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2011 Volatility Factor?¹

Art

Any suggestions on what we should be using for volatility factor for 2011 corn and soybeans "COMBO" premiums at this time? Should we look at 2008?

MG

Dear Mr. G.,

For sales closing on 1/31/11, the current corn price is \$5.74 and volatility is 33. The current soybean price is \$12.61 and volatility is 27 for sales closing on 1/31/11. Those values are posted and are currently being updated on the RMA Website at: <http://www3.rma.usda.gov/apps/pricediscoveryweb/ActiveDiscoveryPeriods.aspx>

For sales closing on March 15, I am calculating a similar volatility. The current RMA volatilities are based on the CME September contract, not the December corn or November soybeans CME contracts. The current corn volatility is about 32-34 and 23-25 for soybeans for sales closing on March 15. This could clearly change over the next 60 days.

Art

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Dear Art:

I am a crop insurance agent. One of my companies gave me your email and encouraged me to contact you with a question I have. My question is if an agent's book of business in 2011 remained identical in coverage selected by the farmer, acres and crops planted, enterprise unit usage, etc., etc. would the agent realize any increased revenues under the new 2011 SRA? Basically, I have the opinion that all things remaining identical in 2011 as 2010 the agent will realize no more income unless they get more customers or increase coverage levels because of the national premium threshold provision which reduces agent commissions if national premium volume exceeds an amount, which I believe was based on the national premium in 2006 or 2007?

In short, if you do nothing to your book and the price continues to increase as it is right now, will the agency make equal, more or less amounts of money.

Lastly, it would seem that the Profit Sharing bonus provisions of agency contracts will likely be of little value this year as in 2008. Prices are going to be high enough in the insurance contract that they very likely will fall thus creating a revenue loss per the terms of a revenue policy. If it falls dramatically as in 2008 then it will be near to impossible for carriers to make a profit thus eliminating the profit share to the agent. So, my hunch is that I probably would make more money if the prices were lower than I will make with high prices. That sounds a little crazy, but I am fearful it is true!

Your thoughts would be appreciated.

Thanks,

Crop Agent

Dear Agent,

I estimated the impact of the SRA on agent commissions last fall for the 4 State crop insurance workshops. The market is little higher since then so the estimated commission rates posted in table 1 below are likely a little lower than last fall's estimate.

However, corn and soybean agents gain from higher prices because while the commission rate is lower one multiplies times a higher premium cost. Also the total Administrative and Operating (A&O) dollars are fixed so commissions are prorated. Some of this is explained in a paper posted on AgManager.info at:
http://www.agmanager.info/crops/insurance/risk_mgt/rm_pdf10/AB_AgentCommission.pdf

My current estimate of agent commission rates is about 10-11%. Agents may also pick up nearly a point for doing their own processing. There may also be a profit

share paid. However, the combined profit share and commission cannot exceed the total A&O by state.

I think it is too early to estimate any loss or gain on the insurance book, especially based on a lower price forecast. If one really thinks price is going to fall then one should short the market! Unless you have some inside information there is no reason to believe the market is wrong and prices are too “high”.

Because the total A&O dollars are fixed at the national level, the effect of higher corn and soybean prices is to shift A&O dollars from States that are insuring commodities with crop insurance prices that have not increased. Next year’s corn and soybean prices maybe lower and that would reduce commissions from current levels in the Corn Belt.

The estimated A&O estimates are based on current prices and are presented in Table 2 below. The A&O limit does not apply to GRIP, GRP or to new products.

If sales do not increase, then Corn Belt agents will likely see a 30-40% reduction in commissions. It will be a smaller percentage reduction for Great Plains’ agents because agent commissions started at a lower level.

Art

Table 1. Estimated Agent Commission Rates.

Coverage Level	Prior A&O Rates	Congressional Changes	SRA Change	Forecasted	
				A&O	Max Agent Rate
Rates for YP, APH and RP-HPE					
75% or less	24.2%	21.9%	Same	14.4%	11.5%
80%	21.7%	19.4%	21.9%	14.4%	11.5%
85%	21.0%	18.7%	21.9%	14.4%	11.5%
Rates for RP					
75% or less	20.8%	18.5%	Same	12.2%	9.8%
80%	18.7%	16.4%	18.5%	12.2%	9.8%
85%	18.1%	15.8%	18.5%	12.2%	9.8%

