayed as good actors. IIABA puts no stock into any initiative by RMA to inhibit abuse of the program when they allow such fragrant loopholes to exist. Furthermore, if this is RMA's idea of promoting competition in the industry, then the future looks very bleak for anyone involved in the delivery of this important risk management program, and I shutter to think of the impact it will have on America's agriculture producers.

Comment Period

RMA activated a 60-day comment period on the preliminary rules beginning on February 25th and ending on April 25th, 2005. During this window, 805 formal comments were submitted to RMA from virtually every stakeholder – from the company down to the farmer – in the crop insurance industry. Out of these 805 comments, an astounding 94% voiced concerns regarding the deleterious impact PRPs will have on the delivery system. It is important to note that the one company offering a PRP offered a financial inducement (a pair of leather work gloves) to any agent or policyholder who submitted comments based on their suggested talking points, and provided them with a

copy. This attempt to skew the outcome of the comments, which amounts to nothing more than a perversion of the rulemaking process, should have resulted in immediate disqualification. However, when questioned by a Member of this Committee, RMA's Office of General Counsel contended that they were not aware of any law or regulation that would be broken by an interest group providing a financial inducement to encourage individuals or entities to provide comments to a regulation, thereby insinuating their decision not to determine the influence this offer had made on the comments. It is IIABA's conclusion that, absent the incentive offered for favorable comments, the percentage of negative comments would have been considerably higher than the already overwhelming 94% received.

The lopsided results during the comment period, so heavily opposed to the preliminary rules for several reasons, should have prompted an immediate second comment period to ensure that all of the issues raised by the public and Members of this Committee were addressed. However, on April 19th, 2005 during an industry meeting, officials from RMA indicated that the Agency's intention was to move forward with promulgating final rules by July 1st, in time for the 2006 reinsurance year. As mentioned above, the closing date of the comment period was April 25th; since this statement was made on April 19th, it is evident that the outcome of the comment period would have no bearing on RMA's version of the final rules. If the comments

were to be read and utilized in the final rules, then it would be impossible for RMA to make such a broad statement regarding a completion date without having information regarding the final scope of the comments received.

IIABA contends that RMA has made a mockery of the comment period. Out of 805 submissions, 757 (94%) were negative. If RMA's intention is to arbitrarily promulgate the final rules without following proper procedure, then it is in Congress's best interest to place a moratorium on the PRP program until a thorough third party investigation, such as the Government Accountability Office, can be completed.

Conflict of Interest

The regulatory guidelines set forth in the 2005 Standard Reinsurance Agreement (SRA) further complicate the relationship between the agent and the loss adjustor. Let me be clear – IIABA in no way believes that the agent should be adjusting losses for the farmer and we firmly support the barrier between these two separate roles during the indemnity stage. However, in RMA's effort to thwart abuse and waste, the new procedures regarding agent and loss adjustor cooperation not only ends once a claim has been filed, but a $10,000 fine has been created and instituted for any subsequent violations. This fine will be levied against agents who fail to conform to the new policy.

This new policy is not only onerous and oppressive, but it flies in the face of RMA's latest effort to promote good farming practices in the new era of Asian Soybean Rust. It is difficult at best for agents to advise their clients on good farming practices via the manuals provided by the companies when it is in turn a violation of the SRA to advise the farmer during a claim, beyond the basic paper filing. Furthermore, with the realistic possibility of a $10,000 fine, most, if not all agents will make overly-defensive and cautious business decisions, which will place a serious burden on their livelihood. This irrational policy decision by RMA is completely inconsistent with how the crop insurance industry is supposed to operate. RMA has circulated a draft of a "revised" conflict of interest bulletin, but by all accounts the latest version only further defines what was already stated.

It is interesting that RMA has built the barrier between the agent and the loss adjustor while at the same time, moving ahead to implement PRP with reckless abandonment, since scenarios under future PRPs present a contradictory situation. For example, according to the conflict of interest bulletin, if a policyholder provides records to his/her agent for the adjuster to use to determine the claim, this is considered a conflict of interest, since the SRA limits the agent to simply collecting production information and provide it to the company. However, under a PRP scenario, the agent and the policyholder can be one in the same. To illustrate my point, consider a

producer who has opted-in to a PRP where the company's efficiency is created through the farmer's responsibility to service their policy over the internet. Given this it is impossible for the agent and the loss adjuster not to communicate through the claims process, since the farmer is acting as his own agent. This is an acute concern given the fact that RMA is moving forward with the PRP rulemaking process, and could be an even bigger issue should more companies offer a discount program utilizing the internet as a primary delivery tool.

Perhaps the most disturbing element of this policy decision is the fact that it was made during the renegotiation of the 2005 Standard Reinsurance Agreement, which precluded any consultation from the agent community whatsoever. As non-SRA signors, RMA determined that we are not qualified to contribute to the negotiation, despite the fact that several provisions in the SRA, particularly the conflict of interest, have a direct regulatory impact on the agent. Had we been given an ability to voice our concerns while the SRA was being discussed by the industry, issues such as this provision would have benefited from the perspective of Main Street agents. Instead, RMA chose to force it on us after the fact and use inappropriate scare tactics such as excessive and unwarranted fines. The proper due course is to invite the agent community to the negotiations for any SRA appendix that has even a

marginal effect on their role in the delivery process. Anything else is a violation of reasonable due process.

Conclusion

Premium Reduction Plans are the wrong policy at the wrong time. Under PRPs, our nation's farmers are on the losing end, and the level and quality of service of their risk management will suffer. The access to available plans will be greatly reduced, and the knowledge and understanding of the system will be limited to those farmers who are willing and have the time to educate themselves on the complexities of crop insurance, while all the while servicing their farm on a full time basis. There are people at RMA who seem to think that "direct" insurance, similar to the delivery system employed by companies like Geico or USAA -- the United Services Automobile Association – is a realistic scenario that can be applied to the crop insurance delivery system. I can assure you that after two decades in this industry, that is an irrational and irresponsible conclusion and therefore lacks any merit whatsoever.

The insurance marketplace is too complex to regulate with broad strokes, and I implore the Congress to shelve section 508(e)3, either through a timeout or a total repeal, before it effectively dismantles the most successful public/private partnership our country has had in over 25 years. I also encourage the

Committee to initiate a third party investigation into the stability and long-term impact of the PRP, preferably through the Government Accountability Office, before any additional action is taken that would advance the program into the 2006 reinsurance year. As you have heard today, there are several unanswered questions regarding the future of this program, and an investigation will guarantee that RMA moves in the right direction, a direction that is in the best interest of the crop insurance industry, and, more importantly, our nation's agriculture producers. Thank you for the opportunity to testify before you today, and I would be pleased to entertain any questions you may have.

TESTIMONY OF BILLY ROSE, PRESIDENT/CEO
CROP 1 INSURANCE, URBANDALE, IOWA

EXECUTIVE SUMMARY

Congress authorized the federal crop insurance system to offer premium reduction plans for farmers in 1994 and again in the Agriculture Risk Protection Act (ARPA) of 2000. The premise is simple: If an insurance company is willing to meet USDA's Risk Management Agency (RMA) criteria for administrative and operating efficiencies, the savings can be passed on to farmers in the form of Premium Reduction Plan (PRP) policies.

Some large insurance companies and agents are attempting to stop RMA from spending FY2006 dollars to administer PRP on federal crop insurance. This is both bad federal policy and bad for farmers. To accept such an amendment tells farmers Congress cares more about insurance company profits and agent commission checks than about helping farmers save money.

Occidental Fire and Casualty Insurance of North Carolina (Occidental) and its managing general agent, Crop 1 Insurance (Crop 1), have been approved to offer PRP. In an effort to make PRP broadly available they have appointed over 400 independent agents in 15 states who have written over 16,000 farm policies. Additional companies have applied to sell PRP, but have not yet been approved pending the current RMA rulemaking or, in some cases, were not approved for other reasons.

Occidental, Crop 1, their employees, licensed agents and, most importantly, their farmer customers will be the victims of any precipitous act by Congress. What is their "crime"? They applied in good faith for a federal government program that was approved by an agency of the federal government.

PRP's success has companies which have not yet been approved to sell PRP nervous. Why? Farmers have shown they want to save money and reduce risk by purchasing higher coverage levels with PRP. The attacks on PRP and its providers come down to an issue of competition among crop insurance companies. Rather than competing in the marketplace, some companies are asking Congress to effectively kill the PRP program along with the first and only company approved by the federal government to provide farmers a price discount on their crop insurance. Reduced competition will enable large, existing insurance companies to retain higher profit margins and market share.

Prior to PRP, crop insurance companies didn't compete on the farmer's cost for insurance; rather they competed with each other on agent commissions. Companies "recruited" other firms' agents by offering higher and higher commissions, leading to the departure from the marketplace of companies that could not afford the bidding war. This practice continues today.

Perhaps the most significant risk to the viability of companies approved to offer the federal crop insurance program is continued escalation of commissions. This was one of the factors leading to the collapse of American Growers and it still occurs today. Crop 1 has evidence other

companies are offering its agents in excess of 20% commissions if they will move their farmers from Crop 1. To date our agents have resisted these predatory attempts to undermine the PRP's agent delivery force since they believe in the program.

RMA is expected to complete its formal rulemaking updating PRP participation in the next several weeks. When the rule is released, it is expected all companies that wish to sell PRP will be required to apply or reapply for approval. This is fair.

If the issue is really the merit or value of PRP rather than marketplace competition – as some allege – then Congress should stop talking with insurance companies and start talking directly with farmers for whom the crop insurance program was created to benefit. They are best positioned to discuss the relative merits of programs designed for their benefit. Crop 1 and its agents are eager to cooperate in any legitimate effort to make a good program – one with obvious farmer benefit – better.

In the meantime, opponents of PRP and critics of RMA want Congress to accept an amendment to the FY2006 agricultural appropriations bill based on distortion, myths and rumors.

Below are the myths and facts being circulated about PRP and Crop 1:

Myth: *Crop 1 is a "government-sponsored monopoly" because it's the only firm selling PRP.*

Fact. Crop 1 is simply the ***first*** company to sell PRP because Occidental's application, naming Crop 1 as its crop insurance general agency, was approved by RMA. Six other companies have applied but have not yet been approved. We hope other companies will be approved to offer savings to farmer in the near future.

Myth: *Crop 1 sells insurance only over the Internet.*

Fact. Crop 1 has over 400 independent agents selling PRP in 15 states. Crop 1 invested over $3 million in software and an IT platform allowing its agents to provide faster, more comprehensive evaluations and service to farmers. This is part of the reason why Crop 1 has met or exceeded every requirement of RMA to sell PRP. While other crop insurance companies may have upgraded their IT systems, the benefit of these upgrades are not passed along to the farmers in the form of premium reductions.

Myth: *Crop 1 is "cherry picking" – selling only in low-risk states and to large farmers.*

Fact. Crop 1 is in 15 states, including high-risk states such as Texas and North Dakota, and plans to expand to six additional states in 2006. For the 2004 crop year – the last year for which the most recent statistics are available -- by policy, 66% of Crop 1's policies insure less than 255 acres. Approximately *60% of Crop1's farmer customers operate less than 500 acres; 21% have between 500-1,000 acres. Only 19% are larger farmers with over 1,000 acres.*

Myth: *Farmer service suffers with PRP*

Fact: Over 94% of PRP policyholders renewed their PRP policies this past year. Over 95% of the PRP policyholders who had a claim renewed their policies. Expert reviews by recognized ag economists suggest that PRP is likely to lead to more professional service, not less.

Myth: *Crop 1 is operating without proper RMA oversight.*

Fact. USDA's Chief Economist Dr. Keith Collins called Crop 1 "The most scrutinized crop insurance company" in his memory. Crop 1 not only succeeded in winning approval to sell PRP, but has also been audited, reviewed and reaudited throughout its three years of operation. Any amendment to stop PRP effectively punishes Occidental, Crop 1, and their agents for being successful. The question needs to be asked: Could other firms selling multiperil crop insurance at regular government-set rates withstand the same scrutiny?

Myth: *Only Crop 1 opposes an amendment to limit PRP.*

Fact. Occidental, Crop 1, their 400 insurance agents, and thousands of farmer policyholders oppose the amendment. And, anyone wanting to avoid another crop insurance company bailout should oppose the amendment as well.

FORMAL TESTIMONY

Chairman Chambliss, Senator Harkin, members of the committee, my name is Billy Rose, and I am president and chief executive officer of Crop 1 Insurance, a privately held crop insurance provider in Urbandale, Iowa.

I want to thank the Chairman for convening this oversight hearing to review, in part, the significant merits of the premium reduction plan (PRP) authorized under Sec. 508(e)(3) of the Federal Crop Insurance Act (FCIA). While I won't deal with our specific comments on the RMA rulemaking to implement Sec. 508 (e) (3) of the FCIA, I ask that my formal statement, including Crop 1's formal comments on USDA's proposed rule, be made a part of the hearing record.

As the committee knows, Occidental Fire & Casualty Insurance of North Carolina, with its managing agency Crop 1 was the first to apply and be approved by USDA to provide PRP, or what we call our Premium Discount Plan (PDP). We welcome the opportunity to explain how Occidental and Crop 1 have made PRP work, to provide insight into how other companies can offer farmers and premium discount on their crop insurance, and, hopefully, to dispel rumors and innuendo perpetuated about not only PRP, but also Crop 1 as a company.

Crop 1's estimates show PDP has saved farmers over $1 million in premium cost in the last two years. It is important to note this premium reduction is strictly from expense savings. The farmer-paid portion of the premium available to pay losses has not changed as a result of the PRP. Thus, this premium reduction does not increase risk for insurers, reinsurers, the FCIC, or the American taxpayer.

Crop 1's PRP product is available in 15 states, many of which are represented by the members of this subcommittee. To date, Crop 1 has sold policies in 682 counties in those states. And, given the opportunity to service more farmers in more states, we will expand our service in a prudent, manageable business manner.

It is our understanding six other companies applied to RMA for approval to sell PRP products prior to RMA beginning its current rulemaking process. It is Crop 1's hope that some or all of these companies will be approved because we strongly believe enhanced competition is good for the industry, the American farmer, and taxpayers.

PHILOSOPHY, HISTORY, INNOVATION, OPERATION OF CROP 1

The business philosophy of Crop 1 agents is simple: Provide farmers the best possible crop insurance product -- with good service -- at the best price. We and our agents can successfully deliver on this philosophy because we've developed the technology and processes necessary to provide coverage and services to producers while controlling our administrative and operations expenses, coming in within the administration and operating (A&O) expense allowance provided by USDA.

Our goal has always been to help farmers reduce their insurance costs and reduce the time it takes agents to analyze the different risk management options available to farmers today. Before

founding Crop 1, I managed a business helping farmers obtain loans and crop insurance. I saw first hand how hard it is for many farmers to make ends meet. More importantly, as a crop insurance agent I saw how difficult it is for them to come up with the extra cash to buy the higher levels of insurance coverage they actually needed. In addition, I saw how much time it takes to analyze all the different crop insurance options available to farmers. This is especially difficult when evaluating the marketing alternatives that must be considered when developing a risk management plan.

We decided something needed to be done to help the American farmer reduce his crop insurance cost and to help agents better analyze the different risk management options with their farm customers. This led to the development of Crop 1.

We worked hard to ensure our program complied with all the rules and regulations governing the crop insurance program while offering a savings to our farm customers. We also worked closely with our agents, who now number over 400, to develop a program that works for them and helps them provide better service to their farm customers.

It takes a lot of hard work by a dedicated team of employees at Crop 1, a team largely made up of people who, like me, have lived in rural America. This teamwork allows us to achieve what we set out to do: We help farmers purchase higher levels of insurance coverage without significantly increasing their costs.

As part of our investment in technology, we developed software enabling agents to efficiently analyze years of history and provide counsel and advice to their farm customers. We developed Internet websites for all of our agent affiliates, and continue to enhance those websites with information for both agents and their customers.

Today, Crop 1 offers PDP on all federally reinsured crop insurance programs except CAT, and offers farmers a guaranteed savings of up to 10.5% on the farmer-paid premium. PDP is available for all crops in Idaho, Illinois, Indiana, Iowa, Kansas, Michigan, Minnesota, Missouri, Nebraska, North Dakota, Ohio, South Dakota, Texas, Washington and Wisconsin.

It is important to note the reduced premium (savings) is strictly from expense reductions and that portion of the farmer premium available to pay losses does not change. Thus, this type of premium reduction does not bring more risk to the insurer, reinsurer, or federal government.

We are fortunate to have a well-managed insurance company supporting us, a company which also believes in our goal. Occidental Fire & Casualty of North Carolina has a surplus of over $100 million. More importantly it has senior management with many years of crop insurance experience. Attached is a letter from Ken Coon, senior vice-president of Occidental. Crop 1 collaborates closely with Occidental, which in turn provides oversight and support, as discussed in the letter from Mr. Coon.

In addition to support and oversight from Occidental, PDP is backed by Occidental's owner – a privately held company with more than $800 million in surplus and five highly rated private

reinsurers. This year our reinsurance treaty was over-subscribed and we have excellent reinsurance support for our program.

As the members of the subcommittee can readily see, Occidental and Crop 1, with strong financial backing, intend to be in the crop insurance business for a long time, providing continuing service and innovation to all our farmer customers.

WHY PRP AND WHY NOW?

The issue before us is quite simple. Is a federal program allowing premium discounts to farmers in need of affordable crop insurance a good idea? Or put another way, should companies like Crop 1 – and other firms which can be expected to be approved to sell PRP – who are providing the best available crop insurance product at the best possible price to the farmer, be permitted to continue to offer this valuable service?

The answer, based on our experience, is an unequivocal "yes." However, our experience also suggests not all producers and agents may want PRP. Even so, the bottom line is that Crop 1 strongly believes producers should have the option to purchase crop insurance at a discount. We believe in free markets, competition, and playing by the rules.

Many on this committee participated over the years in various overhauls of the federal crop insurance program, including the efforts which led to authorizing PRP. As you'll recall, Congress enacted PRP authority in 1994 to give farmers more options to manage risk by allowing for price competition among crop insurance providers, all part of the broader goal of increasing farmer participation and increasing farmer coverage levels in the federal crop insurance program.

Such forward thinking is axiomatic to successful modern business. Competition spawns innovation, and innovation, properly managed increases quality, improves service, and lowers price. This is why we have PRP. It is an innovation sorely needed in an industry just beginning to move into the 21st century.

Congress, in authorizing PRP, recognized risk management tools and least-cost production are not mutually exclusive. Enhanced competition provides incentive to others, particularly smaller companies, to participate in the crop insurance market. Let's not forget: The crop insurance industry, like much of production agriculture, is consolidating. In 1985, there were more than 50 companies in the crop insurance market; by comparison in 2002 – at the time Crop 1 entered the market, the number of companies participating in the program was in the low teens, with the two largest companies controlling more than half of the market.

There are those who allege PRP will "destabilize" the crop insurance industry. We submit PRP, rather than upsetting the industry balance, serves to stabilize and vitalize the crop insurance industry so it can provide to farmers what Congress intended: Readily available – and affordable -- crop insurance coverage that meets an individual farm operation's unique situation and demand.

One of the primary benefits of PRP is it causes those crop insurance companies who want to offer a PRP to operate within the A & O expense budget proscribed by the FCIC. Today, some companies have operating costs exceeding that A & O budget formula. These companies are forced to rely on speculative underwriting gains to cover operating expense. This is bad business.

When we have a year or years with poor weather and/or bad prices, companies relying on underwriting gains may not be able to pay their operating expenses. Losing crop insurance providers is what destabilizes the industry. This has happened in recent years in part because companies have operating costs exceeding A & O reimbursement, e.g., the collapse of Am Ag, formerly a company located in Council Bluffs, IA. The PRP program protects companies, the American farmer, and the American taxpayer from such situations because it causes them to operate within their A & O budgets.

If companies must rely on underwriting gains to pay their operating expenses they can only realistically operate in states where they are fairly confident they will receive an underwriting gain. However, under PRP a company can be confident it can pay its bills even without an underwriting gain. This "Live Within Your Means" strategy permits a firm to go into higher risk states where it has historically been difficult to generate underwriting gains. This is why in 2005 much of Crop1's volume was generated from higher risk areas in North Dakota and Texas

We do not believe companies should be forced to offer a PRP. Many agents and companies may choose to operate with the traditional business model. They should have that right. But, we believe that the traditional model presents a greater risk to the industry and American taxpayers.

We believe PRP enhances the ability of a new company like Crop 1 to enter higher risk crop insurance markets For example, this past year Crop 1 expanded into Texas. Historically, loss ratios in Texas have been relatively high. Without PRP, I doubt that we would have entered the Texas market. However, with PRP we not only entered the Texas market, we added more volume this past year in Texas than we did in any other state, and by a wide margin. We believe that this is strong evidence that we are not attempting to "cherry pick". Mr. Chairman, there are not many cherries grown in Texas.

PRP is the logical next step in the evolution of the crop insurance industry. When first established, federal crop insurance was available only to drought-ravaged Plains states; today, crop insurance is available in all states. For decades, federal crop insurance was available only for grains, oilseeds and other program crops; today, it is available on almost all crops, including revenue coverage's and specialty crop production. In 2000, with passage of the Agriculture Risk Protection Act (ARPA), Congress added to the evolutionary process, providing first time authority to pilot test livestock risk protection insurance, giving livestock producers a much-needed risk management tool previously denied them.

ARPA 2000 also included language restating the need for less expensive federal crop insurance and enhanced price competition, reinforcing congressional intent to authorize crop insurance providers the opportunity to offer PRP products.

Prior to each of these landmark shifts, some clamored such a departure from the traditional system of crop insurance would mean the end of – or at the very least, severe damage to -- the crop insurance industry. However, each time Congress stood by its commitment to enhance farm risk management options, and today we see an industry where these predicted disasters are now revenue centers for crop insurance companies. So much for Chicken Little. The sky did not fall.

Some critics assert because nearly 80% of eligible acres were enrolled in the federal crop insurance program in 2004, innovations such as PRP are unnecessary. Seventy-five years ago these same naysayers would probably have claimed since we farmed 80% of the arable farmland in the U.S., we didn't need tractors.

In fact, what has happened since RMA added price competition into the expanding crop insurance menu is exactly what AgRisk Management's Dr. Bruce Babcock and Dr. Dermot Hayes predicted in their outside review of RMA's proposed rulemaking. Consider the following excerpts from this review:

> "Agents will attempt to forestall competition through political pressure or other means ... (raising) all sorts of issues about how premium reduction plans are not good for the industry. For example, concerns raised about small, minority and limited resource farmers can be viewed as an attempt by those with a vested interest in the current system to derail competition."[1]

What is occurring today is exactly what Dr. Babcock and Dr. Hayes predicted earlier this year. I am sure you have already heard quite a variety of false statements regarding PRP, as perpetuated by some who represent "The Big I" insurance lobby and others.

In their independent expert review of PRP, Dr. Babcock and Dr. Hayes emphasize several other points, concluding that as price competition within the FCIC program moves forward, it can be expected "the agent force will have a higher opportunity cost of time and they will become more professional ... (causing) the bundle of services that agents provide (to) change. Agents will provide only those services that farmers truly value ..."

