Testimony of

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Risk Management

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Chairman Boswell, Ranking Member Moran, and members of the Subcommittee, as Administrator of the Risk Management Agency (RMA), I am pleased to meet with you today to discuss the latest developments in RMA, the progress and challenges of the Federal crop insurance program, and, in particular, to provide an update on the recently negotiated Standard Reinsurance Agreement (SRA) and its benefits to the agricultural community and the American taxpayer. My staff and I work daily to validate the utility of current insurance products –making certain we have the best protection possible for all of America's farmers and ranchers. We work to ensure outreach to small and limited resource farmers, to promote equity in risk sharing and to guard against fraud, waste and abuse within the program. In our role as regulators, we must also ensure the continued integrity and actuarial soundness of the Federal crop insurance program.

Secretary Vilsack asked me to administer the Federal crop insurance program in a manner that provides effective risk management services necessary for American farmers and ranchers; and that offers such services and opportunities to participate in the program to farmers and ranchers in all geographical areas regardless of the size of their operation. The Secretary and I are aware that in today's economy it is important that the program be cost effective and give a fair value for the taxpayers' dollar.

The crop insurance program has grown in coverage and in value to producers over the last decade. In 1999, just 73 percent of insured acres for the ten staple crops had buy up coverage, compared to 92 percent in 2009. Not only are coverage levels increasing, but the type of coverage farmers are purchasing is shifting to the more comprehensive revenue coverage. Many banks require crop insurance coverage in order to make operating loans to crop producers. Federal crop insurance has become a fact of life for many farmers – and one in which American farmers would find it difficult to continue providing America and the world with an abundant supply of food, fiber and fuel without the program.

This growth has been accomplished in an actuarially sound manner as required by Congress and the program is working well. Over the last two decades, premiums (producer premiums added to premium subsidies) have been sufficient to cover the indemnities paid to producers plus a reasonable reserve, as directed by the Federal Crop Insurance Act.

The 2011 Standard Reinsurance Agreement

The Food, Conservation, and Energy Act of 2008 (2008 Farm Bill) allowed the renegotiation of the Standard Reinsurance Agreement (SRA), which is the agreement between USDA and the approved private insurance companies who deliver the program through a network of insurance agents. Negotiations began late in 2009, and on July 13, 2010, USDA announced that all of the approved crop insurance companies had signed the new SRA. At the beginning of the negotiations, Secretary Vilsack and I established six objectives for the new SRA that would build on the strengths of the program. The objectives were designed to align with RMA's primary mission to help producers manage the significant risks associated with agriculture. We maintained our focus on those objectives throughout the process and they have served us and America's farmers well. They are:

1) Maintain producer access to critical risk management tools;

2) Align the Administrative and Operating (A&O) subsidy paid to insurance companies closer to actual delivery costs;

3) Provide a reasonable rate of return to insurance companies;

4) Protect producers from higher costs while equalizing reinsurance performance across states to more effectively reach under-served producers, commodities, and areas;

5) Simplify provisions to make the SRA more understandable and transparent; and

6) Enhance program integrity.

During the negotiations RMA held many meetings with the companies to hear their concerns and suggestions. Elements of several provisions in the final agreement were suggested by the companies during the negotiation. RMA and the companies negotiated in good faith and with respectful dialogue resulting in an agreement that provides a reasonable rate of return to the companies for delivering the program, and will achieve $6 billion in savings over the next 10 years. Two-thirds of the savings from the new SRA, $4 billion, will go toward paying down the federal deficit. The $4 billion in budget savings USDA achieved is one of the first and most significant steps that a federal agency has achieved in reducing mandatory spending from the long term federal deficit. The President has laid out an aggressive plan for reducing the deficit and we are pleased to take a leadership role in that effort.

The remaining third will support high priority risk management and conservation programs. This $2 billion invested in farm programs will be used, in part, to improve and expand several RMA risk management products. In fact, the Pasture, Rangeland, and Forage (PRF) program has already been expanded as a result of the savings obtained through the SRA. Under the Rainfall Index (RI)-PRF plan of insurance, RMA will expand coverage for the 2011 crop year to specific counties in Colorado, and all counties in the states of California, Florida, Georgia, New York, North Dakota, Oklahoma, Pennsylvania, South Carolina, and Texas, bringing the total number of States where the program is available to 16. The

Vegetation Index (VI)-PRF will be expanded to the balance of counties in Idaho, Oregon, and South Dakota, and all counties in the states of Arizona, New Mexico, and Utah for 2011, bringing the State total where VI-PRF is available to 9.

RMA has also received requests for further expansion of PRF in Nevada, Arkansas, Maryland, and Minnesota. RMA will take the expansion request for the 2012 crop year to the Federal Crop Insurance Corporation Board of Directors later this year for their consideration and potential approval.

As a result of these savings, RMA also plans to provide a performance based discount or refund, which will reduce the cost of crop insurance for certain producers. Additionally, USDA has used this opportunity to increase Conservation Reserve Program (CRP) acreage to the maximum authorized level; investing in new and amended Conservation Reserve Enhancement Program initiatives; and investing in CRP monitoring.

The new SRA will have no adverse impact on farmers' premium costs. In fact, some farmers may even see reduced insurance costs with a performance-based discount or refund that result from the savings generated by this agreement.

SRA Structure

The 2011 SRA was structured to reflect the realities of today's agriculture economy. Since government payments to crop insurance companies are tied to crop prices and price volatility, the unprecedented spike in commodity prices in recent years caused government payments to companies to more than double, from $1.8 billion in 2006 to $3.8 billion in 2009. The new SRA allows A&O payments to fluctuate within a range that removes the extremes. This will prevent windfall profits created by price spikes, like those we have seen in recent years, but will also ensure an adequate A&O subsidy is provided to companies. The new agreement provides a maximum A&O amount of $1.3 billion in 2011, and increases it yearly with inflation to $1.37 billion in 2015. This is almost 40 percent more than the $935 million the crop insurance companies received in A&O payments in 2006 (the last year before the price spikes) and 35 percent less than the $2 billion the industry received in 2008 (the height of the price spikes). Companies will be protected against extremely low crop prices by a minimum A&O reimbursement. This provision will ensure that the crop insurance companies receive at minimum about $1 billion in A&O payments, or slightly more than what it received in 2006 to deliver the program. This added protection will ensure that the companies have enough money to deliver the program, even if prices or price volatilities fall sharply.

