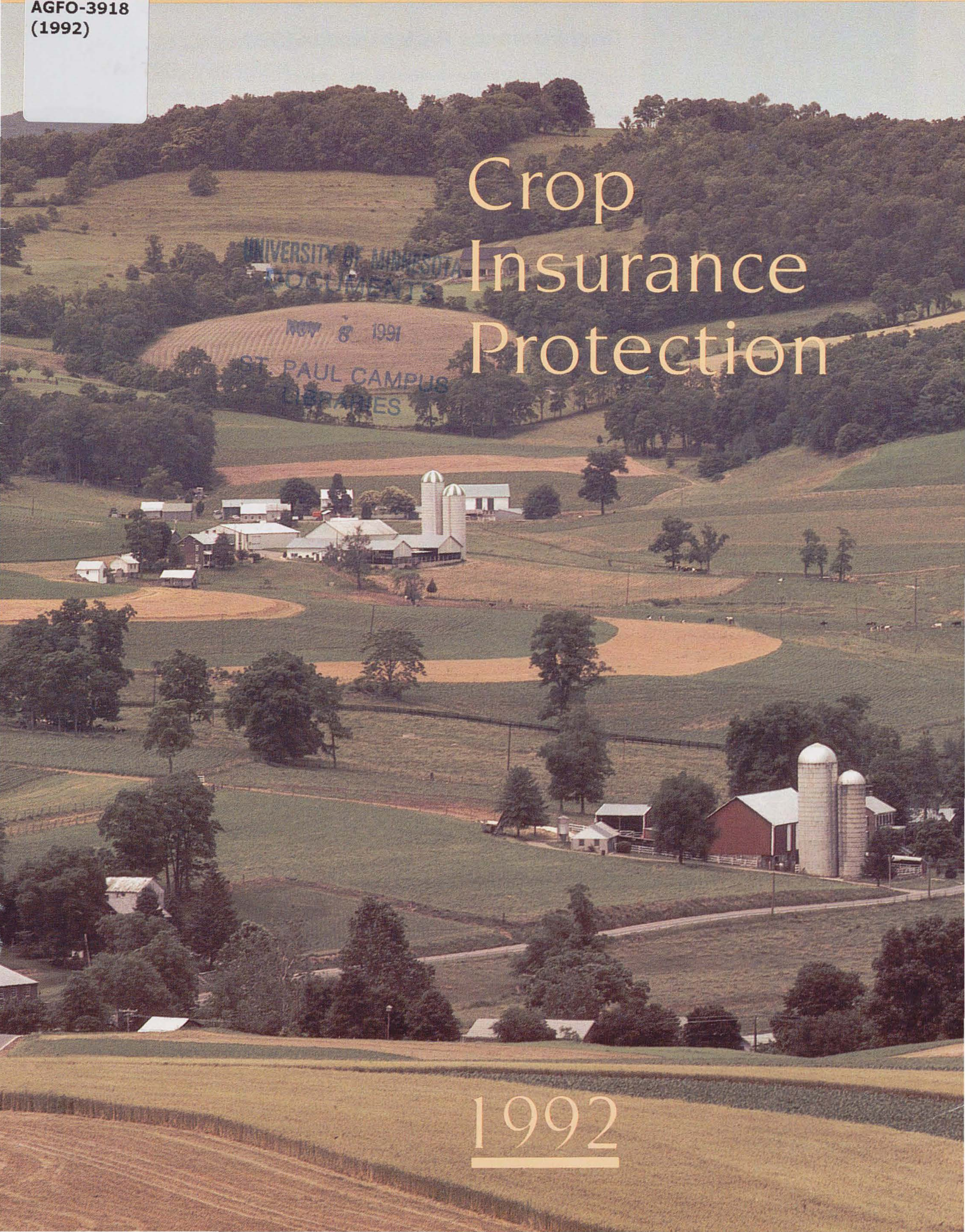
A Guide to Crop Insurance Protection



1992

Risk Management and the Year 2000

The year 2000 should now be well within your planning sights. But if there's one lesson the business of farming teaches time and again, it's the need to have a plan that considers both a "best case scenario" and a "worst case scenario."

