

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.