Agents' Compensation

To ensure the viability and integrity of the crop insurance delivery program, RMA took steps in the new agreement to limit compensation to crop insurance agents. Even in the face of cuts in A&O imposed by Congress, companies were unable to contain the escalation in agent commissions. A recent analysis showed that about 20 percent of A&O is needed to pay expenses related to loss adjustment, information technology, employees, and other operations (excluding agent commissions), yet many companies were paying agents far above the entire A&O subsidy amount in certain parts of the country. In 2009, average agent commission rates in the Corn Belt States (Iowa, Illinois, Indiana, Minnesota and Nebraska) were 18.6 percent of premium and the A&O paid to the companies was 17.1 percent. Therefore, these companies were relying on underwriting gains (which may or may not be realized) to pay for costs other than agent commissions. Companies were also moving A&O payments and bidding up agent commissions in the Corn Belt, which generally includes the most profitable states.

The new SRA includes a cap on agent commissions to ensure that companies have sufficient funds to pay the other operating expenses in years in which there may not be an underwriting gain. As the regulator for the Federal crop insurance program, RMA saw a clear need to ensure that companies have sufficient funds to pay operating expenses (including agent commissions) without resorting to the reliance on uncertain underwriting gains.

History has shown us that this step is necessary. In 2002, the largest crop insurance company in the program, American Growers Insurance Company, failed in large part because of high commissions paid to retain and acquire agents. American Growers' expenses exceeded the amount of A&O received so they were forced to rely on underwriting gains to remain solvent. Since 2002 was a moderately bad crop year, many crop insurance companies did not receive underwriting gains. American Growers actually ended the year with a small underwriting gain. However, its failure to receive an underwriting gain large enough to cover its commitments cause the company to collapse. This major failure caused widespread confusion and uncertainty in the crop insurance program, and the remnants of this failure still are being felt by the program today.

Eight years later, in 2010, companies are still relying on large underwriting gains to operate the program and have been fortunate to have seen an unprecedented run of profitable underwriting years. The real possibility of even a modest loss year, such as 2002, however, creates a situation where several companies could be at risk for failure and thus jeopardize the entire delivery system.

The new agreement limits companies' expenditures on base agent commissions to 80 percent (soft cap) of the A&O subsidy at a state level. Companies may still use profit sharing, but total agent compensation will be limited to 100 percent (hard cap) of the A&O subsidy at a state level to ensure fair and equitable competition among all companies in all states.

While the second draft proposal included only a "soft cap" on agent commissions equal to 80% of the A&O subsidy, the final agreement added a "hard cap" on total agent compensation at 100% of A&O subsidy on a state basis. This was done after considering concerns expressed by many companies and others that a soft cap alone would create equity issues between the states and provide an incentive for some companies to only write business in the most profitable states. Companies writing in these most profitable states would attract agents by claiming a potential for more consistent and higher rates of return and, consequently, greater availability of funding to provide for agent profit sharing. Providing a hard cap on profit sharing will limit the potential for companies to engage in such market-disrupting activities. Federal crop insurance is a nationwide program and the SRA should ensure that the companies and their agents have the incentives to provide service to all producers.

Even with the hard cap, the expected amount of compensation potentially available to agents will be about $1.3 billion annually, given the expected A&O subsidy and average expected underwriting gain amounts provided by the agreement. On average, for the 2011 to 2015 life of the SRA, agent commissions will be limited to about $1.1 billion annually, while profit sharing will be limited annually to about $270 million. On average, the 100 percent cap allows around one-third of total underwriting gains to be shared with agents, as determined by the companies.

RMA analysis shows that the cap will primarily affect the Corn Belt states where companies generally have been paying average agent commissions above the total A&O subsidy. All other states have seen average commissions paid below the total A&O subsidy and are not likely to be affected.

For this year – 2010 – under the current SRA, agent commissions are already expected to decrease due to lower commodity prices and price volatilities not due to the new SRA. For example, Iowa agent commissions are expected to fall from about $140 million in 2009 to about $110 million in 2010, under the current SRA. The new SRA hard cap will be placed at about $105 million in 2011. Therefore, the provisions of the new SRA will result in an average5.7 percent decline from 2010 in dollar terms in Iowa.

However, this is 72% greater than the dollars Iowa agents received in 2006, even though the number of policies serviced is virtually unchanged. In effect, expected 2011 agent compensation reflects the equivalent of compounded annual income increases of 12% over this five-year period, an impressive record that can be matched by very few others in the recent, sluggish economy. In an environment where the number of Iowa policies is stagnant, therefore, RMA believes compensation to agents through the new SRA is more than reasonable for 2011 and, with the built-in inflation adjustment factor, the compensation cap is guaranteed to increase with expected inflation.

Risk Sharing

The previous agreement's risk sharing terms were structured in such a way that some states in the Corn Belt experienced much greater profitability for companies and agents than in other states. Analysis by Milliman, Inc. also indicates that the industry as a whole has been making far above a reasonable rate of return. This analysis shows that over the last 21 years a reasonable rate of return for the companies averaged 12.7 percent, while the companies actually received an average rate of return of 17.0 percent. The new agreement provides an expected return to companies of about 14.5 percent, almost 2 percentage points above the reasonable rate of return.

The new SRA rebalances the risk sharing terms to better equalize expected returns throughout the different states, including terms that are more profitable for states outside the Corn Belt. The new SRA also maintains the Assigned Risk Fund, which provides companies with stop loss protection at a state level.

The new agreement sets the Net Book Quota Share at 6.5 percent, with 1.5 percentage points of underwriting gain to be distributed to those companies that sell and service policyholders in 17 underserved or less-served States (Group 3 States). This provides an additional financial incentive for companies to continue doing business in these underserved or less-served States.

Together, the changes we have made in the new SRA, through negotiations with the private companies, will create a more sustainable Federal crop insurance program, and the expansion of key risk management and conservation programs will improve the safety net for America's farmers and ranchers. The new SRA represents a fair deal for farmers and the government, the companies, the agents, and the taxpayers.

Status of the Federal Crop Insurance Program

The Federal crop insurance program is helping the men and women who produce America's agricultural products to manage risk in an inherently risky business. For crop year 2009 with 1.2 million policies on 265 million acres, the program provided coverage for $79.6 billion in crop value. Of the $8.9 billion in total premium, USDA subsidized $5.4 billion for farmers, and paid out over $5 billion in claims for lost or damaged crops. In addition, RMA awarded $8.6 million in Partnership Agreements to assist small and underserved producers across the country.

Producers generally have a choice of crop or livestock policies, with coverage they can tailor to best fit their risk management needs. In many cases, producers can buy insurance coverage for a yield loss, or revenue protection to provide coverage for a decline in yield or price. Today, most producers "buy up" to higher levels of coverage ranging up to 85 percent (smallest deductible), although a low level of catastrophic coverage (CAT) is still available for a nominal fee with the premium fully subsidized. Indemnity payments are usually made within 30 days after the producer signs the claim form.