The difference is usually due to events beyond your control. Unpredictable and unavoidable. (Think how often you've heard someone say, "it would have been a good year except for....")

Farming is thus still a year-at-a-time business and experience tells you that some things will go wrong some of the time. Some years of good weather, for instance, and then suddenly a year of terrible weather. Without warning.

That's why the best business plan for achieving the goals you've set is one that includes prudent financial risk management — including adequate insurance protection for the substantial cash investment in your principal crops.

It comes down to this: the better you've planned for a worst case scenario, the less likely you are to have one.

Policy Highlights

Crop Insurance Protection for 1992

You can purchase insurance on your share of an insurable crop provided it's produced on insurable acreage. The protection is available to owner-operators, tenants, renters, crop-share landlords, partnerships, corporations, and estates. If you have less than a 100-percent interest in an insured crop, the premium and any indemnity payments are prorated on the basis of your share.

The policies guarantee yield per acre for most crops. If production on the insured acreage falls short of the guarantee, an indemnity payment makes up the difference in cash (up to the dollar amount of coverage stated in the policy). For certain other crops the guarantee is stated in a dollar amount of coverage per acre rather than yield per acre.

Crops that can be insured this year include the 50 crops listed below. Not all are insurable in every county, however, so check with your agent.

Almonds • Apples • Barley • Canning beans • Citrus • Citrus trees • Corn • Cotton • Cotton, extra long staple • Cranberries • Dry beans • Dry peas • Figs • Flax • Forage production • Forage seeding • Fresh market sweet corn • Fresh plum • Grain sorghum • Grapes • Green peas • Hybrid seed corn • Hybrid sorghum seed • Macadamia nuts • Macadamia trees • Nursery • Oats • Onions • Peaches • Peanuts • Pears • Peppers • Popcorn • Potatoes • Prunes • Raisins • Rice • Rye • Safflower • Soybeans • Sugarbeets • Sugarcane • Sunflowers • Stonefruit • Sweet corn • Table grapes • Tobacco • Tomatoes • Walnuts • Wheat

Protection is provided against the perils specified in the policy — including practically all unavoidable causes of loss in the case of most field crops. For certain other crops (principally fruits and vegetables), the policy may cover only the most frequent and catastrophic causes of loss.

Quality damage is also covered for most crops. When poor quality reduces the value of the crop, a reduction is made in the production to count, thus potentially increasing your indemnity payment.

Guarantees based on yield are calculated from average historical production, using your own records for the years you have them and yields that reflect the county average for any years that you don't. This is referred to as your APH (Actual Production History) yield.

It's up to you to decide what percentage of the APH yield you want your insurance policy to guarantee. The options are 50 percent, 65 percent, and 75 percent. An indemnity is paid when your yield is less than the guarantee you've selected.

The dollar amount of protection per bushel or pound is also your decision, up to a certain maximum (your agent can tell you what your options are). This is the amount the policy will pay for each bushel or pound of loss.

The cost of insurance is determined by multiplying the premium rate for the crops you're insuring in the location where you farm by the dollar amount of insurance protection that you choose to purchase. Premium rates are reviewed periodically and adjusted upward or downward to reflect recent loss experience.

The deadline to apply for insurance is normally about 1 month prior to the usual planting date for the crop. Allowing insurance to be purchased after this date would not be actuarially sound since it could prompt some producers to apply for coverage only in years when conditions appear to be unfavorable. This would cause premium rates to be raised and be unfair to those producers who insure their crops every year. Your agent can tell you the exact application deadline for the crops you are considering insuring.

The premium for crop insurance generally does not have to be paid in advance. A bill for the premium usually isn't mailed until about harvest time. This is in contrast to most other types of insurance that have to be paid at the *start* of the protection period. By deferring payment until you've already harvested a successful crop, carrying crop insurance doesn't add to your expenses at planting time. In a year when you have a loss, the premium cost is deducted from your indemnity payment.