Another way to look at these changes is through the eyes of GlobalAgRisk, Inc.'s RMA-commissioned outside review, which analyzed the average cost of selling and servicing a crop insurance policy. The study concluded that if companies offered a premium discount similar to that offered by Crop1 the past several years (3.5% of base premium) companies would have about the same amount of A & O expense reimbursement (even after adjustment for the new SRA) as they had in 1999. GlobalAgRisk also noted that it was "Not aware of any evidence that would suggest the average cost to sell and service a crop insurance policy has increased

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[1] Babcock, B.A. and Hayes, D. J., "Review of Premium Reduction Plan Issues," conducted by AgRisk Management , LLC, January 7, 2005. Available on USDA website at http://www.rma.usda.gov/aboutrma/fcic/2005/224agrisk.pdf

significantly over the past five years."[2] In addition they recognized that had the new SRA not changed reimbursements to the premium subsidy structure for the four crops analyzed, "A & O expense reimbursements per buy-up policy would have increased by approximately 20 percent higher than it was in 1999."

Increasing participation was not the only reason Congress authorized PRP. Congress decided price competition among crop insurance companies was not necessarily a bad thing; in fact, Congress correctly reasoned price competition would bring benefits not only to farmers, but also to the crop insurance industry as a whole. Crop 1 agrees.

While it is important to keep acreage enrollment high, it is equally important to let premium price competition keep prices low, allowing farmers to buy higher coverage. Giving farmers the opportunity to buy higher levels of coverage without significantly increasing their operating cost was one of my goals in creating Crop 1.

The industry's goal – and certainly the explicit intent of Congress in 1994 and 2000 – is to protect farmers from risk, allow them to choose coverage levels appropriate to their individual risk management needs, and, implicitly, to protect American taxpayers from costly disaster programs and insurance company bailouts. As noted in the attached farmer and agent letters, we have proven that PRPs encourage farmers to buy higher levels of coverage.

PRP-enhanced price competition and innovation among companies are key to *maintaining* high farmer participation levels, increasing coverage levels, and to staying in business in an industry during years where there may be no underwriting gain.

It's in the farmer's best economic interest and that of the crop insurance industry to keep competition among remaining crop insurance companies as robust as possible while operating within a budget that does not rely on uncertain underwriting gains. This is what PRP helps ensure. Crop 1's success is tangible evidence of this fact.

Prior to PRP, crop insurance companies didn't compete on premium prices offered to farmers; rather they competed with each other on agent commissions. Companies recruited other firms' agents by offering higher and higher commissions, leading to the departure from the marketplace of companies that could not afford the bidding war. Crop 1 reiterates: PRP allows companies to compete not on which firm can pay the most to an agent, but on price and service to their customers.

Crop 1 embraces universal availability as the foundation of crop insurance protection. However, with PRP, universal availability takes on a new dimension. Even though Crop 1 does not have a large crop insurance book, it has devoted considerable resources to helping its agents inform farmers of the PDP option. This has included sponsoring trade show exhibits, magazine ads,

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[2] Barnett, Barry, Black, Roy, and Skees, Jerry., "Crop Insurance Premium Reduction Plan Issues – 04 – 02," conducted by GlobalAgRisk, Inc. January 7, 2005, Available on the USDA/RMA website at http://www.rma.usda.gov/aboutrma/fcic/2005/224global

radio spots, advertising over satellite news networks, Internet websites, direct mail, and e-mails. Third parties have reviewed Crop1's prospect lists and found them to be "evenly balanced" among market segments. Crop1 has certainly not denied access to eligible farmers, as PRP opponents have suggested.

PRP opponents also argue that a farmer's crop insurance purchasing decision is complicated by factoring in price. Crop 1's experience demonstrates our farmer customers are not daunted by shopping price. Farmers expect to factor price on everything to do with their operation, so they welcome the ability to compare prices among crop insurance providers.

The Occidental/Crop 1 experience shows that given the ability to shop for crop coverage among providers, some offering PRP and others not, farmers seek the best package of coverage for their farming situation. Just as not all agents align with a company providing the highest commission, not all producers sign up with a company offering the lowest premium. There is balance, equilibrium not achievable without enhanced competition.

One of our Iowa customers said it best, "The premium discount enabled us to increase our coverage level with the same premium dollars. *We feel it is very important for the crop insurance structure to be more of a 'free enterprise' and less of a bureaucracy.*" (Emphasis added)

PRP OVERSIGHT WELCOMED

Crop 1 is the best example – because it's the first and only example – of how Congress' foresight in authorizing PRP offers smaller companies a chance to compete effectively with larger firms. A marketplace dominated by a few large companies robs farmers of choices and cost savings. Market domination also limits industry innovation because it removes incentives for change. Managing general agencies and their policy-issuing companies applying for PRP authority are being required to demonstrate that their cost savings are realistic and demonstrable so as to prevent unfair competition based upon pie-in-the-sky cost savings projections. At the same time, RMA should revoke approval of any company offering PRP, which does not meet the federal standards of performance.

CONCLUSION

Occidental and Crop 1 commend Congress for having the foresight to authorize PRP in 1994 and reinforce that effort in 2000; we also applaud USDA for seeking to make permanent the process and criteria by which companies apply for and are approved to offer PRP, as well as providing the oversight critical to PRP's success.

As the only company currently approved by USDA to offer PRP products, we fully understand our PDP program is a case history which can be studied by this committee and others who need to understand how well PRP works in the real world when offered by a company which takes its responsibility to the farmer customer seriously.

PRP is the latest step in the nearly 75-year evolution of the federal crop insurance program. Each time innovation has been proposed for the crop insurance program, there has been

resistance, and ultimately, that resistance has been shown to be unwarranted. Crop 1 is confident history will repeat itself.

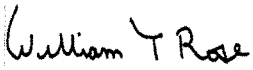
Given an opportunity to grow and expand as more companies enter the marketplace, PRP will become an even more important aspect of farm risk management, if only because PRP enhances competition among crop insurance providers, and inevitably leads to better products and services for the farmer customer.

Crop 1's experience demonstrates over and over again that including price comparison in the crop insurance shopping formula is a welcome improvement for farmers who constantly battle to develop the best possible combination of crop insurance options for their particular farming situation. To paraphrase one of our Iowa customers, shopping for crop insurance needs to be more free enterprise and less bureaucracy.

For the American farmer struggling to attain and maintain least-cost production, Crop 1 and its PDP program represent the first opportunity within the federal crop production program to shop and compare crop insurance coverage by price. This allows Crop 1 to deliver again and again on its business philosophy: We provide farmers the best available crop insurance products and service at the best possible savings.

Mr. Chairman, I thank you and the subcommittee for your attention, and I'd be happy to answer any questions you may have.

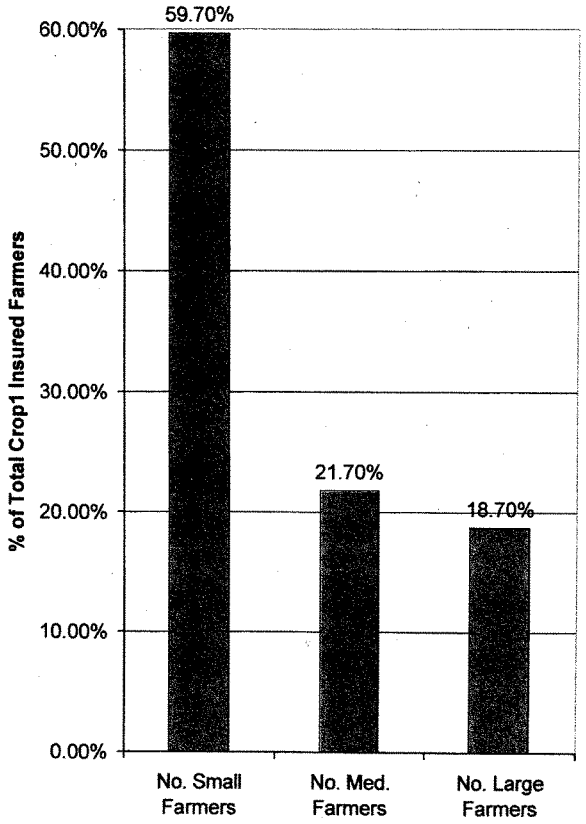
Respectfully submitted,



Billy Rose
President and Chief Executive Officer
Crop 1 Insurance
Urbandale, Iowa

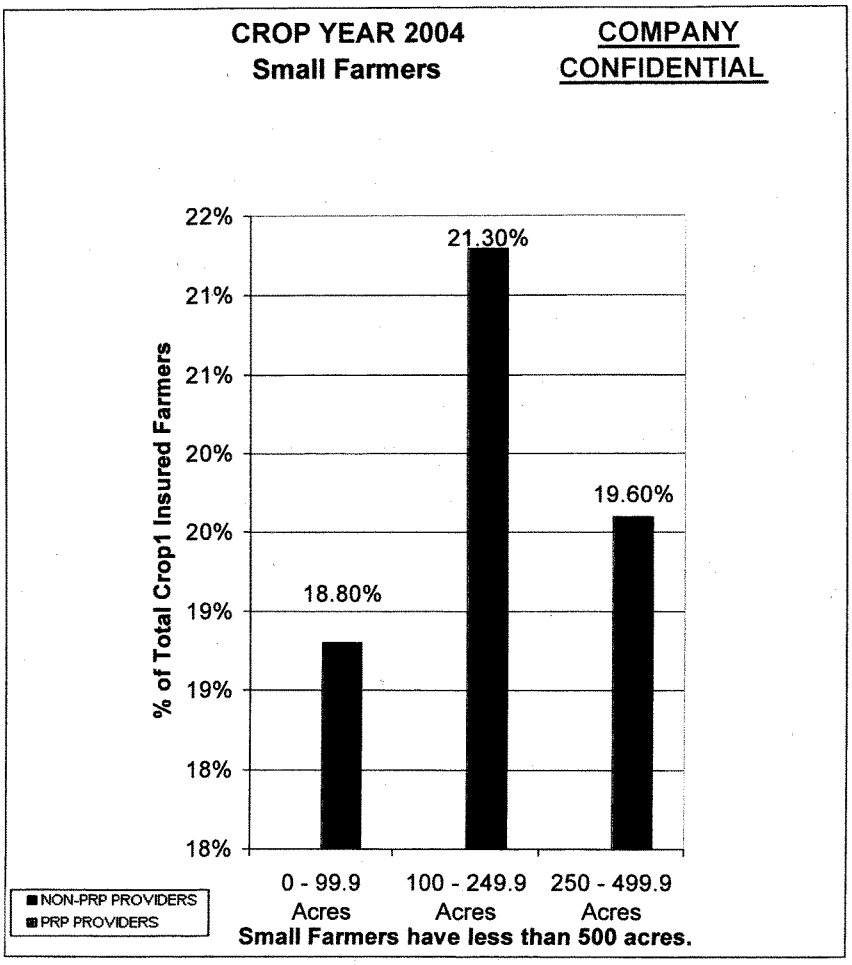
CROP YEAR 2004
Small, Medium, and Large Farmers

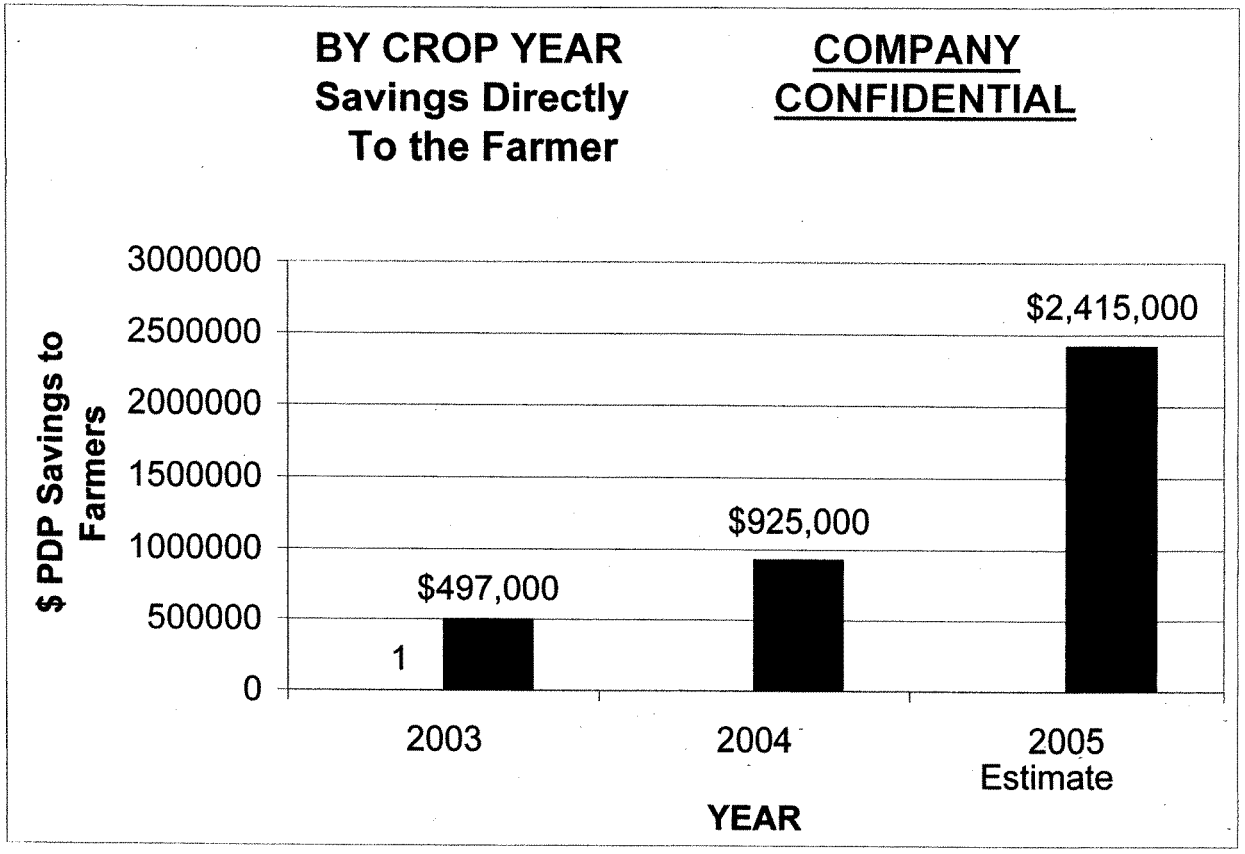
COMPANY CONFIDENTIAL



Small Farmers have less than 500 acres. Medium Farmers have 500 to 999 acres. Large Farmers have over 1,000 acres.

PRP PROVIDERS


CROP YEAR 2004
Small Farmers
COMPANY CONFIDENTIAL
22%
21%
21%
20%
20%
19%
19%
18%
18%
% of Total Crop1 Insured Farmers
18.80%
21.30%
19.60%
0 - 99.9 Acres
100 - 249.9 Acres
250 - 499.9 Acres
Small Farmers have less than 500 acres.
NON-PRP PROVIDERS
PRP PROVIDERS


BY CROP YEAR
Savings Directly
To the Farmer
COMPANY
CONFIDENTIAL
$ PDP Savings to Farmers
3000000
2500000
2000000
1500000
1000000
500000
0
$497,000
$925,000
$2,415,000
1
2003
2004
2005
Estimate
YEAR

Review of Premium Reduction Plan Issues

Conducted by

AgRisk Management, LLC

For the United States Department of Agriculture Federal Crop Insurance Corporation Board of Directors

January 7, 2005

Executive Summary

Premium reduction plans can serve two possible public purposes. First, by further lowering producer crop insurance premiums they should increase use of the crop insurance program as a risk management tool by U.S. farmers. This increased use is consistent with the policy objectives of ARPA. Our estimates of the extent to which use of the crop insurance program will increase if a premium reduction plan which reduces premiums by 3.5% of total premium becomes widely available to corn, soybean, and wheat farmers are as follows:

Estimates of the Change in Acreage from a 3.5% Premium Reduction Plan

	Increase in Insured Acres	Increase in Buyup Acres*	Increase in Acreage Above 65%
Corn	1,595,491	3,518,203	3,617,658
Soybeans	1,717,443	3,406,284	3,390,145
Wheat	793,777	2,507,397	2,212,704
3-crop Total	4,106,712	9,431,885	9,220,506

*Buyup acres are those insured at a 65% or greater coverage level.

Of course, the change in acreage will have increase taxpayer costs of the crop insurance program. We estimate the following taxpayer cost increases:

Changes in Total Premium, A&O Reimbursement, and Underwriting Gains

	Change in Total Gains	Change in A&O Reimbursement	Change in Underwriting Gains
Corn	$88,310,597	$19,428,331	$8,831,060
Soybean	$65,190,814	$14,341,979	$6,519,081
Wheat	$27,668,572	$6,087,086	$2,766,857
3-Crop Total	$181,169,983	$39,857,396	$18,116,998

From these estimates we conclude that widespread use of premium reduction plans will reinforce the goals of ARPA, namely to increase use of the crop insurance program by U.S. farmers.

The second policy objective that premium reduction plans can meet is to determine whether significant reductions in A&O can be obtained without significantly impacting the ability of U.S. farmers to access the crop insurance program. Lower A&O reimbursements could result in taxpayer savings if the premium reduction plans were eventually rescinded.

Widespread use of premium reduction plans would have a far reaching impact on the distribution of benefits from the crop insurance program. Under current incentives, crop insurance agents and farmers are the two groups that benefit from the program.

Because AIPs actively compete for agents' books of business, any excess profits they may accrue are effectively competed away. Agents earn excess profits under the current structure because agents cannot compete on price. Premium reduction plans will increase competition between agents because they will be able to compete for farmers' business by the ability to offer a lower price for crop insurance. This competition will reduce and then eliminate agents' excess profits, if RMA flexibly administers and approves premium reduction plans. This reduction in agent profits would mean that farmers would really be the only group that would benefit from the crop insurance program.

The transition from the current system to one where agents' excess profits are eliminated would follow the same steps that other industries went through when faced with increased competition. First, agents will attempt to forestall competition through political pressure or other means. Thus, agents will raise all sorts of issues about how premium reduction plans are not good for the industry. For example, concerns raised about small, minority and limited resource farmers can be viewed as an attempt by those with a vested interest in the current system to derail competition. Although there might well be a small negative impact of premium reduction plans on this group of farmers, the current system has such a large negative impact on this group, that it should be corrected first if this is really a concern. Second would be consolidation of agencies and a large reduction in the number of agents who sell crop insurance. This consolidation will increase the average level of knowledge and education of crop insurance agents. Farmers will have, on average, access to better advice and analysis of their crop insurance options. But this consolidation will also likely reduce the amount of personal time farmers spend with their agents. The agent force will have a higher opportunity cost of time and they will be more professional. Third, the bundle of services that agents provide will change. Agents will provide only those services that farmers truly value because only those agents that provide high value service at the lowest costs will be the only ones to survive the increase in competition. Agencies and AIPs that are not nimble in their response to this increased competition will go out of business.

RMA should refocus its application and approval process for premium reduction plans on the most important cost that AIPs face: namely agent commissions. The focus on efficiencies needed to be obtained from fixed costs are misplaced. If RMA wants to facilitate competition then it should allow AIPs to flexibly obtain cost reductions by plans that reduce agent commissions. AIPs already have a strong incentive to reduce other costs through the adoption of new information technologies. Their number one driver of costs is the competitive need to outcompete other AIPs for agents' books of business. And, of course, the only mechanism they have for this competition is agent commissions.

We recommend that if the Board wants to use premium reduction plans to further the goals of ARPA or if it wants to increase competition between agents and restructure the way that crop insurance is delivered to farmers, then RMA should be instructed to adopt a flexible application and approval process that focuses on agent commissions as the number one source of costs efficiencies needed to justify lower producer premiums. Furthermore, RMA should expect AIPs to apply for selective plans. Variability in plans reflects the desire for agents and AIPs to minimize the short-run impacts of competition and it reflects the underlying variability in competitive pressures. RMA should approve selective plans to the extent that they reflect true variations in profitability.

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Babcock, B. A., C. E. Hart, and D. J. Hayes. "Actuarial Fairness of Crop Insurance Rates with Constant Rate Relativities." *American Journal of Agricultural Economics* 86(2004):563-575.

Coble, H., B. Goodwin, A Ker, and T. Knight. "Rate Review Analysis: Report for External Review." Prepared for the Board of Directors of the Federal Crop Insurance Corporation, December 15, 2002.

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Full Text of the Report is available on the RMA web at:
http://www.rma.usda.gov/aboutrma/fcic/2005/224agrisk.pdf

CROP INSURANCE PREMIUM REDUCTION PLAN ISSUES-04-02

BPA #45-RMA1-5-0021 Work Order #RMA-05-0002

January 7, 2005

GlobalAgRisk, Inc. 1008 S. Broadway Lexington, KY 40504

CROP INSURANCE PREMIUM REDUCTION PLAN ISSUES-04-02

BPA #45-RMA1-5-0021
Work Order #RMA-05-0002

January 7, 2005[1]

GlobalAgRisk, Inc.

1008 S. Broadway Lexington, KY 40504

[1]This report was prepared by Drs. Barry Barnett, Roy Black, and Jerry Skees, with assistance from Anne Goes of GlobalAgRisk, Inc., and Celeste Sullivan, editor. Barnett, Black, and Sullivan are subcontractors for GlobalAgRisk, Inc.

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DISCLOSURE: **[Redacted Confidential Business Information]**

Executive Summary

This review investigates the core economic incentives that would cause the approved insurance providers (AIPs) to recommend differential premium reduction plans (PRPs) by state. We believe it is critical for the Board to understand these issues as they consider the appropriate role for the Board and the RMA in reviewing these and future PRP submissions.

We make the case that administrative and operating (A&O) costs per policy are likely relatively constant over time. However, A&O expense reimbursements per policy have increased significantly over the past several years. A&O expense reimbursements are a direct function of gross premiums. Gross premiums per policy have increased significantly in the past several years. Increased premium subsidies have resulted in farmers purchasing policies with higher coverage levels and a greater percentage of revenue insurance policies. In 1999, only about 40 percent of gross premium was written at coverage levels higher than 65 percent. By 2004, approximately 70 percent of gross premium was written at coverage levels higher than 65%. Further, in 1999 revenue insurance products comprised only 37 percent of gross premium. By 2004, revenue products exceeded 70 percent of gross premium. In 1999, gross premium per policy was about $2000. By 2003, the value was over $3000.

We asked just how high PRPs could go, on average, so that the A&O expense reimbursement (net of the PRP) per policy would be the same for the 2003 book of business as it was for the 1999 book of business – which was the highest year up to that point. Our analysis suggests that the AIPs could implement a flat 3.5 percent PRP for all policies and all states and still obtain the same net A&O reimbursement per policy in 2003 as they did in 1999. This analysis carefully incorporates the rules for A&O expense reimbursement that are in the new SRA. The simulations performed use the summary of business data from the RMA homepage. It is important to note that the 3.5 percent is an average value. While significant differences exist by state, coverage level, or plan of insurance, those differences were not addressed in our analysis.

Next, we examine the linkages between underwriting gains and the competitive structure for acquiring access to sales agents. Since AIPs can obtain higher underwriting gains in certain core states, it is economically rational to expect that agents in those states will be paid higher base commission rates. Using data supplied in these submissions and data on the average premiums retained by AIPs by state, we show that the correlation between base commissions paid to agents and percent of gross premiums retained by AIPs is nearly 80 percent. These PRP submissions request differential PRPs by state that are consistent with AIP premium retention. This strongly suggests that as expected underwriting gains increase, the requested PRPs also increase.