The crop insurance program has seen sustained growth as demonstrated by the increasing proportion of acres insured at buy up levels over the last decade (see Attachment 3). In 2009, 92 percent of insured acres for the ten staple crops had buy-up coverage, compared to just 73 percent in 1999. Not only are buy up levels increasing, but the type of coverage being purchased is shifting to the more comprehensive revenue coverage (see Attachment 4). In 2009, revenue coverage accounted for 57 percent of the insured acres, compared to just 27 percent in 1999. In addition, the average coverage level (percent of the total crop covered) for buy up insurance has increased. In 2009, the average coverage level rose to a record-high of 73 percent. In 1999, the average was 67 percent.

Program Integrity

In conjunction with the improved quality control requirements in the new SRA, RMA Compliance has revised its work plans to reflect a more balanced approach between quality assurance and investigating program abuses. In a time of declining resources and increased responsibilities, effective internal controls provide a significant cost-benefit compared to identifying and prosecuting program abuse alone. RMA is currently reviewing company operations and internal controls to determine the success of their efforts to address crop insurance program vulnerability concerns.

RMA continues to make significant progress in preempting fraud, waste and abuse through the expanded use of data mining. We have preempted millions of dollars' worth of projected payments, and RMA continues to use data mining to identify anomalous producer, adjuster, and agent program results. With the assistance of the Farm Service Agency (FSA) offices, RMA and companies conduct growing season spot checks to ensure that claims for losses are legitimate. These spot checks based on data mining have resulted in a significant reduction in anomalous claims for those situations.

We are improving the timing and quality of our sanctions requests as well. RMA continues to work with USDA's Office of General Counsel (OGC) to limit the number of cases declined due to insufficient evidence. This improvement is attributable to Compliance personnel becoming more proficient at identifying evidence and establishing cases that will pass legal sufficiency requirements. The Administrative Sanctions regulations that were identified by the General Accounting Office (GAO) as requiring publication were published and were effective on January 20, 2009. Although RMA was using the statutory authority to impose sanctions before the regulations were published, RMA agreed with GAO that the publication should be prioritized to ensure that program participants and other interested parties were given appropriate constructive notice of the rules.

RMA is continually seeking new and more effective ways to work with the other regulatory bodies and government agencies as well as insurance companies, agents and producers to ensure the integrity of the Federal crop insurance program. RMA compliance reviews continue to reveal that there are only a small number of producers who have been involved in fraud or illicit activity. While no level of criminal or abusive behavior is acceptable, RMA continues to believe the number of persons involved in criminal activity is relatively small.

While RMA, FSA and the insurance providers have preempted tens of millions of dollars of improper payments through quality controls, data mining, and other measures, RMA is constantly identifying ways to balance competing needs to make our products less susceptible to fraud 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 program waste, fraud and abuse.

In the recent past, there have been some concerns expressed about unresolved Office of Inspector General (OIG) Audit recommendations. In particular, RMA was cited as having 70 OIG audit recommendations pending for a year or more after agencies agreed to implement them. However, according to RMA's records, there are only 14 audit recommendations that now meet this criterion. RMA believes that both OIG and GAO audits have resulted in program improvements over the years and continues to commit significant resources to resolving and implementing audit recommendations that can reasonably be expected to achieve greater efficiency or effectiveness for the program and the taxpayer.

Organics

In January 2010, RMA submitted a report to Congress entitled Organic Crops and the Federal Crop Insurance Program, as required by the 2008 Farm Bill. The report included information on the numbers and varieties of organic crops insured; the status of the development of new insurance approaches to organic crops and the progress of implementing organic initiatives required by the 2008 Farm Bill. The

2008 Farm Bill also required that RMA contract for research into whether or not sufficient data exists upon which RMA could determine a price election for organic crops; if such data does exist to pursue further development of a pricing methodology using that data; and that RMA contract for research into underwriting, risk and loss experience of organic crops as compared with the same crops produced in the same counties during the same crop years using nonorganic methods. Three studies that resulted from this research, *Organic Crops: Report on Research of Additional Price Elections; Organic Crops: Final Development of Additional Price Elections and Organic Crops: Revised Written Rating Report* are expected to be released shortly.

Review of Rating Methodology

RMA contracted with Sumaria Systems Inc. for a thorough actuarial review of the methodology and procedures used to determine the Actual Production History (yield) target rates and the rating process for the new Common Crop Insurance Policy Basic Provisions (often referred to as Combo policy) under the Federal crop insurance program. The draft report was received in November 2009 and was made available for public comment. A final version of the review is now available at http://www.rma.usda.gov/pubs/2009/comprehensivereview.pdf on the RMA Web site.

The review found that RMA's general premium rating methodology (based on historical losses) is appropriate and should continue to be used. However, the study identified several areas for potential improvement, the most significant of which is to determine if all historical losses should be given the same weight in determining premium rates. In addition, key aspects of today's crop insurance program along with crop production technology would also be considered and evaluated for potential effects on past experience. This would provide a basis for evaluating the degree to which past catastrophic events may affect the historical loss data used in establishing current premium rates, and as appropriate, allow for adjustments to those rates. This could potentially result in lower premium rates in several parts of the country, especially the Corn Belt. RMA is currently in the process of soliciting bids for this review of its historical loss data so that work can commence later this year. In the near term, premium rates for the most popular revenue products, Crop Revenue Coverage (CRC) and Revenue Assurance (RA), are expected to be generally lower for the 2010 crop year as a result of decreasing price volatilities.

New Common Crop Insurance Policy (Combo Policy)

The new Common Crop Insurance Policy, frequently referred to as the Combo policy, is an initiative by RMA to combine and simplify the crop insurance program. RMA has combined CRC, RA, Income Protection (IP), and Indexed Income Protection (IIP) into a single uniform policy. RMA kept and combined the principle features of the five plans that producers bought most often and developed a single rating and pricing component so all insurance coverage is consistent in insurance protection and cost to producers. The new Basic Provisions are effective for the 2011 crop year for crops with a contract change date of April 30, 2010 or later (effective for most 2011 crops) and for the 2012 crop year for crops with a 2011 crop year contract change date prior to April 30, 2010.

