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Questions and comments<sup>1</sup>

*Dear Art,*

*I have you seen the crop insurance premiums this year? They are really high. Should I cut my coverage this year?*

*Kansas corn grower*

Dear Grower.

**No!** Until the Farm Bill is settled the only safety net is the crop insurance program. The strike price in revenue insurance is \$5.40 for corn, \$5.06 for grain sorghum, and \$13.36 for soybeans. The strike price for corn in the current farm program is \$2.35 for corn and \$5.36 for soybeans. Because of increased cost farmers are broke at those counter cyclical price levels and it very unlikely that price will fall that low. But unless Congress increases those strike prices in the Farm Service Agency's farm program then the only real protection is from revenue insurance, options and other risk tools. **In addition, I strongly suggest farmers purchase Revenue Insurance with the Harvest Price Option (RA-HPO)** over the Crop Revenue Coverage (CRC) contract because of the price limits in CRC. In today's market those CRC price limits are no longer realistic and should be increased. However, not all farmers have the RA choice, so the next best alternative is CRC.

Farmers buying Group Risk Income Protection (GRIP) should also buy the Harvest Revenue Option. However, GRIP now has the same price limits as CRC and RMA has cut the subsidy level on GRIP. In some locations RMA has also increased the premium rates on GRIP. Farmers who do not want to spend the money on the Harvest Revenue Option probably should consider Group Risk Program (GRP) that is based on county yields only.

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These group contracts are based on county yields only and a farmer could have a crop failure and not be paid under these contracts. The reverse is also true.

ART

*Dear Art*

*I saw the following comment on the WEB. Is he correct?*

*No you are not relatively safe. You can't imagine the risks if things don't fall correctly. It is going to take all your insurance money to buy out your contracts that you couldn't deliver on and it will not be a bushel for bushel buyout. There are penalties plus if the market is like wheat was last summer it will take two of your insurance bushels to buy out one of the contract bushels. Don't forget basis is involved too. Then after you get raked over the coals for that deal what are you going to LIVE ON FOR THE REST OF THE YEAR. It has been tough surviving around here from not being able to fill a 20 bu per acre contract with 40 bu per acre aph and a 65% CRC policy. I've got wheat that I had to roll into 08 and after penalties will net in the \$3.00 range. It hasn't been fun , try your best to get this out of your insurance man, elevator man or broker. They have no clue how to handle next year until you get over committed on contracts and can't deliver, Then its crystal clear.*

*Kansas Wheat Grower*

Dear Grower,

There is some truth in those comments. My first comment is it looks like they rolled the contract over to the next year. I really believe farmers would be better off to just buy their contract out when they can not make delivery and take the loss now. They can then move on to selling the next crop. Because of today's margin calls, in the future I doubt very many elevators will roll the contracts forward if one can not make delivery. So it is likely farmers will have to buy out their contracts and take their loss now.

In most locations the basis on grain is negative, and often by 30-40 cents. Revenue insurance pays at 100% of the Board price (zero basis) and in nearly all Kansas location that favors farmers. It is true the revenue contracts are settled on an average price for the month. So it is possible to lose on the basis gain described above because one could pay the cancellation penalty on one day in the month and then have the market move against the grower by an amount greater than the 30 cent expected basis gain. However, that risk cuts both ways and farmers could gain more than 30 cents on the basis during that monthly average.

The price limits in CRC is the reason to purchase RA-HPO rather than CRC. Those CRC price limits in an ethanol driven market are no longer relevant. The price limits in CRC; \$2 for wheat, \$1.50 for corn/milo, \$3 for soybeans and 70 cents for cotton. Those price limits were set in 1990 and need to be expanded to reflect the risk in the market that has clearly changed.

I would **NOT** buy RA without the harvest price option. RA-HPO has the advantage over CRC and is the better product because there are no price limits. The CRC corn contract is capped at \$6.90 and copped at \$3.90 for corn. The greatest risk is to exceed the upside price limit, but there is also downside risk and if harvest prices fall below \$3.90 on the Board at harvest, the CRC payments will be capped while the RA payments will continue to increase as prices fall.

Grain Sorghum has the price limit of \$1.50 and there is no RA offer on grain sorghum in any location. There are also some states that have no RA offer on wheat, corn, soybeans, and cotton. In those states the only revenue option for farmers is CRC with the current price limits. Also those same price limits have been applied to GRIP combined with a reduced subsidy rate on GRIP. The subsidy rates have not been changed on the other contracts. Table 1 contains a list of crop and states with the RA offer.

The winter wheat CRC contract is capped at \$7.88 while RA-HPO coverage is unlimited. Currently wheat is trading over \$11 and if farmers have wheat losses in Kansas the price will likely go even higher. The problem for example is a Kansas wheat farmer whose crop fails, he has forward contracted those bushels for \$7.88 and the price increases to \$12.88. The farmer will need to replace those bushels at a price of \$12.88 to deliver on the forward contract at \$7.88. The RA-HPO contract will pay \$12.88 while CRC will pay \$7.88 and the CRC insured farmers will make up the difference of \$5 out of their pocket. In this market CRC insured farmers really need the crop, otherwise those who have forward sold their wheat crop are going to take a big hit.

Yes, Kansas wheat farmers could have bought RA-HPO. However, there is no RA-HPO offer on Texas wheat and in many other states. There is no RA offer on grain sorghum in any state including Kansas and those farmers must live with the \$1.50 limit. This limit would encourage farmers to plant corn (where possible) rather than milo and insure with RA-HPO.