Indemnity payments for crop losses are based on a calculation of your actual production by an independent loss adjuster. Insurance companies pride themselves on being able to make loss adjustments and indemnity payments promptly.

FEDERAL CROP INSURANCE CORP.
USDA

Answers to Often-Asked Questions About Crop Insurance

Q. Can I insure some crops but not others?
A. It's entirely up to you to decide which crops you want to insure.

Q. When I insure a particular crop, do I have to insure all of my acreage in that crop?
A. You must insure your interest in all acreage of that crop that is planted in the county.

Q. What if I apply for insurance but don't plant the crop?
A. Simply report that the crop wasn't planted. There won't be any premium charge.

Q. Suppose I lose a crop early in the season, while there's still time to replant?
A. Policies include a replanting requirement, and for some crops there is a replanting payment. Check your policy, and if you have any questions contact your agent promptly.

Q. Does the insurance require that I maintain production records on insured crops?
A. Yes, for most crops. The information must be reported by a date described in the policy. Separate records are required for each insurance unit.

Q. Is there any linkage between crop insurance and other farm programs?
A. Eligibility for insurance benefits requires compliance with "sodbuster" and "swamp-buster" provisions of the 1985 Food Security Act. In addition, to meet the eligibility determinations for a Farmer's Home Administration (FmHA) emergency loan, you must have a multiple-peril crop insurance policy in force on the damaged crop if insurance was available. Contact an FmHA loan officer or your crop insurance agent for details.

Q. What if I am unable to harvest an insured crop during the insurance period?
A. Contact your agent promptly to protect your right to an indemnity payment.

Q. What should I do if I have crop damage?
A. Contact your agent, file a Notice of Loss, and protect the crop against further damage.

Q. Are premium rates for crop insurance reduced by a Federal subsidy?
A. Yes. In addition, the Federal Government pays certain administrative, actuarial, underwriting, and selling expenses that would otherwise have been included in the premium cost. The premium rate your agent quotes for the coverage you choose is the *net* premium rate.

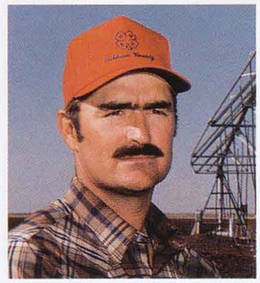
Q. Does the policy automatically continue from one year to the next?
A. Yes, it does unless you provide written notice of cancellation by a date specified in the policy.

Q. Can I change my coverage levels from one year to the next?
A. You can change any or all of the various coverage options such as percentage yield guarantee, price selections, optional unit coverage, if applicable, and the hail and fire coverage election.

Q. Are there ways to reduce the cost of insurance?
A. One way is by choosing a lower yield guarantee or a lower price per bushel or pound payment. Another way is by providing your agent with past production records that document a history of above-average yields. The higher your yields relative to the county average, the lower your premium rate will be.

Still another option that affects the premium cost is whether to include hail and fire protection in the coverage. Excluding the hail and fire coverage and carrying at least an equal amount of protection under a separate policy can reduce the cost of the multiple-peril policy by as much as 30 percent. Also see page 7 for an explanation of how a "unit" insurance option may entitle you to a 10-percent premium rate discount.

POLICYHOLDER PROFILE



Name: Brady Goen
Location: Shallowater, TX
Farming Operation: 1,000 acres of cotton.
Comment: Inputs in farming today are very costly and it's difficult to decide which inputs to make without some assurance I can recover a part of my investment. The cost of crop insurance is a small price to pay for knowing I will be able to pay most of my obligations back and still farm next year should disaster strike. In addition, to secure a loan in today's financial environment it's nearly a must to have crop insurance.

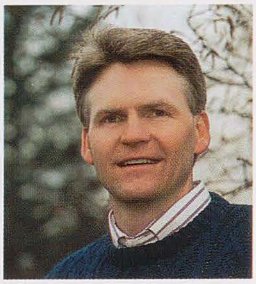
Income Protection: Flex Acres Reduce It; Insurance Increases It

The designation of 15 percent of farm program base acreage as flex acres with no deficiency payments means that although your production expenses will remain as high or higher, you will have less income you can count on to help *pay* them. What's more, it means less cash "up front" to defray planting expenses as they are incurred. Translation: more *risk*, because you need to commit more of your own money or more borrowed money.

