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SRA Will Cut Agent Commission Rates, Perhaps Below 10%¹

“ACRE, SURE, and Ad Hoc Disaster: How Can Anyone Sell Crop Insurance?” is the title to my second presentation at the 4 State Crop Insurance Workshop. Tom Sell with the Combest, Sell & Associates, LLC, will help with this presentation. An update on ACRE, SURE and Ad Hoc Disaster will be covered but since the conference agenda was set, the Risk Management Agency (RMA) has issued a new Standard Reinsurance Agreement (SRA) that will have major impacts on crop insurance agents’ commissions.

Policy makers also reduced the premium cost share on Group Risk Plan (GRP), Group Risk Income Protection (GRIP) and GRIP with Harvest Revenue Option (GRIP-HRO). As a result, GRIP and GRP insured farmers will pay a higher share of the premium rates. There was no reduction in the RMA premium cost share for Revenue Protection (RP), Revenue Protection with the Harvest Price Exclusion (RA-HPE), and Yield Protection (YP). The reduction in the government’s premium cost share will have little effect in the 4 State region, because few GRP and GRIP contracts are sold.

When crop insurance was first moved to the private sector the Administrative and Operating (A&O) expense rate was set at approximately the same rate provided in a private property-casualty insurance contract. Policy makers wanted to attract crop insurance companies and agents into this new market. Over the years the Congress has

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cut this rate as a part of the budget process. Also the number of crop insurance companies is less than half of the companies that were in the program at its peak. Currently many of these “small” crop insurance companies have been purchased by large insurance and re-insurance companies, both on and off shore.

Recently Congress made additional budget cuts in crop insurance and the A&O. Using the SRA, RMA increased the stated A&O rate on the 80% and 85% coverage crop insurance contracts, but most of the coverages are written at a lower level so this may have little benefit for many agents. RMA also increased the A&O rate on the Revenue Protection with the Harvest Price Exclusion (RA-HPE) to the same rate paid on Yield Protection (YP). Policy makers set the A&O rate on the Revenue Protection (RP) at a lower rate.

On the surface this looks like RMA increased the A&O and the resulting commission rates that agents might expect to earn. The argument was RMA needed to provide “contract improvement” before imposing effective A&O cuts without Congressional approval. However, the new SRA establishes a commission limit of 80% times the A&O expense rate. This limit is applied by state and companies do not have to pay the maximum. If a company wants to limit its exposure in a state they can do so by reducing their commission rate. There is no minimum rate but there is a maximum rate of 80% times the A&O rate. Few Great Plains insurance agents were receiving 80% of the A&O, so this limit may have its greatest impact on Corn Belt agents.

In addition, the SRA includes **a hard dollar limit on the A&O aggregate dollars paid** at the national level. If the aggregate A&O dollars exceeds the dollar limit, then the A&O rate will be reduced on a pro rata basis. However, all crop insurance contracts are not subject to the industry level A&O dollar limit. Contracts that come under the limit include YP, RP, RP-HPE and Actual Production History (APH) that mostly covers fruits and vegetable type crops. There was some confusion if the APH contracts were included in the A&O cap but that has now been confirmed by RMA. Adding to the confusion are insurance contracts excluded from the cap that include GRP, GRIP and GRIP-HRO. Other area insurance plans and livestock insurance plans are also not subject to the A&O dollar cap.

Because the A&O is based on a percentage times the premiums; then higher premiums increase the A&O. However it is almost a certainty that the A&O percentage rate will be reduced because the aggregate A&O dollars will exceed the SRA limit. In order for the A&O rate not to be prorated, corn futures prices would need to fall below \$3.09 by March 1.

The USA corn and soybean stock to use ratio is under 8 percent. The US corn supply-demand numbers are based on a 156 bushel corn yield. There was only one yield that was higher over the past five years and 156 bushels is the third highest corn yield on record. The USDA is currently forecasting stocks to use ratio of 6.7%, the second lowest ratio on record. If the final corn yield is 2 bushels lower, the stocks to use ratio would be under 5.5%. This would suggest a carryover approaching the record low for stocks to use

ratio that was under 5% set in the 1995/96 marketing year. This would suggest the potential for higher prices and increased price volatility that will increase A&O before the cut.

Under these conditions one would expect the nearby futures contract to trade at a premium to the 2011 new crop corn contract. It is the December 2011 corn futures contract that will set the price election in the new RP crop insurance contract. Remember higher prices will likely be accompanied with higher volatility and the combination will cause higher premiums. Because of the A&O payment cap the A&O rate will be prorated and the resulting agent commissions under some reasonable market scenarios would be under 10%.

Current grain market prices will need to decline by 35-45% by March 1, to prevent cuts in the stated A&O rate and resulting agent commissions. Complicating the issue, winter wheat premiums are already set, so if market prices for crops with a March 1 sales closing date increase, that will shift additional A&O dollars to corn, cotton and soybeans. Agents are then limited to a maximum of 80% times the reduced A&O payment rate.

Based on current grain market prices, agent commissions would be cut by 400 to 600 basis points from the stated value in the SRA. Higher grain prices could cut the agent commission for RP below 10%! This is how increasing agent commissions to 14.8% (18.5% X 80%) turns into a 10% agent commission rate.

In order for agents to increase their dollars of revenue they will need to increase their premium volume over last year by 29% on the non-excluded crops. If the market price of corn and soybeans increase by \$1.50, then agents will need to increase premium volume by 39%. Agents with a large amount of premium from winter wheat sales or APH contracts with non-market discovered price elections will have a very difficult time achieving this level of sales increase because the winter wheat price is locked in and APH contracts with a non-market based price election are unlikely to have an increase in price elections sufficient to offset the pro rata.

Ways to increase premium volume and offset the cut in the commission rates is to sell higher levels of coverage or coverage on more acres. Another way is to avoid a reduction in revenue is to sell other types of coverages that don't have an RMA payment cap. Under the SRA the payment cap only applies to "Combo" as there is no dollar cap on GRP or GRIP, so higher crop prices will increase the dollars of commission received by agents. Under current market conditions agents can earn higher revenue by selling GRIP-HPO than selling RP. However the government premium cost share for GRIP and GRP were cut too, so farmers will pay a larger share of the premium on those contracts.

In high yield risk counties, agents will take a reduction in their commission dollars if they sell their client an RP contract that includes the harvest price. In this case the agent will earn more dollars of commission on a RP-HPE contract than a RP contract.

Then the question becomes, if the incentive is to sell other types of coverages is that in the best interest of the farmer? In addition to agents, farmers too may want a better understanding of the sales incentives in the new SRA.

This is a complex issue that will be covered in the 4 State Risk Management Workshop starting in Brush, Colorado (November 2), Grand Island, Nebraska (November 3), Salina, Kansas (November 4) and Enid, Oklahoma (November 5). Enrollment is limited and **late enrollment carries a higher registration fee**. There are many other topics covered in the workshop that will interest a broad audience including insurance agents, farmers, ag lenders, USDA employees, county agents, and others. The link to review the full program and register on line is at:

<http://www.agmanager.info/events/Insurance/2010/Default.asp>

I hope to see many of you at the 2010 Insurance Workshop; “USING NEW TOOLS TO MANAGE RISK”!