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RISK MANAGEMENT AGENCY
FEDERAL CROP INSURANCE COPORATION

Statement of William J. Murphy, Administrator and Manager before the Subcommittee on Agriculture, Rural Development, Food and Drug Administration and Related Agencies

Chairman Kingston, Ranking Member Farr and members of the Subcommittee, I am pleased to discuss the fiscal year (FY) 2012 budget for the Risk Management Agency (RMA). The Federal Crop Insurance Program is an integral part of the farm safety net. RMA works 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. RMA works 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 RMA's role as a regulator, it must also ensure the continued integrity and actuarial soundness of the Federal Crop Insurance Program. We are also aware that in today's economy, it is particularly important that the program be cost effective and give a fair value for the taxpayers' dollar.

That is why we are proud that the new Standard Reinsurance Agreement (SRA), which we and the Approved Insurance Providers (AIPs) diligently negotiated in good faith last July, 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 the Department of Agriculture (USDA) obtained is one of the first and most significant steps that a federal agency has achieved in reducing mandatory spending and the 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 Food, Conservation, and Energy Act of 2008 (2008 Farm Bill) authorized the renegotiation of the SRA, which is the agreement between USDA and the 17 AIPs who deliver the program. Of the $6 billion saved by RMA, the remaining $2 billion that did not go toward deficit reduction went toward support of high priority risk management and conservation programs. This $2 billion was invested primarily to improve and expand several RMA risk management products as well as provide a Good Performance Refund that will benefit farmers and ranchers for years to come.

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 2010 with 1.1 million policies on 256 million acres, the program provided $80 billion in risk protection. Of the $7.5 billion in total premium, USDA subsidized $4.7 billion for farmers, and paid out nearly $3.5 billion in claims for lost or damaged crops. In addition, RMA awarded $13.4 million in outreach and risk management education partnership agreements during FY 2010, of which $5.6 million directly supported small and underserved producers across the country.

Producers generally have a choice of crop 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.

Producers also have their choice of livestock programs, which are designed to insure against declining market prices of livestock. Coverage in these programs is determined using futures and options prices from the Chicago Mercantile Exchange Group.

The crop insurance program has seen an increasing proportion of acres insured at buy up levels over the last decade. The type of coverage being purchased is also shifting to the more comprehensive revenue coverage. In 2010, revenue coverage accounted for 65 percent of the insured acres, compared to just 33 percent in 2000. In addition, the average coverage level (percent of the total crop covered) for buy up insurance has increased to approximately 73 percent for 2010, compared to 68 percent in 2000.

In crop year 2010, Federal crop insurance was available for approximately 350 commodities, in over 3,141 counties covering all 50 States and Puerto Rico. RMA maintained a participation rate of nearly 82 percent for the ten principal crops in 2010. Many banks now require or at least encourage crop insurance coverage in order to make operating loans to producers. Federal crop insurance has become a fact of life for many farmers. American farmers would now find it difficult to continue providing America and the world with an abundant supply of food, fiber and fuel without the program.

Improvements to the program have been accomplished in an actuarially sound manner as required by Congress. 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.

In line with what Congress has directed RMA to do with respect to this law, we have been working to administer the Federal Crop Insurance Program in a manner that provides effective risk management opportunities to farmers and ranchers in all geographic areas regardless of the size of their operation.

OVERVIEW OF THE FY 2012 RMA BUDGET PROPOSAL

The FY 2012 RMA budget proposal reflects a conservative funding level and a small but important increase for the discretionary Administrative and Operating (A&O) Expense Account. The mandatory Federal Crop Insurance Corporation (FCIC) Fund is less than half the FY 2011 request due to timing shifts outlined in the 2008 Farm Bill. The mandatory request also reflects a legislative proposal to reduce the imputed premium amount for catastrophic (CAT) coverage, resulting in an estimated savings of $1.77 billion over 10 years. Because CAT is fully subsidized for the farmer, changing the premium amount will not affect farmers’ costs for CAT, and will only affect payments to AIPs.

In order for the Federal Crop Insurance Program to support risk protection coverage of $93.6 billion in 2012, the funding level proposed for the FCIC Fund is $3.1 billion, and for the A&O Expense Account, $82.3 million.

A&O EXPENSE ACCOUNT:

RMA's FY 2012 request of $82.3 million for discretionary administrative expenses includes an increase of $2.0 million for information technology (IT) investments. The increase provides for an increase in IT maintenance costs associated with the IT modernization (ITM) initiative, as mandatory funding provided in the 2008 Farm Bill expires at the end of FY 2011. RMA will be required to maintain both legacy and new modern systems during final implementation to ensure uninterrupted operations while the new system becomes fully operational. The increase in funding will also help to guarantee that RMA can properly exchange data with private insurance partners and interface with industry and other government entities, resulting in optimal program performance, delivery, and monitoring.