When new flex acreage provisions of the 1990 Farm Act went into effect a year ago, prudent money managers recognized that it made sense to counter the reduction in income by carrying insurance on their crops. It makes sense again *this* year.

Another important consideration favoring insurance: to the extent a poor crop year boosts average market prices, deficiency payments are reduced *at the very time you need them most* (that's a double whammy if your yields are down and you have less available to sell at the higher market prices!).

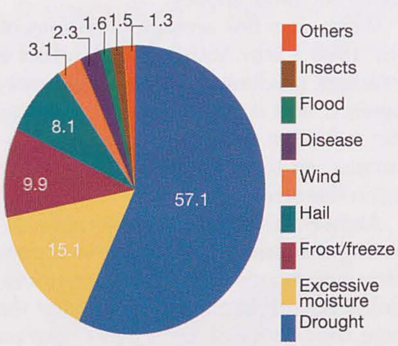
POLICYHOLDER PROFILE



Name: Jamie Tronnes
Location: Shelly, MN
Farming Operation: 1,000 acres wheat, barley, sugarbeets.
Comment: There are many aspects of a farming operation that we as producers are able to control, but we can't control the weather — the one thing that has the greatest impact on our profitability. I use multiple-peril crop insurance to minimize the impact weather can have. It gives me the flexibility to choose the coverage that best fits my farming operation, but above all else I like the peace of mind that crop insurance gives me.

Major Causes of Crop Loss

Although crop losses occur every year (see chart, page 6), the ever-present uncertainty is *whose* crops will be damaged or destroyed and *how*. Drought, as you'd probably expect, is historically the major peril to crop production, but in an average year more than 4 of every 10 crop losses are due to causes *other* than drought.



Data: 1948 to date

If These Are Your Objectives for 1992, Here's How Crop Insurance Can Help You to Achieve Them

In farming as in any business, objectives are only as good as the plans you make for achieving them. The following are some of the goals farmers most frequently set for themselves — and reasons why adequate crop insurance should be included in the plans for achieving them.

- *Avoid additional debt.* Now that farm debt has been reduced to more manageable levels, most farmers want to keep it that way. Crop insurance indemnity payments can translate into a dollar-for-dollar reduction in the need to incur additional debt.
- *Maintain cash flow.* Financial problems are due less frequently to a lack of assets than to a lack of cash (see report on page 6). Carrying crop insurance provides improved cash-flow stability by providing what amounts to a cash-flow floor.
- *Obtain credit on good terms.* It stands to reason that the less you have to pay for borrowed money, the more you stand to make on your money. Studies have shown that crop insurance policyholders have an advantage when it comes to obtaining credit and the cost of credit.
- *Control expenses.* By the yardstick of cost per bushel or pound of production, there's no crop more expensive than the crop that you lose. Crop insurance provides a source of income to cover expenses in a year when a crop is damaged or destroyed.
- *Get the best price for your crops.* The best price is often a price that's available prior to harvest, through hedging or forward contracts. A crop insurance policy can reduce the risk of contracting a crop by assuring you'll have either the crop to deliver or the cash you insured it for. (See page 6.)
- *Expand your business.* Whether expansion takes the form of additional land, equipment, or buildings, it will require additional investment. Crop insurance helps provide the certainty of income that's needed when you take the financial risks associated with expansion.
- *Increase net income.* To accomplish this, it's as important to limit losses as it is to maximize profits. The benefit of crop insurance is obvious. It helps prevent a few poor years from wiping out the financial gains realized in good years.

Environmental Responsibilities Linked to Crop Insurance and Vice Versa

No one has ever had to tell farmers that good environmental management is good *business* management. Common sense dictates that you provide conserving care for resources that provide your principal source of income. Even so, as practical responsibilities have also become a legal obligation, it's worth noting that crop insurance not only *requires* good environmental practices but, in a poor crop year, it also provides income to help *pay* for them.

