Plug Your Risk Exposure

Whole-Farm Plan Insures Your Margins

Marcia Zarley Taylor , DTN Executive Editor
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The attraction of Production Cost Insurance in 2016 was that it allowed farmer Mark Bryant to insure much higher income guarantees per acre than with federal revenue crop insurance. (Photo by Jodi Miller)

SAG HARBOR, N.Y. (DTN) -- Veteran Ohio farmer Mark Bryant has spent much of his career gleaning lessons from the 1980s. So it's no surprise his goal for his family's Washington Courthouse operation in the current ag recession is to minimize losses, conserving strength to prosper when prices rebound.

"Everyone is realizing that the floor underneath us is falling a lot further than the year before, and our inputs just aren't coming down fast enough," says the 13,000-acre Washington Courthouse producer who farms with his brother Mike and other family members. Last spring's federal crop insurance guarantee had plunged to $3.86 per bushel on corn and $8.85 on soybeans, below cost of production when Bryant figures the family's average costs for corn, soybeans and wheat, including land. Price forecasts also make corn's February 2017 crop insurance guarantee potentially threadbare, perhaps $3.73 or lower.

"Bottom risk is what people need to concentrate on," said Bryant. "For the last 7-10 years, buying 85% crop revenue insurance provided a floor that averaged $50 to $70 per acre below our corn cost. Some years you could even guarantee a profit at 85% levels. But this year, federal crop's best coverage was $100 per acre underneath our production cost, and prospects for 2017 now look worse."

Protecting the farm's "floor" is what persuaded the Bryant family to test a novel product in 2016 called Production Cost Insurance, a concept first launched by a Canadian insurer Global Ag Risk Solutions five years ago and available in the U.S. on a limited basis in 20 states in 2016. At least two insurance providers -- CGB Diversified Services and ARMtech Insurance Services -- are offering the plan in 2017, with coverage in more than 30 states. The program is underwritten by Everst Re Group, a respected Canadian reinsurer.

WHOLE-BUSINESS PROTECTION

Like business interruption insurance used by nonfarm businesses, Production Cost Insurance guarantees a fixed dollar amount per acre per farm. "The product insures your gross margin above your individual input costs -- fertilizer, seed and chemicals," said Joanie Grimes with ICAP Crop Insurance, Bryant's crop insurance agent.

For example, your average production cost per acre (blending corn, wheat and soybeans together) might run $270 per acre. Then you'd choose what level of margin to add on top, be it $100, $200 or even $400 more per acre to cover a portion of your fixed costs like land, labor and equipment. (See example in sidebar below).

Claims pay 60% as soon as preliminary numbers are reported after harvest, with the remaining 40% by May 1. This allows a grower to complete the marketing season for that crop and account for actual sales on an accrual basis.

"It wasn't cheap, but it is all about risk and reward," Bryant said. "I don't worry so much about the costs as the net outcome. What it did for me was protect that much more revenue that I wasn't willing to lose. The outlay versus the guarantee was worth it for us to raise our floor."

Premiums depend on a growers' actual five-year records for gross income and input cost, so no two quotes are identical. But in 2016, another one of Grimes' clients found that for an extra $10 or $15 per acre above what he'd pay for 85% crop revenue coverage, he could insure 100% of his production at many more thousands of dollars coverage, she said. The concept takes time for growers to absorb, but she expects more of her clients to enroll in 2017.

COMPARISONS TO FEDERAL CROP

Unlike federal crop revenue coverage, this policy sets a fixed guarantee before planting that doesn't deviate based on crop yield or price fluctuations during the growing season. It is based on a whole farm's historic five-year revenues from all commodities, so its revenue guarantees can at least temporarily capitalize on some excellent income years. In 2016, the average whole farm revenues of crop years 2010-2014 established the base.

Lower income years will eventually replace those peaks, but Grimes believes it would be worth considering, especially if federal crop insurance guarantees stay depressed.

The main advantage in Bryant's mind is that Production Cost Insurance gave them leeway to spend more on the crop during the growing season, as conditions warranted. "The insurer wants us to work ourselves out a claim," he said. For example, southwest Ohio experienced a dry summer, then suddenly was deluged in July. Some growers abandoned rescue efforts.

"I bet there wasn't 20% of the normal fungicide sprayed on corn in our area, because for people who thought they might have a federal insurance claim, it was a non-recoverable cost. We sprayed every acre," Bryant said. "It gave us the confidence to go out there and still use best management practices. We were able to give the crop everything it needed to get the most yield out of it we could."

The motivation to maximize yields year-in-and-year-out is what Grant Kosior, president of Global Ag Risk Solutions, believes is the real value of the insurance program. For each 5,000 acres of corn, encouragement to hit an extra 20 bu. per acre is worth about $350,000 to $400,000 annually.

That's potentially life changing, he says. "One out of every 10 years you might have a claim. We call that one year of insurance and nine years of assurance."

Some critics contend the real "at-risk" income of private products like this is small, and the premium is high per dollar of coverage. It's hard for a private insurance company to compete with the federal government, which pays $6 in subsidies for each $10 in premium cost, they argue.

However, larger-scale growers already worry that Congress might opt to reduce or eliminate their crop insurance subsidies in the next farm bill rewrite.

"There's a need for a product like this, if Congress ever starts yanking subsidies," said Texas A&M economist Danny Klinefelter. "Farmers will need a backup plan."

In the meantime, Bryant sees reasons to test the program now. "Making money is just about impossible with this market environment and it's just going to be really tough over the next few years. So my goal is managing risk and making sure we don't lose too much. If we could lose only 2% to 3% of our working capital in a year like 2016, instead of 10% or 15%, I'd be thrilled to death."

HOW PRODUCTION COST INSURANCE WORKS

Forget what you know about federal crop insurance. Production Cost Insurance is a private policy that operates more like whole-farm revenue protection, not insurance on individual crops or fields.

On a 10,000-acre farm in Iowa, for example, the farm purchases $300 per acre of fixed-cost margin coverage for all its corn and soybean acres. The farm typically uses $400 per acre of seed, fertilizer, and chemicals for both crops averaged together. So Canadian insurer Global Ag Risk Solutions would guarantee $700 per acre of revenue.

The farm has $7.0 million of whole farm revenue protection. If input costs rise to $450, due to additional passes of fertilizer, fungicide, etc., the total coverage will increase as well. Now the farm has $450 per acre of inputs, plus $300 of additional margin coverage, equaling $750 per acre of Production Cost Insurance coverage.

So this 10,000-acre operation has $7.5 million of guaranteed revenue. If the revenue falls below the guaranteed level, Global Ag Risk Solutions will cover the difference.

For example, with $7.5 million in guaranteed revenue, if farm revenue is only $4.0 million due to an insured peril, Global Ag Risk Solutions would cover the difference of $3.5 million for that farm.

Coverage is available up to $800 per acre plus your input costs, based on qualifications. Premiums vary by an individual's historical gross margins.

EDITORS NOTE: Learn more about how to reinforce your 2017 crop insurance coverage at "Farm Strong," the DTN-The Progressive Farmer Ag Summit in Chicago Dec. 5-7. Details at www.dtnagsummit.com.

Marcia Zarley Taylor can be reached at Marcia.taylor@dtn.com

(CZ)

Marcia Taylor

About the Author

Connect with Marcia:

@MarciaZTaylor