Questions and answers from Session 2
Managing Margin Risk

1. Could you elaborate more on the up to 150% of a county yield option on GRP and GRIP plans? What are the advantages and additional costs associated with that plan? Do you have to prove that you have better than county average yields?

(Revised 2/13/09)

You can insure up to 150% of the county expected yield or revenue. The intent is to allow farmers with above average yields to get higher protection per acre. Let’s assume the county expected yield is 100, the price is $5 and we have a trigger yield of 90% and a protection level of $450 (100 X 90% X $5). If the actual county yield was 80, there would be a yield shortfall of 10 units. The indemnity would be ((90 -80)/90) = 11.1% X $450 = $49.95. For the farmer insuring the higher yield, say 150, the protection level would be 150 X 90% X $5 = $675 (50% higher than the previous example). The percent shortfall would be calculated the same way, based on county yields, for both farmers. However, the indemnity for the farmer with the higher yield/protection level would be 11.1% X $675 = $74.94. Thus, farmers with above average yields can get higher protection and a larger indemnity in the case of a loss. This advantage costs more – the 50% higher coverage costs 50% more. Farmers do not need to prove yields with GRP/GRIP because the expected and actual county yields are used. Past or current performance of a farmer does not affect GRP or GRIP. My calculations may not be the exact FCIC procedures, but they illustrate the underlying idea.

2. To determine APH yields, can crop insurance history be used? The last program (2002) required actual scale tickets from the grain elevator.

To clarify, Actual Production History (APH) yields are crop insurance yields and can be established in various ways. Check with your crop insurance agent. I think the question intended to ask whether APH yields can be used for ACRE. This will be determined by the Farm Service Agency (FAS).
What does the Net Cost mean and could you go over again how to read this type of analysis?

This slide comes from the Crop Insurance Payment Simulator on the U. of Illinois website and estimates the net cost of crop insurance over a long period. Farm levels yields are used to estimate performance of the various types and levels of coverage of crop insurance.

The net cost of insurance is the producer premiums paid minus the estimated indemnities received over many years. For example, the 75% APH coverage has an estimated net cost of $8.43 per acre per year, and the CRC at the 75% level is more, $13.50 per acre.

Over many years, the premiums paid are estimated to exceed indemnities received by $8.43 per acre for CRC at the 75% level. For many counties, the net cost (especially of the group policies) is a negative number. The negative number indicates that estimated indemnities exceed premiums, so the farmer would make money by carrying insurance with a negative net cost.

We will present some research results on the net cost of insurance in some Indiana counties in Session 4.
4. We promised to update our best guess on the prices for ACRE given the most recent crop report.

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<thead>
<tr>
<th></th>
<th>U.S. Corn price</th>
<th>U.S. Soybean Price</th>
</tr>
</thead>
<tbody>
<tr>
<td>2006</td>
<td>$3.04</td>
<td>$6.43</td>
</tr>
<tr>
<td>2007</td>
<td>$4.20</td>
<td>$10.10</td>
</tr>
<tr>
<td>2008 (Feb 09)</td>
<td>$3.90</td>
<td>$9.25</td>
</tr>
<tr>
<td>2006/07 Avg.</td>
<td>$3.62</td>
<td>$8.265</td>
</tr>
<tr>
<td>2007/08 Avg.</td>
<td>$4.05</td>
<td>$9.675</td>
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The following are comments from a crop insurance agent. We thank him for his insightful comments and encourage anyone with expertise on the topics we’re covering to share their thoughts.

5. There is an upside limit on the price for revenue policies for crop insurance of 200%. There is no downside limit.

That is correct. I was just thinking on the downside

6. I was pretty confused on slide #32, “FCIC and Spring CRC Prices.” The numbers on the left under corn and beans I believe are the prices at which indemnities were/will be paid for APH and GRP policies. The numbers on the right are presumably the CRC (as well as RA & GRIP) spring prices, but they are incorrect. In 2008, the spring price for corn for revenue policies was $5.40, and the spring price for soybeans was $13.36. There is typically a significant difference in the price for revenue policies and yield-only policies. For 2009, the corn price for APH & GRP policies is $4.00, and the soybean price is $9.90. The price for revenue policies is being set this month. It is important that producers understand that the significant difference in premium between revenue policies and yield-only policies is largely due to the difference in the spring price.

I was trying to indicate some of the factors affecting the premiums. The first column is the FCIC prices for APF and GRP with a typo on ’09 soybeans. The other column is the CRC price in spring with’08 futures prices in January to be comparable to the same time in ’09. I wanted to show that the difference between the APH?GRP prices and the revenue products was decreasing. APH/GRP prices are approaching futures prices.

Price is a factor in premiums – with APH if prices double, then premiums double. The effect on revenue product premiums is more complicated. Higher prices tend to involve greater
volatility and higher premiums. With lower future prices, premiums are likely to be lower for ’09 than they were in ’08.

7. **ACRE & crop insurance are stand-alone products and have no bearing on one another.**

Crop insurance indemnity payments have nothing whatsoever to do with potential or realized ACRE payments. Professor Gray mentioned tonight that crop insurance indemnity payments will be reduced by the amount of ACRE payments, which prompted a question. If I understood Professor Gray correctly, he then said he didn’t think crop insurance payments were reduced by ACRE payments. ACRE and crop insurance, unlike SURE and crop insurance, have no connection whatsoever. SURE coverage, on the other hand, is directly tied in to the coverage level and price election chosen by the producer in his crop insurance policy. No policy, no SURE coverage. 85% policy, 85% SURE coverage. Part of the wording in the SURE provisions is there to encourage producers to purchase buy-up crop insurance policies so the government can get away from the ad hoc disaster payments.

ACRE and crop insurance are stand-alone products. Neither program affects the other in terms of payments. Insurance premiums do affect the farm-level ACRE guarantee level as those premiums are to be added to the base revenue for the farm (unless USDA changes that in the rules). Nonetheless, on the indemnity side one does not affect the other. You are correct on SURE that indemnities from both crop insurance and ACRE affect the SURE payments.

8. Lastly, producers need to understand that they are going to get zero help from the personnel at FSA offices with regard to making a decision on signing up for the new programs or not. The latest we have been told is that FSA staffers were told in no uncertain terms that they are not to give advice or recommendations due to the complex nature of the decision and the fact that several critical rules remain yet unwritten. A knowledgeable crop insurance agent is certainly going to be the best source of information as producers try to make this decision. My general counsel at this point is to be patient—producers have until June to make their decision, at which point we will have a better idea what the commodity prices are doing.

This is not new. This is the standard position of USDA with respect to FSA offices. However, the FSA office can be very helpful in determining details of sign-up and how the mechanics of the ACRE program will work. They cannot give recommendations but they can “arm” the producer with the information they need to make an informed decision on their particular farm.