The policies themselves include a requirement that, as a condition for coverage, you employ sound crop management. Also note that eligibility for farm program benefits — including the subsidy provided in your crop insurance policy premium — requires compliance with provisions applicable to highly erodible lands and wetlands, the swampbuster and sodbuster rules. Recent changes have tightened some rules, so be sure you understand them.

Suggestion: You may want to obtain a copy of the *1991 Yearbook of Agriculture*, dealing with the environment. Available after November, 1991, it covers such topics as conservation tillage, sustainable agriculture, ground water quality, global climate, and computer programs for fertilizer and pesticide applications. Single free copies are available from Members of Congress.

Insurance Is Less Expensive than Debt
Compare the Costs

A crop loss frequently requires having to take on additional debt, and the cost of servicing this debt (principal and interest payments) is likely to *far exceed what it would cost to carry crop insurance*. Consider this example:

A producer borrows $10,000 to be repaid over 10 years at 12-percent interest to cover the expenses of a $10,000 crop loss. Principal and interest costs over the 10-year repayment period will total $17,700. And, of course, that won't provide protection against any additional crop losses.

In contrast, that same sum of money ($17,700) would pay the average farmer's total premium expense for $10,000 worth of crop insurance *every* year for the next 30 years (assuming a 6-percent premium rate). The chart illustrates this.

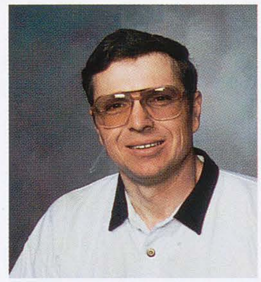
If your insurance premium rate is	The cost of repaying a single $10,000 loan over 10 years at 12-percent interest would pay your premium cost on $10,000 of insurance coverage for this many years:
$3.00 per $100	60 Yrs.
$6.00 per $100	30 Yrs.
$9.00 per $100	20 Yrs.
$12.00 per $100	15 Yrs.

Prepare a Crop Insurance Calendar for 1992

With information that your agent can readily provide, a calendar of important crop insurance dates and deadlines can serve as a useful reference throughout the crop year. Those included below are applicable to most insurable crops.

CROP			
Sales Closing Date (deadline to apply for coverage)			
Final Planting Date (contact agent if unable to plant by this date)			
Acreage Report (date to report planted acreage)			
End of Insurance Period (date insurance coverage ends)			
Premium Billing Date (approximate date you'll be billed for insurance)			
Payment Due Date (date to pay to avoid interest charges)			
Cancellation Date (date to give notice if you don't want insurance to continue to next crop year)			
Report Production (on insured acreage)			

POLICYHOLDER PROFILE



Name: Lloyd Klein
Location: Elgin, ND
Farming Operation: Wheat, barley, oats, corn, sunflower, backgrounding beef calves and cow-calf.
Comment: Today's large investment in growing a crop requires us to minimize our financial risk. Crop insurance accomplishes this. Because our operation is spread over a large area, where we could have a loss in a specific area but not on the rest of the operation, the crop insurance "unit option" is important to us. The price and level of coverage selections allow me to choose the amount of coverage that we need to meet our financial situation.

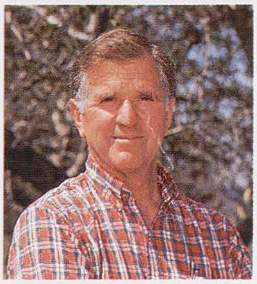
When Planning for Retirement, It Pays to Plan for the Unexpected

If yours is like most farm families, you're expecting the net worth of your business and other investments to steadily grow to the point where they'll someday provide a comfortable retirement income. The trouble is that even a single uninsured crop loss along the way can deal a serious setback to such plans — a bigger setback than you think.

For example, assume you're still 15 years away from retirement and suffer a $20,000 loss. A loss of this amount could ultimately reduce your net worth at retirement by more than $83,000. (That's what the $20,000 could have grown to through compound earnings over 15 years at 10-percent per annum.) And this assumes you experience only *one* such loss along the road to retirement.

