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### 2009 Recommendations for DCCP, ACRE, SURE, & Crop Insurance<sup>1</sup>

**Recommendation # 1.** Farmers should evaluate changing their crop insurance from optional units to enterprise units by crop. The National Association of Corn Growers (NCGA) was able to get a pilot in the Farm Bill that increases subsidy for enterprise units (table 1). Farmers will be able to increase their coverage but pay the same or less in crop insurance premiums. For example, increase ones coverage from 65% option units to an 80% enterprise unit will increase the subsidy from 59% to 68%, receive the enterprise premium discount, increases the total dollars of revenue coverage, and increases the “free” SURE coverage. While this will reduce the claims for a spot loss, i.e. a hail claim on one field, most that reduction in protection can be offset by increasing the coverage level or purchase private hail insurance. Because of the reduction in subsidy on GRIP, GRIP insured farmers should also consider changing to an enterprise unit. The savings in premiums under the enterprise pilot for many if not most farmers will exceed any ACRE or SURE payments. Farmers should **KEEP** their optional unit records because this is a 3 year pilot so like GRIP, USDA could cut the subsidy in the future and farmers may want to change back to optional units.

**Recommendation # 2.** It is recommended that farmers maintain eligibility for SURE, the new “free” disaster program. SURE is a whole farm revenue guarantee and it is unlike past disaster programs that were based only on yield losses. SURE payments can

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be triggered by low prices, low yields and/or a combination of low yields combined with low prices. There is no sign-up for SURE but farmers are required to insure or pay NAP fees on all crop acres to be eligible for SURE coverage. Spring planted crops in most of the country have a March 15 dead line to buy crop insurance and to pay \$250 NAP fees to the Farm Service Agency (FSA) for uninsurable crops. Failure to insure and pay NAP fees will make those farmers ineligible for SURE coverage, unless the crop meets a *de minimis* test. Therefore, farmers should check with their county FSA office prior to March 15 and insure all of their crops when meeting with their insurance agent. This means enrolling all possible crops on their insurance contract. Most agents already have their farmers signed up for all crops. There are no premium costs unless one plants the crop. The SURE coverage works best for a non-diversified farm, e.g. a single crop farm located in only one county will have the same SURE “unit” structure as an enterprise unit under crop insurance.

**Recommendation # 3.** Farmers should sign-up for the Direct and Counter Cyclical Program (DCCP) program and then later amend their contract for ACRE but wait until May to make their ACRE decision. The later the decision the more market information and yield information one will have to make an informed decision. A freeze on the winter wheat crop is possible prior to June 1, and that would likely effect the ACRE decision. It is unlikely that cotton or rice producers will elect ACRE because ACRE requires a 30% reduction in the loan rate that will effect these crops in addition to a 20% reduction in direct payments for the next 4 years (assumes a 2009 election). However sign-up is by farm serial number so in some cases cotton and rice farmers may be able change crop acre plantings and sign-up only farm serial numbers with wheat, feedgrains, and soybeans. The decision to participate will depend on if ACRE is in the money, i.e. the ACRE strike price is higher than the expected 2009/2010 Marketing Year Average (MYA) price. One will also want to consider the state yield but only winter farmers will have any information about the 2009 state yield in mid May.

### **Decision Details and Analysis**

The NASS 2008-09 weighted Marketing Year Average (MYA) price is used for both the Average Crop Revenue Election (ACRE) and the **S**Upplemental **R**Evenue Assistance Program (SURE). The 2008-09 MYA price is averaged with the 2007-08 MYA price to set the strike price for the 2009 ACRE program. Also the 2008-09 MYA price is used to settle claims on the 2008 SURE programs.

**2008-09 MYA price.** The KSU estimated 2008-09 MYA price is about 80% complete for wheat because the wheat marketing year starts June 1 through May 31 while the marketing year for the other crops is September 1 through August 31. Therefore, the 2008-09 MYA price for corn, grain sorghum and soybeans is about 50%-60% complete (table 2). The 2008-09 MYA price is used to set the 2009 ACRE guarantee and to settle 2008 SURE claims. A higher 2008-09 MYA price will increase the ACRE guarantee but reduce payments under SURE for 2008 revenue losses. Farmers may participate in both ACRE and SURE.

**Enterprise Unit vs. Optional Units.** Optional units insure a crop by “field” so an insurance claim on one field will not be affected by the yields on other fields. An enterprise unit will combine all corn fields together into a single guarantee, but the soybeans would be a separate guarantee. A whole farm unit under SURE and some crop insurance contracts combine all crops together into a single guarantee. A whole farm unit would average corn and soybean losses together. Any aggregation of optional insurance units lowers the risk of paying a claim, but this can be offset by buying a higher coverage level.