Comprehensive Information Management System

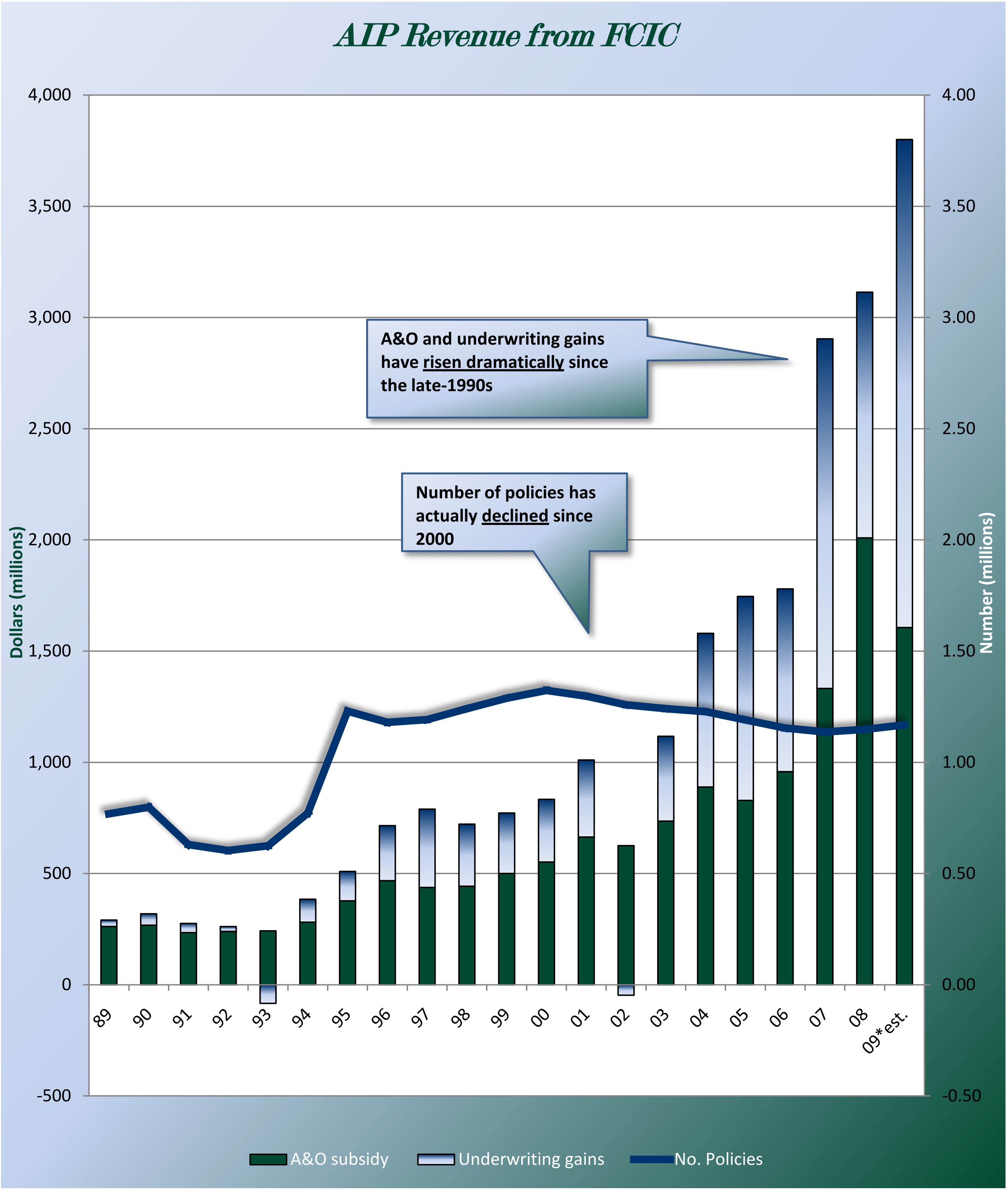
The Comprehensive Information Management System, referred to as CIMS, is designed to provide approved users timely access to 2006 thru 2010 RMA and Farm Service Agency (FSA) producer information and data. The system has improved operations between RMA and FSA and has the potential to continue improving information transfer. At this time, FSA employees have access to CIMS, which has led to a 56% reduction in entity differences for producers participating in the programs of the two agencies, including support for the SURE program. Crop insurance companies have made over 18 million CIMS inquiries or requests for information, reducing resources and costs to obtain electronically data similar to the hard copy information that normally resides at the FSA County office. Companies are also incorporating the use of Common Land Unit reporting into their systems to enhance reconciliation efforts for acreage reporting and other applications for administering programs for prevented planting and cause of loss verification. RMA also is actively participating in the USDA Acreage/Crop Reporting Streamlining initiative to establish common USDA producer commodity reporting standards to facilitate greater use of CIMS and Agency sharing and reconciliation of data, along with potential incorporation of data obtained through the use of precision-ag technology.

Information Technology Modernization

RMA's Information Technology Modernization (ITM) program is a multi-year, phased-implementation reengineering initiative to support Combo and new insurance programs and products, increase actuarial capabilities, and provide efficient policy and financial processing for producers and insurance companies. The first phase, successfully operational in April 2010, focused on actuarial processes, policy processing, premium calculations, and other functions needed to administer various 2011 crop year insurance offers, and implement the new Combo policy. The next phases of the ITM program, corporate business reporting and financial accounting, are in development with final completion scheduled for the end of 2011.

I, along with members of the Federal Crop Insurance Corporation Board of Directors, all the RMA staff across the country, recognize that the program is dependent on a reliable delivery system. The approved insurance companies, who deliver this program with their network of agents, and RMA, are mutually dependent on each other to operate the program efficiently and effectively to meet the needs of producers. We are very aware of our responsibility to be good stewards of taxpayer money. By creating a new standard reinsurance agreement that maintains excellent service to farmers and ranchers, provides incentives for companies to operate in underserved and less served areas, provides a reasonable return for the companies and removes windfall government payments that were an unintended consequence of the past SRA structure, RMA is pleased to have met the goals set at the beginning of this negotiation. Again, thank you for the opportunity to participate in this important hearing. I look forward to responding to your questions.