Conclusion: Crop insurance protects not only your financial *present*; it's also sound protection when you're taking a longer view of your financial *future*.

POLICYHOLDER PROFILE



Name: Jim Cooley,
Cooley Enterprises
Location: Dixon, CA
Farming Operation: 1,600 acres processing tomatoes, wheat, dry beans, walnuts and alfalfa.
Comment: I look at crop insurance as a business tool. I use it to reduce my risks and protect my investments and income while making sure there will be a positive cash-flow. I particularly like that it does what no single-peril policy will do: it covers all the causes of crop loss I'm concerned about. I believe that as farmers we need to protect ourselves and not expect Congress to bail us out when a disaster hits. By the way, I can also tell you my lender likes the fact that I have crop insurance protection.

The Farm Bill, Market Skill, and Crop Insurance

Price and payment provisions of the Farm Act of 1990 clearly place more emphasis on *marketing skills*. This requires continuously searching available markets for the best way, place, and time to sell your crops.

The best way is frequently through forward contracts or hedges, and the best time may be prior to harvest. With this, however, comes risk: the risk that in addition to losing your crop and money invested in it you could also incur a substantial market loss if you are unable to fulfill a delivery commitment.

A way to *manage* this double-edged risk is by *insuring* those crops, thus creating an opportunity to contract advantageously before harvest. The hedge or contract provides more income if you have a good crop, and the insurance provides income to help fulfill delivery commitments if you don't.

Shift in Lending Focus: Away from Equity and Toward Cash Flow

Difficulties of large financial institutions made headlines, but plenty of farm lenders have also experienced problems with loans relying too heavily on real estate equity and too little on cash flow. When a poor crop year or a dip in farm income came along, some borrowers had repayment problems at the same time land prices weakened.

That's one reason why lenders have shifted the focus from borrowers' equity to the borrowers' *repayment ability*, that is, the ability to maintain a high enough level of consistent cash flow to ensure timely loan repayments even if there are crop losses. It's also why farmers who carry insurance to provide a cash flow floor have an advantage when it comes to borrowing money and repaying it.

Crop Insurance Is Collateral You Can Take to the Bank

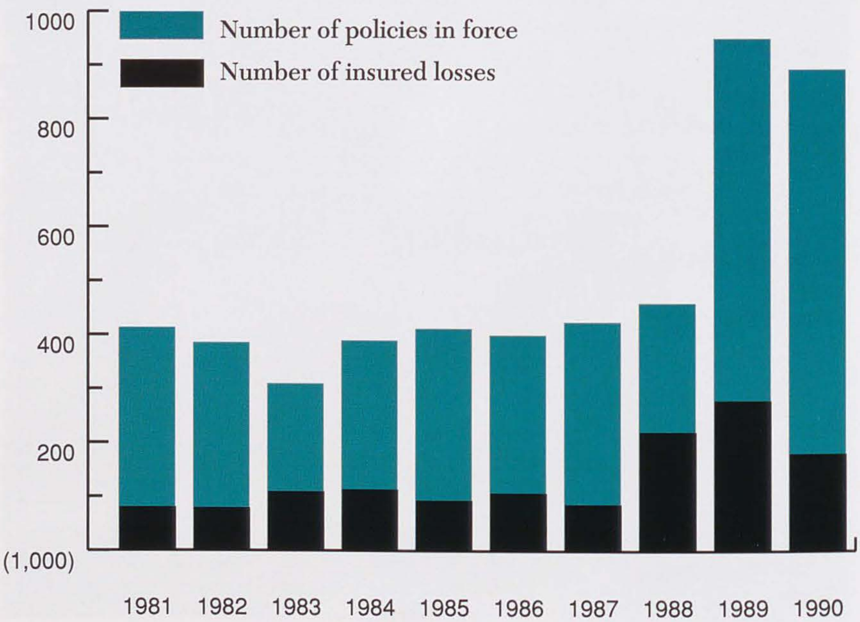
The policy itself can be pledged as loan collateral, with indemnity payments going directly to the lender you designate. Ask your agent about this optional policy feature.