For example, farmers changing their crop insurance coverage from 65% optional units to an 80% enterprise unit will do the following:

1. Changing from option units to an enterprise unit will increase the subsidy from 59% to 68%. The author would suggest farmers spend the same premium amount they would have paid for option units and apply those same premium dollars to an enterprise unit and increase their coverage by 10%-15%.
2. Premiums are discounted for farmers who change from optional to an enterprise unit.
3. Buying higher levels of enterprise coverage increases the total dollars of revenue coverage on the farm but often results in no increase in premium costs.
4. Buying higher levels of enterprise coverage increases the “free” SURE coverage.
5. CRC and RA-HPO have a different definition of the enterprise unit. The CRC enterprise discount is base on acres planted while RA-HPO’s discount is based on the number of sections the crop is planted. Therefore, there are often very different premiums for enterprise units under CRC versus RA-HPO. For some farmers the premium savings maybe 30% or more but there is no difference in the guarantee on soybeans and only a slight difference on corn. The author would suggest select the contract with the lowest premium costs because the downside price limit has been eliminated in CRC. The price limit has been increase to 2 times the base price (about \$8 for corn) and the same limit now applies to RA-HPO too, starting with the 2009 crop.
6. The enterprise unit is by crop, so farmers with wheat, irrigated corn and dryland corn may want to keep their optional units on their corn but select the enterprise unit on wheat. Those farmers could also plant the dryland corn acres to grain sorghum and then select enterprise units on all three crops.
7. Should farmers select APH over RA/CRC on their soybeans because of the RMA set inverted price election of \$9.90 for APH versus \$8.95 (as of 2/20) for revenue insurance? The higher price election would have the effect of increasing the SURE coverage, but in most states there is no enterprise unit for APH. Therefore, farmers may want to stick with their revenue coverage and take advantage of the increased enterprise subsidy. Also the prices could change by harvest and still cause a larger payment from revenue insurance, if there is a claim. Under the new Farm Bill the impact of RMA inverting the prices for revenue insurance not only impacts crop insurance but also impacts the FSA SURE program.

**ACRE.** There are a number of press stories claiming signup for ACRE is a “no brainer” but I must not have a brain because I don’t agree. Currently farmers will want to signup for DCCP program and then FSA will amend their contract for ACRE. Current FSA does not have the software ready to go for ACRE signup. This is good news because the longer the wait to signup the better information farmers will have on price and yield. It was suggested to me the software might not make the June 1 deadline, and my response was good! The longer it takes the better able farmers will be able to adverse select on ACRE.

I disagree that ACRE is complicated, it is only new. The SURE program is the complicated program. ACRE is simply a “put option” on expected state revenue. A Chicago put is an option on expected price. ACRE works like the put so the odds increase for payment if ACRE is in the money. At signup (before June 1) one would have to assume average 2009 yield (state yields do not vary as much as farm yields) but one will know if there is a current “loss on price” at signup, i.e. if the ACRE is in the money. It is assumed the market traded futures prices for new crop delivery is the best current estimate of the price to settle ACRE claims. However, unlike market traded puts the “premium” cost for ACRE does not change. The “premium” cost for ACRE will be 20% of the direct payment for the next 4 years. If the expected harvest price is out of the money for ACRE, the “premium” is still 20% of the direct payment for the next 4 years. The premiums are lower for market traded options that are out of the money.

Historically ACRE would only have paid in 1 year out of several years, i.e. history does not show multiple consecutive years of “large” payments from ACRE. So the cost is more expensive to enroll in the first year because the cost is 20% of the direct payment for the next 4 years but in 2010 the cost drops to 3 years of direct payments for a chance of one “large” payment. Therefore, one would not want to enroll in 2009 if ACRE is out of the money.

If ACRE is in the money then odds of an ACRE payment increase but it does not guarantee it. In the money put options expire worthless too. If ACRE is “deep” in the money then one could buy call options and reduce the risk of no payment, i.e. one would either collect from the call or ACRE.

The only argument for selecting ACRE out of the money is if the crop is a small percentage of the acres and the other crops planted on that farm serial number are in the money. The other reason for participating in an out of the money ACRE offer is if 20% of the direct payment is a small amount of money. For example, farmers planting corn on wheat base with a cost in direct payments of \$2 (\$8 for the 4 years) for a chance at \$100 is less risky than the average rice farmer is betting \$80 (\$20 per year).

The program triggers payments only if there is a state revenue loss. If the state triggers a loss then farmers must also show a revenue loss below their benchmark to collect the payment. There is double trigger on payment but there is no double deductible as suggested by some people commenting on ACRE.

Farmers are more likely to meet the benchmark test if the state triggers an ACRE payment in a small state like Delaware where ACRE is effectively a “county” rather than a state program. ACRE is almost a GRIP contract in Delaware. In a small state there is very little chance individual farmers will not meet the benchmark if the state triggers a payment.

Few people expect any Counter Cyclical (CC) or Loan Deficiency Payments (LDP) on soybeans, feedgrains, or soybeans, therefore the tradeoff is a potentially “large” ACRE payment in return for a 20% reduction in direct payments and a 30% reduction the loan for the next 4 years (signup is for the duration of the Farm Bill). The reduction in loan rates will likely generate real costs for cotton and rice producers and further reduce the number of ACRE participants.

If all crop ACRE “options” are out of money; do not signup.

