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### Comments and Questions on SURE and Crop Insurance<sup>1</sup>

Dear Recipient,

Below are the responses to many common questions that I have been answering on SURE and Crop Insurance. You may recognize your question. However, I have changed the location and other things to protect your privacy but without changing the intent of the question. Thanks to all who called or sent me questions. It is hoped these responses will answer questions for those who did not write. **Remember the deadline for spring crops signup for both crop insurance and NAP fees for SURE is March 15, 2009** (Monday March 16 this year because the 15<sup>th</sup> is a Sunday).

ART

*Dear Art,*

*I was wondering if you can give me any insight on why the factors for crc and ra are so high? It is hard to explain to insureds why the premium is higher this year than last when the prices are lower.*

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<sup>1</sup>Prepared by G. A. (Art) Barnaby, Jr., Professor, Department of Agricultural Economics, K-State Research and Extension, Kansas State University, Manhattan, KS 66506, March 2, 2009, Phone 785-532-1515, e-mail – [barnaby@ksu.edu](mailto:barnaby@ksu.edu).

*Iowa crop insurance agent*

Dear Agent,

I have had this question from a large number of farmers and agents. The short answer is it is the government's rating method. The implied volatility is higher on Chicago options this year. Either the market perceives higher price risk, or it may be a case of fewer options sellers caused by the financial crisis.

The key question is; does the implied volatility of a Chicago option measure the price risk in a RA/CRC contract? The Chicago traded option has the right to be exercised and is based on a spot market. Buyers of options can sell them on the spot market at any time and they will sell for a minimum of their intrinsic value because of the right to exercise. Normally option selling values will exceed their intrinsic value by the amount of the remaining time value. The time value will approach zero as the Chicago option nears expiration, i.e. harvest time for December corn and November soybean futures.

The RA/CRC options are yield adjusted Asian options that have no right to be exercised and are settled on an average price that will generate no time value that can be captured by the insured. The price loss is then adjusted by the level of yields. Therefore, do those implied volatiles from Chicago traded options with exercise rights really measures the price risk in CRC/RA? The RA-HPO/CRC contract has both a yield adjusted Asian Call and a yield adjusted Asian put. By definition one of those options will expire worthless but it is unclear how the rating accounts for this fact. After adjusting for the yield, the other option will "often" expire worthless too.

I would go with the short answer; it is just the government's rating method.

ART

*Dear Art,*

*A few weeks ago you made a presentation in South Dakota and we talked about SURE.*

*I know this was discussed but I can't remember the right answer to this question: "Are Crop Hail Insurance proceeds included in SURE calculation?"*

*One more question. For SURE to kick in, either the county of residence or a bordering county needs to be declared Disaster. Is this correct?*

*Ag lender,*

Dear lender,

Any private crop insurance including private hail insurance is not included in SURE. Private crop insurance coverage does not increase the SURE coverage and any private crop insurance indemnity payments do not count against the guarantee. In addition, private crop insurance coverage does not reduce the 90% cap on SURE payments per acre. Private insurance is just ignored in the SURE calculations.

The easy method for gaining eligibility for SURE payments is to be in a county that has a Secretary's county disaster declaration or contiguous county (Presidential disaster declaration does not count). Farmers who farm in multiple counties will only need one of their counties to be eligible for SURE and that will make their entire farm eligible for the SURE program, that is a whole farm guarantee. Farmers who are located in a non-disaster county or a non-contiguous county can qualify for SURE, but that will require a 50% crop revenue loss on their farm (doesn't include livestock).

The entire state of North Dakota has been declared a disaster for 2008 crops. Kansas has 60 counties that have either received the disaster declaration or they are contiguous counties for 2008 crops. SURE is a revenue guarantee, therefore with the decline in prices it will likely require only "small" yield losses to trigger SURE payments on 2008 crops for farmers located in counties with the Secretary's disaster declaration or contiguous county.

Farmers will need to file for those SURE claims after the marketing year. For 2008 crops that will not happen until the fall 2009. At this point the FSA implementation rules have not been published so farmers will need to wait for the rules on how to file a claim. Farmers should keep all of their 2008 records so they are ready to file a SURE claim next year on their 2008 crop loss.