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COMMENTS OF CROP ONE INSURANCE DIRECT, INC. ("CROP1")
ON PROPOSED RULE FOR PREMIUM REDUCTION PLANS
(7 CFR PART 400)

Introductory Comment by Crop1

Crop 1 Insurance Direct, Inc. ("Crop1") applauds the RMA for proposing the adoption of regulations (the "Proposed Rule") governing premium reduction plans ("PRPs"), implementing §508(e)(3) of the Federal Crop Insurance Act. The Proposed Rule is timely, and much needed to enhance competition in the crop insurance market.

Crop1 believes that the fundamental purpose of §508(e)(3) was to offer producers more choices while saving money on crop insurance, by increasing competition in the crop insurance market through offering crop insurance providers the opportunity to compete on price. In 1985, shortly after the program was privatized, over 50 insurance providers participated in the crop insurance market. By the time Crop1 introduced the first RMA-approved PRP in January 2003, there were barely a dozen approved insurance providers and the largest companies controlled an increasing share of the market. Before Crop1 introduced its PRP, providers were competing, not on price to the producer, but primarily by recruiting other companies' agents through offering higher and higher commissions, leading to the departure from the market of companies that could not compete on this basis. The introduction of PRPs into the market allows insurance providers to compete on price and service to producers, rather than simply on who pays the highest commissions. The Proposed Rule promotes the interests of the American producer by institutionalizing the PRP approval process into a permanent rule that will enable insurance providers to pass along cost savings to producers.

The RMA has appropriately left agent commissions to be set by the market and Crop1 does not support a cap on commissions. In a free market, Crop1 believes that, agents should be free to "shop" among multiple insurance providers to obtain the best commission available to them. However, the American producer should have the right to shop for crop coverage amongst many providers, large and small - some offering PRPs, some not - to secure the most desirable program for the producer's operation at the lowest possible cost. Not all agents will align with the company offering the greatest commission, and not all producers will align with the company offering the lowest premium. There will be a balance. Without competition, market forces cannot cause such balance or market equilibrium to occur.

We also applaud the RMA for recognizing the importance of allowing smaller companies the opportunity to offer PRPs and compete more effectively with larger companies. As indicated above, the market prior to PRPs was dominated by a few large companies, which is bad for producers as their choices and their opportunity for cost savings brought about by innovation and competition are limited. Of course, it is important that the RMA impose appropriate controls to allow only economically viable companies to participate in the program. The Proposed Rule strikes the right balance between allowing new entrants into the crop insurance marketplace, but with adequate controls to ensure that producers are protected.

The Proposed Rule also imposes appropriate review criteria for PRPs that should ensure the PRPs are based on cost savings that are realistic and demonstrable and to prevent unfair competition based on unrealistic and unattainable cost savings. It also imposes appropriate controls to prevent "cherry-picking" by insurance providers through PRPs; that is, targeting PRPs to apply only to particular geographic areas, crops, groups, or individual producers with lower risk of loss. Crop1 strongly supports the Proposed Rule's requirement that PRPs must be provided to all producers in all states in which the provider does business and be applicable to all crops. Crop1 also supports the emphasis in the Proposed Rule on marketing efforts to small and limited resource, women and minority producers.

The specific comments below are presented in the order contained in the Federal Register publication, and relate to the Proposed Rule itself, as well as the background information that precedes it. As to matters not specifically addressed in the comments below, Crop1 either has no position or is supportive but has no information to provide beyond that contained in the Proposed Rule or the background to the Proposed Rule.

CROP1 COMMENTS ON "INDEPENDENT REVIEW" (p. 9001)

Overall, Crop1 agrees with the Independent Reviewers' expectation that PRPs are likely to result in "a modest increase in participation ... although increases in coverage levels are more likely." However, should proposals in the President's Budget and by some in the Congress for cuts in federal subsidies of the cost of insurance become law, PRPs will allow producers to mitigate increases in the cost of crop insurance and perhaps allow them to maintain their same level of coverage, notwithstanding those increases.

CROP1 COMMENTS ON "BACKGROUND" (pp. 9003-9010)

Implementation of Section 508(e)(3) and Guiding Principles (p. 9005)

Crop1 applauds the RMA for implementing §508(e)(3) through the promulgation of permanent regulations and promoting the interests of the American producer by institutionalizing the PRP approval process that will enable insurance providers to pass along cost savings to producers.

We agree with all four principles listed in the Background section that underlie the Proposed Rule. We note that the first principle (requiring documentation to demonstrate ability to operate within expense reimbursement and to reduce costs below the expense reimbursement received from RMA) and the second principle (requiring that claimed efficiencies be easily verifiable by RMA) are related. Section 508(e)(3) requires premium reductions to be based on real efficiencies that reduce a provider's costs below the RMA's expense reimbursement and that can be passed through to producers. It is both appropriate and necessary that such efficiencies be objectively documented and verifiable by the RMA. Allowing price reductions that cannot be documented or that exceed objectively demonstrable efficiencies likely will invite unfair competition by providers seeking to undercut their competition with discounts that cannot be matched through savings. This abuse could threaten the provider's solvency and also give rise to

market disruption by directing producers away from the more reputable providers. Having an existing, approved PRP, Crop1 knows that it is possible to satisfy these requirements.

Crop1 believes that approved insurance providers who apply and receive approval to offer a PRP should be required to offer the savings to all their producer customers, and that in advance of making the offering, the insurance provider should be required to prove within their marketing plan how they expect to reach these producers. Thus, Crop1 is supportive of the fourth principle, non-discrimination, and each of the four mechanisms listed (at p. 9005) in which the Proposed Rule would address unfair discrimination: (1) requiring PRPs to be provided to all producers insured by the provider, (2) requiring the submission of marketing plans to show how the provider will reach small and limited resource, women and minority producers; (3) denying approval of PRPs not supported by an adequate marketing plan, and (4) allowing for the withdrawal of approval of a PRP for failure to implement the approved marketing plan. We believe that each of these tools is important to ensure that all producers have equal access to cost savings offered by PRPs.

Alternative Program Structure (pp. 9005-9006)

The alternative program structure under consideration which proposes to share cost savings by insurance providers with producers after the fact is plainly inferior to a plan that provides premium savings up-front and could harm producers. The farming business is fraught with enough uncertainty without asking producers to bear the additional risk associated with an uncertain premium discount. Crop1 believes that, ideally, producers should know with certainty, before they decide among competing insurance providers, the cost of each choice so they can make an informed decision and engage in informed business planning.

Further, insurance providers are in the business of managing risk, and are therefore best positioned to manage uncertainty by providing the producer with a certain premium discount at the outset. Using appropriate business tools, insurance providers can accurately forecast (and demonstrate to the RMA) the amount of savings necessary to offer a PRP, and should be required to pass those savings - up-front – on to producers.

The RMA has stated (at p. 9005) that the providers would not be able to "advertise or otherwise represent the amount of the premium reimbursement in advance of the sale...." The RMA has also stated (at p. 9006) that the insurance providers would not be able to market the plan "based on a guaranteed amount of premium reimbursement." It is unclear whether the RMA is contemplating a prohibition against *any* marketing, even of potential savings, or only guaranteed savings. If providers are allowed to market potential savings, it could allow or even encourage providers to make unrealistic or exaggerated projections about their anticipated savings in order to attract or keep their customers in a price competitive market. Not only will this cause competitive injury to providers attempting to compete fairly based on real cost savings and reasonable projections of such savings, but it will inevitably harm producers who are lured by the potential of large cost savings that prove to be illusory in the end. Further, even if the RMA's intent is to prohibit marketing of even potential savings, we question how such a prohibition could be enforced and whether the RMA has or is willing to commit the kind of resources

necessary to enforce this market conduct requirement. In the absence of strict enforcement, we believe that unscrupulous providers will inevitably boast exaggerated, illusory savings in order to attract market share.

To allow providers under the alternative approach to refer to historical reimbursements in their marketing is also problematic. Historical reimbursement levels are not necessarily a strong indication of what a producer will receive in the form of a discount in the upcoming year. Market conditions change from year to year, and a provider that achieves savings in one year might not achieve them in the next year. It would also allow a provider who achieves savings one year to market based on those savings the following year, even though it has no intention of implementing the necessary measures to achieve them in that year. Capping the provider for the following year or perhaps even the next three years as a penalty would help to discourage this practice, but it would not necessarily remedy in the meantime the harm caused to reputable competitors.

In response to the RMA's specific question as to provider workload, based on its experience, Crop1 believes that the workload to demonstrate savings up front is not materially greater than the workload to demonstrate savings after the fact. In this regard, we note that a core benefit to the current structure is that it requires participating insurance providers to focus on administrative costs up front, to demonstrate savings that can be achieved, and to impose the necessary mechanisms to achieve them. The alternative structure eliminates this incentive and discourages providers from identifying, designing and implementing necessary cost-saving mechanisms and practices before the savings can be realized.

Under the current structure, another core benefit to producers is that competing insurance providers will market their various programs with specific discount information, thereby permitting producers to make informed insurance purchasing decisions. The alternative approach eliminates this benefit. Deprived of knowing with certainty what their final premium cost will be up front, any benefit to producers under the alternative approach is a matter of pure chance.

Finally, we request that if the RMA decides to move forward with an alternative structure, that it do so by publishing its specific terms and conditions as a proposed rule so that Crop1, other insurance providers and members of the public will have the opportunity to review and provide comments on it.

Fundamental Program Change (pp. 9006-9007)

Crop1 supports the requirement that approved insurance providers must offer the PRP in all states where the insurance provider does business, and for all applicable crops, policies and plans of insurance, and that there may be no variation in the amount of the premium reduction based on the percentage of the net book premium.

We agree that variability of discounts among states, crops, and insurance plans and policies requires complex accounting decisions. The "all states/all crops/all insurance plans and policies

requirement" also makes it easier for our customers, and eases the accounting and other necessary tracking of our business systems. This allows RMA to verify savings, and allows producers to make informed business decisions without having to evaluate different pricing structures offered by multiple providers based on numerous factors.

This requirement also prevents "cherry picking" by providers of more profitable producers. Congress intended that all producers – large, small, under-served or minority, and whatever the crop – be served. The "all states/all crops/all insurance policies and plans" requirement is in keeping with the intent of Congress.

a. Competitive Harm (p. 9006)

Preceding the Crop1 PRP application approval, insurance providers had not competed on price and had no incentive to do so. We believe price competition is good for the American producer and the crop insurance delivery system. We also agree with the RMA's concern that allowing "targeted" premium reductions to meet specific market conditions would create the opportunity for unfair competition among providers. Care must be taken to assure stability in the private provider system. To suddenly allow a myriad of state-by-state choices could foster an unstable situation. We believe that the Proposed Rule and its "all states/all crops/all insurance policies and plans" requirement minimizes the risk of unfair competitive disadvantage among PRPs.

Crop1 also agrees with the RMA's position that varying levels of agent compensation from state to state should not be allowed to justify a difference in premium reduction from state to state, although Crop1 acknowledges that market forces cause insurance providers typically to pay different rates of agent compensation around the country.

As noted by the RMA, agent compensation is a large component of the expenses that are incurred in the delivery of crop insurance (currently seventy percent), and thus its reduction is a common, if not universal, component of PRPs. Over the more than two decades since the crop insurance delivery system was privatized, insurance providers, absent a PRP program, have competed by recruiting other companies' agents through offering higher and higher commissions. It is notable that agent commissions in 1981 when the delivery system was first privatized were in the 10-14% bracket. In recent years, some large agencies have enjoyed commissions of nearly twice the original amount when considering "transfer bonus" payments and other incentives offered in the agent recruiting process. This has contributed to the significant reduction in the number of providers in the program to the detriment of producers. The number of crop insurance providers has long been shrinking, from over 50 in 1985 after the program delivery system was originally privatized in 1981, to barely a dozen at the time Crop1 entered the market in January 2003.

Crop1 believes that, just as agents should be free to "shop" among multiple insurance providers to obtain the best commission available to them in the market, the American producer should have the right to shop for crop coverage among agents for multiple providers to secure the most desirable program for the producer's operation. Some producers will seek the lowest premium cost available, while others may decide that other factors outweigh the premium savings

available through a PRP. Quite simply, we strongly believe that just as agents are free to find the provider that will enable them to maximize their income, American producers should have a similar option enabling them to maximize profit by reducing their premium cost.

We further emphasize that such choice for the American producer can strengthen the crop insurance delivery system. It should be noted that recently, when a large crop insurance company collapsed, auditors discovered that its demise was not due to losses in its book of business, but rather to a high cost structure driven largely by relatively high agent commissions. Thus, without a strong PRP program, the crop insurance industry will simply fall back to the cycle of increasing commissions to gain new business that in the long-run endangers the delivery system.

b. Verification by RMA (pp. 9006-9007)

Crop1 agrees that allowing PRPs to vary premium reductions by state would greatly complicate the provider's administration of the PRP and the RMA's verification of the provider's efficiencies and reductions. It would require the application of unduly complex cost accounting rules by both the provider and the RMA. Additionally, it would be even more complicated, if not impossible, for providers who use captive agents to allocate costs across states, so such providers would be competitively disadvantaged when compared with independent agency providers who could vary price reductions by state and thereby target favorable market conditions and favored crops and producers, to the detriment of the crop insurance marketplace.

c. Uniform Service and Unintended Effects (p. 9007)

Crop1 agrees that state variability could adversely affect the level of service to some producers, which is directly contrary to the fundamental requirement of the crop insurance program that all producers are entitled to the same level of service, regardless of their size or loss history. In addition, it would require additional, more complicated bookkeeping not only for the RMA, but also for the provider and insurance agent. It would also disadvantage captive agent companies, for whom such bookkeeping would be even more burdensome and complex.

Timing of Submissions (p. 9007)

We concur that that "15 day" window for submission of revised plans is appropriate for this year only, since the finalization of the Proposed Rule will leave a very tight time frame. However, we believe that May 1 would be a more appropriate deadline for subsequent applications; an April 1 deadline for submissions comes too closely after the Spring crops sales closing deadline.

Confidentiality Requirements (p. 9008)

Crop1 agrees that it is absolutely necessary that all trade secrets and confidential commercial or financial information in submissions remain completely confidential.

CROP1 COMMENTS ON PROPOSED RULE

400.701 Definitions

> *"Efficiency. '... Only a portion of the approved insurance provider's monetary savings can come from a reduction in compensation, the rest must come from changes in administrative and operating procedures. ... Cost savings attributed to projected increased sales due to the offering of a premium reduction plan of insurance are not considered efficiency, nor are proposed reductions in loss adjustment expenses, unless such reductions in loss adjustment expense are a result of implementing loss adjustment procedures authorized by RMA. ...'"*

Crop1 Comment: We support the complete definition of "Efficiency" and feel that the RMA's effort not to place specific limits on compensation is appropriate. A provider's overall cost of operation is what is most important and we believe the free market will ultimately determine the appropriate balance between agent compensation levels and service provided. We believe agents should have the option to seek the most attractive compensation available in a competitive market, just as producers should be able to seek the most attractive crop insurance program available to them. The most attractive program for agents and producers will likely require them to consider both associated costs and the level of service provided.

Crop1 also expresses support for the qualification in the second sentence quoted above, without which the playing field would be tilted in favor of large insurance providers over smaller providers. We are strong believers in free market competition, which requires a fair, level playing field in which small and large providers alike may compete for the benefit of producers.

> *"Profit sharing arrangements. 'An arrangement to make a payment based on whether the approved insurance provider receives an underwriting gain on the total book of business ....'"*

Crop1 Comment: We support the definition as a whole, but point out specifically that "... gain on the total book...." (emphasis added) is important because the alternative would allow an approved insurance provider to divide its book for purposes of creating incentives and disincentives for agents. Since the law requires equal service to all producers, Crop1 views the division of books of business to create such incentives/disincentives and any resulting market segmentation as likely to result in providers and/or their agents avoiding their legal obligation to serve all producers on an equal basis.

Further, we suggest that the amount of any profit sharing payment under a PRP should be subject to the same limit as the PRP reduction. For example, if the maximum premium reduction is 4% under a PRP, Crop 1 recommends that this be the maximum profit sharing payment allowed in the year covered by the PRP. In addition, to enhance the stability of the crop insurance program, we believe that providers should not be allowed to pay a "profit sharing bonus" if they have not

generated an average underwriting gain of at least 15% of gross premium over the preceding two years.

> *"Unfair Discrimination. 'A premium reduction plan will be considered unfairly discriminatory to a producer if .... is based on the loss history of the producer, the amount of premium earned under the policy, or precludes in any manner producers in an approved State from participating in the program.'"*

Crop1 Comment: We applaud this definition because it ensures that crop insurance providers and their agents serve all producers.

Crop1 Comment: **Request for Additional Definition** -- We request a clear definition for "Producer." We recommend that "producer" be defined as a "crop insurance policy holder."

400.714 Revised Plans of Operations for premium reduction plans.

(a) For the 2006 reinsurance year, revised Plans of Operations must be received by RMA not later than [date 15 days after the date of publication of the final rule].

Crop1 Comment: This "15 day" requirement is an extraordinarily tight deadline, but we support the requirement because we recognize that the crop season deadline is coming up very fast and thus the tight deadline is necessary.

(b) For all subsequent reinsurance years, revised Plans of Operations must be received by RMA not later than April 1 before the reinsurance year, or the date RMA otherwise determines the Plan of Operations is due.

Crop1 Comment: Although we support the tight "15 day" deadline in Part (a) above, we are concerned about an April 1 deadline for future years. Since April 1 is only 15 days after the Sales Closing Date, and there is also an approved waiting period in which the agent can complete record keeping, we believe a later date is more appropriate. Recognizing that the RMA needs the opportunity to spread its work load evenly, we recommend May 1.

(c) Any revised Plans of Operations that is not timely submitted will not be considered by RMA and any other revised Plans of Operations submitted by the approved insurance provider during the reinsurance year will not be considered until the next reinsurance year.

Crop1 Comment: We support this provision because we are committed to a level playing field in which producers have the opportunity to make insurance choices having full access to the information they need to make informed business decisions. In order to allow producers this opportunity, PRPs must be submitted by all providers and approved by the RMA in a timely and consistent fashion.

(d) A revised Plan of Operations may be withdrawn no later than 15 days after .... If a revised Plan of Operations has not been timely withdrawn, the approved insurance provider will be required to implement an approved premium reduction plan.

Crop1 Comment: We agree. Since the law clearly requires that providers who make savings must pass them on to producers, there would be no valid reason to withdraw a PRP once savings are proven since they must be passed on to the producers. This provision benefits producers, as well as the FCIC Program as a whole, because it provides strong protections to producers.

(e) Any confidential commercial or financial information submitted with a revised Plan of Operations will be protected .... In accordance with, 5 U.S.C. 552 (b) (4).

Crop1 Comment: The submissions to the RMA that are required in order to obtain approval of a PRP include a significant amount of confidential commercial and other information that, if disclosed, could cause significant competitive harm to the provider. Thus, insurance providers will not participate in the PRP program if confidential information in their submissions is open to public disclosure, defeating the purpose of the Proposed Rule.

We note, however, that 5 U.S.C. §554(b)(4) protects "trade secrets" as well as commercial or financial information. Accordingly, Crop1 suggests adding the following language to this subsection in order to track 5 U.S.C. §552(b)(4): "Any trade secrets and commercial or financial information submitted with a revised Plan of Operations will be protected ...."

400.715 Limitations and prohibitions.

(a) For the first two reinsurance years after [effective date of the final rule], the premium reduction plan may not offer a premium reduction based on an efficiency less than 1.0 percent nor greater than 4.0 percent of the net book premium. For subsequent reinsurance years, RMA will announce the minimum and maximum limitation on the premium reduction, if applicable. Premium reductions must be offered in .5 percent increments.

Crop1 Comment: Crop1 supports the imposition of a cap. Crop1 believes it provides a benefit to producers by acting as a stabilizer to the marketplace and making sure that providers who seek approval of a PRP do so with due care and submit only accurate information. However, we urge the RMA to raise the cap to 5.0%. It will continue to benefit producers while maintaining stability in the market if the RMA allows this additional amount of flexibility for providers to identify and pass through cost savings to producers, and for the RMA to approve them if they are adequately documented.

(b) If a premium reduction plan is offered it must be offered in all states where the approved providers doing business and for all crops, coverage levels, policies.

(c) The amount of the premium reduction offered based on the percentage of the net book premium may not vary between states, crops, coverage levels, policies or plans of insurance, or on any other basis (For example, if the approved insurance provider can reduce costs by 2.5 percent, such reduction must be provided to all policyholders in all states where the approved insurance provider is doing business).

Crop1 Comment: As discussed above, Crop1 generally supports both provisions (b) and (c) because they are consistent with Congressional intent that all producers be served equally – all crops, all regions, all states, all policies and coverage levels – prohibiting what is informally called "cherry picking," (*i.e.,* agents and/or insurance providers individually selecting their customers so that they serve only the larger ones, or only the ones who are predicted to be least likely to have losses). Crop1 views this provision as very specific necessary protection to producers across the nation.

However, Crop1 recommends that providers have the option not to offer a premium reduction on CAT policies as producers do not pay a premium (only an administrative fee) for CAT policies. Further, we would recommend the clause "or any other basis" be eliminated and replaced with "or any basis which could limit or restrict access to a premium reduction, in whole or in part, to some producers." As long as cost savings programs are fair and equally available to all producers, they should be presented to and considered by the RMA.

400.16 Contents of the revised Plans of Operations for a premium reduction plan.

(h) Based on the applicable Expense Exhibits, a statement that summarizes the A&O costs before implementation of the efficiency, the cost savings associated with the efficiency, the A&O costs after implementation of the efficiency (which includes the budgeted cost of all reports and certifications required in §§400.714-720), the expected A&O subsidy, and the projected total dollar amount of premium reduction to be provided to producers (This statement must demonstrate that after the implementation of the premium reduction plan, the approved insurance provider's A&O costs, including the budgeted cost of all such reports and certifications, plus the amount of any premium reductions will not be greater than the provider's A&O subsidy.

Crop1 Comment. To ensure that efficiencies are evaluated accurately, Crop1 urges that any efficiencies related to agent compensation be evaluated on the basis of information that must be reported to the IRS and counted on 1099 tax forms. Crop1 also notes there is a conflict here in terms of reporting – annual basis vs. crop year basis -- for bonuses which could be paid to agents after the crop season is over and after providers have accurately determined the amount of realized profits, if any.

(i) A financial reserve plan that:

(1) Is triggered immediately upon discovery by the approved insurance provider or RMA that the total dollar amount of the actual efficiency is not sufficient to cover the total dollar amount of the premium reduction provided to producers;

(2) Consists of actions to be taken by the approved insurance provider that would produce cost savings or income that is at least 25 percent of the projected total dollar of premium reduction to be provided to producers immediately upon discovery under paragraph (i)(1) of this section.

Crop1 Comment: Crop1 supports this provision, but suggests that it be clarified to recognize that additional "income" may come from contracts or third party agreements executed by the approved provider that are designed to provide a reserve for such a contingency.

400.719 Standards for Approval

(a) RMA may approve the revised Plan of Operations if, in the sole determination of RMA, the revised Plan of Operations demonstrates that the following criteria are met:

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(9) The marketing plan must be reasonable and effectively reach small producers, limited resources producers as defined in section 1 of the Basic Provisions, 7 CFR 457.8, women and minority producers.

