United States Department of Agriculture

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

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

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

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

The third chart shows the amount of time and deliberation that it takes to bring a new product to market -- on average nine years from concept to full implementation. RMA is working hard to encourage and oversee the responsive and responsible development of a broad range of new products while expediting the process where feasible. I will highlight some of our progress later in my statement.

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

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

RMA Program Issues

Expansion of County Crop Programs

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

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

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

New Outreach, Education, and Research Partnerships for 2004

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

American Growers Update

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

The current cost to the Federal government for the failure of Grower's currently stands at approximately $40.7M with minimal outputs still accruing to the cost of the run-off. Some recovery of residual assets is expected to offset this amount as the final disposition of Growers is completed by the State of Nebraska.

Information Technology Budget Situation

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

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

Prevented Planting Request

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

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

The Agency also reviewed a request to change the earliest date for grazing land on which prevented planting payments were received without a reduction in the prevented planting payment from November 1, to an earlier date. Unfortunately the request could not be granted without subjecting the program to increased litigation risk.

Pilot Programs Status

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

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

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

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

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

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

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

Compliance Activities

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

Annual Report to Congress - The 2002 Crop Year Compliance Annual Report to Congress is in the final stages of Departmental clearance and we expect it to be delivered to Congress very soon. The report shows continuing gains against waste, fraud and abuse from the use of data mining and remote sensing to identify anomalous producers within the policyholder base. The SRA for 2005 will build on these results by incorporating data mining into the selection of policies that will be reviewed by the companies as part of their quality control requirements.

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

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

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

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

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

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

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

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

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

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

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

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

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