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GROUP RISK PLAN A NEW PROGRAM FROM THE FEDERAL CROP INSURANCE CORPORATION



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New Federal Crop Insurance Program¹

Until September 30th, South Dakota wheat producers have an opportunity to participate in a pilot program from the Federal Crop Insurance Corporation (FCIC) in the following counties: Campbell, Corson, Dewey, Haakon, Hughes, Lyman, Perkins, Stanley, Sully, Tripp, and Ziebach.

This issue of the Commentator will discuss the nature of the program and examples of how the program works. Agricultural producers, and those agribusinessmen and lenders who work with them, will want to know about this program as it is being talked about as the agricultural disaster program for the future. Also, South Dakota will likely be selected as one of the states to pilot the effort directed at 1994 spring planted crops.

The New Group Risk Plan

Agricultural producers have been aware of production risks in agriculture for a long time. Many producers have examined the Federal Crop Insurance Multiple Peril Crop Insurance (MPCI) program as one tool to help manage risk. Some producers may have decided that MPCI was too costly for their low risk operations or may have decided that the program was too complex for their operation. Recognizing these attitudes, the Federal Crop Insurance Corporation is introducing the new Group Risk Plan.

The Group Risk Plan (GRP) is a dramatic departure from traditional

approaches to crop insurance protection. It offers less paperwork and a lower cost than the MPCI program. GRP is based on the premise that, when an entire county's crop yield is low, most farmers in that county will also have low yields. Therefore, GRP pays only when the yield of the entire county drops below the expected county yield set by FCIC. Payment is based on the percentage decline below expected county yield, the coverage level the individual farmer purchases, and the amount of protection purchased.

Group Risk Plan For Everyone?

For relatively low-risk farmers, the cost of MPCI crop insurance may have exceeded the risks. With the new GRP program, farmers are no longer forced to choose between MPCI or no coverage at all. GRP gives producers a choice - comparable risk management at a lower cost and a simplified program.

Still, GRP may not be the best alternative for every producer. The new GRP program will be the most effective for those producers whose crop yields are closely correlated with county yields. If an individual producer is in an unusual area of the county, however, MPCI may be a better alternative. Producers will need to examine both programs as they will not be allowed to purchase both GRP and MPCI for the same crop in any one year.

GRP is Simple

Everything about the new GRP program is simple compared to the MPCI program. The concept is simple, the premium calculations are simple, and the calculations are simple. Even the paperwork is simple.

Because of the way the GRP program works, the only information a producer need provide is the number of acres of the crop planted by the acreage reporting date. Since payments are made on losses based on the county yield, no evidence of loss need be presented to FCIC. Producers need not even provide yield histories because everything is based on the expected county yield.

Expected County Yield

Producers are familiar with the term "average" yield that is used for most USDA programs. The GRP program is different in that it uses an "expected" yield which is adjusted for more accurate results. The reason is that average yields typically don't take into account unusual weather years or advances in technology. "Average" yields are simply the sum of the yields of the previous ten years divided by ten.

In contrast, the expected county yield used for GRP is calculated using many years of county data from the National Agricultural Statistics Service (NASS) and includes adjustments for such factors as new technology, improvement in farming practices, and other yield trends. The result is a county yield value that should prove to be closer to what farmers actually expect to produce.

GRP Cost

As with MPCCI, GRP provides maximum protection for crops, but generally at a lower price (GRP premiums are subsidized by FCIC just like MPCCI premiums). GRP is even designed to pay 100% protection in the unlikely event of a zero county yield. The cost of GRP is generally lower than, but with many similar basic premises to, the current MPCCI program. For instance, the cost of GRP will decrease or increase depending on the coverage level chosen. Farmers in counties with higher yield risks will pay more than farmers in counties with lower yield risks.

How Much Protection?

The new GRP program can be effective for any producer, but is attractive for those producers who are typically low-risk high-yield growers. The GRP program allows producers to insure crops at values that exceed average county revenues by up to 50%. For example, if the expected county yield is 30 bushels and the established price is \$3.00, the maximum protection an individual may purchase is \$135.00. The \$135.00 is 50% more than the county average of \$90.00 per acre. Even those producers who are not high-yield growers can purchase the higher level of

risk protection.