Crop1 Comment: We very much support the need to actively market to small, limited resources, women and minority producers, as defined above. However, we are concerned that as the size of acreage declines, so do the savings; thus, Crop1 respectfully suggests that the standard should focus only on whether the plan is reasonable in its approach and not on the marketing "effectiveness" of the plan's reach. In cases where it appears that the plan's reach isn't working effectively, the RMA will work with the provider to strengthen the plan.

400.720 Terms and conditions for approved premium reduction plans.

The following terms and conditions apply to all approved insurance providers whose revised Plans of Operations are approved:

(a) Approved revised Plans of Operations for premium reduction will only be effective for one reinsurance year.

Crop1 Comment: For good business planning purposes as well as maximizing stability in the crop insurance marketplace, we strongly urge that approvals continue beyond one year. As long as the rules are met, providers should not have to reapply for annual approval of the PRPs.

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(e) All producers insured by the approved insurance provider will automatically receive the premium reduction contained in the approved premium reduction plan.

Crop1 Comment: We support this provision because we believe that providers who offer PRPs must be required to serve all producers/all crops in the states in which they are licensed. This prevents "cherry-picking" and thus furthers Congressional intent. However, we strongly

feel that this sentence should include the word, "applicable" following the words "receive the" in the preceding sentence. As previously noted, for CAT policies, no premium reduction would be applicable as the producer pays no premium.

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(g) The approved insurance provider must provide semi-annual reports, or more frequently as determined by RMA, that permit RMA to accurately evaluate the effectiveness of the premium reduction plan, in the manner specified by RMA. At a minimum, each report must contain: ……..

(3) The number of small producers, limited resources producers as defined in section 1 of the Basic Provisions, 7 CFR 457.8, women and minority producers making application as result of the implementation of the marketing plan;

Crop1 Comments: Crop1 agrees that it is very important that premium reductions are offered to all producers. The required reporting, however, should not be of the numbers of small, limited resources, women and minority producers that have made applications. In some regions of the country, it is likely there will be very few, if any, small/limited resources/women/minority producers. It is also likely for newer crop insurance providers that their sales to such groups may not be statistically valid as they enter new states. Thus, we recommend that each insurance provider offering a PRP only be required to report, and judged on, their outreach efforts as a whole in all states in which they are licensed.

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(h) If at any time RMA discovers that the cost reduction or efficiencies contained in the premium reduction plan are not attained, are not sufficient to cover the dollar amount of premium reduction, or that the reduction in premium is not corresponding to the efficiency, RMA will require that the amount of efficiency used to determine the premium reduction for the next applicable reinsurance year be limited to the actual cost savings obtained for the reinsurance year, excluding any financial reserve plan measures that may been used to make up for the effects of the deficiency.

Crop1 Comment: We support this provision on the basis that an "overstated" premium reduction is unfair to producers. Any company applying for approval to offer a PRP should be required to accurately document their savings, allowing for the "financial reserve plan" as a back-up. Overall, we see this as protection to producers, since approved providers might be tempted to use a PRP as a loss-leader to enter new markets if the savings are not substantiated and if they are not penalized for failing to achieve the savings they represented to the RMA would be made.

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(i) RMA will closely monitor the approved insurance provider's efforts to market the premium reduction plan to small producers, limited resources producers as defined in section 1 of the Basic Provisions, 7 CFR 457.8, women and minority producers to ensure that no unfair discrimination takes place and if it is discovered, RMA may withdraw

approval for the premium reduction plan, in accordance with paragraph (n) of this section.

Crop1 Comment: The Congress and RMA has been very clear that no "cherry-picking" is allowed in the delivery of the FCIC program. Exceptions for PRPs should not be made. Crop1 specifically supports this provision on the basis that a PRP is and should be good for all producers.

(j) The approved insurance provider is solely liable for all damages caused by any mistakes, errors, misrepresentations, or flaws in the premium reduction plan or its implementation.

Crop1 Comment: Crop1 agrees that the FCIC and RMA should not have any liability for damages arising from these matters, but is concerned that this provision attempts to re-allocate liability for damages among private parties, which should be left to state law. For example, in the implementation of an approved PRP, an agent could make errors or misrepresentations for which the agent bears some or all of the liability to third parties injured thereby under applicable state law. Moreover, this provision could be interpreted to create a new, federal cause of action for these matters, which Crop1 does not believe is or should be the RMA's intent. Crop1 believes that state law should govern both the existence of a cause of action for these matters, as well as the allocation of liability among private third parties. Accordingly, Crop1 proposes the following change: "~~The approved insurance provider is solely~~ In no event shall the RMA, the FCIC or any other agency of the United States Government be liable for ~~all~~ any damages caused by any mistakes, errors, misrepresentations, or flaws in the premium reduction plan or its implementation."

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(m) At its sole discretion and upon written notice, RMA may withdraw or modify its approval of any premium reduction plan if RMA determines that:

(1) The approved premium reduction plan, or its implementation, no longer satisfied all the terms and conditions in 7 CFR 400.714-720;

(2) There have been instances of unfair discrimination;

(3) The stated efficiencies have not been realized or the approved insurance premium reduction is not provided to all existing policyholders and producers as required by subsection (e); or

(4) The integrity of the crop insurance program is jeopardized in any way, as determined by RMA, by the premium reduction plan.

(n) If any condition in paragraph (m) of this section exists, RMA will notify the approved provider in writing:

(1) That approval has been withdrawn or a modification to the premium reduction plan is required;

(2) The date such withdrawal is effective or modification must be made;

(3) If modified, such modification must be approved by RMA before implementation;

(4) The basis for such withdrawal or modification; and

(5) If approval is withdrawn, the approved insurance provider must cease offering the associated premium reduction effective for the next sales closing date.

Crop1 Comment: Crop1 agrees that the RMA should be able to withdraw approval or require modification of a PRP if any of the criteria in (m) exists. Crop 1 believes, however, that before it withdraws approval, the RMA should give the provider a thirty day cure period. The provider may not have been aware of the problem, and this gives it a reasonable period within which to fix it. Additionally, Crop1 requests that a provider whose PRP has been withdrawn or required to be modified should have the right to request reconsideration, as the Proposed Rule (400.719(c)(2)) would allow if a revised Plan of Operations is disapproved. Crop1 specifically proposes the addition of a new subsection (o) stating as follows:

"(o)(1) Before withdrawing or modifying its approval of a premium reduction plan, RMA will notify the provider in writing of the contemplated withdrawal or modification of approval and the reason therefor, and allow the provider at least thirty days to cure. If the provider does not cure within such period to the RMA's reasonable satisfaction, the withdrawal or modification shall be effective after the expiration of such thirty day period and as of the date specified in the notice.

(2) If approval of a premium reduction plan is withdrawn or modified, the insurance provider may request, in writing, reconsideration of the decision with the Deputy Administrator of Insurance Services, or a designee or successor, within 30 days after the effective date of such withdrawal or modification and such request must provide a detailed statement of the basis for the reconsideration."

Testimony of
Bert Little
Tarleton State University
Director, Center for Agribusiness Excellence
for the Senate Committee on Agriculture, Nutrition, and Forestry
Tuesday, June 28, 2005 10 AM
SR-328A

Thank you for the opportunity to appear this morning before the Senate Committee on Agriculture, Nutrition, and Forestry to discuss the extension of the 2000 Agricultural Risk Protection Act (ARPA 2000), a vital legislative bulwark for rural America.

I. WHO IS TESTIFYING

I am Bert Little, Associate Vice President for Research and Professor of Computer Science and Mathematics at Tarleton State University. Tarleton has been a member of the Texas A&M University System since 1917. In this role, I also direct the Center for Agribusiness Excellence (CAE), founded at Tarleton specifically to address a section of ARPA 2000 that directs the Secretary of Agriculture to use data mining and data warehousing to improve integrity and compliance in Federal crop insurance. As the Committee knows, program abuse was a central concern of both Congress and farm producers during the development of ARPA 2000. Testimony made clear that crop insurance abuse was hurting farmers everywhere by weakening program credibility and creating pressure for higher farmer-paid insurance premiums. The resulting statute contained several important planks to address this problem by tightening oversight and toughening penalties. Key among these was Section 515(f), which directs the Secretary to detect abuses by tracking agents, producers, and other program participants with disparate performance records and to provide Congress with an Annual Report on Program Compliance and Integrity Efforts. To accomplish these ends, Section 515(j)(2) on Information Management directs that

> "The Secretary shall use information technology known as data mining and data warehousing and other available information technologies to administer and enforce this title."

In open competition in July 2002, CAE won a five-year USDA contract to perform these tasks laid out in Sections 515(f) and 515(j)(2) of ARPA 2000. At the time, CAE had been working with RMA under a Cooperative Agreement from December 14, 2000 to research a report on disparate performance in the program. As a result, CAE now has built a record of more than five year of experience and accomplishment in this field and, working with RMA, has demonstrated how data mining techniques can dramatically improve program operation in real world practice. The results of CAE's work under ARPA 2000 were reported in RMA's Annual Reports on Program Compliance and Integrity Efforts, as required under Section 515(i) and cited below.

II. HOW MUCH SAVINGS FOR USDA RMA

I say with some pride that the record of accomplishment by RMA and CAE under the data mining program has been formidable. In two of its reports issued so far on the program, for instance (Risk *Management Agency Program and Integrity June 2000 – December 2001* (http://www.rma.usda.gov/pubs/2002/ComplianceReport.pdf) and *Annual Report on Program Compliance and Integrity Efforts, Risk Management Agency: Preventing Fraud. Protecting Farms. Program Compliance and Integrity Annual Report to Congress. January 2002 – December 2002* (http://www.rma.usda.gov/pubs/2004/compliance2002.pdf), RMA reported that CAE saved the Federal Crop Insurance program respectively $72 million and $110 million during crop year 2001 and 2002 through indemnities not paid because of increased scrutiny of anomalous policies. In its draft Annual Report on Program Compliance and Integrity Efforts for January 2003 – December 2003 (not yet published) RMA will report that CAE's data mining effort saved the US crop insurance program $81 Million for 2003. RMA Administrator Ross Davidson has reported similar levels of savings numerous times in testimony before Congress:

> "...in the first year of operation, data mining helped prevent nearly $94 million in improper payments and helped recover approximately $35 million in improper indemnities." (http://appropriations.house.gov/_files/RossDavidsonTestimony.pdf)

III. HOW SAVINGS WERE ACHIEVED: DATA MINING AND WAREHOUSING

These savings were achieved through a number of coordinated initiatives, and I compliment RMA and its staff in its effective use of this new tool at its command compliance arsenal. At this point, CAE has developed a data warehouse that contains all RMA policy information from 1991 to the present (2005). In addition, CAE has integrated data on weather, soils, and other agronomically relevant factors into its warehouse. The total data in the warehouse is in excess of two terabytes (terabyte = 1 trillion words of information) and are standardized to the same scaling and format to allow multi-year analyses, previously not possible. The data warehouse is updated monthly by information provided from USDA RMA. The data warehouse is secured behind the USDA RMA firewall, subject to the same privacy and security protections as data maintained by USDA itself.

Through various programs and algorithms, we have worked with RMA to identify multi-year patterns that signal suspicious or anomalous crop insurance claims. One specific effort, called the Spotcheck List program, follows a simple process to translate this data into concrete program savings:

(1) Often using as a starting point anecdotes from the field (investigators, producers, agents, adjusters), we use our data mining system to identify schemes that appear to be in use to obtain possibly improper crop insurance indemnities through data mining;
(2) The potential scheme is analyzed to determine whether it exists in the national data, where, and to what extent. We include teams of RMA and CAE analysts to review the data and determine whether the scheme is reasonable or practical from an agricultural or field perspective;

(3) We place these schemes and the specific producers identified as having participated in them on a Spotcheck List. The list is deployed to USDA RMA Compliance staff which reviews it and may add additional persons of interest to it;
(4) The Spotcheck list is then provided to USDA's Farm Service Agency (FSA), whose local county offices are asked to conduct growing season inspections (GSIs) on the crop fields on the Spotcheck List;
(5) At an early point in the growing season, FSA sends letters, notifying each producer on the Spotcheck List that a GSI will be performed on their crop and an additional pre-harvest visit will be made.

IV. BEHAVIOR CHANGES IN INDEMNITY

Not surprisingly, producers who are on the Spotcheck List react to the information by backing off any contemplated abusive activities, resulting in drastic, visible, measurable improvements in program performance. Growers change their behavior as a result of, simply knowing that they are being scrutinized. In most cases, (see Figure 1) the effect lasts for two years. A small proportion (one-fifth) changes their behavior only one year (Figure 2).

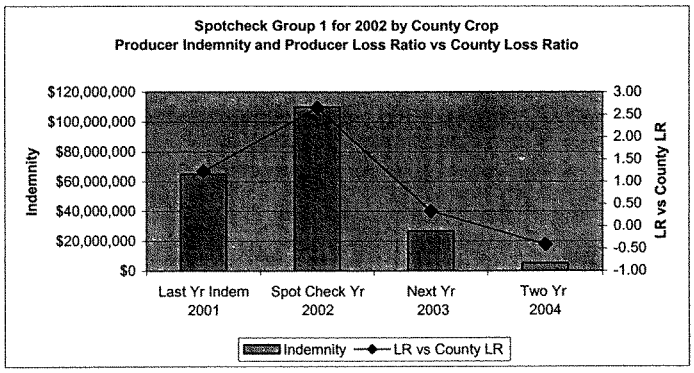

FIGURE 1. Spotcheck List for Group 1, Indicating Marked Decreases in Indemnity for The Same Producers Followed Over Time

Figure 1 tracks the group of policies on the Spotcheck List in 2002, and shows the dramatic decreases in indemnities paid to those producers in 2003 as well as similar decreases in 2004. This indicates a decrease of almost $100 million from 2002 to 2003. Note that Figure 1 has a heading of "Spotcheck Group 1," which comprises approximately two-thirds of the people on the Spotcheck List.

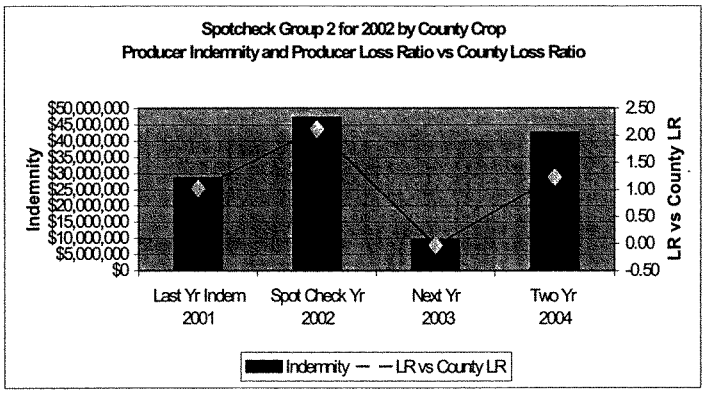

FIGURE 2. Spotcheck List for Group 2, Indicating Marked Decreases in Indemnity for The Same Producers <u>For Only One Year</u>

Figure 2 tracks the group of policies that were on the Spotcheck List in 2002 and shows a similar pattern: dramatic decreases in 2003 for only one year, though no similar decreases when followed to 2004. This indicates a decrease of almost $40 Million from 2002 to 2003. Note that Figure 2 has a heading of "Spotcheck Group 2," which comprises approximately one-fifth of the policies on the Spotcheck List. Policies in Spotcheck Group 2 returned to their prior indemnification behavior after only one year. Altogether, over four years (2001 to 2004), this one initiative, the Spotcheck Lost, produced indications of reduction in unneeded indemnities of approximately $316 million.

V. OTHER COST SAVINGS ACTIVITIES BY CAE

CAE produces more than the Spotcheck List for RMA Compliance. During 2004 we produced 115 additional research products at the request of USDA RMA aimed at identifying program abuse, each laying the groundwork for additional cost savings. In addition, we have used our data mining tools to assist the USDA Office of Inspector General (OIG) in its investigations and audits of USDA programs, the Government Accountability Office (GAO), plus the work of Federal prosecutors and the Federal Bureau of Investigation (FBI). CAE personnel also have served as expert witnesses for Federal prosecutors when requested.

VI. COST BENEFIT CONSIDERATIONS

We believe that data mining as mandated under ARPA 2000 has been a dramatic success for Congress and USDA. For an investment of $16,004,784.65, it has conservatively produced program savings of over $300 million from December 14, 2000 through May 31, 2005, just looking at the Spotcheck List alone. The pubic interest argues strongly that it should and must be continued.

VII. FUTURE OF CAE

At this point, however, despite wide support for data mining and a strong record of accomplishment, the future of the program remains much in doubt. ARPA 2000 provided funding for data mining through the Federal crop insurance fund rather than through annual agency appropriations. This funding provision from ARPA 2000 is due to expire in fiscal year 2005. To bridge the gap until Congress determines whether to extend the provision, the President has requested in his 2006 budget a single-year funding bridge at $3.6 million, and recently the House Appropriations Committee provided this amount but with a caveat stating as follows: "While the Committee provides the budget authority to extend this program through the end of fiscal year 2006, the Committee will not fund this program in the future."

We hope that Congress will find an appropriate method to continue the ARPA 2000 data mining program beyond fiscal 2006, preferably by funding it on a multi-year basis through the Federal Crop Insurance fund, extending the system that has worked so well over the past four years under the original statute. Otherwise, if this program is allowed to expire or lapse into uncertainly, a significant amount of program savings, as well as a working, effective tool against program abuse, inevitably will be lost. This would be a severe setback for Federal crop insurance, farm producers, and American taxpayers. We stand ready to work with you to help address this issue.

VIII. SUMMARY

Thank you again for giving us this opportunity to summarize CAE's record of providing cost savings to the Federal crop insurance program under the ARPA 2000 data mining program. Congress and USDA deserve a great deal of credit for taking the bull by the horns and implementing this program in an effective way to the benefit of farmers and taxpayers. We have been honored to be part of the process.

STATEMENT BEFORE THE UNITED STATES SENATE COMMITTEE ON AGRICULTURE, NUTRITION AND FORESTRY

Hearing to Review the Agricultural Risk Protection Act of 2000 and Related Crop Insurance Issues
Tuesday, June 28, 2005, 10:00 a.m. in SR-328A

Bruce A. Babcock
Center for Agricultural and Rural Development
Iowa State University

Thank you, Mr. Chairman, for the opportunity to participate in today's hearings. ARPA authorized the Risk Management Agency to approve new insurance products for livestock. ARPA also set up a mechanism to provide incentives to the private sector to create innovative insurance products. The private sector responded by creating two new insurance products that can help livestock producers manage financial risk.

Producers of hogs, fed cattle, and feeder cattle in 19 states can insure against unexpected declines in the price for their product with Livestock Risk Protection (LRP) insurance. Hog producers in Iowa can insure against an unexpected decline in the average margin (over feed costs) from hog marketings over a five-month period with Livestock Gross Margin Insurance (LGM).

Public Policy Justification for Federal Livestock Insurance

LRP and LGM are the first federal safety net programs for livestock producers. What justification is there for Federal involvement in the livestock sector? LRP and LGM offer livestock producers who own their own livestock efficient risk management tools that allow them to manage their price risk independently of packers. Thus LRP and LGM support a policy objective of maintaining a livestock sector that is independent of packer

control. Large, independent producers will find LRP and LGM useful, but they can also efficiently use similar risk management tools available to them from the commodity exchanges, such as the CME and the CBOT. But small- to medium-size livestock operations cannot efficiently use futures and options to manage their price risk because they do not have the required scale of production. Thus, LRP and LGM are most useful to small- to medium-size independent livestock operations and they serve to increase their financial viability.

The question then becomes, why do these products only cover price risk? Why not cover loss of animals? The answer is that the private insurance sector already provides coverage against accidental mortality, and it simply does not make sense to insure against losses that are caused by poor management, such as lack of disease control or poor feeding practices. Thus, for small- and medium-size operations, the current livestock products do meet a public purpose and they do not duplicate existing private insurance coverage.

Producer Acceptance of Livestock Insurance

The extent to which small- to medium-size livestock operations will use federally reinsured livestock insurance products remains to be seen, however. In the current reinsurance year, there is not a state in which more than 3 percent of eligible livestock is insured under either LRP or LGM. Iowa hogs, at 2.27 percent, and Kansas feeder cattle, at 1.94 percent, have the highest participation rates.

There are a number of reasons for this low participation. Federal livestock insurance is still a new concept. History has shown that it takes time for farmers, crop insurance agents, and insurance companies to become knowledgeable and comfortable with new products. For example, most crop insurance agents know little about price risk or the livestock sector. And most crop insurance companies know little about how to offset the risk that they assume when issuing a policy. Market penetration of these new products will not be rapid unless companies invest in training programs for their staff and their agents.

Another reason for low participation is that both LRP and LGM were pulled from the market in December 2003 following discovery of BSE in the United States. Following substantial program modifications, sales of both resumed in October 2004. Sales momentum for both products has picked up in recent months.

It remains highly uncertain whether a large fraction of livestock will ever be insured under Federal livestock insurance programs. Based on marketing research that we recently conducted, a significant portion of cattle producers list risk management as a top concern. But whether that concern will translate into the purchase of insurance remains to be seen. We know that a significant portion of livestock producers have no interest in these programs because they do not own their own livestock and therefore face no price risk. And the experience with the U.S. crop insurance program shows that crop farmers are reluctant to buy high levels of insurance without significant premium subsidies. But extending premium subsidies to livestock producers to encourage participation would be counterproductive because livestock supplies are much more responsive to subsidies than are crop supplies. Large premium subsidies would likely lead to a significant expansion

in supply and a resulting drop in market prices—exactly the event for which the livestock insurance products are designed.

My colleague at Iowa State has studied feeder pig production in Canada and attributes a significant proportion of the recent increase in Canadian production to an income guarantee that is based on the Olympic average of the previous five years of income. This allows producers to ride through the hog cycle without having to go through the tremendous stress of the low points. While this might be good for individual farmers, it has large production-enhancing, price-suppressing effects, and trade distorting effects.

Lessons Learned from the Pilot Programs

The first lesson learned is that any insurance product that uses market prices in its guarantee should not allow producers to observe market moves subsequent to the guarantee setting before deciding whether to purchase the insurance. For example, when BSE was found in December of 2003, the cattle market responded with limit-down moves, with more limit-down moves indicated. Producers clamored to buy LRP, which had a guarantee and premium that were based on the previous day's market. Clearly, farmers were trying to insure a burning barn. With regard to LGM, the guarantee was fixed two weeks before the sales closing date, allowing farmers to jump in if prices moved down during this period, or to hold off if prices moved higher. Both products now set their guarantees at the close of markets and allow sales at that guarantee only until markets open the next day.

Policy Recommendations

Over the next three to five years we should learn whether independent livestock producers find that Federal livestock insurance products are important to their operations. By then a large proportion of hogs, fed cattle, feeder cattle, and the dairy herd will be covered by one or more of the products. In addition, agents and companies will have had time to learn how to sell the products and manage their own risk. If it turns out that a significant number of producers want to purchase livestock insurance, then Congress will need to revisit the $20 million limitation on annual expenditures that is included in ARPA.

