



A New Crop of Insurance

NEW WAYS TO PROTECT YOUR BOTTOM LINE

BECAUSE CROP INSURANCE MUST be purchased well before planting, making an informed decision is crucial to executing a risk management strategy. The choices producers make or don't make will affect their ability to confidently price a percentage of their crop before harvest. With crop insurance, producers can market the insured portion of their crop with confidence. They know that they will have either the crops to deliver or insurance indemnities to purchase the commodities necessary to meet delivery obligations.

For most producers, guaranteeing revenue is the bottom line of all risk management strategies. To that end, the U.S. Department of Agriculture's Risk Management Agency (RMA) has made available three forms of revenue insurance that extend the coverage to include fluctuations in price. Each type combines yield and price risk protection into a single crop insurance plan to protect crop revenue. While revenue insurance is not a substitute for a marketing plan and other risk-reducing farming techniques, the increased protection is a welcomed change for many producers.

1. Income Protection

Income Protection (IP) policies protect producers against reductions in gross income when either a crop's price or yield declines from early-season expectations. Using corn as an example, a *projected price*, using the February average of the December Chicago Board of Trade (CBOT) corn contract, is used to establish guaranteed revenue. (The revenue guarantee equals the product of the producer's historical yield, the projected price, and the coverage level selected by the producer.)

Revenue shortfall is determined by using a *harvest price*, which is the November average of the same December contract.

The price at which the crop actually sells is not used to calculate a loss payment. A producer is paid for a loss when the actual and appraised yield multiplied by the harvest price falls below the revenue guarantee. Other crops use similar pricing periods as specified in the crop insurance policy.

For example, suppose that a corn producer has an average historical yield of 115 bushels per acre, the projected price is \$2.50 per bushel, and the producer selects 75 percent coverage. The producer's revenue guarantee is \$215.63 per acre (115 bu. x \$2.50 x .75). Using the

information above, the following two scenarios illustrate conditions under which IP would pay producers:

Low yields/High prices

The producer harvests only 55 bushels per acre, but the harvest price is \$2.60 per bushel. The producer's calculated revenue is \$143 per acre (55 bushels x \$2.60 per bushel).

So, the producer is paid the difference of \$72.63 per acre (\$215.63 - \$143).

Normal yields/Low prices

The producer harvests 115 bushels per acre, but the actual harvest price falls to \$1.80 per bushel. The producer's calculated revenue is \$207 per acre (115 bushels x \$1.80 per bushel).

So, the producer is paid the difference of \$8.63 per acre (\$215.63 - \$207).

The premium for IP coverage reflects the historic yield variation and the variation in gross income due to yield and price movements during the crop year.

2. Crop Revenue Coverage

Like the Income Protection plan, Crop Revenue Coverage (CRC) provides revenue protection based on price and yield expectations. CRC, however, pays for losses below the yield guarantee at the higher of an early-season price or the harvest price. For most corn, the *early-season price* is 95 or 100 percent of the February average daily settlement price of the CBOT December corn futures contract. The *harvest price* is 95 or 100 percent of the November average daily settlement for the same December contract. The price at which the crop actually sells is not used to calculate a loss payment. Commodity exchanges, measurement periods, and contract months may vary for other crops.

The CRC revenue guarantee equals the product of the producer's historical yield, the coverage level, and the higher of the early-season price or the harvest price.

For example, suppose that a corn producer has an average historical yield of 115 bushels per acre, the early-season price is \$2.50 per

