Supplemental Coverage Option (SCO) for Wheat: New Crop Insurance Option from the 2014 Farm Bill

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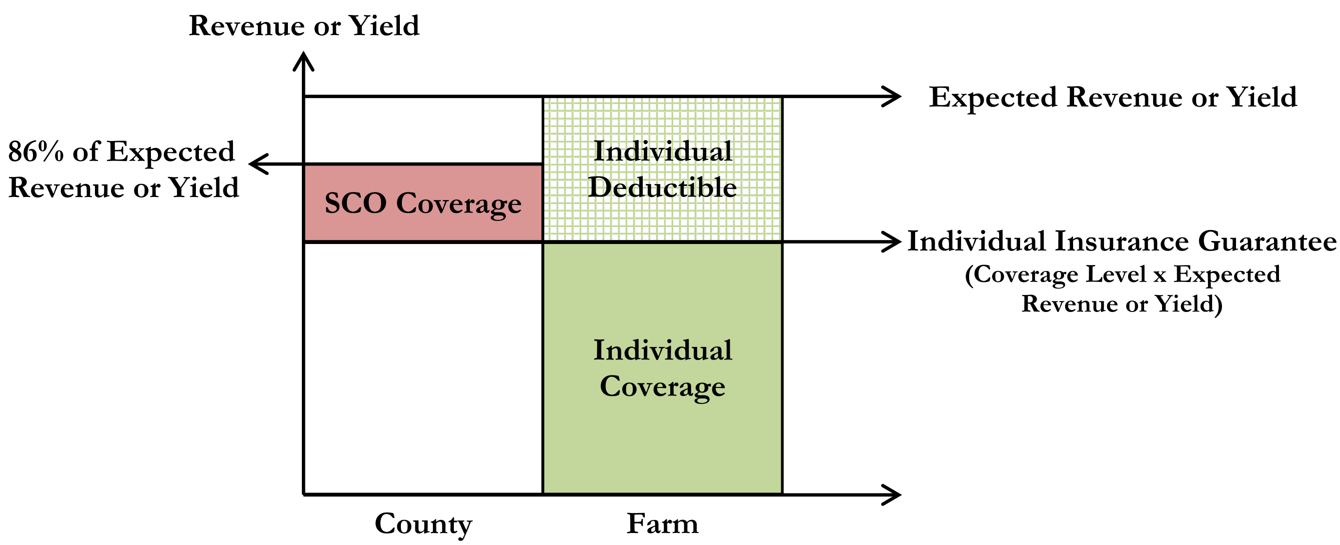
The USDA-Risk Management Agency (RMA) released the policy details for Supplemental Coverage Option (SCO), a new crop insurance policy mandated by the 2014 Farm Bill. This fall, SCO is available for winter wheat in select Wisconsin counties, and next spring, SCO will be available for corn and soybeans in several Wisconsin counties. This fact sheet explains how SCO works for winter wheat and the highlights some important implications of SCO for farmer signup for commodity support programs sometime this fall and winter.

The SCO Concept

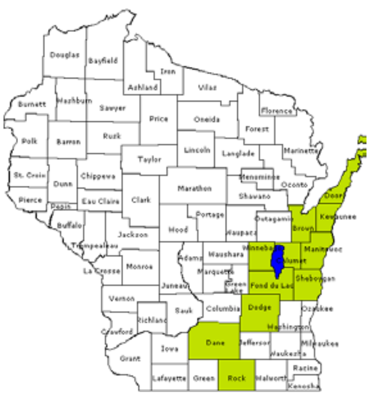
SCO is a second crop insurance policy that is layered with the standard individual policies Revenue Protection (RP), RP with the Harvest Price Exclusion (RP-HPE) or Yield Protection (YP), so that a farmer must also buy RP, RP-HPE, or YP to buy SCO. For these individual crop insurance policies, expected revenue (or yield) is determined for the farm, then the farmer chooses a coverage level as a percentage of this expected revenue (or yield) as an insurance guarantee. For example, if a farmer chose a 75% coverage level, then the farmer at a minimum always gets 75% of expected revenue (or yield), since the policy indemnifies losses exceeding 25%. In other words, the first 25% of losses below expected revenue (or yield) are covered by the farmer as a deductible. SCO is a county policy that covers part of this deductible for the individual policy.



County policies are currently sold that are essentially the same as RP, RP-HPE, or YP, except that they use the USDA-NASS county yield, rather than a farm's own yields, and the same crop prices as individual policies to determine indemnities. These policies are called ARP, ARP-HPE, and AYP, where the A is for "area". SCO essentially lets a farmer combine one of these policies with their individual coverage to cover part of their individual policy's deductible. The maximum total coverage between the two layered policies is 86% of the expected revenue (or yield) for the individual policy. Thus for example, a farmer who buys 75% RP could add SCO that paid indemnities like an ARP policy for county losses above 14%, up to 25%, while a farmer who buys 65% YP could add SCO that paid indemnities like an AYP policy for county losses above 14%, up to 35%. The SCO policy would cover "shallow losses" at the county level that fell between the 86% county guarantee and the farmer's individual policy guarantee. The figure above illustrates this layering for the two policies.