In summary, ARPA was a success with regard to livestock insurance. It set up a mechanism to encourage the private sector to develop innovative products. It gave RMA authority and the financial means to offer reinsurance and support for the products. Some private insurance companies may be reluctant to offer price insurance because when low prices unexpectedly occur, all insured producers will be indemnified. However, most insurers will find that, in general, adding livestock insurance to their portfolio can actually reduce the overall riskiness because livestock prices are largely independent of crop prices and yields.

Statement by Mike Clemens
On behalf of the American Soybean Association, National Sunflower Association, and U.S. Canola Association

Before a Hearing of the
Committee on Agriculture, Nutrition and Forestry
U.S. Senate

June 28, 2005

Mr. Chairman and Members of the Committee, thank you for the invitation to testify today. I am here on behalf of the National Sunflower Association (NSA), the U. S. Canola Association (USCA), and the American Soybean Association (ASA). I am a producer from Wimbledon, North Dakota, where we grow sunflowers, soybeans, corn and wheat on our farm. I am also Chairman of the NSA.

While the immediate concerns of each oilseed association vary, as farmers we support a strong, national crop insurance program that ensures that all producers can obtain affordable coverage. I will briefly discuss the major issues for each commodity and ask that my full statement be included in the hearing record.

SOYBEANS

Finding effective policies to address soybean rust is a top priority for the American Soybean Association. During the past two years, ASA has been the leader in soybean rust education. Nearly 2,000 producers have participated in seminars hosted by ASA in cooperation with USDA and industry partners and more than 60,000 copies of the 20-page ASA Soybean Rust Reference Guide were produced and distributed. Through print, radio and the Internet, ASA has reached more than 250,000 U.S. soybean producers over the last two years.

The United States is the world's leading soybean producer and exporter. The farm value of soybean production last year was $18 billion, second only to corn among U.S. crops. Soybeans are planted on one-third of total U.S. row crop acreage. To maintain soybean production and prevent significant market disruptions to other U.S. crops, successfully combating soybean rust must be a priority for the U.S. Government. This extends to making sure that yield losses due to soybean rust are covered under the Federal crop insurance program.

Soybean producers are significant customers of the crop insurance program, carrying 22% of the total crop insurance liability in 2004. Last year 77% of total U.S. soybean acres were insured, or 58 million, out of 75 million acres. Soybeans have traditionally been some of the best business

in the crop insurance portfolio. Last year, soybean policies posted a loss ratio of .78 on nearly $10 billion of liability.

However, while participation numbers for soybeans are impressive, there remain wide regional variations in the type of policies soybean farmers buy and their attitudes toward this program.

For example, consider the different position a soybean farmer from Iowa and a soybean farmer from Arkansas is likely to find himself in if both suffer a 40% yield loss from soybean rust. In Iowa, the state with the most soybean acres, 94% of the acres in 2004 were covered with a buy-up policy, with the most farmers choosing coverage at 75%. In Arkansas, the Southern state with the most soybean acres, only 46% of the acres were covered with a buy-up policy. In fact, only about two-thirds of Arkansas growers bought crop insurance at all and, of those, more than half bought CAT policies. For those growers, a 40% yield loss would not even be covered.

In Georgia, soybean farmers are in a similar situation: only 71% of soybean acres are insured at all, and fully 38% of all policies are at the CAT level.

These statistics are not anomalies. It is important for the Committee to recognize the ongoing problem with buy-up participation among Southern growers. In the nine Southeastern states where soybean rust was confirmed last year, 34% of soybean growers bought CAT policies, compared to 11% soybean CAT policies nationwide.

We don't know yet what type of policies farmers bought for 2005 crops. We do know that the consensus among many growers in Southern states is that crop insurance isn't worth the cost. Others have decided that investing in improving their land (with irrigation, for example) is a better risk management tool. This is an issue that has perplexed Congress as well as the American Soybean Association for many years. If Southern growers are under-insured when they face a rust outbreak, the problem with low buy-up participation in the South may turn out to be a deciding factor in whether farmers continue to grow soybeans there at all.

Soybean farmers have real concerns that despite our best efforts to protect ourselves through the crop insurance program, losses due to soybean rust will not be adequately covered, and disaster assistance will be necessary. The criteria for paying indemnities due to soybean rust seem terribly subjective to farmers: There is no certainty with this disease as to when to spray, when it's too late to spray, what product to spray, how many times to spray, and the list goes on. In short, the possibility that a farmer will buy crop insurance and still not have his claim paid seems very real.

The American Soybean Association strongly believes that losses due to soybean rust should and must be covered through the crop insurance program. The policy clearly states that soybean rust, as a disease, is an insurable peril.

If crop insurance fails to help farmers manage their risk as they believed it would when they bought it, Congress understands exactly what will happen. It is not the decision of the American Soybean Association or any farm group on whether to request assistance for crop losses: this

demand comes from the grassroots. Our expectation is that soybean farmers who are not indemnified by their crop insurance policy will ask Congress for help.

Again, especially for those growers from Southern states who have historically concluded that crop insurance does not, for either agronomic or economic reasons, "work" for them, their decision to under-insure or self-insure may drive demand for disaster assistance. We hope that Congress and RMA will move to address this perennial problem. It continues to undermine the crop insurance program.

SUNFLOWERS AND CANOLA

For sunflowers and canola, a major concern is the inability to expand crop insurance coverage availability in a timely manner. One of ARPA's goals was to expand coverage to more crops. Planting flexibility was also part of the 1996 and 2002 farm bills to give producers the ability to expand into alternative crops in response to market forces. Unfortunately, Congressional intent is being thwarted by the way RMA is now interpreting the crop insurance statute.

Historically, farmers have used written agreements -- designed to offer coverage in a county where crop insurance is not in place for a certain crop -- to help make the transition into growing a new crop. This also helped compile enough experience for RMA to extend a crop insurance policy into that county. However, under current RMA rules, three years of production history are now required before a producer can get a written agreement. In most cases, this prohibits a producer from even trying an alternative crop, since lenders routinely require their borrowers to buy crop insurance every year, let alone go for three years without insurance.

We understand the need for actuarial soundness in the crop insurance program. However, we believe the cropping history of a producer's similar insurable crops could be used to gauge his or her ability to grow new crops. In fact, such similar crops data were used by RMA for many years. We therefore ask the Committee to consider amending the crop insurance statute to allow the use of "similar commodities" to establish the cropping history for written agreements.

This change would help growers react to the market forces that are driving demand for sunflowers and canola. For instance, the addition of trans fats to the Nutrition Facts label as well as the growing interest for renewable energy sources such as biodiesel are both factors contributing to increased demand for these crops. Many Members of the Committee may also be aware of the current severe shortage of confection-type sunflower seeds, since numerous stories in the press this spring have highlighted baseball's concern that players may not have enough sun-seeds to last them through the baseball season.

To meet the growing demand, it is estimated that sunflower acreage will need to expand from the present 2.7 million acres to 4.5 million acres by 2010. Congress was also looking to the future as research funds have been – and continue to be – annually appropriated for the National Canola Research Program. That research is now bearing fruit. New winter canola varieties have been developed that could allow the planting of 500,000 acres to 750,000 acres of canola in the Southern Great Plains in the coming years. However, we will be hard-pressed to meet these

acreage goals without the expansion of sunflower and canola crop insurance coverage to these new regions through the use of written agreements.

We would be remiss in not recognizing that RMA recently made an effort to expand crop insurance for sunflowers and winter canola, and in fact did extend sunflower coverage to some counties bordering existing sunflower producing counties. We thank them for these efforts and recognize that the underlying statute will not allow them to do more without the change that we are requesting.

Another area of concern, especially for sunflowers, is the method used to determine the Actual Production History (APH) price election for sunflowers. Rates were announced at $9.30 cwt last fall that were based on a formula off the Chicago soybean oil futures contract of dividing the nearby CBOT soyoil futures price by two and subtracting one. However, sunflower prices have largely divorced themselves from the Chicago oil board. This APH price election was not even close to being adequate when compared to the new crop contract prices that were being offered at the time. We worked with USDA agencies that assist in developing RMA price formulas and an additional price election for the 2005 crop was announced by RMA. USDA has assured the NSA that they will continue to look at this issue in more detail to make sure the APH price election more accurately reflects the actual price for sunflowers. Likewise, RMA also needs to restructure the formula for determining the Revenue Assurance (RA) price for sunflowers in future years in order for it to be a useable program for sunflower farmers, as the change in the soybean oil/sunflower seed price relationship affects this price determination in a similar manner.

Canola growers are also concerned with the method used to set the APH price election for canola. Currently, RMA uses the USDA projected canola price, i.e. the season average expected price for both winter and spring canola, because NASS does not distinguish between fall and spring planted canola. And because the earliest sales closing date for fall seeded canola is August 31st, the price election by law must be announced by June 30th, or almost a year prior to the time-frame spring canola is planted, which currently comprises over 95 percent of the canola crop. This time lag has led to canola APH price elections that have been radically departed from other spring seeded oilseed crops, as well as the actual market price that was ultimately received for the crop. RMA assured USCA a year ago that they were developing a product that would address our concerns by providing all canola growing regions yield or revenue coverage that recognizes three different price discovery periods to match the respective available sales closing dates now in place. At the time, RMA predicted that this new product would be available for either the 2006 or 2007 crop. Since policy changes need to be in place by June 30th, we ask that the Committee urge RMA to redouble their efforts to meet this schedule.

In closing, I want to again thank the Committee for the opportunity to speak on crop insurance issues. I will be happy to address any questions you may have.

National Association of Wheat Growers

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Testimony of Ray Buttars
Chairman of the Domestic Policy Committee
National Association of Wheat Growers
Before the
Senate Committee on Agriculture, Nutrition and Forestry
Crop Insurance Hearing
June 28, 2005

Mr. Chairman, and Members of the Committee, my name is Ray Buttars, and I grow wheat in the great state of Idaho. I am pleased to be here on behalf of the National Association of Wheat Growers (NAWG), and I'm pleased to have this opportunity to offer NAWG's thoughts on the federal crop insurance program.

We have great respect and appreciation for this committee. We thank you for your ongoing efforts to provide effective and affordable crop insurance for America's farmers.

The passage of the Agricultural Risk Protection Act (ARPA) in 2000 was a major improvement in crop insurance, and today, 80% of planted acres are covered by some level of crop insurance. Our testimony and suggestions today build on ARPA's improvements.

Crop insurance is a critical risk management tool. And, like any other important tool on the farm it needs periodic maintenance and "sharpening," which will extend the useful life of this tool as well as increase its utility and effectiveness.

Over the past few years Congress has passed disaster legislation to provide risk protection where crop insurance could not. America's farmers have listed crop insurance as one of their top priorities. The "sharpening" which we recommend is identified in four primary improvements as follows:

1. Affordable premiums for higher levels of coverage.

2. Minimize the "erosion effect" of consecutive disasters on Actual Production History (APH) and a farmer's ability to obtain adequate insurance thereafter.

3. Establish Risk Management Accounts, which would enable a farmer to co-insure the portion of his, or her crop which is presently unprotected.

4. Insure a minimum Harvestable Value.

Coverage levels

The higher levels of coverage currently available are not affordable. Even with the existing premium support, most farmers can only afford either 65 or 70 percent coverage. With fuel and fertilizer costs being double of just a crop or two ago, it's easy to understand that production costs usually exceed 90 percent of the average crop value. At 70% coverage, a farmer loses three years of income before any claim is paid. Higher coverage is critical. However, it must also be affordable.

NAWG has requested that Group Risk Plans be made available to wheat growers. These policies are more affordable, but will only work for a portion of our farmers because counties in the Wheat Belt tend to be large and have multiple climates. Greater premium subsidies for the 75 to 85 percent levels appear to be the only real solution to making these higher levels attractive.

Risk Management Accounts

We have developed a concept we call Risk Management Accounts. Such accounts could provide a mechanism for a federal and private partnership to address the most glaring hole in the crop insurance program: The uninsured portion between a farmer's average crop, and the percentage of his crop which he is able to insure. Presently, this initial "deductible" is far greater than the slim margins we work with. Recent ad hoc programs have tried to address this. We believe the time is right for a proactive solution.

These Accounts would be available to farmers who buy a crop insurance policy, and would be linked to the value of the crops insured. Policyholders would be allowed to deposit 4% (as an example) of the value of their crop in a tax deferred account each year, with a smaller federal contribution. Limits and caps would define the program, and facilitate budget scoring. Farmers could draw from this co-insurance account when yields fall to 92.5% or less. Participants would not be eligible to withdraw to cover losses which are covered by the primary insurance policy.

We believe Risk Management Accounts are a responsible solution to a difficult problem. We have made an effort to be conservative in outlining their rules and structure. Further details are attached to this testimony.

Actual Production History (APH)

The nation's wheat growers know all too well the effects of prolonged drought. Over the last several years, much of the nation's Wheat Belt suffered from extensive drought and therefore loss of the crop. Each year of crop failure reduces a farmer's APH, eroding the safety net provided by crop insurance. We are exploring and would like to suggest two separate remedies.

First, we could use the producer's previous APH, rather than the current county yield. Also, we recommend replacing the 60% factor with the coverage percentage purchased by the insured (a producer with 70% coverage would use a yield plug of 70% times his APH).

The second remedy would index the producer's APH to a graph of county yield trends, effectively installing a "shock absorber" on individual insurability. This concept has good potential, and needs to be tested on a large model to determine the cost and benefit.

The Risk Management Agency is aware of the problems associated with APH erosion. Given the crop production challenges of the last several years, we anticipate a prompt solution.

Minimum Harvestable Value

Many times the residual value of a damaged crop is less than the cost of gathering or harvesting the remaining crop. Determining the point at which a crop is not worth harvesting, and the actuarial cost of this option should be very simple. We suggest that farmers be allowed to purchase optional coverage to insure the un-harvestable residual. We also recommend that this option be assignable to a custom harvester.

Conclusion

Mr. Chairman, members of the Committee, we sincerely thank you again for this opportunity. The NAWG leaders, staff and I are ready to respond to any questions you have. We pledge our support and assistance. We look forward to working with you to sharpen the risk management tools of the American farmer.

Attachments
Risk Management Accounts

National Association of Wheat Growers

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Risk Management Accounts

NAWG has developed a concept we call Risk Management Accounts (RMA), which would provide a mechanism for producers to self-insure the initial deductible not covered in current policies. These Accounts would function in a manner similar to the co-insurance of the health insurance sector on the initial portion of a loss. These are the details:

(a) Tax Status: Funds deposited into RMA's will be tax-deferred, to be taxed on withdrawal.
(b) Who is Eligible: Producers who buy crop insurance at any level are eligible. Accounts must be held in the name of the policy holder.
(c) Annual Contribution Percentage: Up to 4% of the Whole Policy Projection (WPP) for the current year. The formula for the Whole Policy Projection is as follows: (WPP = APH X Crop Insurance Indemnity Price X Total Acres Insured X Insured's Share).
(d) Maximum Annual Contribution: A $20,000 limit per policy holder would allow full participation for farms with WPP up to $500,000.
(e) Government Match: The match is based on the level of crop insurance purchased, and could be up to 4% of total crop insurance guarantee. For example, at a 70% level of coverage, and assuming the producer contributes the maximum 4% of WPP, the match would be 4% X 70% x APH X Crop Insurance Indemnity Price X Total Acres Insured X Share. Or, more simply, 4% X 70% X WPP.
(f) Maximum Fund Balance: 30% of WPP, up to a maximum of $150,000. This allows full participation for farms with WPP up to $500,000.
(g) Withdrawal Trigger: Triggered by a 7.5% minimum yield loss based on WPP. At this level, a crop that is 92.5% of normal or less could be supplemented with the Risk Management Account.
(h) Maximum Withdrawal: In any year, withdrawal would be limited to actual whole policy loss, less crop insurance payments.
(i) Termination of Farming Business: Mandatory distribution to policy holder or heirs & assigns, not to exceed five years from date of termination.

Account Investment Restrictions: Accounts held at financial institutions. Investments are limited to insured instruments.

Statement of the United States Senator Debbie Stabenow
Agriculture Committee Hearing on
Agricultural Risk Protection Act of 2000 and Crop Insurance Issues
June 28, 2005 10:00am

Mr. Chairman, thank you for calling this hearing today. I worked on the Agriculture Risk Protection Act when I was a member of the House Committee on Agriculture. We devoted a significant amount of time to crop insurance issues, and I look forward to working with this committee as we work on reauthorizing this law.

Farming is an inherently risky business. From natural disasters and market sensitivity to pests and diseases, there is no way for our farmers to know what they will face each growing season. This is why federal crop insurance programs and affordable coverage are so fundamentally important to the future of our family farmers.

Michigan is one of the most diverse states in terms of crop production, so I am interested in crop insurance for both traditional program crops and fruits and vegetables. The availability of crop insurance for specialty crops varies across the different regions of the country and I want to make sure our fruit and vegetable farmers have access to good, affordable coverage that takes into consideration potential impacts to farmers in other regions of the country.

I look forward to hearing from our witnesses today.

Prepared Statement of Senator Max Baucus from the State of Montana

After years of crippling drought producers in my state are fully aware of the importance of crop insurance. As such, I would like to thank Chairman Chambliss, as well as Ranking Member Harkin, for holding this important hearing.

Crop insurance is of critical importance to livestock and crop producers in my state of Montana. In 2000 the Congress took up the difficult task of reforming the crop insurance system of the United States and I am proud to have helped that process to completion. After five years of operation it is now time to take stock of our reforms. In my view, the reforms of 2000 have spurred on many positive developments such as an expansion in the availability and level of enrollment of producers in insurance programs and I am greatly encouraged by such development.

I am however troubled by a number of recent developments in relation to the program. First, producers in my state have suffered through years of drought and as a result APH (Actual Production History) yield numbers have eroded over time. Ensuring that producers are not unjustly penalized by having their baseline production yields and thus their coverage decline as a result of excessive drought is very important to Montana and RMA must quickly act on this issue.

Second, the President has recently announced a number of changes to the statute as part of the FY2006 budget. To say I am concerned about these changes would be an understatement. Now is not the time to be raising the cost of crop insurance to producers.

Third, while some of Montana's livestock producers have been afforded the opportunity to purchase livestock insurance, one industry in my home state has consistently been denied insurance vehicles. I believe that the FCIC's decisions to decline to create a livestock risk insurance product for the lamb and sheep industry runs counter to the intent of the statute. I echo the thoughts of many of my colleagues on this Committee that believe that the FCIC must work to actively engage and assist in the development of a livestock risk insurance program for the lamb and sheep industry.

Finally, many of my colleagues have commented on the concerns they have with regard to the premium discount plan (PDP). I share many of those concerns. While I acknowledge that agencies like RMA should be looking for ways to more efficiently service producers, I also recognize that oversight and management for crop insurance is a vital and necessary function. We should never sacrifice the availability of insurance coverage in an effort to marginally increase efficiency. Some of the policies that RMA have announced with regard to the PDP potentially threaten the availability of insurance coverage in high risk areas across the country, including Montana. Given the vital importance of crop insurance to my state I look upon PDP with an extremely critical eye. I am also not blind to the allegations leveled against RMA's first PDP provider Crop1 Inc.. I affirm my colleague Senator Grassley's call for a detailed investigation into this matter and I will reserve judgment until the results of this investigation are known.

Thank you again Mr. Chairman and Ranking Member for holding this hearing, and I also want to thank the witnesses who participated in this hearing.

DOCUMENTS SUBMITTED FOR THE RECORD

JUNE 28, 2005

Testimony

Of

Leon Corzine
President
National Corn Growers Association

Review of the Agricultural Risk Protection Act of 2000 and related crop insurance issues

Committee on Agriculture, Nutrition, and Forestry
U. S. Senate

Tuesday, June 28, 2005
Russell Building 328-A

Mr. Chairman and members of the Committee, I appreciate this opportunity to provide you input for your review of the Federal Crop Insurance Program. On behalf of the National Corn Growers Association (NCGA), I cannot overemphasize the importance of this program to the risk management planning of our 33,000 members and more than 350,000 farmers who contribute to corn checkoff programs in 19 states. With the variety of insurance products available today, particularly revenue-based insurance policies, producers are in a much better position today to protect their farm operations against the disastrous effects of low yields and low prices.

The reforms adopted in the Agriculture Risk Protection Act of 2000 (ARPA) have had a dramatic impact on the percentage of corn acres insured increasing from 42 percent in 1989 to 77 percent in 2004. By committing additional resources and restructuring premium subsidies to encourage purchases of higher levels of coverage, Congress has enabled far more producers of a wide variety of crops to purchase of higher levels of coverage. Drs. Bruce Babcock and Chad Hart of Center for Agricultural and Rural Development have suggested in their research paper of April, 2005 that "the acres of corn, soybeans, and wheat insured at more than 65 percent coverage relative to acres insured at 65 percent and greater coverage levels more than doubled because of ARPA." Clearly, the changes in financial incentives and the coupling of premium subsidies to the level of coverage have enhanced the effectiveness of federal crop insurance policies.

NCGA appreciates the bipartisan support of the Federal Crop Insurance Program that is continually demonstrated by the leadership and members of the Senate Agriculture Committee. This 'shared cost' program remains the most important risk management tool for corn growers and a critical component of the farm safety net in the 2002 Farm Bill. We also recognize the tremendous challenge before this Committee and the Risk Management Agency to adequately meet the wide range of risk management needs in our

nation's extremely diverse agriculture industry. Over the past two years, NCGA, through its Public Policy Action Team, has carefully reviewed a number of concerns raised by our grower members regarding the future of federal crop insurance. Building on the progress facilitated by ARPA, NCGA has developed several policy recommendations for your consideration which we believe would further strengthen the value and integrity of the program.

In examining suggested solutions for addressing remaining inequities in premium rates, NCGA has learned of a disparity between subsidized premiums for optional unit coverage and enterprise unit coverage, an unintended consequence of introducing the new subsidy structure of ARPA. Today, less than 3 percent of acres are covered by policies with enterprise unit coverage compared to almost 61 percent for optional units (field) and 36 percent for basic units (all cropland of a single crop either owned for cash rented, or that is under a single crop share arrangement). Although premiums are discounted for enterprise unit coverage (all cropland of a single crop into one insurance unit), the reduction in premium costs does not fully reflect the declining variability in yield and/or revenue as a producer aggregates the unit structure. One alternative that would enable producers to secure a more equitable amount of premium savings is to decouple per-acre premium subsidies from the unit of coverage selected by the producer. This change would allow producers to continue selecting optional and basic unit coverage while rewarding producers who assume more risk (enterprise and whole farm unit coverage) higher levels of coverage at a lower cost. NCGA believes this reform would create greater efficiency in the program without increasing costs to the taxpayer. Moreover, these changes offer the potential opportunity to reduce moral hazard and adverse selection of insurance coverage.

