

Crop INSURANCE

Fall Harvest Prices & Indemnity Payments

The RMA released the final fall harvest prices for revenue crop insurance prices at \$5.46 per bushel for corn and \$11.63 per bushel for soybeans. These numbers were the final piece of information to finalize potential indemnity payments for many revenue insurance products including Crop Revenue Coverage (CRC) on corn and soybeans and Revenue Assurance with the Harvest Price Option (RA-HPO) for soybeans. Many Iowa farms that suffered significant production losses in 2010 will receive indemnity payments reflecting these harvest prices over the next few weeks, especially if they insured using CRC coverage.

In 2010 Iowa farmers insured 89% of all the corn and soybean acres. Of these insured acres, 74% were covered by CRC and 12% with RA. The CRC policies use the higher of the spring base price or harvest price to determine the revenue guarantee, which is very similar to the RA-HPO coverage. Farmers have to designate on an RA policy whether to elect the Harvest Price Option (HPO) or simply use only the spring base price (RA-BP). An insured that chose to use RA or CRC coverage in 2010 would have made the designation on or before the March 15th enrollment deadline.

CRC and RA-HPO policies are very similar products except for small differences in the premium charged and the fact that CRC uses the month of October average for December corn futures prices while RA-HPO uses the November average. Thus indemnity payments for RA-HPO coverage on corn will be determined in December. It's quite possible that that November average futures prices might be higher than the October average, so those with RA-HPO may have a slight advantage insuring corn in 2010 because it uses the November price. The insured using RA-HPO would have less risk of the "buy-back" bushel price being lower than the insurance harvest price, compared to those CRC policy holders.

CRC and RA-HPO both provide protection against a decline in market prices as well as a shortfall in production. The guarantee is in dollars and a loss situation occurs when the dollar value reflecting actual production falls below the dollar guarantee. CRC or RA-HPO offers protection whether prices increase or decline:

- In most years when the price usually declines as harvest approaches, you are guaranteed a predetermined amount of income per acre using the Spring Base Price.
- In a year of rising futures prices at harvest, a production shortfall would be compensated at the higher market-based harvest price. This is critical if any lost production must be replaced at higher market prices for on-farm feeding or to fulfill delivery on a forward contract.
- Should a significant shortfall of production occur, the insured may need to "buy back" bushels through their grain merchandiser at the prevailing cash price.

Buying Back Bushels

The key to the issue surrounding "buying back" bushels is fairly straight forward but is often confusing until the insured receives their indemnity check. However, the crop revenue insurance products that feature the fall harvest price will create a higher harvest guarantee and a larger indemnity payment when harvest futures price rise, like occurred in 2010. In the example below, crop insurance bushels total 105 bushel per acre (140 bu/A APH X 75%). For someone that commits a large portion of these "insurance bushels" to delivery on an annual basis they should consider the use of either a CRC or RA-HPO policy. In 2011, these policies will be combined into one policy called Revenue Protection (RP).

To illustrate how indemnity payments are determined an example of CRC coverage for corn will be used.

2010 Minimum Guarantee Example— Average APH yield X spring base price X coverage level:

Example:

140 bushels per acre X \$3.99 X .75 = \$419 per acre minimum guarantee

Harvest Price — The price used to determine calculated revenue and harvest guarantee is based on the December CBOT futures average daily price during October 2010 for a CRC policy on corn.

Harvest Guarantee — Average APH yield X harvest price X coverage level:

Example:

140 bushels per acre X \$5.46 X .75 = \$573.30 per acre harvest guarantee

Calculated Revenue — Value of your production determined by bushels produced X harvest price:

Example:

100 bushels per acre produced X \$5.46 = \$546 per acre calculated revenue

Note: The actual price you receive for selling your crop is not a factor in **CRC** calculations.

Final Guarantee — Higher of the minimum or harvest guarantee.

Note: Your premium will **not** increase if final guarantee is higher than the minimum guarantee.

Indemnity — Final guarantee – calculated revenue:

Example:

\$573.30 – \$546 = \$27.30 per acre indemnity payment estimate.

Summary

As long as the insured did not commit to delivery more than the 105 bushels per acre, they should have adequate funds to “buy back” any shortfall in bushels. In the example above, the insured has an extra \$27.30 per acre as an indemnity payment to make up the difference for the missing 5 bushels. The indemnity payment will reflect the higher fall harvest price of \$5.46 per bushel. As long as the insured can find replacement bushels for a cash price less than this amount, the indemnity payment

covers any shortfall in dollars for those bushels forward contracted for delivery. Thus, there is basis risk should the cash price exceed the futures price average or the basis narrow at harvest should the “buy back” of bushels be required.

The problem for a few Iowa farms in 2010 was that they didn’t produce enough bushels to meet their forward contract obligations. In a rising futures price scenario as witnessed during October 2010, as long as the local cash price is less than this average harvest price the indemnity payment should allow for the “buy back” of any shortfall in those bushels committed for delivery.

If a producer with CRC coverage on corn delays their “buy back” strategy beyond early November, they assume risk should cash prices increase. In this case, the indemnity payment might not cover the total amount needed to “buy back” bushels.

Always contact your insurance representative with specific questions regarding the coverage on your farm.

Adapted from USDA RMA’s 2010 COMMODITY INSURANCE FACT SHEET, Corn—Crop Revenue Coverage, March 2010.