Attachment 1



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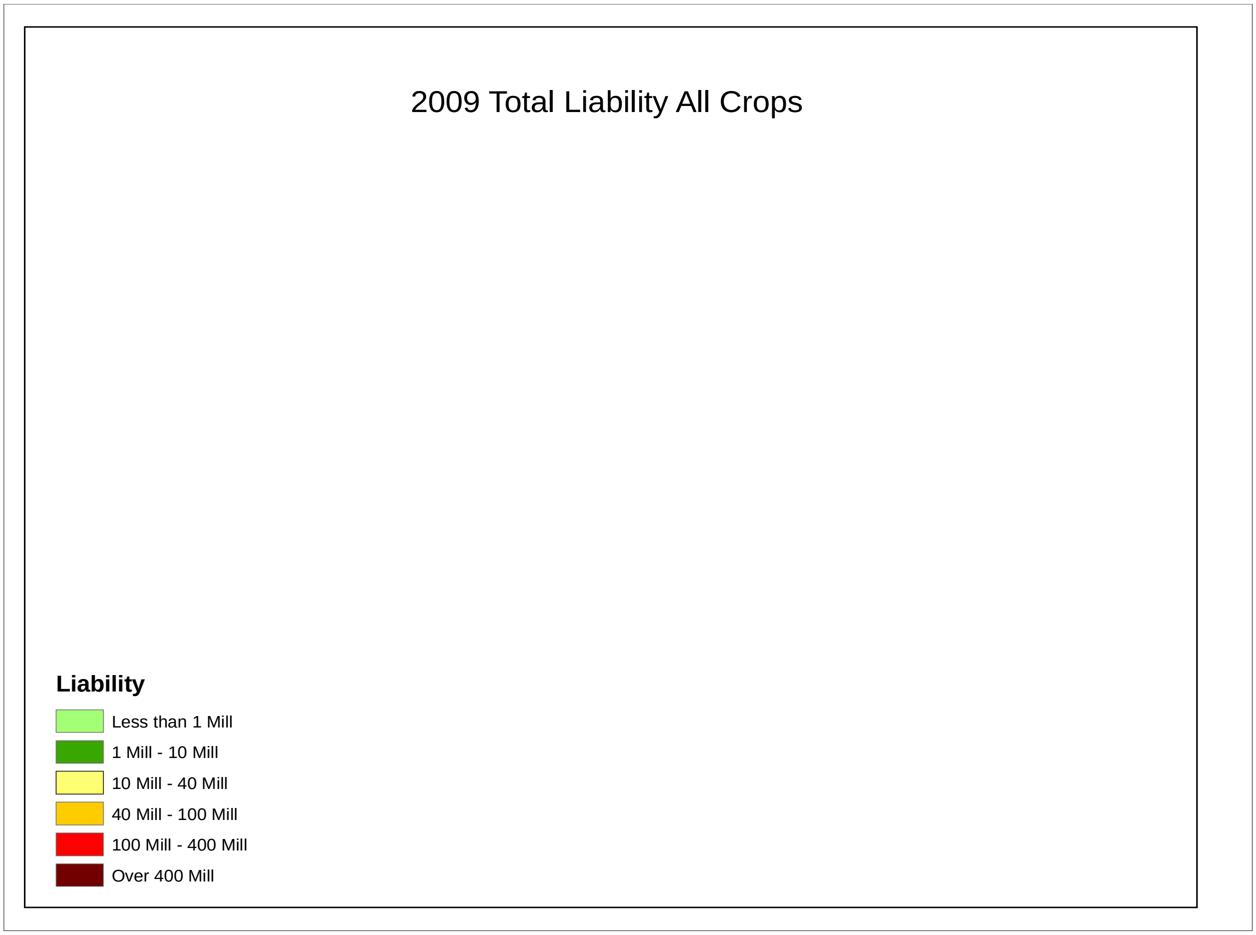

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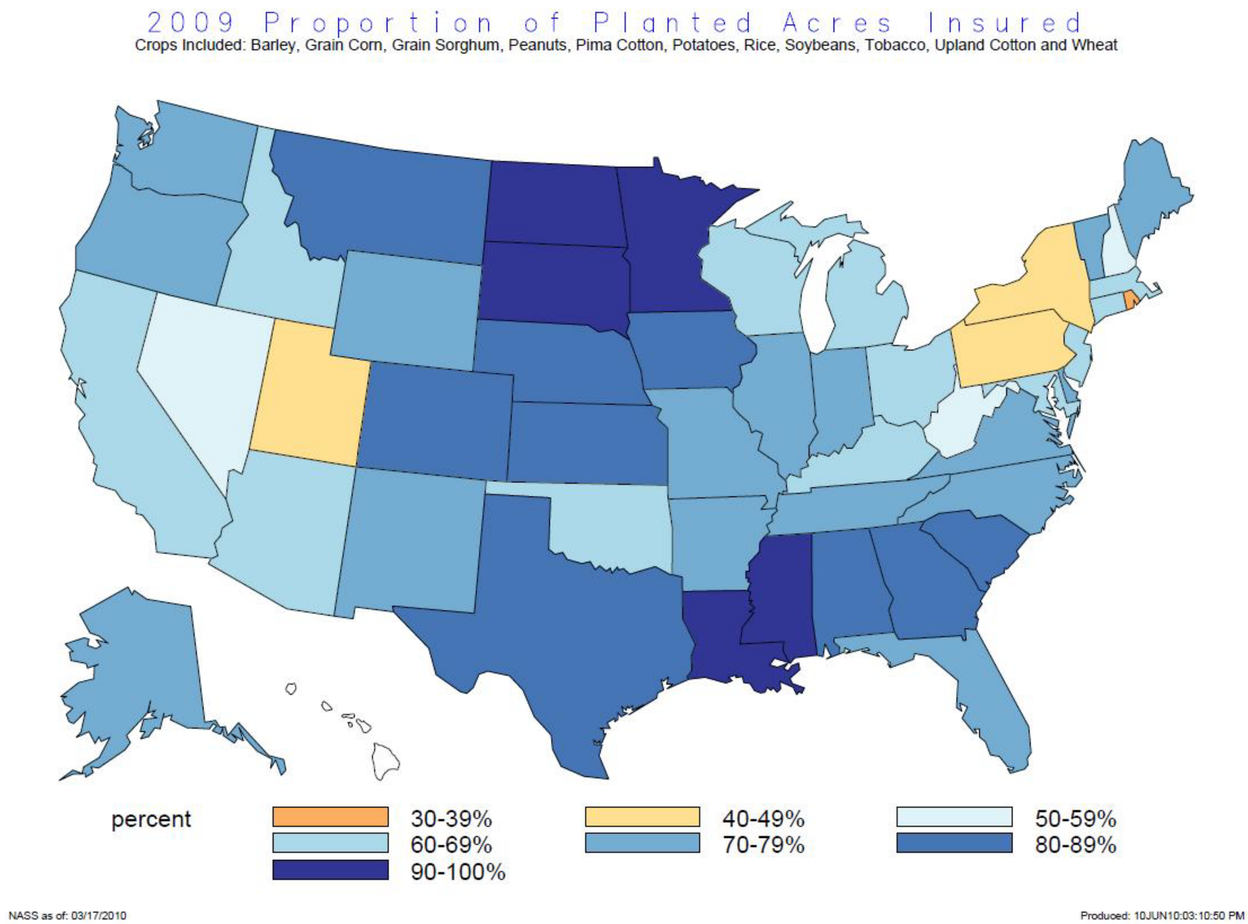