If all crop ACRE “options” are in the money; then the odds increase for an ACRE payment. Historical data suggest if there is a “large” ACRE payment it will only happen in one of the four years.

If there is a mix of in and out of the money ACRE “options” then it will depend on the following:

1. Is the farmer’s dominant crop in the money?
2. Are farmers over the payment limit?
3. Does the crop base generate only “small” direct payments so if ACRE does not pay there is a “small” loss in direct payments?
4. Will farmers’ landlord agree to ACRE?
5. Does their state have a negative price-yield correlation?
6. What state is the farm located? ACRE is “nearly” a county program in Delaware versus a very large corn-soybean state like Illinois.
7. Because ACRE is based on the crop planted farmers can change the acreage of the crop next year to an alternative crop that is in the money.
8. Farmers that do not elect ACRE in 2009 may elect it in any of the following years. Farmers that elect ACRE in 2010 give up 20% of their direct payments for the next 3 years versus 4 years for those electing ACRE in 2009.

If farmers were required to make a decision on ACRE today, then wheat farmers would have the greatest incentive to participate. Wheat ACRE is 20% in to the money while Corn is about break even. The KSU estimated price 2008-09 price would set the ACRE strike price at \$4.32 but the USDA estimate would set the ACRE strike price at \$4.05. If the USDA estimate is correct, that will make the ACRE guarantee lower than the KSU estimate and less attractive to corn growers. I am very nervous providing an estimate that is higher than the USDA estimate, but my estimate will improve with time. Therefore, there is no reason for farmers to be in a hurry to signup for ACRE. The markets could change by June 1 and if we were to have another freeze on the winter wheat crop in May, the outlook for ACRE would change.

The major reason that ACRE will likely pay less than many people were suggesting during the Washington debate last summer is because of the lower expected 2008-09 MYA price for corn. The lower 2008-09 MYA price will lower the ACRE guarantee for corn. The reason for the lower expected 2008-09 MYA price for corn than wheat is the wheat marketing year started on June 1. The marketing year for corn started on September 1, about the same time as the financial crisis and resulting declines in grain prices. As result wheat looks like a better bet than corn for ACRE but that could change by June 1.

**Table 1. Increased subsidy rate on enterprise & whole farm units**

Coverage Level	50	55	60	65	70	75	80	85
Current Subsidy Level	67%	64%	64%	59%	59%	55%	48%	38%
Increase Subsidy for:								
Enterprise Units*	80%	80%	80%	80%	80%	77%	68%	53%
Whole Farm Units*	n/a	n/a	n/a	80%	80%	80%	71%	56%

\*New increased subsidy for Enterprise and Whole Farm units are only on insurance plans and in counties that RMA offers Enterprise and Whole Farm units.

**Table 2. Estimated Weighted National Average Price and Projected % ACRE Price loss and % SURE Price Loss (02/06/09)**

Crop	Grain			Soy-
	Wheat	Corn	Sorghum	beans
Est. 2008-2009 NASS Price <sup>1</sup>	\$6.89	\$4.43	\$3.42	\$10.29
% of 08-09 NASS Price Settled <sup>2</sup>	82%	56%	65%	62%
% Over (Under) Est. NASS Price	6%	5%	14%	5%
07-08 NASS Published Price	6.48	4.20	4.08	10.10
<b>2009 ACRE Strike Price</b>	<b>6.68</b>	<b>4.32</b>	<b>3.75</b>	<b>10.19</b>
Current Futures New Crop Price <sup>3</sup>	5.81	4.21	3.20	9.40
\$ ACRE in (out) of the Money	\$0.87	\$0.11	\$0.55	\$0.79
<b>% ACRE in (out) of the Money</b>	<b>13%</b>	<b>2%</b>	<b>15%</b>	<b>8%</b>
<b>2008 RA &amp; SURE Strike</b>	<b>8.60</b>	<b>5.40</b>	<b>5.06</b>	<b>13.36</b>
2008 RA Harvest Price	8.60	3.74	3.87	9.22
2008 NASS SURE Claim Price	6.89	4.43	3.42	10.29
\$ Price Loss in SURE Claim	\$1.71	\$0.97	\$1.64	\$3.07
<b>% Price Loss in SURE Claim</b>	<b>20%</b>	<b>18%</b>	<b>32%</b>	<b>23%</b>

<sup>1</sup>The NASS 2008-09 Marketing Year Average (MYA) price is averaged with the 2007-08 MYA price to set the strike price for the 2009 ACRE program. Also the 2008-09 MYA price is used to settle claims on the 2008 SURE programs.

<sup>2</sup>The estimated 2008-09 MYA price is about 80% complete for wheat because the wheat marketing year is June 1 through May 31 while the marketing year for the other crops is September 1 through August 31 therefore the 2008-09 MYA price for corn, grain sorghum and soybeans are about 50%-60% complete. The estimate becomes more accurate as more actual NASS prices are added to the weighted average price.

<sup>3</sup>It is assumed the market traded futures prices for new crop delivery is the best current estimate of the price to settle ACRE claims.