Table 2 Estimate of the National A&O for Crop Insurance Companies and Agents

	Total 2010 Premium ¹	Estimated Total 2011 Premium	Estimated Total 2011 A&O	Estimated Capped 2011 A&O
Corn APH/YP	165,679,009	241,296,608	52,843,957	34,813,669
Cotton APH/YP	53,184,777	94,163,212	20,621,743	13,585,632
Sorghum APH/YP	24,836,668	36,179,398	7,923,288	5,219,873
Rice APH/YP	12,411,244	13,920,062	3,048,494	2,008,352
Soybeans APH/YP	118,622,688	161,663,926	35,404,400	23,324,466
Wheat APH/YP	124,884,949	171,476,642	37,553,384	24,740,220
Barley APH/YP	24,535,798	35,734,188	7,825,787	5,155,639
Canola APH/YP	5,691,197	7,756,200	1,698,608	1,119,045
Sunflowers APH/YP	12,607,805	17,182,440	3,762,954	2,479,039
Other Crops APH	854,956,166	916,040,415	200,612,851	132,164,012
Corn CRC	1,939,890,964	2,761,549,041	510,886,573	336,572,752
Cotton CRC	406,894,899	610,342,349	112,913,334	74,387,455
Sorghum CRC	102,898,008	146,481,375	27,099,054	17,852,893
Rice CRC	41,320,326	42,205,762	7,808,066	5,143,964
Soybeans CRC	956,153,654	1,291,791,556	238,981,438	157,441,289
Wheat CRC	613,834,311	808,630,439	149,596,631	98,554,459
Corn RA-HPO ⁴	473,895,250	674,617,800	124,804,293	82,221,234
Cotton RA-HPO ⁴	1,302,559	1,953,839	361,460	238,130
Rice RA-HPO ⁴	4,121,256	4,209,568	778,770	513,055
Soybeans RA-HPO ⁴	471,510,186	637,024,055	117,849,450	77,639,374
Wheat RA-HPO ⁴	316,430,953	416,848,156	77,116,909	50,804,722
Barley RA-HPO ⁴	6,319,382	8,996,013	1,664,262	1,096,418
Canola RA-HPO ⁴	35,065,371	47,374,342	8,764,253	5,773,902
Sunflowers RA-HPO ⁴	58,356,960	81,811,432	15,135,115	9,971,034
Corn RA ⁴	52,655,028	74,957,533	16,415,700	10,814,685
Cotton RA ⁴	144,729	217,093	47,543	31,322
Rice RA ⁴	457,917	467,730	102,433	67,483
Soybeans RA ⁴	52,390,021	70,780,451	15,500,919	10,212,026
Wheat RA ⁴	35,158,995	46,316,462	10,143,305	6,682,423
Barley RA ⁴	702,154	999,557	218,903	144,214
Canola RA ⁴	3,896,152	5,263,816	1,152,776	759,450
Sunflowers RA ⁴	6,484,107	9,090,159	1,990,745	1,311,505

Table 2. Continued.

	Total 2010 Premium ¹	Estimated Total 2011 Premium	Estimated Total 2011 A&O	Estimated Capped 2011 A&O
Corn IP & IIP	1,879,560	2,675,664	585,970	386,038
Cotton IP	146,393	219,590	48,090	31,682
Sorghum IP	549,945	782,879	171,451	112,952
Soybeans IP & IIP	858,527	1,159,895	254,017	167,347
Wheat IP	448,528	590,865	129,400	85,249
Barley IP	256,701	365,429	80,029	52,723
AGR	13,705,028	13,705,028	3,001,401	1,977,327
AGRLT	6,375,012	6,375,012	1,396,128	919,771
AQU	467,559	467,559	102,395	67,458
ARH	26,072,682	26,072,682	5,709,917	3,761,701
DOL	102,462,237	102,462,237	22,439,230	14,782,994
TDO	20710588	20,710,588	4,535,619	2,988,072
YDO	19566131	19,566,131	4,284,983	2,822,952
APH based Contracts	6,981,433,137	9,443,135,939	1,811,896,356	1,193,679,724
Dollar Contracts	189,359,237	189,359,237	41,469,673	27,320,276
		CAP	1,221,000,000	
		Over CAP	632,366,029	
		Gross Total After CAP	1,221,000,000	1,221,000,000
		Pro rata	65.88%	

¹Source of data: Risk Management Agency Web Page on 10/11/2010

²Barley price was assumed to have the same price ratio with its respective 2010 price as corn. Canola price was assumed to have the same price ratio with its respective 2010 price as soybeans. If corn and soybean prices increase over 2010 prices these related crops are assumed to increase by a similar amount. There are multiple types of barley and sunflowers and early futures are used to set corn and soybean prices in the South. Other things that can increase the total aggregated premium include increased insured acres, higher coverage levels, and increased volatility, but an increase in price will have the largest impact. However, higher prices are often accompanied with higher volatility values.

³There are multiple types of wheat but the winter wheat price and volatility is set for 2011. However an increase in spring wheat prices, volatility, insured acres, and/or higher coverage levels would increase the total aggregated wheat premium but a decline in any of these parameters would have the opposite impact causing a lower total aggregated wheat premium.

⁴Revenue Assurance data published by the Risk Management Agency does not separate RA contracts between those that included the Harvest Price Option and those that excluded the harvest price. It was assumed that 90% of the aggregated premium was generated from contracts that included the Harvest Price Option.