ART

*Art,*

*What does the volatility factor of .0997-.0997 for TX CRC corn mean? It is the same number-not really a range. Thanks.*

*Insurance Analyst*

*Dear Insurance Analyst,*

When CRC was first started I would end up with a slightly different value for the high factor than the low factor. RMA does not use my method and they only estimate one factor for both the high and low. I have had no involvement with CRC since 2002 but I don't think there is any real issue with just one value.

ART

*Dear Art,*

*Worrying about commodity prices! APH price of \$9.90 for soybeans is attracting attention from old line mpci buyers (like me) that are having "sticker shock" with the volatility factor...*

*APH Insured*

Dear APH Insured,

Several farmers have asked about changing from RA/CRC to APH and pay a lower premium. If the farm is just corn and soybeans, then buying revenue on the corn and APH on soybeans just might work, especially if farmers increase their APH coverage. The higher APH price and higher coverage will increase the “free” disaster coverage (SURE) that is a revenue guarantee. The guarantee is whole farm so it is not as good as the crop insurance guarantee by crop but the higher APH coverage and price will make the SURE better. So farmers would still have some revenue protection on the whole farm even if they select APH on soybeans.

Farmers are giving up the protection from a price change by selecting APH. If prices fall it will require a smaller yield loss to trigger RA/CRC payments. Also RA/CRC payments are larger if prices increase. However this advantage for revenue insurance can be partially offset by purchasing higher coverage levels of APH. The combined higher percent APH coverage combined with the higher APH price election will also increase the “free” SURE coverage that is a revenue guarantee. It will require a 50% crop revenue loss to gain SURE eligibility unless the county is declared or is a contiguous disaster county then it will only require one crop of significance to suffer a “10% yield loss”. The strategy of combining APH with SURE will work better if the farm is not diversified, i.e. corn-soybeans only; no NAP crops. One alternative is to remain with the RA/CRC but select the enterprise unit that has had the subsidy increased by up to 22 points that was discussed in prior AgManager.info analysis.

The APH (MPCI) price election is also higher on grain sorghum, \$3.56 for CRC versus \$3.85 for APH. RMA has set the APH grain sorghum price election at a 15 cent discount to the \$4.00 APH corn price election. However, RMA has set the CRC grain sorghum price election **at a 48 cent discount to the RA/CRC corn price of \$4.04!** The current basis is weak for grain sorghum but there is no reason to believe this weak basis will remain. The southern Great Plains is a feedgrain deficit area and grain sorghum will produce the same amount of alcohol as corn, so within a few months ethanol producers will likely take advantage of the wide basis and bid out the basis out.

In any case RMA set the basis on APH grain sorghum at 15 cents under. So how does RMA justify a 48 cent under basis for CRC grain sorghum? This makes no sense and explains why grain sorghum farmers are so cynical about RMA price setting methods. After inverting the soybean and grain sorghum price elections, maybe it is time to let the

market set these prices and remove RMA's judgment. Congress is requiring a review of RMA's method for setting grain sorghum crop insurance price elections, thanks to Congressman Moran (R-KS). This not the first time grain sorghum has been shorted on the price election so this review will make for some interesting reading.

Grain sorghum producers that have the option to plant corn may be better served by changing to corn and take advantage of the higher price elections. Even if the crop does not make those farmers planting corn may end up with higher net revenues because of the higher CRC/RA corn indemnity payments combined with perhaps some SURE payments.

ART

*Dear Art,*

*We were in one of your Ohio seminars and discovered that we may be ineligible for SURE on our 2008 crop that had significant yield losses and also on our 2009 crops. We missed the dead lines for paying NAP fees on wheat straw hay. I check with FSA and they agree the straw is a crop and must be insured or covered with NAP fees. The straw value will exceed the \$9,090 de minimis crop test that would have eliminated the requirement to pay the NAP fee. This is frustrating because we did pay the NAP fees on other crops to maintain eligibility. Are there any alternative that we are over looking?*

*Ohio farmer*

Dear Ohio farmer

If the farm is "large" then there is alternative test for a *de minimis* crop when the crop value exceeds the \$9,090 test (\$3,636 for 2008). If the crop represents less than 5% of the total crop revenue (exclude livestock), then "large" farmers can meet the *de minimis* test with a crop value greater than \$9,090 or \$3,636 for 2008. For example if crop sales are \$250,000 then a straw hay crop that produces less than \$12,500 of revenue meets the *de minimis* test and one is not required to pay NAP fees. The straw would not count in the SURE guarantee nor does any production/revenue from the straw count against the guarantee. Because of the lower NAP coverage of 50% of yield and 55% price, a NAP crop will lower the average SURE guarantee therefore, farmers are better off to have any NAP crop meet the *de minimis* test.