- With or without the policy pledged as loan collateral, having insurance to back up loans means the lender gets repaid promptly and in the form of repayment the lender prefers. Cash!
- Prompt loan repayment from crop insurance proceeds saves you additional interest costs and can reduce or eliminate the need for additional debt.
- Insurance as loan collateral reduces the risk of losing productive assets such as land or equipment, avoids a lien against future earnings, and won't reduce your net worth if it has to be used to satisfy a loan.

Crop Losses: They Happen Even in the Best of Years

Everyone remembers years like 1988 when searing heat and rainless months sent yields plummeting and financial losses soaring. That year almost half of all crop insurance policies in force had losses resulting in indemnity payments.

But, as the illustration below shows, losses occur *every* year. There's obviously no way of knowing when or where they'll happen. That's why crop insurance should be used as a permanent, in-place risk management tool.



Pay for Crop Insurance with 60-Cent Dollars

Premiums paid for crop insurance are a fully tax-deductible business expense. Thus, if you are in a 28-percent tax bracket, every $1 spent for insurance reduces your tax bill by 28 cents. In addition, since each $1 of outlay for insurance lowers the amount of taxable income by that amount, you save approximately 12 cents in self-employment (Social Security and Medicare) tax.[1]

With a total of 40 cents of each $1 of insurance premiums offset by tax savings, you're paying for protection with the after-tax equivalent of 60 cent dollars.

The savings are even larger when *state* income tax is considered. For example, if you farm in a state that levies a 5 percent tax on income, the sum of federal and state tax savings means each $1 of insurance premium costs you only 55 cents after taxes!

Farmers with sharp pencils or quick computers will also recognize other advantages. For one thing, the likelihood is that indemnities from crop insurance may be received in years when their tax rate is lower or even in years when there is no taxable income. In addition, insurance indemnities help maintain the earnings base for future Social Security benefits. This can be particularly important for someone approaching retirement.

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[1] *Effective rate after allowance for partial deduction of self-employed tax.*

Loss Adjusters: How They Do Their Job

No one who carries insurance ever hopes to have a loss, but when it happens, your objective is to have the loss adjusted and collect the indemnity payment as promptly as possible. Crop insurance companies view this as an important part of their service commitment to policyholders.

If you anticipate a loss, contact your agent as soon as possible. Once you've filed the Notice of Loss with your agent, a loss adjuster will arrange to meet with you.

The adjuster's first step will be to determine the acreage. The next step is a determination of production on the insured acres. If the crop hasn't been harvested, the adjuster will appraise production based on representative field samples. If a loss is determined after harvest, production will be calculated on the basis of quantity in farm storage, commercial storage or sales receipts, feeding records, etc.

Based on these determinations, the adjuster will prepare a claim form for your review and signature. Claims are generally paid in less than 30 days.

When Some Yields Are High and Others Aren't: It Can Pay to Have "Unit" Flexibility

With your production of a given crop divided into two or more separate insurance "units," indemnity payments are calculated for each unit without regard to production on any other unit. This means you could be paid for a loss on one unit even if production on other units is more than guaranteed. For insurance purposes, there are two types of units:

Policy units. These are based on different ownership interests in the crop. For example, acreage that is owned or cash rented constitutes a separate policy unit from acreage that's farmed on crop shares.

Optional units. These are units that can be insured separately when certain location, production, and recordkeeping requirements are met. Your agent can provide details.

Also ask your agent about the 10% premium rate discount that applies when you have only separate policy units or elect to insure all of your acreage which could be an optional unit as a single unit.

POLICYHOLDER PROFILE

Name: A.M. Felts, Jr.
Location: Berlin, VA
Farming Operation: 200 acres corn, 200 acres peanuts, 150 acres soybeans. Farms with father, A. Meredith Felts, Sr.
Comment: Carrying crop insurance is a sound, logical business decision in the high risk profession of farming. We can control many variables in production and marketing, but there are some things we can't control. The early 1980's were a good lesson in having crop insurance as a risk management tool. By using the insurance in our risk management strategy, we add overall stability to the bottom line in our farming operation.