In addition, NCGA has evaluated the impact of recent disaster assistance legislation and its interaction with the federal crop insurance program. While it is widely understood that repetitive years of catastrophic crop losses can have an extremely negative impact on farm income and future crop insurance guarantees, NCGA's Public Policy Action Team has recently focused on the large financial losses of growers who suffer back to back shallow losses that do not qualify for traditional disaster assistance and receive minimal crop insurance indemnity payments. NCGA remains very concerned that disaster aid packages continue to target payments to crop losses that could have been insured and that little progress has been made on new products that can mitigate the costly effects of a declining APH and multiple shallow crop losses on future guarantees and premium rates. In fact, the Public Policy Action Team of NCGA has served as an active reviewer of a product design by 4B Consultants, Inc. in cooperation with Science Applications International Cooperation (SAIC). The goal of this effort was to develop an actuarially sound approach to cover both consecutive years of catastrophic and shallow losses for a major crop. Unfortunately, this innovative concept did not fit within the parameters of RMA's solicitation for research proposals addressing "Alternative Methods for Mitigating Declines in Approved Yields After Successive Years of Low Yields". In the absence of progress on these issues, NCGA urges the Congress to give serious attention to adopting legislation that would address this hole in the current farm safety net. One proposal introduced by Representative Sam Graves in 2002, the Companion Disaster

Assistance Program Act, would reform the delivery of future disaster aid by shifting payments from crop losses that can be insured to better target uninsured shallow losses.

Finally, NCGA has been advised that the RMA has undertaken an effort to use annual premium adjustments to achieve more actually fair premium rates that better reflect the incremental increases costs that accompany higher levels of coverage. In light of a report released earlier this year by USDA's Office of Inspector General's and its finding that corn crop insurance premiums paid exceeded indemnity payments by $1.4 Billion from 1975 to 2003, we request that the Committee help ensure that the RMA continue the with the necessary rate adjustments to eliminate premium inequities across crops.

Once more, NCGA appreciates the Senate Agriculture Committee's careful consideration of the above comments and recommendations.

CROP INSURANCE RESEARCH BUREAU, INC.
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Written Testimony

Crop Insurance Research Bureau, Inc.

to the

Committee on Agriculture, Nutrition & Forestry
United States Senate
June 28, 2005

The Crop Insurance Research Bureau, Inc. ("CIRB") is pleased to offer written testimony to the Committee on Agriculture, Nutrition & Forestry. CIRB thanks the committee for this opportunity.

CIRB is a national trade association whose members are involved in the delivery of federally reinsured crop insurance to the farmers of this nation. CIRB's twenty-three member and associate member organizations represent a broad cross section of the crop insurance industry including companies who hold a Standard Reinsurance Agreement ("SRA") with the government, others who write only private crop-hail insurance and both reinsurance brokers and reinsurance companies who assist in providing financial capacity to the industry.

The Federal Crop Insurance program is one that Congress can be proud. Since the Crop Insurance Act of 1980 was passed creating this unique public/private partnership, it has grown beyond what its originators could have imagined. The program currently covers approximately 83% of eligible crop acreage. Coverage options are more extensive than ever before with producers able to choose from traditional yield-based products to various types of revenue coverage. Additionally, numerous pilot programs are underway to bring even more risk management products to America's agricultural producers. The coverage is coast-to-coast and border-to-border. With respect to crop insurance, America is truly the envy of the world. Nonetheless, the program is complex, and challenges are always present. We will address these challenges in our testimony.

One of the challenges facing the crop insurance industry today is the relationship with the administration of its regulator. The Risk Management Agency ("RMA") is charged with the responsibility of overseeing the diverse federally reinsured crop insurance program and making sure that taxpayer dollars are appropriately expended. Because of the social component of the program, and because it is so expansive and complex, issues sometimes emerge that find RMA and the industry at odds. These

differences have become more acute in the last several years. The partnership between the private sector and government at the senior management level is strained. We hope that in time, these differences can be resolved and the industry can return to the close working relationship with RMA that has been enjoyed for the last twenty-five years.

From a program standpoint, CIRB believes that Congress should address four challenges that face the federally reinsured crop insurance program today. Those are the implementation of a Premium Reduction Plan by RMA, the President's Budget Proposal Relating to Crop Insurance, Conflict of Interest, and the handling of Asian Soybean Rust.

Premium Reduction Plan

CIRB acknowledges that the concept of a premium discount to farmers who utilize crop insurance is, on its face, appealing. On the other hand, CIRB is concerned about the potential for unintended consequences to the delivery mechanism of federal crop insurance under the proposed rule. For that reason, CIRB opposes implementation of the proposed rule and recommends suspension of any further approvals for the Premium Reduction Plan ("PRP") until a comprehensive study of the impact of the plan can be made. CIRB feels that, as proposed, PRP will have an unsettling effect on the crop insurance industry and producers. Specifically, CIRB is concerned that PRP will create a competitive imbalance, promote industry insolvency and will lead to discrimination against smaller producers, smaller agents and states that have historically poor underwriting performance. These factors will threaten the basic premise of the federally reinsured crop insurance program – universal access.

Should PRP be implemented after review and analysis of the comments, CIRB recommends the following revisions to the proposed rule:

CIRB believes that RMA does not have adequate resources or expertise to evaluate the proposed PRP submissions in a timely and proper fashion. In that regard, CIRB feels that an independent CPA or auditing firm(s) or the General Accountability Office (GAO) should be retained to provide comprehensive and objective evaluation of PRP plans that are submitted to assure that such plans meet or exceed the requirements outlined in the regulations. The recommendations of that firm should then be submitted to the FCIC Board for consideration and implementation. Additionally, all approved plans should likewise be evaluated by same CPA or auditing firm(s) at the end of each crop year to assure compliance with the established criteria for offering PRP.

CIRB notes that the current proposed rule does not provide for penalties or sanctions for a submitter that does not achieve the projected savings. The rules must provide for penalties for misrepresentation of a provider's ability to provide PRP according to the established criteria; i.e., reject any and all future

premium reduction plans, charge the amount of the premium reduction as a policy surcharge in the following year, require that amount as an additional expense in each of the next two reinsurance years, etc.

CIRB also believes that the proposed rule is not clear as it relates to ceding commissions and contingency commissions. To clarify, the rules should explicitly not allow reinsurance ceding commissions to offset expenses because this discriminates against those companies who do not rely heavily on outside reinsurance. Aggregate excess reinsurance costs should be included as expense. The current criteria do not require that these be included, thus skewing the expense picture.

Recommendation

CIRB recommends against further implementation of the PRP plan unless or until a comprehensive study has been completed showing the likely long-term effects of PRP on the program as a whole. This study should evaluate the potential impact of PRP to universal accessibility, the implications to the delivery system and, most importantly, the effect on the farmer. Should implementation of PRP move forward the rules must be strengthened, clarified and a strict plan should be in place for how the approval and monitoring process will be executed. Further, procedures must be in place to evaluate the submission at the end of the crop year to assure compliance with the plan.

President's Budget Proposals Relating to Crop Insurance

Crop insurance is a critical part of the overall risk management strategy of many farmers. It is one of the most complex insurance programs putting significant stress on the ability of insurers, regulators and agricultural producers alike to keep up with frequent changes both big and small each year. The SRA provides the framework and the fundamental groundwork defining the relationship between the government and industry. Recognizing the necessity for program stability, it has customarily been in place for several years at a time.

On July 1, 2004 a new SRA went into affect after months of arduous meetings and discussions. The government sought and achieved reductions totaling approximately $78,000,000 from its private sector insurance partners. This has been a trend since the very first SRA nearly twenty-five years ago. Most private insurers can ill afford these cuts but when RMA unilaterally halted negotiations, there was little choice but to sign the agreement or leave the program. Companies immediately began the job of building business plans that would help them cope with the cuts and at the same time not reduce service to producers.

CIRB was extremely disappointed with the proposed cuts to insurers in the President's 2006 fiscal year budget. If these are realized it would seem to call into question the legitimacy of the recently signed SRA. Companies are expected to live up to the provisions of this document as evidenced by the millions of dollars expended annually by them in costs associated with maintaining program compliance. It is reasonable to expect the government to live up to its commitments spelled out in the agreement as well.

The crop insurance program can thrive and prosper in an environment of reasonable stability; however, it is impossible to develop any sort of a coherent business plan when the foundation of your business rests on sifting sands. The failure of a large MPCI insurer just two years ago and the recent exit of the Hartford Group from the program are but two examples of program fragility. To expect the private sector to absorb additional cuts beyond those already called for in the SRA is unfair and improper.

The proposed cuts to the program proposed by the Administration also affect the reinsurance industry, in many ways, an invisible partner in the federal crop insurance program. When program changes are made, frequently the affect on the reinsurance industry is not considered. The federal government could not possibly provide coverage for all the risk that is encompassed in the crop insurance program of today. Private reinsurers cover approximately 50% of the total risk retained by companies. If there is not sufficient stability and return for these global companies, they will simply find other places to invest their capital, leaving SRA signatories without sufficient means to hedge their portfolio risk.

We urge Congress to reject the Administration's proposed cuts to the administrative and operating expenses. The A&O has been reduced to a point that, on average, SRA holders are now operating from 8-10 points over what they are currently being reimbursed. In order to absorb such shortfalls, companies must dip into underwriting gains to make up the difference. RMA has not made a convincing case for further reductions.

We also urge Congress to reject the Administration's proposal to increase the government's net book quota share. One of the objectives of the Crop Insurance Act of 1980 was to create a program where private insurers would bear risk. As a result over the years more and more risk has been assumed by the private sector. There is no justification to deviate from that model especially given that this would be outside the most recent agreement signed by companies.

Conflict of Interest

A March 9 informational bulletin issued by RMA entitled "Prohibition of Agent Involvement in Loss Adjustment Activities" has caused great concern among agents, companies and even producers. The intent of the bulletin was to remind participants in the program of the potential conflicts of interest that can occur if agents attempt to exert too much influence over the loss adjustment process. The effect of

the bulletin has been to cause a great deal of uncertainty and confusion in the crop insurance marketplace. CIRB feels that the effect of the bulletin will be to reduce service to the insured and lengthen the loss adjustment process. RMA has issued several clarifications to the initial bulletin, but their issuance has not been timely and frequently has caused even more confusion.

CIRB agrees that the interaction between agent and loss adjuster should be limited. CIRB does not suggest that agents be allowed to influence the proper adjustment of a claim; in fact, agents who do attempt to exercise undue influence should be dealt with severely. To say that agents should not interact at all with adjusters, however, is a very bad policy and tends to reflect negatively on RMA's understanding of the process. RMA would have been well served if it had met with its private sector partners prior to issuance of this bulletin to avoid that kind of confusion and uncertainty that now exists.

Asian Soybean Rust

It is appropriate that we talk about an immediate threat to one of America's foremost agricultural commodities - soybeans. Asian Soybean Rust, which has been the scourge of South American soybean production the past few years, has now appeared in the United States. It is a very serious threat and will be with us for many years to come. Crop insurers have been proactive in providing growers information about how to mitigate damage and how insurance will work. First of all let me say that RMA has been quite clear that Soybean Rust is a covered peril. Insurers as well as producers, however, experience some frustration over the timeliness and lack of clarity of updates on this issue by RMA. This is a problem that is endemic with bureaucracy in general but it also speaks to the complexity of issues such as this. Of course we have no idea how severe this dreaded disease will be but the potential damage that can be caused is staggering. We have only to look at what has transpired in Brazil to understand the potential losses.

From an insurance perspective, we are being as proactive as possible and providing producers with as much information as we can on how their insurance coverage will work. Rust will be treated in much the same manner as other covered perils where control measures exist. Farmers will be expected to take appropriate measures to mitigate losses from the disease. The March 28 RMA Informational Memorandum states *". . . farmers must use good farming practices to ensure that in the event of any naturally occurring disease outbreak, such as ASR, they will be eligible for an indemnity based on the full amount of loss."* RMA has directed the Industry to communicate this to agents and producers at the company's own expense. Subsequent to this memorandum RMA has issued a brochure to assist in the educational process. Companies are also addressing the issue through their agent and adjuster training activities. Of concern are RMA directives that can be interpreted to be contradictory and thus confusing; i.e. requirements to apply fungicides even when it cannot be justified economically.

Despite the tremendous amount of publicity in the news media, on the Internet, through the Extension Service, etc. there is much to learn about this disease. The insurance industry along with RMA must continue to analyze this information in an effort to assure that all clarity, from an insurance perspective, is brought to this issue. As such it is incumbent upon all of us – industry and RMA - to work through the issues it raises in a manner that best serves our policyholders. The working relationship between RMA and its private sector partners must improve to meet this challenge and others in the future.

Conclusion

If the crop insurance program in the United States is to remain successful, it must continue to evolve to meet the need of producers. This nature of this program is that it constantly deals with many challenges associated with various natural disasters. In many ways dealing with these types of challenges strengthen it and make it better. However, the real challenge to the program's survival rests with the support it receives from Congress and the Administration. We have outlined several challenges that could have long-term effects. If we do not provide adequate funding for the program or if we enter into plans we do not fully understand or possess the ability or resources to administer, then the program may not be able to meet the needs of the American farmer.

Insurers that sell and market federal crop insurance today have a strong commitment to efficiency, program integrity and providing the best possible service to farmers. They also work very, very hard to do these things within the boundaries of the Standard Reinsurance Agreement. Companies must have assurance that the federal government, their partners in this venture, will honor the SRA in the spirit in which it was intended and not make unilateral changes through the budget process.

Paul L. Horel
President
June 28, 2005

Senate Agricultural Committee Hearing to Review the Agricultural Risk Protection Act of 2000

National Grain Sorghum Producers Submitted Testimony June 28, 2005

Grain sorghum is economically important in areas where low rainfall and high temperatures limit production of other summer crops. As pressure on the Ogallala Aquifer increases and less irrigation is possible because of expanding non-agriculture demands, sorghum will return to being a significant crop because it needs less water to yield a good crop. Sorghum is a risk-adverse crop that will continue to be an important risk management tool for farmers in the Sorghum Belt.

When rain, hail, and winds damage crops, sorghum is the replant crop of choice for many producers in the Great Plains. In a typical year, more than 500,000 acres that were originally planted to a different crop are re-planted to sorghum. Consequently, the Risk Management Agency (RMA) replanting rules are important to the sorghum industry and the nation's producers.

After a devastating weather event, insurance providers are charged with the task of determining if it is practical to replant the acreage to the same crop or a different one. Likewise, producers aim to make decisions that will increase both their effectiveness and productivity. The quicker that decisions can be made, the better it is for the producers, their bankers, and RMA. Because so many factors are at play including field conditions and length of season, producers and insurance providers must work together to find solutions that are best for all parties involved.

A change in the "Practical to replant" and "Replanting" definitions in the 2005 common crop insurance basic provisions has confused many insurance providers and producers. These changes led many providers to believe that producers would be required to replant damaged crops through the end of the late planting period. This delayed action for producers by more than two weeks in some cases.

Commodity associations have gained clarification and disseminated information to their stakeholders as RMA also communicated with providers through conference calls. However, there is still a great need for proactive and clear communication from RMA to insurance providers on this issue. Providers need to know that RMA's intention is to give

both providers and producers more flexibility on replanting decisions rather than creating more restrictive conditions.

NGSP urges RMA to revert to the 2004 common crop insurance basic provisions in regard to the definitions of "Practical to replant" and "Replanting."

If RMA finds this is unacceptable, then NGSP urges RMA to reword the definition of "Practical to replant" to the following (new wording in **bold**):

> Our determination, after loss or damage to the insured crop, based on all factors, including, but not limited to moisture availability, marketing window, condition of the field, and time to crop maturity, that replanting the insured crop will allow the crop to attain maturity prior to the **earlier of the calendar date for the end of the insurance period or the average frost date in the county**. It will be considered to be practical to replant regardless of availability of seed or plants, or the input costs necessary to produce the insured crop such as those that would be incurred for seed or plants, irrigation water, etc.

These changes will allow insurance providers to make "Practical to replant" decisions on a case-by-case basis. We believe this was RMA's original intent.

NGSP looks forward to working with Congress and RMA on this issue for the benefit of the nation's producers. Thank you for your attention to this matter.

The National Grain Sorghum Producers (NGSP) represents U.S. sorghum producers nationwide. Headquartered in Lubbock, Texas, in the heart of the U.S. Sorghum Belt that stretches from the Rockies to the Mississippi River and from South Texas to South Dakota, the organization works to ensure the profitability of sorghum production through market development, research, education and legislative representation.

QUESTIONS AND ANSWERS

JUNE 28, 2005

Senator Saxby Chambliss questions for Ross Davidson

Question: It is imperative for RMA to maintain program integrity, but it is also necessary for RMA, as with all of USDA, to consider impacts of its decisions on the producer. Blueberry producers in Georgia were denied coverage through written agreements this year because a previous version, rather than an updated version, of a form was submitted from the insuring company to RMA—even though sufficient information was provided, as ruled in a third appeal in one case. These producers are uninsured for this year and now have a pretty negative attitude toward crop insurance in the future. How can RMA communicate the importance and availability of crop insurance coverage yet deny coverage on a technicality?

Answer:

- The issue of "previous version, rather than an updated version" of the form referred to in the question was not the basis for denial. RMA must deliver crop insurance programs in accordance with established regulatory and procedural requirements. Most of the requests were denied by the RMA Regional Office because the requests did not include the required perennial crop inspection report completed by the insurance company or because the inspection report was incomplete due to no attached blueberry crop addendum, as required by the policy and procedures.

- It is never RMA's intent to deny coverage for viable blueberry growers. However, RMA does not have the latitude of waiving requirements. It is the insurance providers' responsibility to ensure that all minimum supporting documentation, as required by the policy and procedure, is included with the request.

- Blueberries were converted from a pilot to a permanent program for the 2005 crop year. RMA received requests for expansion of blueberry coverage in certain counties for the 2005 crop year, but they were not approved because they failed to meet deadlines and/or lacked the minimum supporting documentation necessary to establish actuarially sound premium rates.

- The problems with the 2005 requests for expansion have been remedied and RMA has added insurance coverage for blueberries in the applicable counties for the 2006 crop year. Six additional counties for Georgia blueberry expansion are being considered for the 2006 crop year. These counties are Burke, Clinch, Coffee, Colquitt, Long and Pierce. All Georgia denials were in the above listed counties.

Question: Funding for data mining and other available information technologies expires after fiscal year 2005. Does the Department believe funds for data mining and other available technologies have been effective and does the Department believe this funding should be extended? Are data mining activities and activities of other available information technologies duplicative of other activities at USDA?

Answer:

- The Department believes that the funding for data mining under the Agricultural Risk Protection Act (ARPA) has been highly effective in improving the integrity of the Federal crop insurance program and that this funding should be continued. The data mining program is not duplicative of other information technology activities at USDA. To our knowledge, similar data mining practices are not utilized elsewhere at USDA.

- Since 2001, RMA has contracted with the Center for Agricultural Excellence at Tarleton State University to develop and implement a data warehousing and data mining system that has become extremely sophisticated in detecting patterns of practice that signal abuse. In its first year of operation applying this tool to our compliance operations, data mining prevented nearly $94 million in improper payments and helped recover nearly $35 million in improper indemnities.

Data mining-based savings to the Federal crop insurance fund for the full five-year period is estimated at $390 million, plus the benefit of improved confidence and trust in the Federal crop insurance program. The Administration's budget for FY 2006 includes a request for $3.6 million to continue data mining for a single year. This is a priority for the Administration and we are looking at various options for continued funding.

- **Question:** RMA has released a draft document outlining proposed conflict of interest provisions. Have you worked with affected parties to address or clarify concerns with the draft document? When do you expect final documents to be released and when will they be effective?

Answer:

- The draft bulletin recently released to interested parties to the program, when issued in final form, will provide supplemental guidance to the requirements found in the 2005 Standard Reinsurance Agreement (SRA). RMA initially met with representatives of the insurance providers in October 2004 to discuss the conflict provisions of the SRA, and has consulted on this draft bulletin with various parties since that time. Further, RMA has withheld issuance of the draft guidance because of the extensive consultation that has occurred between the Agency and interested parties to the program. The document will be issued as soon as RMA has briefed all the parties that have expressed concern over the revised requirements, their issues have been heard and any modifications made are consistent with program integrity and fraud/abuse deterrence.

- The bulletin is intended to provide some guidance on how to deal with the practical questions that have been asked about the impacts of the SRA language on the loss adjustment process and to alleviate to the extent possible concerns over conservative interpretations of that language by some insurance providers and agents. The requirement that seems to be causing the most concern is essentially identical to language contained in the 1998 SRA. That requirement prohibits agents from being involved in loss adjustment activities and loss adjusters from being involved in sales activities. RMA and the Office of Inspector General have found repeated violations of this separation between sales and loss adjustment,

including instances of fraud that point to a systemic vulnerability to the loss adjustment process.

- The 2005 SRA was revised to reinforce conflict of interest reporting and compliance. The changes represent the internal controls necessary to mitigate the observed program vulnerabilities resulting from a near total disregard by some individuals of the required separation of duties and responsibilities.

Question: What is the procedure for revising premium rates and how often does this occur?

Answer:

- RMA has recently implemented the results of a contracted study that addresses this issue. The study, "Analysis of Rating Cycle for Multiple Peril Crop Insurance," was conducted by an actuarial consulting firm. RMA has adopted the study's recommended procedure in identifying which crop/state/county combinations should undergo premium rate reviews for a given year. The procedure identifies these combinations based on the historical actuarial performance for the crop/state/county and the amount of time since the last review. Premium rate reviews are performed at least once every five years, but will generally occur more frequently than that, especially if there is a significant change in loss performance. In general, premium rate revisions are based on the new loss experience gained since the previous premium rate review.

Question: Written testimony provided by Mike Clemens highlights regional differences in levels of insurance coverage. How will USDA work to promote higher levels of insurance coverage in areas of the country with lower levels of insurance coverage?

Answer:

- Since the passage of ARPA, the average level of insurance coverage in the crop insurance program has increased significantly. However, this improvement has not been uniformly distributed. Some regions are significantly below the national average.

- Taking soybeans as an example, 87 percent of all soybean insurance policies in 2004 were for buy-up coverage and the average coverage level was 73 percent. One of the states highlighted in Mr. Clemens' testimony, Arkansas, offers an extreme example of regional variation in coverage. Arkansas had buy-up participation of 45 percent and an average coverage level of 60 percent, the lowest of any state where coverage for soybeans is offered.

- A review by a group of outside experts, contracted by RMA, determined that the premium rates for higher coverage levels should be revised downward in some regions, including Arkansas. This reduction may have a positive impact on participation at higher coverage levels in those regions.

- In addition, RMA has recently completed a comprehensive review of its portfolio of products. One of the key findings of this review was the very issue of certain crops and certain areas in which participation was not as high as others. The study's findings included a recommended tool that could be used to identify why producers are not purchasing in

certain areas, as well as what producers perceive as the risk of loss. This review will guide RMA on which aspects of the program it should focus in order to maximize participation.

- The recommended evaluation tool is designed to address basic insurability questions, such as real and perceived risk and availability of alternative risk sharing mechanisms. The tool consists of 70 questions, and is completed by persons having extensive knowledge of the industry and/or the crop. Information provided by this tool is used to identify potential causes of low participation, evaluate potential product design problems and inform agency priority setting and resource allocation decisions. In addition, the tool provides a systematic approach for developing and maintaining institutional memory for the various crop/region combinations.

Question: How does RMA envision expanding the product development process to accommodate new policies at a more rapid rate?

Answer:

- RMA has greatly expanded product offerings over the past few years. In 1999, RMA insured about 325 commodities and more than 34,800 county-commodity-product combinations. By 2004, the number of insured commodities had increased to 370 and the number of county-commodity-product combinations was more than 43,400. In 2004, a sugar beet stage removal pilot program was introduced, approval was given to a pilot program of crop insurance for Silage Sorghum in two states and Adjusted Gross Revenue-Lite (AGR-Lite) was made available in five additional states. RMA also expanded the availability of the Livestock Risk Protection plan of insurance to additional states and for additional types of livestock.