GRP Payments

Payments are based on the percentage of decline below the expected county yield, the coverage level selected, and the amount of protection per acre purchased. There are six coverage levels from which to choose: 65%, 70%, 75%, 80%, 85%, and 90%. The trigger yield is the level below the expected county yield where GRP coverage begins. For example, if the expected county yield is 30 bushels and the 90% coverage level was selected, the effective trigger yield would be 27 bushels. [30 bu/ac X 90% = 27 bu/ac = Trigger Yield].

Continuing this example, assume the county yield drops to 20 bushels per acre. This would be a 25.9% shortfall below the trigger yield [(27 - 20) / .27 = .259 = Shortfall]. If a policy was purchased for the \$135 maximum protection described previously, the indemnity payment would be \$34.97 [.259 X \$135 = \$34.97 = Indemnity Payment]. A payment matrix illustrating this concept is shown in Figure 1.

In the event that the county has substantial losses, FCIC may make a preliminary payment as early as September. However, in most instances the final payment will be made after NASS releases its final report on actual county yields in May following fall harvest.

Other Considerations

While the advantages of the new GRP program may outweigh the disadvantages, the GRP program, like any insurance program, is not a magic solution. Two important considerations in making informed decisions about whether the new GRP is right for any individual are the following.

1) Payment Without Loss - With the new GRP program, the possibility exists for producers to receive payments even if they don't experience yield losses on their own farms, although such instances would be exceptional. The GRP program is designed so that all farmers who have a policy receive a payment when the county

yield, not individual yield, falls below the chosen trigger yield. This is an essential component of GRP.

This provision of the new program is important because it provides incentive to all farmers to produce an economically optimal yield. Even though weather conditions may be such that a payment can be expected from GRP, farmers are motivated to keep farming because they know they will receive at least some income from the crop they produce.

2) Loss Without Payment - While unlikely, there is the possibility that a farmer will experience a loss and not receive a payment. For an individual farm, the effectiveness of the GRP program depends on the correlation of the farm yield with the county yield.

For those farms whose yield history is different from the rest of the county, the GRP program may not be the best insurance plan. These farmers do have alternatives that provide added protection which merit consideration. Fire and hail policies from the private sector protect farmers against losses that may affect their farm without affecting the county yield.

Switching MPCCI Protection to GRP

Some farmers are already using the MPCCI program as a risk management strategy. For these farmers, there is no loss to switch to the GRP program. MPCCI premium discounts are based on the individual's experience with MPCCI. Since GRP is based on county yields, individual premium discounts are not applicable. Farmers using the new GRP program can switch back to the MPCCI program at any time during the pilot test and the premium discounts will be restored. Farmers need to remember that the MPCCI program requires annual production records which should be maintained during the GRP pilot test period. By maintaining these records, farmers will not be required to furnish reports for missing years if they decide to switch back to MPCCI from the GRP program.

GRP may be the innovative risk management program farmers have been needing and waiting for. Farmers interested in the new GRP program should contact their crop

insurance agent for further explanation and actual comparisons.

GLOSSARY

GRP - Group Risk Plan

MPCCI - Multiple Peril Crop Insurance

Expected County Yield - The yield FCIC expects a particular county to have. It is based on many years of data and advances in technology. It is the basis for determining coverages and payments under GRP.

Trigger Yield - The expected county yield times the coverage level chosen by the insured. Payments are made if the county yield falls below the trigger yield.

Preliminary Payment - A partial payment that will be made if it is reasonably expected that county yields will be low enough to cause a GRP loss.

Final Payment - The payment made after the actual yields of the county are known and finalized.

----- ENDNOTE -----

1. This information is revised from the brochure Wheat Crop Risk Plan (GRP): A Pilot Test. A Guide To The Wheat Group Risk Plan by Federal Crop Insurance Corporation, United States Department Of Agriculture, GRP Guide - Wheat X000-00-000-0157, July 1993.

See Figure 1 on back of this page.

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Figure 1. Payment Matrix
 Based On Expected County Yield of 30 Bushels/Acre And Protection/Acre of \$135.00.