Because Farming Is a Family Business, Crop Insurance Is a Family Decision

Stop and think about it: When crops are damaged or lost, where does the budget knife cut first? Into funds needed for fertilizer or into money earmarked for a family vacation? Into the budget for seed or fuel or into plans for purchasing a new car? Into debt service obligations or into an account for personal savings? The answers are obvious because when money's tight, keeping the *business* going is the first priority.

And these, relatively speaking, are the *easier* decisions. What about money needed for personal life or medical insurance, health care, and tuition payments? Thus, your decision about crop insurance and how much to carry should consider everyone and everything that could be adversely affected if there *isn't* any crop insurance.

A Crop Insurance Worksheet for 1992

Taken step by step, it's a simple matter to answer such questions as: How much insurance protection can you qualify for? What would your yield guarantee and dollar amount of protection be at the various levels of coverage? And, at different levels of coverage, what would the cost be? Using current price selection and premium rate information your agent can provide, this worksheet will serve as a quick way to make these calculations.

Crop	Your Yield Average ×	Level 50% 65% 75% =	Guarantee Per Acre ×	Price Election =	Protection Per Acre ×	Premium Rate =	Premium Per Acre

When You Talk with a Crop Insurance Agent: What to Expect and How to Get It

Agents for multiple-peril crop insurance are not only well trained and well qualified, but they're also *experienced*. They've seen first-hand the financial impact of crop losses and know how big a difference insurance can make. It's experience you can draw on.

- Start by seeking the agent's help in assessing your exposure to crop loss risk — the potential impact of crop losses on your income.
- Ask the agent to review the available coverage options and what each would cost (you can use the worksheet on this page).
- Have the agent explain specifically how losses are calculated and how indemnity payments are figured.
- Review the provisions of the policy and ask for an explanation of any you don't fully understand.
- With the agent's help, prepare a crop insurance calendar for the crops you are insuring (see page 5 of this guide).
- Ask about the agent's availability to answer questions that may occur to you during the crop year.
- Inquire about the advice and assistance the agent can provide in the event you have or expect to have a loss on an insured crop — including what to do to get the payment you're entitled to as promptly as possible.

Crop Insurance: Why Professional Farm Managers Aren't Farming Without It

Professional managers recognize that it's far easier to explain why their clients' money *is* being insured than to have to explain later why it *wasn't* insured. Absentee farmland owners, like other investors, prefer predictable and stable income. Unexpected fluctuations in investment returns can play havoc with financial, tax, and estate planning, and may force an untimely liquidation of an investor's other assets (such as stocks or bonds) to cover farming losses. Insurance to limit downside income risk is smart management and that's what professional managers get paid for.

If You Have The Money: *Poor Crop Years Can Provide Good Buying Opportunities*

A year when low crop yields have taken a slice out of spendable farm income is historically often the best time to find good buys on farmland and machinery. When more farmers are likely to be interested in selling, and fewer are likely to be interested in buying, prices tend to dip. The same goes for purchasing or repairing buildings because contractors may be less busy. Crop insurance can stabilize your income and allow you to be a buyer at a time when there may be bargains.

Insurance Advantages for Large Farming Operations

1. Larger-than-average farming operations tend to be capital intensive rather than labor intensive and crop insurance helps meet two important management priorities: Capital preservation and predictability of the annual income stream.

2. A larger-than-average farming operation may be in a better position to benefit from the risk diversification and flexibility provided by "unit" insurance coverage.

3. To the extent larger-than-average farming operations have a recorded history of yields that are above average for the area (at least on some units), it is possible to qualify for higher levels of insurance coverage and reduced premium rates. For example, recorded yields that are 30 percent above average typically reduce the cost of insurance (per $100 of protection) by about one-fourth.

4. Larger-than-average farming operations with above-average annual incomes realize the maximum benefit from the tax-deductibility of crop insurance premiums.

Crop insurance policies sold or reinsured by the Federal Crop Insurance Corporation are available to all producers regardless of race, color, national origin, sex, age, or disability.