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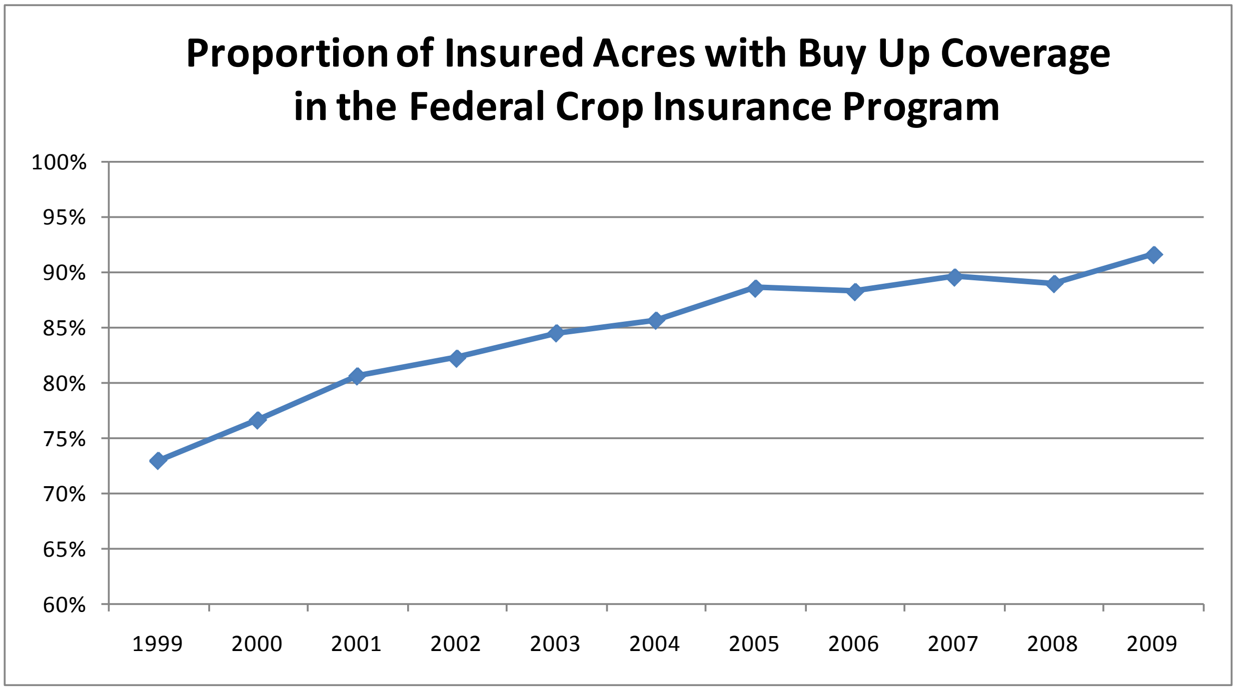

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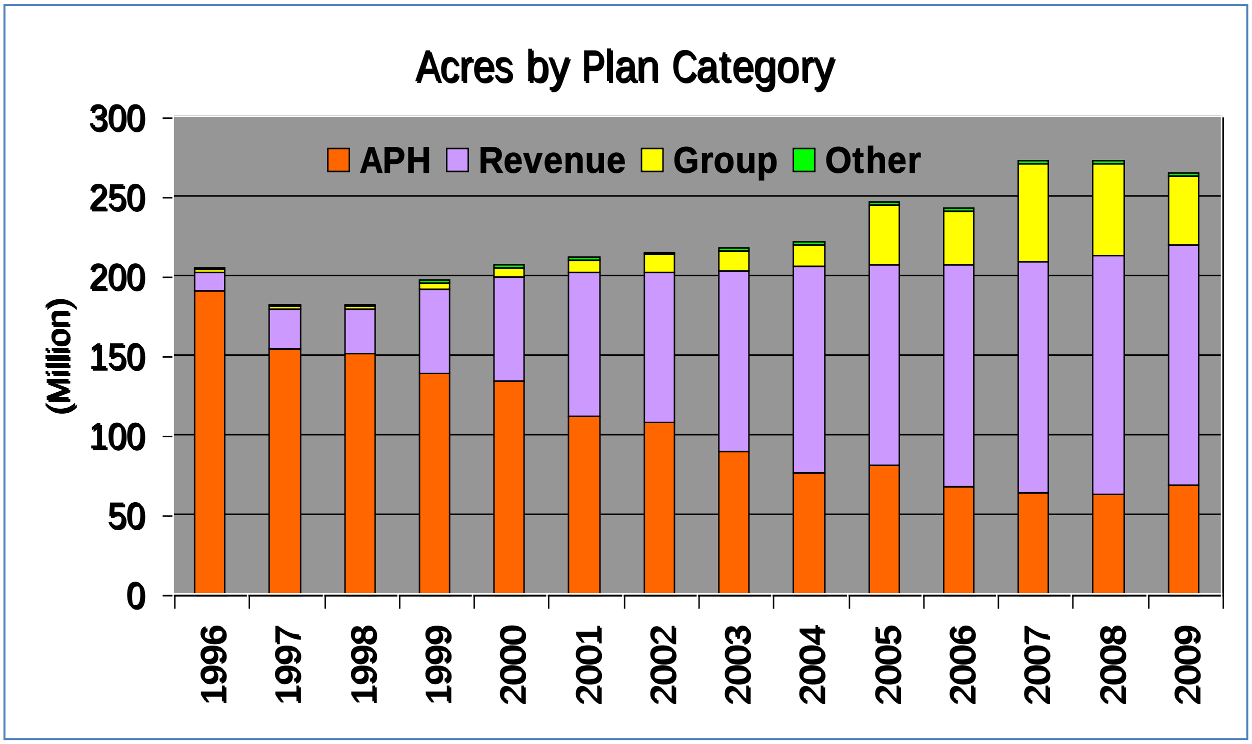