**Clearly RA-HPO is the preferred contract on corn but how much more should one pay over the CRC contract?** In some case RA-HPO is priced below the CRC contract and the decision is easy, buy RA-HPO. If the additional cost per insured bushel is less than 5 cents then buy RA-HPO. Farmers can afford to pay up to 10 cents per insured bushel more for RA-HPO than CRC. However, what should one do when the cost approach 20 cents? An alternative is to buy CRC and a \$6.90 call. I would probably buy the call on only half of the guarantee bushels and carry the risk on the rest. The call does not require a yield loss and it is not by unit. It only requires prices to increase to generate a payment.

While most of the higher premiums are caused by market prices on corn increasing from \$2.50 to over \$5, the RA-HPO higher premiums are also justified based on the increased price risk in the Yield Adjusted Asian Options (YAAO) that are built into the revenue contracts. I have a video on AgManager.info that covers those options. The link is: [http://www.agmanager.info/crops/insurance/risk\\_mgt/Video/Barnaby%20seminar.wmv](http://www.agmanager.info/crops/insurance/risk_mgt/Video/Barnaby%20seminar.wmv) If one really doesn't understand the difference between YAA options and Chicago options, I think the video will help. On wheat this year an in the money YAA call does not pay in an RA-HPO contract if the farmer does not have a yield loss while the Chicago/Kansas City call does pay.

ART

*Dear Art,*

*2008 corn volatility 0.28 GRIP and 0.30 for RA. Why with same agency, same crop, same discovery period, different answer?*

*Don't know, I will check with RMA.*

*RMA's response*

*The RA/GRIP Corn difference is due to the difference in the time periods used on for the harvest price discovery. The market's implied volatility is adjusted to reflect the period between now and harvest price discovery. The adjustment is determined as the square root of the percent of the year covered in between the given day and the middle of the harvest price discovery period.*

*RMA*

*Art's comment*

This was the RMA response and they have the “gold so they get to make the rules” but the answer does not make sense. RMA response on the difference in volatility values based on time to expatriation makes sense if one is rating American options traded in Chicago but this is not the case. These options built in to RA, GRIP, and CRC are Yield Adjusted Asian Options. They are settled on an average price, not a spot price and the holder has no right to exercise the option. It is not clear to me that RMA is adjusting for the fact there is never an early payment caused by price (early claims are paid based on planting price and yield loss) with YAAO as is the case for American options traded in KC and Chicago because option holders have the right to exercise the option.

Under RA the insurance company gets an extra 30 days to pay the claim and can earn interest (or reduce interest costs). The reverse is true for the farmer who must pay interest for an extra 30 days while waiting on the indemnity check. Because there is no right to exercise the option is the reason the delayed payment always works against the

farmer's interest (Is that good or bad depends on which side of the desk one sits). So in effect RMA is charging extra premium for a 30 day delay in the payment.

What does make sense is the premiums should be higher for the RA because there are no price limits. The CRC cuts off the price tails (\$1.50 limit on corn) and in the current market there is risk in those tails. Otherwise there would be no need to increase the CRC price limits, or offer RA in all states and all CRC insured crops so that all farmers with the CRC choice only could choose RA.

I would hope the folks at RMA would think about the rating issue; in the mean time grain sorghum producers can self insure for prices over the CRC \$1.50 limit or buy \$6.90 calls, that will probably cost about 40 cents per bushel.

ART

**Table 1. List of States with RA Offers**

State	Feed Barley	Malting Barley	Canola/ Rape-seed	Corn	Cotton	Rice	Soy-beans	Sun-flowers	Spring Wheat	Winter Wheat	Grain Sorghum
Alabama	<b>No RA Available</b>										
Alaska	<b>No RA Available</b>										
Arizona					x						No RA
Arkansas				x	x	x	x			x	No RA
California	<b>No RA Available</b>										
Colorado	x	x		x			x	x	x	x	No RA
Connecticut	<b>No RA Available</b>										
Delaware	<b>No RA Available</b>										
Florida	<b>No RA Available</b>										
Georgia	<b>No RA Available</b>										
Hawaii	<b>No RA Available</b>										
Idaho	x	x	x						x	x	No RA
Illinois				x			x				No RA
Indiana				x			x			x	No RA
Iowa				x			x		x	x	No RA
Kansas				x			x	x		x	No RA
Kentucky				x			x			x	No RA
Louisiana				x	x	x	x				No RA
Maine	<b>No RA Available</b>										
Maryland	<b>No RA Available</b>										
Massachusetts	<b>No RA Available</b>										
Michigan				x			x			x	No RA
Minnesota	x	x	x	x			x	x	x		No RA
Mississippi	<b>No RA Available</b>										
Missouri				x			x			x	No RA
Montana	x	x						x	x	x	No RA
Nebraska				x			x			x	No RA
Nevada	<b>No RA Available</b>										
New Hampshire	<b>No RA Available</b>										
New Jersey	<b>No RA Available</b>										
New Mexico					x						No RA
New York	<b>No RA Available</b>										
North Carolina				x			x				No RA
North Dakota	x		x	x			x	x	x		No RA
Ohio				x			x			x	No RA
Oklahoma				x	x		x			x	No RA
Oregon	<b>No RA Available</b>										
Pennsylvania	<b>No RA Available</b>										
Rhode Island	<b>No RA Available</b>										
South Carolina	<b>No RA Available</b>										
South Dakota	x	x		x			x	x	x	x	No RA
Tennessee				x			x			x	No RA
Texas	<b>No RA Available</b>										
Utah	<b>No RA Available</b>										
Vermont	<b>No RA Available</b>										
Virginia				x			x				No RA
Washington	<b>No RA Available</b>										
West Virginia	<b>No RA Available</b>										
Wisconsin	<b>No RA Available</b>										
Wyoming	<b>No RA Available</b>										