A key point to note is that the SCO policy pays indemnities based on county yield outcomes, while the individual policy pays indemnities based on farm yield outcomes. These yield outcomes are correlated, but not exactly connected, so that four payment outcomes are possible: 1) Individual policy and SCO do not pay, 2) Individual policy pays, but SCO does not, 3) SCO pays, but individual policy does not, and 4) Both individual and SCO policies pay. In other words, just because a farm has a shallow loss that does not trigger indemnities for the individual policy, SCO does not necessarily pay; the county yield and revenue outcomes must be right to trigger an SCO payment.

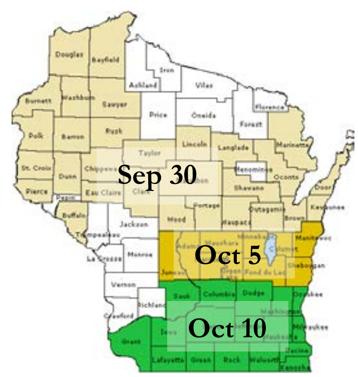
SCO Policy Details for Winter Wheat



Counties with SCO available for winter wheat

SCO is a crop insurance policy that is bought from a crop insurance agent just like any other policy. For the 2015 crop year, SCO is available in 11 counties, roughly in a line from Door County down to Rock County (see map to the left). After setting the details for the underlying RP, RP-HPE or YP policy, a farmer can then evaluate SCO in terms of cost and risk management benefits. At this time, crop insurance premiums cannot be determined, since the final wheat price and volatility factors have yet to be set based on futures prices. However, the SCO premium is subsidized at 65%, so that farmers pay roughly the same proportion of the actuarially fair premium as they do for other policies. All eligible winter wheat acres a farmer has in a county will be insured under a single SCO policy.

The sales closing date is September 30 for any winter wheat crop insurance policy in Wisconsin. The final planting date for insured winter wheat varies across Wisconsin counties, from September 30 across the north to October 5 n east and central Wisconsin to October 10 in the south (see map to the right). Winter wheat is insurable in every Wisconsin county, but a written agreement is needed to insure it in the counties in white on the map.



Final plant dates for insured winter wheat

SCO and Commodity Support

The 2014 Farm Bill created two new commodity support programs: Price Loss Coverage (PLC) and Agriculture Risk Coverage (ARC). Signup dates and program details have yet to be announced for these programs, but the expectation is for updating of base acres and payment yields to occur this fall, and then program signup in winter. PLC is very similar to the previous counter cyclical payments program, but with higher support prices, while ARC is a revenue support program. An important issue is that SCO can only be purchased if a farm is enrolled in PLC, but not ARC. In other words, crop acres enrolled in ARC are not eligible for SCO coverage (though individual coverage can still be purchased). This restriction puts farmers considering SCO for winter wheat in a tough spot, since if they purchase SCO, they have implicitly decided to sign up for PLC without knowing the programmatic details or even when the signup date is. As a result, for this year only, farmers can buy SCO and then decide by December 15 whether to pay the premium or to opt out at no cost. December 15 is the acreage reporting date for the winter wheat crop insurance policy and the expectation is that programmatic details for PLC and ARC will be available by then so that farmers can make more informed decisions about SCO, PLC and ARC.

SCO Recommendations

At this time, it is difficult to make recommendations regarding signup for PLC versus ARC. The Farm Bill funded development of farmer decision aids and these should be released soon, but must await the release of programmatic details for PLC and ARC. Thus the recommendation at this time is for farmers potentially interested in PLC to maintain their options and wait for more information. Thus, farmers who grow wheat in the 11 counties where SCO is now available for 2015 may want to "buy" SCO by the September 30 sales closing date to maintain their options. These farmers can then delay SCO premium payment and the actual PLC/SCO versus ARC decision until December 15 when the actual decision for SCO must be finalized (i.e., SCO premiums are due). Note that farmers can sign up for PLC for some crops and ARC for other crops, so that conceptually a farm could enroll their winter wheat base acres in PLC and buy SCO, but use county ARC for their corn and soybean acres (or vice versa). Also, SCO will be available for corn and soybeans in most Wisconsin counties in 2015. Finally, though the PLC versus ARC decision is a onetime decision for the life of this Farm Bill, SCO is an annual purchase decision. As a result, farmers who decide to enroll in PLC for winter wheat do not have to buy SCO this fall in order to be able to buy it in subsequent years.

In general, SCO was developed to give farmers support in years with "shallow losses" when revenues are lower than normal, but above levels that trigger crop insurance indemnities. Farmers who do not find such shallow losses a problematic risk will not find SCO particularly beneficial. The layering of coverage from individual policies and county-level SCO policies is not exact, since farm yields are only correlated with county yield. Farmers whose yields are more closely correlated with the county yield will likely find more value from SCO. The layering of coverage between SCO and the PLC price support program is also not exact. SCO uses the same futures-based price as crop insurance, while PLC uses the national marketing year average price, plus both have different levels for triggering payments. PLC uses a reference price of $5.50 for wheat ($3.70 for corn and $8.40 for soybeans), while the SCO price trigger depends on the chosen coverage level. As a result, in any given year, one of the programs could make payments due to low prices while the other would not.

Additional Resources

USDA-RMA SCO Fact Sheet (July 2014) available at http://tinyurl.com/mxa2dxr or http://www.rma.usda.gov/news/currentissues/farmbill/2014NationalSupplementalCoverageOption.pdf.

SCO in Wheat: University of Illinois FarmDOC Fact Sheet that includes numerical examples: http://farmdoc.illinois.edu/manage/newsletters/fefo14_14/fefo_14_14.pdf.