FCIC FUND:

The FY 2012 budget proposes under current statute that "such sums as may be necessary" be appropriated to the FCIC Fund. This ensures the program is sufficiently funded to meet estimated growth based on the latest program indicators.

The basis for premium subsidy stems largely from USDA's latest projections of participation and expected higher market prices. However, due to changes outlined in the 2008 Farm Bill collection of premium will be accelerated. As a result, the need for premium subsidy in FY 2012 is reduced. The FY 2012 estimate for such subsidy is $2.9 billion.

Additionally, changes outlined in the 2008 Farm Bill require RMA to delay payments for administrative and operating reimbursements provided to AIPs and underwriting gains into FY 2013. Therefore, there is no budgetary requirement for either of these items in FY 2012.

Federal Crop Insurance Act initiatives total $59.5 million. Program outreach and risk management education (RME) projects, among other key activities such as research and development contracts and the Comprehensive Information Management System, are funded from this amount. The $9 million decrease in FY 2012 is because authority for the Information Technology Modernization activity expires in FY 2011.

RECENT KEY ACCOMPLISHMENTS

GOOD PERFORMANCE REFUND:

RMA has several improvements to its programs underway. As a result of the savings from the SRA, RMA has published a proposed rule for a Good Performance Refund (GPR) program, which would return a portion of out-of-pocket premium costs to farmers and ranchers who have had favorable insurance history in the Federal Crop Insurance Program. This refund program intends to reward producers' good insurance performance and encourages them to continue participation in the program and use the best available management practices. Farmers and ranchers have expressed interest in a premium discount or refund program since the mid-1990s, when there was a premium reduction program.

We anticipate that $75 million will be available for this program each year, beginning in crop year 2012, and benefitting farmers and ranchers across rural America. According to the proposed rule, RMA expects that there would be qualifying producers in over two-thirds of the counties nationwide. RMA published the proposed rule in the federal register on January 6, 2011 and the comment period ended on January 21, 2011. RMA is carefully reviewing the comments that were provided.

INFORMATION TECHNOLOGY MODERNIZATION (ITM):

RMA's ITM project 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 AIPs. The first phase, which became 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 which affects about 75 percent of FCIC's $80 billion program. The next phases of the ITM program, corporate business reporting and financial accounting, are in development. ITM is already enhancing services and benefits to producers through improved actuarial ratings, policy processing, and program integrity.

PROGRAM INTEGRITY:

In conjunction with the improved quality control requirements in the new SRA, RMA Compliance Division 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 and reduce common errors. Reviews conducted by RMA in response to the requirements of the Improper Payments Information Act of 2002, as amended, over the past seven years indicate that the program operates with an error rate of around 5 percent. This compares favorably with the private Property and Casualty Insurance

Industry that typically reports error rates between 15 and 20 percent for those lines of business in the private sector.

RMA continues to make significant progress in preempting fraud, waste and abuse through the expanded use of data mining. Through data mining and data warehousing, RMA uses geospatial data, satellite data, National Oceanic and Atmospheric Administration weather data, soil surveys, statistics, and probability theory to support the Agency's underwriting and oversight activities. RMA continues to save hundreds of millions of dollars through its data mining program to identify anomalous producers, agents and loss adjusters. With assistance from the Farm Service Agency (FSA) state and county offices, RMA and AIPs review producers' farm operations to ensure that the crop losses are valid.

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. To date, these concerted efforts have saved $720 million through the Spot Check List program, which is a cooperative effort with RMA, FSA and the AIPs.

REVIEW OF RATING METHODOLOGY:

RMA contracted a review of its methodology and procedures used to determine the yield target rates and the rating process for the new COMBO policy. This review found that RMA's general premium rating methodology (based on historical losses) is appropriate and should continue to be used. RMA contracted for the review with Sumaria Systems, Inc. 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 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, the study suggested that key aspects of today's crop insurance program along with crop production technology (such as biotechnology) should be evaluated for potential effects on historical loss 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. Last fall RMA solicited bids to conduct a follow up review of its historical loss data, and the contractor Sumaria Systems, Inc. currently has work underway addressing these issues.

CONCLUSION

Along with members of the Federal Crop Insurance Corporation Board of Directors and all the RMA staff across the country, I recognize that the risk management tools that RMA provides are a critical part of the farm safety net for America's farmers and ranchers. We are also very aware of our responsibility to be good stewards of taxpayer money. By creating a new SRA that maintains excellent service to farmers and ranchers, while reducing costs to taxpayers, and by making several other important improvements to the program in the last year, we at RMA have acted responsibly with our private sector partners to improve the farm safety net. Again, thank you for the opportunity to participate in this important hearing.

Mr. Chairman, I would be pleased to answer any questions that you and other members of the Subcommittee may have. Thank you.