If the straw value exceeds 5% of the farms crop revenue, then I would assume they are likely out on 2008 crops but for 2009 they could either cash rent the straw, or they could do a crop share rent on the straw. The crop share would likely put them under the 5% of the total farm crop revenue and met the *de minimis* test for 2009. As for the 2008 crop I am sure the straw is baled and sold, so this farmer's only help is to meet the 5% test. However, there is a "Washington rumor" that 2008 may be reopened and allow farmers to pay \$100 NAP fees to gain eligibility for 2008 SURE claims (NAP fee increased \$250 for 2009).

This all still depends on what yield and price is used to value the crops. I don't expect FSA will use farmers' prices but FSA will likely use farmers' yields.

ART

*Dear Art,*

*Have you heard how FSA will be using the GRIP insurance coverage with the SURE program? Most of the GRIP policies I sell are the 90% level with various volumes of the insurance, such as 90/100% or 90/60%.*

*Insurance Agent*

Dear Agent,

The last "rumor" on this issue was FSA was really stumped on what to do with GRIP and GRP. The Law just says to treat the non-yield policies like AGR-Lite (insurance based on tax returns) equal to the APH products. However, GRIP/GRP are yield based contracts but they are based on county yields rather than farm yields. So one alternative is to use county yields for farmers insured with GRIP or GRP. Using county yields would also save the cost of FSA doing the farm level loss adjusting because there is no farm level loss adjusting under a GRIP/GRP contract. If FSA uses farm yields, I cannot imagine FSA giving GRIP/GRP insured farmers a 90% coverage individual farm revenue guarantee. If they do, then farmers will likely change to GRIP/GRP. If GRIP/GRP buyers are given a farm level yield based SURE guarantee, then the logical equivalent would be to use 75% coverage for a 90% GRIP/GRP insured farmers.

So this SURE treatment of GRIP/GRP buyers is a real open question. Because the GRIP subsidy was cut a year ago combined with up to a 22 point subsidy increase in the enterprise unit, several farmers have told me they plan to switch back to RA/CRC to get those higher enterprise subsidies.

ART

*Doc -*

*I have several of my customers who had previously bought CAT policies just so they'd stay eligible for any federal disaster programs that came available during the growing season. It appears that CAT coverage in the SURE program is next to worthless.*

*What is the best minimum crop insurance coverage they could buy to maximize their benefit under SURE yet keep their premiums at a minimum level? I've been saying GRP*

*90/80. Have they figured out exactly how GRP/GRIP will work in the SURE program yet? I'm assuming it would work, right?*

*My point is that GRP (not GRIP) is very cheap, but at the 90/100 level would cover a very high percentage of the county yield. In some instances, very small (hobby) farmers would actually be paying less for GRP coverage than CAT at the new fee.*

*I'm guessing USDA will allow farmers to use county yields for their SURE guarantee. After all that is the yield they purchased in the policy.*

*Ohio agent*

Dear Agent,

CAT is worthless under SURE. I don't know what FSA will do with SURE guarantees for GRIP/GRP insured farmers. I am assuming SURE will use farm level yields but I doubt they will give farmers a 90% individual farm revenue guarantee. If FSA were to provide a 90% individual farm revenue guarantee then GRIP would be the preferred contract. The Law reads so FSA could also use county yields for GRIP/GRP buyers. It is anyone's guess.

Yes, real small farmers might be better off with GRP. It is cheap but small farmers normally do no marketing so they may have a higher need for GRIP. However, if they are only corn-soybeans, then SURE will provide some revenue protection.

RMA cut the subsidy on GRIP and increased the subsidy on enterprise units by up to 22 points. So I think we will see a lot of farmers select RA/CRC at 80% with an enterprise unit. However RMA set the soybean APH a dollar over the market. When combined with SURE that maybe the best option on soybeans this year especially for the small farmer you are referring to in your email.

ART