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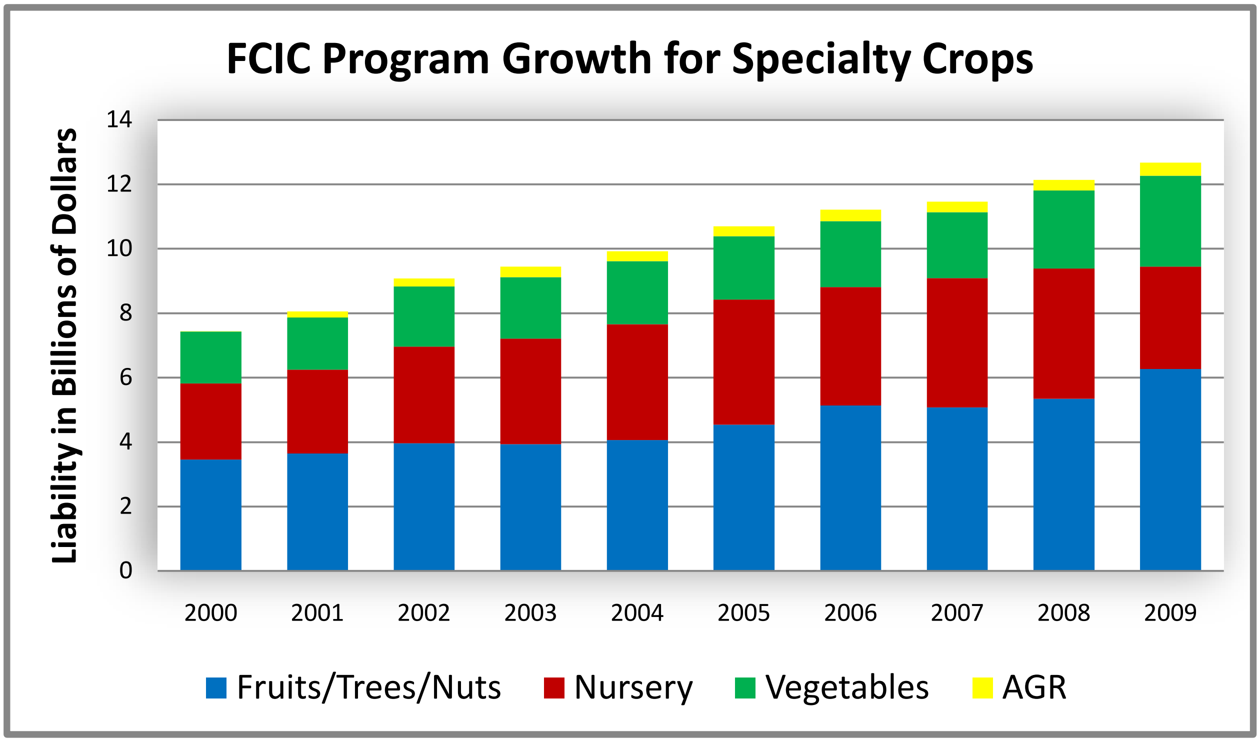

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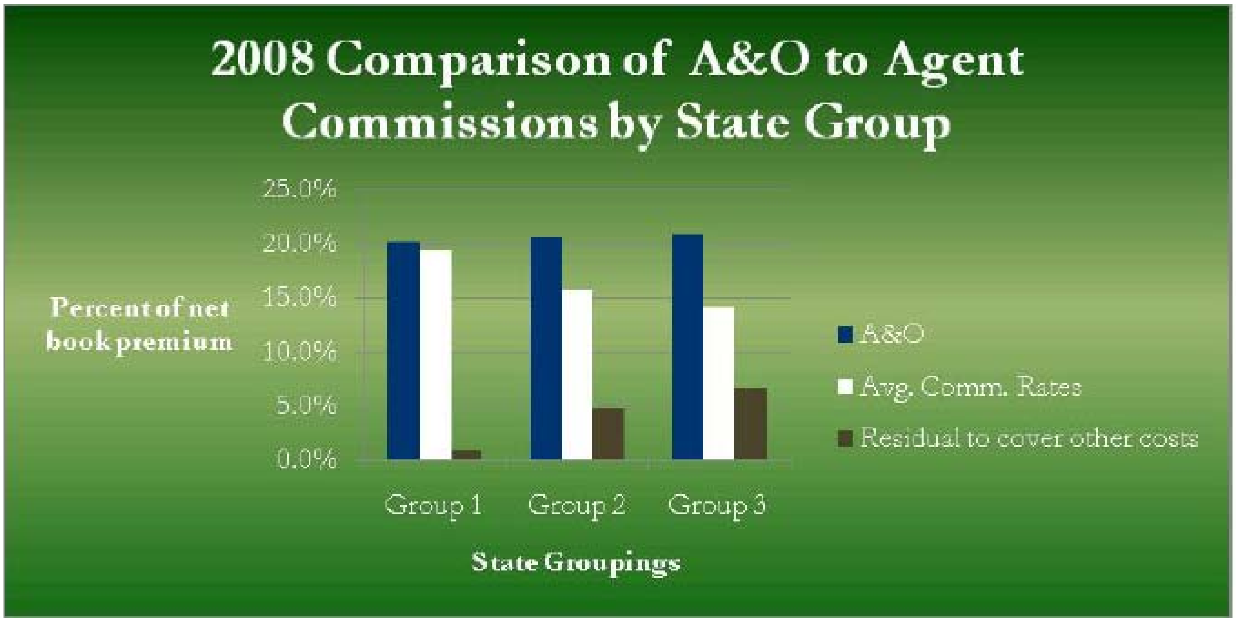
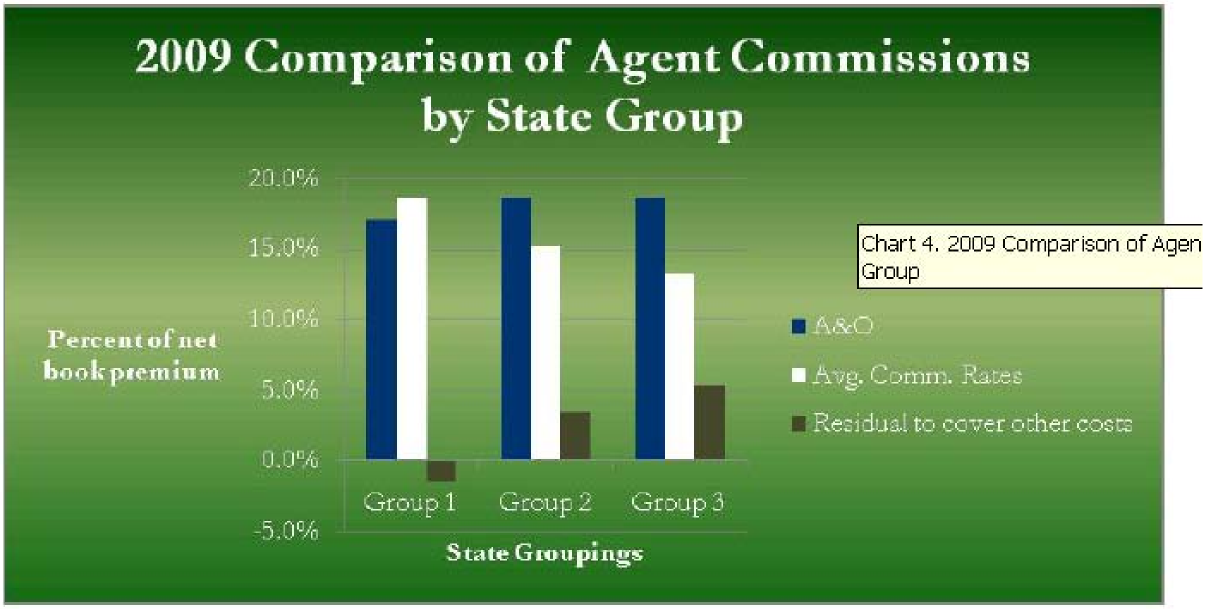