- Reflecting the expanded availability of products for specialty crop producers, program liability increased for specialty crops by 30 percent from 2000 to 2004. For underserved states, program liability in these areas has increased by about 65 percent since 2000, while the number of policies in force has increased by about 20 percent.

- RMA has also issued four contracts for development of new risk management tools for pasture, rangeland and forage, with two of these products anticipated to be available for 2006.

- RMA is also looking for potential new program offerings that are applicable to a broad range of commodities, as opposed to the dedicated crop-specific products of recent years. A particularly germane example is the Small Value Crops (SVC) program currently under development. SVC has the potential to bring an additional 50 crops into the Federal crop insurance program and be relatively easy and cost-effective for RMA and reinsured companies to deliver and administer.

- RMA is also instituting a number of measures to increase the efficiency and efficacy of new product development. The Program Development Handbook is being revised to more clearly delineate the roles, responsibilities and functions of all parties involved in the product development process, including contractors. This revision also will address the analyses,

documentation and other materials needed to support a new product submission and facilitate approval from the FCIC Board.

- In addition, new standards for private submissions under section 508(h) of the Act to the Board have been adopted for all new product submissions. These standards are also being applied to products developed by contractors of RMA to bring greater uniformity and consistency to the product approval process. RMA is also modifying the collaboration process between the Agency and developers so that issues and concerns are resolved more quickly and efficiently. This is designed to minimize the need for program changes after the developer has delivered its work product, which would speed the introduction of new products to the marketplace.

- In addition, RMA has requested that the FCIC Board consider allowing national expansion of pilot programs once they are approved at the end of the pilot period. The Board agreed to do this for the Pecan Pilot Program in those counties where sufficient production data was provided by producers to determine actuarially appropriate premium rates. Because it takes a great deal of time to write, publish and receive comments and finalize a regulation to implement a program nationwide, this action actually reduced product implementation time by approximately 18 months for those pecan-growing areas that were able and willing to provide the needed data.

Question: What accounting rules and practices are the Standard Reinsurance Agreement (SRA) holders required to follow when qualifying for and maintaining their SRA?

Answer:

- The SRA is the contract between the FCIC and the insurance company, which is required to file statutory financial statements with the state insurance department. Statutory accounting principles are prescribed by the National Association of Insurance Commissioners (NAIC). Further, the FCIC has published rules governing the qualifications of insurance companies at 7 C.F.R part 400, subpart L. The SRA also contains specific requirements for insurance companies to qualify and maintain an SRA, including additional financial reporting.

Question: Does RMA have staff adequately trained in accounting, reinsurance, and insurance laws to review documents required of companies by the SRA?

Answer:

- RMA has staff adequately trained in accounting and reinsurance and will augment and continue to train staff as needed. Consistent with Department practice, RMA relies on the Office of the General Counsel for review of and advice on legal requirements and documents.

Senator Baucus questions for Ross Davidson

Mr. Davidson, currently Montana's growers would like to grow sunflowers but are unable to get crop insurance. Current RMA rules require three years of actual production history before a producer can get a written agreement. Since lenders routinely require their borrowers to buy crop insurance every year before granting a loan, this RMA requirement effectively prohibits Montanan producers from even trying an alternative crop.

One of Agricultural Risk Protection Act's goals when it was enacted in 2000 was to expand insurance coverage to more crops. In addition, the 1996 and 2002 farm bills incorporated planting flexibility in order to give producers the ability to expand into alternative crops in response to market forces. Unfortunately, Congressional intent is being thwarted by the way RMA is now interpreting the crop insurance statute. I concur with the concerns of my colleague Senator Roberts that RMA's interpretation of the statute is preventing the planting of alternative crops.

Question: Mr. Davidson, what types of alternative documentation requirements will RMA put in place to more accurately interpret the statute and more closely reflect the will of Congress? Would RMA, for example, use the cropping history of a producer's similar insurable crops as a gauge of his or her ability to grow new alternative crops such as canola or sunflowers?

Answer:

- Section 508(a)(4)B) of the Federal Crop Insurance Act (Act) states that "In an area of the United States or specified in paragraph (A) where crop insurance is not available for a particular agricultural commodity, the Corporation may offer to enter into a written agreement with an individual producer operating in the area for insurance coverage under this title if the producer has actuarially sound data relating to the production by the producer of the commodity and the data is acceptable to the Corporation." (Emphasis added). Since section 508(a)(4)(B) expressly refers to the production by the producer of the agricultural commodity for which insurance is not available, RMA is unable to allow producers to use the cropping history of similar crops without a revision to the Act.

- Section 18(f)(2)(ii) of the Basic Provisions codifies that written agreement requests in a county without a crop program requires acceptable production records for at least the most recent three consecutive crop years. RMA has determined this to be the minimum amount of production history necessary to be actuarially sound and is generally consistent with section 508(g) of the Act, which provides for yields for actual production history without penalty when there is at least four years of production history. These requirements exist to ensure that sufficient data exists to determine the actuarially sound insurance rate on which to make an insurance offer. Despite its keen desire to be responsive to such requests, RMA is bound by the language in the Act to maintain a minimum standard of production evidence that is acceptable for determining an actuarially sound premium rate and coverage under these circumstances.

- The Agency is willing to make changes as suggested if statutory authority to do so could be granted. This would then need to be reflected in Agency rules and procedures and would

require action by RMA to approve changes to the written agreement procedures approved by the Federal Crop Insurance Corporation (FCIC) Board of Directors (Board).

Question: Mr. Davidson, the erosion of APH due to drought is of critical importance to producers in Montana. I understand that RMA will be coming out with two new proposed products to help remedy this situation and I look forward to reviewing these proposals. Can you please provide an anticipated timetable for the implementation of these proposals into viable products which producers can access?

Answer:

- RMA has recently awarded two contracts to address this challenging and important area of concern. One will research and develop new or revised methods for mitigating declines in an insured's approved yield following successive years of low yields. A second will look at alternatives for mitigating declines in approved yields caused by successive years of low yields. The development schedule for one of the contracts is targeting a pilot program for certain 2007 crop year spring crops in select counties. The other contract's deliverable date is targeted for January 2007, with implementation targeted for the 2008 crop year.

Senator Baucus questions for Keith Collins

I understand that, yet again, the FCIC has declined to create a livestock risk insurance product for the lamb and sheep industry. The intent of the statute is clear: livestock risk insurance programs should be available to a wide variety of livestock producers. At the moment programs only exist for the cattle and swine industries. In my view FCIC's rejection of a livestock risk protection program for the lamb and sheep industry circumvents the intent of the statute. In that regard, I share my colleague Senator Crapo's concerns about FCIC.

I understand however that the FCIC has provided some guidance to the lamb and sheep industry with respect to their most recent application to create an insurance product.

Question: Mr. Collins can I have your commitment that the FCIC will actively engage with the lamb and sheep industry in order to help create a viable insurance product? If so what timetable do you expect for completion of such an instrument?

Answer:

- The FCIC Board expressed support for a risk management tool for sheep and lamb producers at its April 25, 2005 meeting. Unfortunately, the Board was unable to determine that the Livestock Risk Protection Lamb submission complied with all applicable provisions of the Act, the interests of producers were adequately protected, premium rates were actuarially appropriate and that program integrity would be protected.

- While the FCIC is prohibited by statute from conducting research and development, RMA and the Board will consider any submission for insuring the lamb and sheep industry and will be of assistance within the confines of its authority. The Board engaged in significant discussions regarding a previous submission for insuring lambs and also engaged five independent expert reviewers who provided meaningful input to the process. All of this

information has been provided to the submitters of the Livestock Risk Protection Lamb proposal for their use in refining the product as applicable. The submitters have notified the Board that they are currently addressing these concerns and will resubmit a modified proposal by December 31, 2005.

Senator Kent Conrad questions for Mr. Davidson

I recently sent a letter to Secretary Johanns concerning the effects of the excessive rainfall on farming operations in eastern North Dakota. In that letter, I identified several steps that USDA could take immediately to assist those farmers who have suffered prevented planting or production losses as a result of the rainfall and flooding.

Question: Have you had the opportunity to review my letter?

Answer:

- RMA has reviewed your letter's recommendations carefully, and has prepared a reply to crop insurance-related questions for the Secretary to include in his response. We expect you will receive the Secretary's response in the near future.

Question: What actions is USDA prepared to take to assist these producers?

Answer:

- You asked RMA to implement a program to allow advance payment of a portion of the estimated prevented planting indemnity. Since producers must include prevented planting acreage on their acreage report in order to be eligible for prevented planting coverage, such payments cannot be made until the producer submits an acreage report. RMA will continue to encourage insurance providers to work prevented planting claims as expeditiously as possible after producers report prevented planting acreage.

- Unfortunately, the penalty for misreporting acreage report information in excess of 10 percent is a policy provision that can only be changed through the regulatory process. However, the policy does provide leniency by allowing producers who are unsure of the correct amount of acres to request an acreage measurement and report "estimated acres." In such case, the misreporting penalty will not apply as long as producers provide the acreage measurement.

- You also requested that the acreage reporting date be extended for at least 10 days beyond June 30, 2005. Current policy provisions allow producers who continue to plant after the final planting date or are prevented from planting during the late planting period to report their acreage for all crops that have a spring final planting date up to five days after the end of the late planting period. For example, the final planting date for soybeans in North Dakota is June 10 – this means the 25-day late planting period would end on July 5, and the additional five-day period would end on July 10. (Since July 10 fell on a Sunday, the five-day period would end on July 11.) The producer would have had until July 11 to submit the acreage report for all crops insured with the same insurance company. Thus, current policy provisions already allow acreage reporting generally consistent with your request for an extension.

Question: In many instances a producer will have a complete loss on part of a unit after investing nearly 100 percent of the production costs and yet not collect any insurance indemnity. However if that same acreage had been prevented planting the producer would get a payment on those acres. This situation will certainly exist in North Dakota this year due to the flooding.

What can be done to address this inequity in the crop insurance program?

Answer:

- Insurance payments are made on a unit basis to avoid large numbers of small claims. The current "deductible" structure allows for a wide range of coverage options, keeps producer paid premiums at affordable levels and avoids high administrative costs associated with large numbers of small claims.

- RMA acknowledges that prevented planting payments are made on a smaller than a unit basis, which causes an inequity between indemnities and prevented planting payments. This was because many producers who were prevented from planting a portion of their acreage but who produced a good crop from the planted acres in the unit did not qualify for an indemnity, even though their production was clearly reduced as a result of the prevented planting. Since coverage for prevented planting is specifically authorized under the Act, RMA elected to provide coverage for those acres that were prevented from planting.

- Prevented planting payments are subject to deductibles because payments are not made unless at least 20 acres or 20 percent of the acres in an insurance unit are prevented from being planted. Prevented planting losses are also paid at a reduced rate that is generally equal to 60 percent of the payment level for planted acreage.

- Program changes could be considered. However, "acre by acre" coverage for planted acreage would result in extremely high premiums, substantially higher costs for program administration and could result in increased opportunities for shifting of production and program abuse.

Question: Do you agree that quality discounts can vary tremendously from one part of the country to another depending upon the level of quality loss that may be prevalent in a particular production region?

Answer:

- Quality discounts can vary significantly from area to area and may change daily. This variation can be due to market conditions, storage availability, the size of the area affected and other factors. Further, there have been cases where buyers were intentionally over discounting production to shift the costs to RMA. For these reasons, RMA developed pre-established quality adjustment discount factors based on a 10-year average of Farm Service Agency (FSA) loan discounts and national average loan rates. This method provides an equal settlement to producers with similar crop damage and does not vary based on day-to-day marketing conditions or allow a manipulation of prices to shift costs to RMA.

Question: What changes has RMA proposed to modify their quality adjustment factors so they are more reflective of the discounts actually realized by producers?

Answer:

- Prior to 1995, RMA relied upon elevator discounts and prices to determine the quality adjustment discounts. However, due to the above stated program integrity issues discovered by RMA and the Office of Inspector General, RMA developed pre-established quality adjustment discount factors based on FSA loan discounts and national average loan rates.

This method provides consistent quality adjustment standards for all producers, allows for more accurate insurance rating, and reduces program vulnerabilities.

- As required by ARPA, RMA contracted with Milliman USA to conduct a study regarding the local quality adjustment factors. ARPA further directed RMA to make adjustments in the procedures based on the contracted study, taking into consideration the actuarial soundness of the adjustment and the prevention of fraud, waste and abuse. RMA posted the Milliman report on its website and requested comments and recommendations for improvement of the quality adjustment procedures from all interested parties, including producers, producer groups, universities, extension offices and private insurance companies. RMA received no uniform support for implementing the study's recommendations. The majority of the respondents favored maintaining the current procedures. RMA remains open to ideas or discussions for exploring alternative options that are consistent with program integrity requirements.

Question: Has RMA expanded its list of quality discount factors to include all discounts that are being applied by merchandisers and processors?

Answer:
- Not all discounts being applied by buyers are covered. For example, as noted in the Milliman study, some discounts may be based on a merchandiser-producer personal relationship. However, RMA strives to include coverage for quality losses caused by perils for which coverage is allowed by the Federal Crop Insurance Act. RMA will continue to review requests for quality related coverage and will work with producer groups and contractors to develop such coverage as the need arises.

Question: The President's FY 2006 budget proposed to cut funding for crop insurance by $140 million per year beginning in FY 2007 ($560 million FY 2006-2010). The proposal would require the purchase of a minimum 50% coverage for commodity program participants, and increase in producer premiums and a reduction in A&O reimbursements to companies.

Specifically what changes in the subsidy levels is the Administration proposing for each level of coverage?

Answer:
- The Administration's budget includes a proposal to reduce premium subsidies by five percentage points for coverage levels of 70 percent and below (75 percent and below for group risk products) and two percentage points for coverage levels of 75 percent and higher (80 percent and above for group risk products). Comparisons of current and proposed premium subsidy levels for individual and area-wide plans of insurance are provided in the table below.
- Note that under the Administration's proposal the farmer's insurance premium will continue to be subsidized, on average, by more than 50 percent. In addition, insurers will continue to be fairly compensated and we will make sure policies will be widely available.

Premium Subsidy Levels for APH Plans and Individual Revenue Plans (CRC, IP, RA)								
	Coverage Level							
	50%	55%	60%	65%	70%	75%	80%	85%
Proposed Subsidy Rate	62%	59%	59%	54%	54%	53%	46%	36%
Current Subsidy Rate	67%	64%	64%	59%	59%	55%	48%	38%

Premium Subsidy Levels for GRP, GRIP, and other area products					
	Coverage Level				
	70%	75%	80%	85%	90%
Proposed Subsidy Rate	59%	59%	57%	57%	57%
Current Subsidy Rate	64%	64%	59%	59%	59%

Question: What would the A&O reimbursement percentage be if the Administration's proposal were adopted?

Answer:

- In the Administration's proposal, the delivery expense (A&O) reimbursement rate would be reduced by two percentage points for all policies above CAT, beginning with the 2007 reinsurance year. Comparisons of current and proposed A&O reimbursement rates for RMA's various plans of insurance are provided in the table below.
- As noted above, under the Administration's proposal the farmer's insurance premium will continue to be subsidized, on average, by more than 50 percent. In addition, insurers will continue to be fairly compensated and we will make sure policies will be widely available.

A&O Reimbursement Rates for APH Plans of Insurance								
	Coverage Level							
	50%	55%	60%	65%	70%	75%	80%	85%
Proposed Reimbursement Rate	22.2%	22.2%	22.2%	22.2%	22.2%	22.2%	19.7%	19.0%
Current Reimbursement Rate	24.2%	24.2%	24.2%	24.2%	24.2%	24.2%	21.7%	21.0%

A&O Reimbursement Rates for Individual Revenue Plans (CRC, IP, RA)								
	Coverage Level							
	50%	55%	60%	65%	70%	75%	80%	85%
Proposed Reimbursement Rate	18.8%	18.8%	18.8%	18.8%	18.8%	18.8%	16.7%	16.1%
Current Reimbursement Rate	20.8%	20.8%	20.8%	20.8%	20.8%	20.8%	18.7%	18.1%

A&O Reimbursement Rates for GRP, GRIP, and other area products					
	Coverage Level				
	70%	75%	80%	85%	90%
Proposed Reimbursement Rate	20.4%	20.4%	18.1%	17.4%	17.4%
Current Reimbursement Rate	22.4%	22.4%	20.1%	19.4%	19.4%

Question: Does the Premium Reduction Program pose any additional management, regulatory or mission challenges that are different from the more standard crop insurance program?

Answer:

- Premium Reduction Plans (PRPs) do impose some additional challenges that differ from those that exist in the current program. For example, RMA will closely monitor all insurance companies offering PRP to assure that they are marketing to small, minority, women and limited resource producers as required by the recently issued interim final rule. RMA has also simplified and strengthened the PRP monitoring and evaluation process by correlating most of the reporting requirements to those of the current SRA. Moreover, insurance companies selling PRP policies must continue to adhere to the same state and Federal regulations that currently govern the sale and service of Federal crop insurance.

Question: Can a company or agents sell both regular crop insurance and participate in the PRP at the same time?

Answer:

- Under the procedures set forth in the interim final rule, insurance companies can select the states in which they offer PRP. However, within a selected state the insurance company and all of its agents must offer PRP to all producers, crops and plans of insurance. Agents may represent more than one company, including insurance companies that are eligible to offer PRP and those that are not. However, such agents must disclose to their customers all insurance companies that they represent that are eligible to offer PRPs.

Senator Kent Conrad questions for Dr. Collins

Question: What would be the impact on the PRP program if more companies began selling discounted crop insurance?

Answer:

- PRP, as a mechanism for providing insurance at lower cost to producers, may encourage more producers to participate in the crop insurance program. In addition, PRP might encourage some producers to purchase higher levels of coverage. As more insurance companies start selling discounted insurance, there could be more competition among insurance companies to gain cost efficiencies in order to pay out higher discounts. This

increased competition would likely result in insurance companies finding new, more efficient ways to provide service to their customers.

Question: Are Premium Reduction Programs sustainable at current levels in the longer term if A&O expense reimbursements are reduced?

Answer:

- Since PRP is based on each insurance company's expenses in relation to its A&O expense reimbursement, future reductions in A&O expense reimbursement might impact an insurance company's ability to offer PRP at current levels. However, participation in PRP is voluntary, and an insurance company can choose whether or not to apply to offer PRP based on its own assessment of expenses in relation to the A&O reimbursement.

Senator Kent Conrad

Senate Agriculture Committee Hearing to Review ARPA --

Questions for Mr. Davidson:

I recently sent a letter to Secretary Johanns concerning the effects of the excessive rainfall on farming operations in eastern North Dakota. In that letter, I identified several steps that USDA could take immediately to assist those farmers who have suffered prevented planting or production losses as a result of the rainfall and flooding.

Have you had the opportunity to review my letter?

What actions is USDA prepared to take to assist these producers?

In many instances a producer will have a complete loss on part of a unit after investing nearly 100 percent of the production costs and yet not collect any insurance indemnity. However if that same acreage had been prevented planting the producer would get a payment on those acres. This situation will certainly exist in North Dakota this year due to the flooding.

What can be done to address this inequity in the crop insurance program?

Do you agree that quality discounts can vary tremendously from one part of the country to another depending upon the level of quality loss that may be prevalent in a particular production region?

What changes has RMA proposed to modify their quality adjustment factors so they are more reflective of the discounts actually realized by producers?

Has RMA expanded its list of quality discount factors to include all discounts that are being applied by merchandisers and processors?

The President's FY 2006 budget proposed to cut funding for crop insurance by $140 million per year beginning in FY 2007 ($560 million FY 2006-2010). The proposal would require the purchase of a minimum 50% coverage for commodity program participants, and increase in producer premiums and a reduction in A&O reimbursements to companies.

Specifically what changes in the subsidy levels is the Administration proposing for each level of coverage?

What would the A&O reimbursement percentage be if the Administration's proposal were adopted?

Does the Premium Reduction Program pose any additional management, regulatory or mission challenges that are different from the more standard crop insurance program?

Can a company or agents sell both regular crop insurance and participate in the PRP at the same time?

Questions for Dr. Collins:

What would be the impact on the PRP program if more companies began selling discounted crop insurance?

Are Premium Reduction Programs sustainable at current levels in the longer term if A&O expense reimbursements are reduced?

Questions for Mr. Rose:

Information provided by Crop 1 indicates that 66% of the policies in force in 2004 were less than 255 acres.

In dollars, what is the average savings for your Premium Discount Program (PDP) clients?

Do the fewer than 255 acre policies include the optional units of an insured?

Do the fewer than 255 acre policies include those issued to landlords that may be insured as part of a larger policy purchased by an operator?

What percentage of the demonstrated savings and efficiencies Crop 1 used to substantiate its eligibility to sell discounted crop insurance were the result of reduced agent compensation and what percentage were from other company efficiencies?

Please identify those non-agent compensation savings.

Question for Dr. Babcock:

Are Premium Reduction Programs sustainable at current levels in the longer term if A&O expense reimbursements are reduced?

Questions for Mr. Clemens:

How would you propose the price election for sunflowers and canola be established?

Would an initial price election that is updated the following spring to reflect market conditions work?

What if the price declines?

Could this be an optional program for producers?

Have your members experienced any problems or dissatisfaction in recent years with the quality adjustment factors and discount compensation levels of federal crop insurance?

The Honorable Charles E. Grassley

We have received comments on the proposed rule. Please be assured that we will take particular care to evaluate each comment and provide appropriate responses in the final rule. We will carefully and thoughtfully address all comments received so that the final rule will allow RMA to administer Section 508(e)(3) of the Act equitably and to the benefit of all producers, large and small, while maintaining the integrity of the Federal crop insurance program.

We offer the following responses to your questions (repeated here for convenience):

Question 1:

According to the proposed rule, the legal interpretation is that the discount has to correspond to the efficiency (pg 9005, 9006, and 9008). At what level does this rule apply? State, policy, plan of insurance?

Answer:

The proposed rule would require an approved insurance provider offering a premium discount to provide the same percentage discount to all producers in all states and for all plans of insurance. From that perspective, the rule would apply equally across the approved insurance provider's book of business for all states that the provider serves. However, as we explained in the preamble to the proposed rule, the rule requires state reporting to help the agency verify that efficiencies achieved in one or more areas are not less than the required single discount, which could result in subsidization of one area by another which is not allowed under section 508(e)(3) of the Act (see p. 9008).

As we stated in the preamble to the proposed rule (see pp. 9006-9007), RMA reached its decision to limit state variability based on an analysis grounded in three principles:

a. The ability to offer such a reduction by state must not cause competitive harm in the marketplace.

b. A premium reduction plan where the efficiencies and reductions vary by state must be easy for the approved insurance provider to administer and easy for RMA to verify.

The Honorable Charles E. Grassley

c. Such a plan must provide uniform service and prevent unintended effects on the business practices of the approved insurance providers.

In the preamble, we invite comments as to whether an approach that allows state variability in the discount is feasible consistent with these principles (see p. 9006). We will carefully evaluate those comments and make appropriate adjustments to the rule prior to final publication.

Question 2:

On page 9008 (middle column) RMA is proposing that the premium reduction amount must be commensurate with the amount of savings obtained from the efficiency in that state. How will RMA enforce this rule? Does RMA intend to require companies to provide state level accounting?

Answer:

The proposed rule requires that approved insurance providers offer the same percentage discount to all producers in all states for all plans of insurance. As we explained in the preamble, section 508(e)(3) of the Act requires that the company must demonstrate that its discount corresponds with its efficiencies. The proposed rule would require that the documentation supporting the insurance provider's plan of operation include the state level accounting necessary to validate that the efficiencies appropriately correspond to the amount and the location of the associated discount as required by the Act.

Under the proposed rule, each year the approved insurance provider can submit a request to offer a PRP. Part of that request will be a stated premium reduction the approved insurance provider is seeking to offer in the marketplace. If approved by RMA, the rule would require that same reduction (say 2.5 percent) to be offered to all producers in each state. The PRP provision in section 508(e)(3) of the Act requires that these premium reductions must "correspond" to the administrative cost efficiency. We interpret this "corresponding" requirement as requiring that the administrative efficiencies attributable to the operations in a state must at least equal the amount of the reduction provided to policyholders in that state. This means that if the provider is offering a 2.5 percent premium reduction, it must do so in all states and the costs savings it attains through its efficiencies must be at least 2.5 percent in each state.

The Honorable Charles E. Grassley

Therefore, in accordance with sections 400.716(h) and 400.719(a)(6) of the proposed rule, RMA would track the expense performance of the approved insurance provider at the state level to ensure that costs are reduced in each state by an amount that is at least equal to the premium reduction. RMA recognizes that the cost of delivery may vary by state due to a variety of reasons (e.g., some policies are less expensive to sell and service, agent commissions are less in some states). If the costs in a state may be reduced even more than the amount of the premium reduction (say 5 percent when the premium reduction is 2.5 percent), the approved insurance provider still cannot vary the premium reduction or apply the additional savings to a different state where the costs have not been reduced by at least the amount of the premium reduction.

Question 3 and 4:

Does RMA believe that it costs the same to deliver a corn policy versus a fruit or tree policy?

Does RMA believe it costs the same to deliver crop insurance in IA as it does in TX?

Answer:

Costs to deliver federal crop insurance may vary by state, crop, plan of insurance, or on other bases and would be different for each approved insurance provider. However, the statute requires that the discount provided by an approved insurance provider correspond to the demonstrated efficiencies, which can be consistent in amount or nature across the entire book of business. If an approved insurance provider can deliver the program for less than the administrative and operating expense reimbursement, then the proposed rule would allow that efficiency to be passed on to the producer, regardless of what variable cost may be, as long as the efficiency corresponds to the discount. This requirement would not preclude variation in delivery costs for different policies or plans of insurance in different parts of the country.

For example, if an approved insurance provider implemented a change in its computer systems that reduced computing costs by 3 percent across the board, costs of processing business would have been reduced by 3 percent, regardless of the absolute level of computing costs in any given area, and therefore could justify a single discount across the entire book of business.

The Honorable Charles E. Grassley

Question 5:

Proposed section 400.715 says that the discount must be offered in every state and for every plan of insurance that the company writes. It further says that the amount of the discount may not vary between states, crops, coverage levels, policies or plans of insurance. TAKEN WITH #2, HOW CAN A COMPANY THAT WRITES IN MORE THAN 1 STATE OFFER A DISCOUNT? DELIVERY COSTS VARY BY STATE, and PLAN OF INSURANCE, HENCE ANY EFFICIENCY WILL VARY BY STATE and PLAN OF INSURANCE. For example, a 1 percent reduction in agent commissions will impact TX agents significantly more than IA agents. Or a computer efficiency will impact States that have more policies written (IA for example) than those with a few policies.

Answer:

The proposed rule requires the same percentage discount be offered in all parts of the country based on a demonstrated and corresponding efficiency. While the dollar costs to deliver insurance may vary on many levels, the federal administrative and operating expense reimbursement and major insurance provider costs, such as agent commissions, can be generally accounted for on a percentage premium basis. As explained in the preamble, the viability of tying a single percentage premium discount to corresponding efficiencies on a percentage of premium basis has been demonstrated in the manner in which premium reduction plans have been administered by RMA under existing FCIC Board approved procedures for the last three years (see pp. 9003-9005).

Question 6:

Is it possible to have non-variable efficiencies in light of variable costs? How detailed will RMA get with its plan and oversight review to make sure efficiencies do not vary by State and the discount truly "corresponds" to the efficiency?

Answer:

Based on RMA history with premium reductions, RMA believes it is possible for an approved insurance provider to demonstrate that it is able to reduce its variable costs nationally by a given percentage (see pp. 9003-9005). For example, the cost of processing policies through a national information system may be variable depending on many factors, but the total cost of processing could be reduced by an efficiency that would apply equally on a percentage basis for all policies.

The Honorable Charles E. Grassley

Each premium reduction plan will vary with the particulars of the approved insurance provider and the proposed plan. The proposed rule would require insurance providers who wish to offer a premium reduction to modify their plans of operation including documentation regarding their administrative costs to support their requested discounts. Accordingly, the proposed rule would look to the approved insurance provider and its certified public accountant to provide the necessary detail to validate that the efficiency meets the requirements of the law and that the discount corresponds to the efficiency. RMA will require disclosures consistent with those plans.

Senator Grassley, we hope these responses help to facilitate a better understanding of the intent of the rule. Again, we offer to brief you or your staff on these or additional matters or to assist you otherwise in your important Congressional oversight responsibilities of the Federal crop insurance program.

Respectfully,

Ross J. Davidson, Jr.
Administrator

Senator Ben Nelson Questions

Question: RMA's policy on conflicts of interest in loss adjusting seems inconsistent with the Administration's views on the agent, client relationship through settlement. How can the agents effectively see a claim through to fruition if communication with the policyholder and loss adjustor is so severely inhibited?

Answer:

- Agents are permitted to explain the policy terms and process to their clients. This can happen in relation to the claims process too. However, while agents can explain the policy terms, they are not permitted to participate in the actual adjustment of the loss. This is the sole responsibility of the loss adjuster. This prohibition has existed in the SRA for a number of years as the Administration's views on the agent-client relationship. Given the potential problems that exist when agents get involved in loss adjustment, especially since they are not trained loss adjusters, the Administration does not see a reason to change its views at this time.

Question: A $10,000 fine may be levied against agents failing to comply? What type of environment do you expect will be created (between agents and their farmer-clients) by this fine? Is it your opinion that program participation, which ought to be encouraged, will be maintained as agents make exceptionally cautious decisions in order to protect their businesses?

Answer:

- Fines are a deterrent to non-compliance with the requirements of RMA, which would include any requirement regarding the prohibition against agent involvement in the loss adjustment process. Further, no fine of any amount can be assessed for failure to follow a RMA established requirement unless the Agency has properly established the violation was willful and intentional and provided the subject with full due process before the penalty is imposed.

- RMA does not share the opinion that precluding willful violations of the requirements established by RMA will adversely influence acceptable business activities relative to sales by agents or claims adjustment by loss adjusters.

Question: A loss adjustor is not allowed to utilize data and records that an agent has readily available, instead having to access data from FSA. What is the basis for this decision? Is it your opinion that program participation, which ought to be encouraged, will be maintained as agency data and records become irrelevant?

Answer:

- The question appears to suggest that loss adjusters do not have access to the policyholder file maintained by the agent when performing adjustment activities. To the contrary, loss adjusters are required to verify all data in the policyholder file used to establish the guarantee, including records relating to yields and acreage, as part of the loss process (as noted in the pending supplemental guidance). In some of its reviews, RMA has determined that by not verifying these records at the time of loss, adjusters have failed to determine accurately the loss amount.

- For example, RMA has identified loss adjusters not validating the FSA information used to establish the guarantee at the time of loss when FSA has conducted random measurements of the policyholder's acreage and made corrections to their certifications after the time such information was reported to the agent. This has resulted in the overpayment or underpayment of claims. The question also raises the issue of insurance companies using FSA information. RMA permits, but does not require insurance companies to use FSA information and continually has to remind insurance companies that it is the producer's responsibility to ensure that certifications of acreage and yield for crop insurance are accurate, not just the same as what they certify to FSA.

Question: Based on your data mining initiative, do you have any empirical evidence that suggests that agents are contributing to fraud and waste in the program? Would you be willing to provide me with this data?

Answer:

- The 2004 Spot Check List produced by the data-mining contractor identified 94 producers associated with agents and loss adjusters whose loss experience was suggestive of collusion. This "triplet" list is the most direct agent correlation identified by data mining. We have attached a map indicating where these "triplets" are located along with other information on the 2004 Spot Check List. While this is the most directly correlated spot check result, RMA has found indications of inappropriate agent behavior in relation to loss determinations in most of the various spot check scenarios produced by data mining. In fact, in many of these scenarios, the producers would not have been able to collect the suspected improper indemnities without the assistance of an agent who is either not fully performing his/her responsibilities or is actively engaged in improper behavior relative to the program.

- Please note that RMA must verify these scenarios before any improper conduct can be established. Just because an indemnity is anomalous in comparison to other indemnities in an area does not mean it is improper. Only through a review of the factual information can RMA determine that an indemnity was incorrect. (Please see additional attachment regarding this issue.)

Question: In a case where farmers are both a policyholder and a 'de facto agent,' would they be in violation of the conflict of interest provision?

Answer:

- This situation clearly represents a reportable conflict of interest that the insurance company would need to be aware of and address in accordance with existing procedures. The procedures to deal with agents and loss adjusters who also have farming interests have been in place for several years and are not affected by the changes to the SRA or the pending supplemental guidance.

Question: How many comments has RMA received on the preliminary rules? What was the percentage of positive comments? Of negative?

Answer:

- RMA received about 1,900 comments from 829 respondents on the PRP proposed rule. RMA reviewed each comment individually in preparing the procedures set forth in the interim final rule. RMA did not categorize comments by "positive" or "negative" because it was not germane to the rulemaking process. RMA was required to implement a rule to permit insurance companies to apply to RMA for the ability to pay premium discounts if their costs associated with delivery of the program were less than their A&O reimbursement. However, RMA did review, consider and make changes to the proposed rule in preparation of the interim final rule that, in many instances, reflected the substantive comments received and addressed the concerns expressed therein.

Question: What is the impact of PRP on producers and their decisions regarding both participation in the program and expected coverage levels?

Answer:

- According to five expert reviewers solicited by the FCIC Board, PRP will likely result in increased producer participation and higher expected levels of coverage as discounts make crop insurance less expensive. However, the interim final rule requires that such discounts be paid only after RMA has verified the actual costs savings and approved a payment based on such savings. Such "back-end" discounts may have less effect on coverage levels and participation in the program but RMA had to weigh the possible immediate benefit to producers with the program integrity and administration issues. On balance, RMA determined that even though premium discounts to producers are uncertain with the "back-end" approach, there is a better likelihood of a more stable crop insurance program. However, producers still have the ability to collect a premium discount that could reduce their future insurance costs.

Question: Regarding the current PRP as approved for only one company: When were companies first eligible to apply? How long since the law was enacted did it take for any companies to decide to apply, and how many companies appear now to be in the pipeline now for approval? Using the current example (one PRP-approved insurance provider), is there enough volume from this sample to provide a fair test, giving us a statistically accurate sample as to how the program might work over the long term?

Answer:

- The authority to offer crop insurance under reduced premiums was established as part of the Federal Crop Insurance Reform Act of 1994. Therefore, insurance companies have been able to apply since that time. However, insurance companies did not approach RMA with an interest in offering PRP until 2002, when Converium Insurance Company and its Managing General Agent, Crop1 applied. Over the past year, six additional insurance companies submitted applications to offer PRP. The applications were subsequently denied because they did not meet all the requirements in the procedures that existed at the time and it was realized that the procedures were inadequate to address the various types of proposals RMA was receiving. During this time, RMA was directed by the FCIC Board to immediately begin a formal notice and comment rulemaking process. The Board asked RMA to prepare a regulation that addressed the issues raised by these applications to be applicable for the 2006 reinsurance year. Further information will be provided in the next few weeks. In response to the Board directive, RMA published an interim rule on July 20, 2005.

- Under the procedures set forth under the interim rule, all 16 insurance companies may request the opportunity to offer premium discounts. On August 31, 2005, RMA announced that nine companies have been determined eligible for the opportunity to offer crop insurance premium discounts in states the companies selected for the 2006 reinsurance year. The nine companies had recently submitted their eligibility requests in accordance with the provisions of the new interim rule.

- A company's eligibility for the opportunity to offer a premium reduction does not require the company to ultimately request approval from RMA nor does it guarantee approval to pay a premium discount to its federal crop insurance policyholders. Any payment of a premium discount by a company will occur only after the company's financial information for the year is independently audited, and RMA verifies and approves the requested discount. Even if a company requests and is approved to pay a premium discount for 2006, its policyholders could receive the discount as late as the spring of 2008.

- Under Crop1's business model for the 2005 reinsurance year, PRP discounts were paid "up-front" and quoted to producers at the time of insurance application. Under the procedures set forth in the interim rule for the 2006 reinsurance year, discounts will be based on actual cost efficiencies achieved during the reinsurance year subject to RMA approval and paid by the company to producers at the "back-end." RMA does not believe that Crop1's experience is necessarily a statistically accurate sample in evaluating how PRP will work over the long term given this structural change.

Question: Once the initial first-to-apply PRP application was approved, what steps did RMA take to oversee the implementation? Are there auditing systems used for analyzing AIPs which do not offer PRPs? Please be specific about the differences, if any, between auditing procedures for PRP providers v. non-PRP providers.

Answer:

- After the first application for PRP was approved, RMA took several steps to oversee PRP implementation. These steps were in addition to the auditing systems in place which exist in the absence of PRP. The auditing system that applied only to the insurance company providing PRP included the following: 1) weekly updates from the current PRP-provider; 2) monthly updates between the managing general agent and the company (SRA holder); 3) mid-year review by RMA to verify that cost efficiencies are being achieved as expected; 4) quarterly reports of expenses; 5) a detailed review after claims have been processed, usually in January or February, to verify whether cost efficiencies have been met; and 6) regular updates by RMA to the FCIC Board regarding specific issues which arise with respect to the approved PRP provider. These audits and reviews are in addition to the standard SRA audits and do not apply to the non-PRP providers.

Question: What authorities (and flexibility within these authorities) does RMA need to insure that as price competition enters the market, company consolidation and potential for collapse not heightened?

Answer:

- RMA believes that the current regulatory framework, both at the Federal and the state level, provides sufficient authority for RMA to ensure that increased price competition will not heighten the potential for insurance company consolidation and collapse. For instance, RMA will continue to monitor insurance companies' financial conditions as part of the SRA approval process and will require regular reports from companies offering PRP. In addition, RMA is working to strengthen its partnership with state regulators and NAIC to enhance oversight of companies and to identify and remedy program vulnerabilities as they arise. As insurance companies manage their expenses to qualify for PRP, their financial stability may in fact increase. Insurance companies operating under the A&O reimbursement level are at less risk that a poor underwriting year will result in a significant reduction in their surplus, as was the case with American Growers.

Senator Roberts questions for Ross Davidson

Question: Does RMA require that signatories to the Standard Reinsurance Agreement follow generally accepted accounting principles, otherwise known as GAAP, as well as those sanctioned by the National Association of Insurance Commissioners (NAIC)?

Answer:

- Insurance companies that have a SRA are required to be compliant with state and Federal law including accounting principles. This would include providing RMA with their statutory financial statements using NAIC prescribed accounting principles.

Question: Does RMA follow general accounting rules as well as accounting rules sanctioned by NAIC when qualifying prospective SRA holders?

Answer:

- RMA evaluates both the statutory and GAAP statements submitted by the prospective SRA holder. RMA also relies on insurance rating agency analyses and ratings which use statutory,

GAAP and financial and market analysis to rate insurers on their financial strength. The statutory accounting principles prescribed by the NAIC emphasize the solvency of the insurance company to ensure that policyholder obligations are met. RMA is concerned about SRA holder solvency as well, and thus conducts greater analysis using the statutory statements and supplementary analyses particular to the crop insurance business. RMA conducts analysis on the managing general agencies and other service providers using only GAAP statements, as they are not required to file on a statutory basis.

Question: If RMA does not follow these rules, why not?

Answer:
- RMA conducts analysis using both GAAP and statutory statements.

Question: If RMA does not follow these rules then, as the regulator of the industry, how does the agency determine the financial condition of each of the SRA holders?

Answer:
- RMA conducts analysis using both GAAP and statutory statements and uses established rating agency reviews and ratings to augment statutory financial ratios. RMA also consults with insurance regulators, who conduct periodic financial examinations of insurers and conducts its own financial and operational reviews.

Question: Last year we had quite a few problems associated with coverage and claims on sprouted wheat in Kansas. We were able to work out an agreement to provide payments to most of those producers, but I am still hearing that the quality loss adjustment procedures do not even come close to recognizing the actual loss in value caused by this type of problem. Will you commit to looking into this issue to assure us it will not be a problem in future years?

Answer:
- RMA is always willing to consider changes to its programs to better meet the risk management needs of producers. However, it must also assure any changes can be administered with available resources, are actuarially sound and do not create opportunities for fraud, waste and abuse.

- RMA was able to work through the issues in Kansas with sprouted wheat using existing procedures without creating additional exposure. The concerns with sprouted wheat were not whether RMA's quality factors were appropriate, but rather focused on the facility that was conducting the testing to determine the source and amount of sprout damage. Once that issue was resolved, RMA's current quality adjustment factors were used in settling claims.

- RMA would be pleased to work with your office to help ensure that the proper balance of policyholder service and program integrity are maintained.

Question: There has been a good bit of discussion taking place regarding the Premium Discount Plan (PDP) and/or Premium Reduction Plans (PRP). As you know, this proposal has been met

with widespread concern in the Congress regarding its potential impact on the program. I have several questions for you on this topic.

First, can a company operate without a Premium Reduction Plan? If the answer is yes, does that mean Crop1 could operate during the 2006 crop year, even if it did not offer premium discounts?

Answer:

- Companies are free to choose whether or not to offer PRPs. Crop1 has been approved to sell insurance for the 2006 reinsurance year. RMA does not know if Crop1 and its SRA holder, Occidental Insurance Company, will choose to continue to participate in the program if they are not approved to offer PRP. However, based on the recent financial and operational review, they would qualify to continue under FCIC rules and standards.

Question: When the PDP/PRP proposals were first brought forward, we were assured through staff briefings that savings for PDP policies would be achieved through actions such as Internet sales. I am not going to ask you to disclose specific numbers, but can you tell us if the majority of Crop 1 policies are being sold over the Internet or via agents?

Answer:

- Reports submitted from Crop1 indicate that the majority of crop insurance policies are being sold via agents, although the internet remains an option for Crop1 insureds and Crop1 reports that some policies are sold through that medium.

Question: One of the big concerns regarding PDP/PRP has been the possibility of cherry-picking. Basically, I and others have been concerned that marketing and sales efforts will only be targeted toward the largest producers and thus the most profitable policies. Are you convinced this is not occurring?

What happens if an agent services policies for two different companies – one that offers a PRP and one that does not? Is the agent required to offer both policies to a producer, or does he have the option of offering only the non-discounted policy? Is this a form of cherry-picking?

Answer:

- As part of its oversight of PRP, RMA received and analyzed information on Crop1's book of business including policy size (measured by average premium per policy and average acres per policy) and compared that with other insurance companies operating in the same states. In several states, Crop1's average policy size was higher than other insurance companies. In most instances, however, at least one other insurance company had a higher or nearly as high policy size. Of course, policy size may or may not be indicative of farm size. However, Crop1 has also represented and provided supporting information on farm size. Based on those reports and analyses, RMA has determined that Crop1 sells a substantial percentage of its policies to smaller producers. RMA has also received anecdotal information from Crop1's competitors that claim that only large accounts leave them to go with Crop1. This is not surprising given the discount available and given the natural tendency to compete for attractive business.

- Further, there is nothing in the current SRA that would preclude insurance agents from soliciting only large producers. This occurs today for most insurance companies, even though they have not participated in PRP. This is one of the reasons that the SRA requires the insurance company to provide insurance to any eligible producer. This ensures that small producers are provided with the opportunity to obtain insurance. In addition, the SRA also now requires that insurance companies promote crop insurance to all producers so that small producers know that crop insurance is available.

- RMA is principally concerned that solicitation of large producers does not occur to the exclusion of serving small farmers. RMA does not have sufficient evidence to conclude that "cherry-picking" of large producers has resulted in small producers not being offered PRP since Crop1 has produced credible evidence that it advertises and sells to small and large producers.

- RMA has further addressed this issue in the recently published interim final rule for PRP. Under the procedures set forth, agents are required to notify producers, as well as those inquiring about insurance, of all insurance providers represented by the agent who are approved to offer PRPs. Thus, the agent will not have the option of only offering PRP or non-PRP policies exclusively to large producers, which can mitigate "cherry-picking" concerns. The rule also requires insurance companies to develop and implement a marketing plan applicable to all producers, especially small, limited resource, women and minority farmers. In addition, the rule includes reporting requirements and sets forth analyses that will assist RMA in identifying if there is credible evidence of such unfair discrimination. Where such discrimination is determined to exist, the rule provides for strong sanctions.

Question: The proposed PRP rule requires numerous financial activities by companies that might be approved to sell the policies. If you have multiple, varying policies that are approved by the board, and which will require significant financial oversight, do you have the necessary financial staff expertise necessary to conduct the financial reviews required under the proposed rule?

Answer:

- The interim rule differs significantly from the proposed rule. The interim rule requires the premium discount to be based on actual costs rather than projections, uses existing expense exhibits submitted to RMA by the insurance companies in their normal annual application for an SRA and provides for a procedure for allocation of costs to states. Thus, the complexity of analysis, the financial reporting and review burden on both the insurance companies and RMA should be substantially less than that included in the proposed rule.

- The interim rule sets forth a uniform PRP structure in which discounts are distributed to producers after the reinsurance year is complete, if cost efficiencies are achieved and verified by RMA. Thus, the general PRP program structure will not vary by company, which will simplify and streamline RMA's oversight process. Moreover, most of the review and oversight will be accomplished by examining financial documents, exhibits and reports already required in the insurance companies' Plans of Operations, submitted as part of the yearly SRA approval process. RMA is also requiring a certification by an accounting firm

experienced in insurance accounting of information provided by the insurance company on its actual costs on which the request to pay a discount is based. RMA is confident that sufficient staff expertise and resources exist to perform all necessary financial reviews.

Question: I have had several questions from both SRA holders and producers regarding the impact and applicability of PRP to CAT policies. Since producers are only paying an administrative fee on these policies, how will PRP apply to them?

Answer:

- Since CAT policies receive a 100 percent subsidy, PRP will not apply to these policies. Producers will continue to pay the normal administrative fee for these policies.

Question: Your written testimony discusses savings to the crop insurance program obtained through data mining. I know that you also had estimated yearly savings through the SRA that was completed last year. Combining the two numbers, what are we looking at in terms of savings over a five year and a ten year period?

Answer:

- If one extrapolates the estimates of fraud deterrence, which RMA believes results from the use of data mining, then the five-year estimate would be approximately $390 million and the 10-year estimate would be $780 million. The estimated annual savings from the changes made to the SRA is approximately $36 million, which would be $180 million for five years and $360 million for 10 years. Totaling these two would produce savings estimated at $570 million for five years and $1.14 billion for 10 years.

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