Attachment 8 – 2008 Comparison of A&O to Agent Commissions by State Group

2008	Group 1	Group 2	Group 3
A&O	20.2%	20.6%	20.8%
Avg. Comm. Rates	**19.3%**	**15.7%**	**14.1%**
Comm % of A&O	95.5%	76.2%	67.8%
Residual to cover other costs	0.9%	4.9%	6.7%

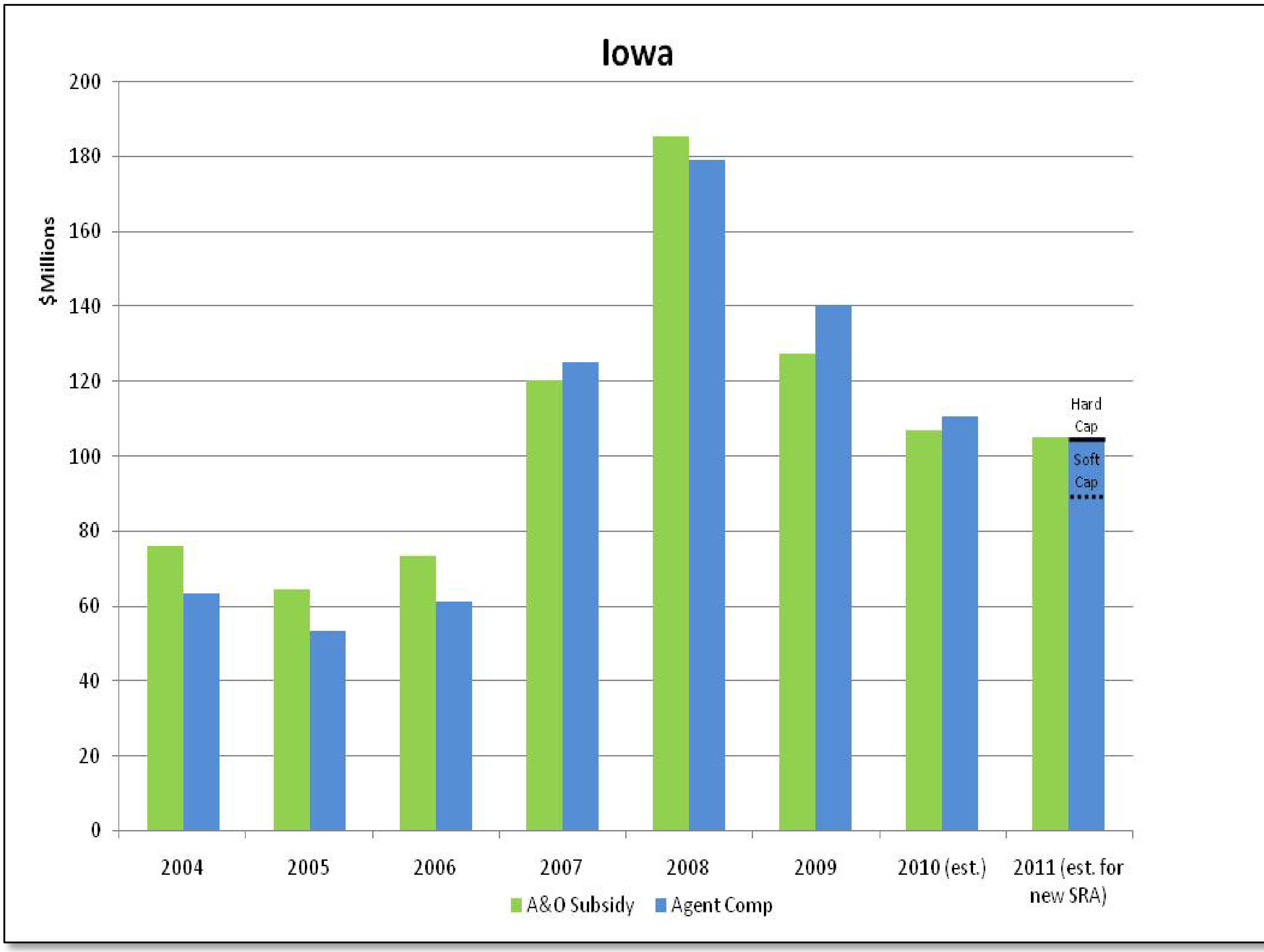
Attachment 9 – 2009 Comparison of A&O to Agent Commissions by State Group



Attachment 10

2009	Group 1	Group 2	Group 3
A&O	17.1%	18.6%	18.6%
Avg. Comm. Rates	**18.6%**	**15.2%**	**13.2%**
Comm % of A&O	108.8%	81.7%	71.0%
Residual to cover other costs	-1.5%	3.4%	5.4%

Attachment 11



Attachment 12

Iowa Agent Compensation Analysis						
Year	No. of policies	Premium ($)	A&O (% of premium)	A&O and CAT LAE ($)	Agent Comp. (% of premium)	Agent Compensation($)
2004	130,286	354,511,745	21.5%	76,087,416	17.9%	63,457,602
2005	127,423	310,529,453	20.8%	64,719,502	17.2%	53,411,066
2006	125,543	366,833,451	20.0%	73,507,061	16.7%	61,261,186
2007	121,633	600,208,831	20.1%	120,463,261	20.9%	125,443,646
2008	123,948	914,548,177	20.3%	185,687,109	19.6%	179,251,443
2009	127,402	743,726,271	17.2%	127,663,700	18.9%	140,564,265
2010 (est.)	127,402	622,151,163	17.2%	107,010,000	17.8%	110,742,907
2011 (est. for new SRA)				105,122,000		105,122,000