USDA

United States Department of Agriculture

Risk Management Agency

# Risk Management Glossary

## Some risk management terms, explained.

As you read about risk management, you may sometimes wonder, "What do these terms mean?"

This glossary should help you understand a few of the more common terms or acronyms used. It is not meant to be a complete list of terms. If you have additional questions, you should contact a crop insurance agent. If you are unable to find an agent, you can go the the Risk Management Agency's agent locator at www.rma.usda.gov/Information-Tools/Agent-Locator-Page.

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## A

**Actual Production History (APH).** Actual Production History is the most common plan of insurance under the Multiple Peril Crop Insurance, or MPCI, umbrella. It is the basis for determining your guarantee under either multi-peril crop insurance or revenue insurance policies. The APH is calculated as a 4- to 10-year simple average of your actual yield on the insured land. If you do not have records of actual yields, a "transitional yield" based on average yields in your county is used.

**Actuarial soundness.** This is an insurance term that describes a situation where indemnities paid, on average, are equal to total premiums collected.

**Agricultural Risk Protection Act of 2000 (ARPA).** This law provided $8.2 billion for insurance premium subsidies and $5.2 billion for market loss assistance payments for producers. Among its other effects, ARPA also modified the crop insurance premium subsidy structure, authorized pilot programs for new forms of insurance, expanded insurance fraud detection and enforcement, and dropped the area yield loss trigger in the NAP program.

**Adjusted Gross Revenue-Lite (AGR-Lite).** AGR-Lite is whole farm revenue insurance that covers almost all of the commodities produced on a farm. It is an individualized revenue insurance based on individual producer yields, quality, and marketing history that equals gross income.

## B

**Buy-up coverage.** This refers to crop insurance coverage that exceeds the CAT (catastrophic) level. Coverage is available up to 75 percent of your expected yield or expected revenue (which is yield times price). In some areas, coverage up to 85 percent is available for some crops. You pay part of the premium, but government premium subsidy rates are now over 50 percent for most levels of coverage.

## C

**CAT coverage.** CAT is short for "catastrophic," and refers to crop insurance coverage at the lowest, or catastrophic level. CAT coverage is set at the 50/55 level, which means that your yield must fall below 50 percent of your average yield before a loss is paid. These losses are paid at a rate of 55 percent of the highest price election. You must pay an administrative fee to become eligible to receive CAT coverage, but the government pays the entire premium.

**Crop Revenue Coverage (CRC).** CRC is the most widely available revenue protection policy. This policy guarantees an amount of revenue (based on your actual production history (APH) x commodity price), called the final guarantee.

**Crop revenue insurance.** Crop revenue insurance pays you indemnities based on gross revenue shortfalls instead of just yield or price shortfalls. Types of crop revenue insurance includes Crop Revenue Coverage (CRC), Revenue Assurance (RA) and Income Protection (IP). These programs are subsidized and reinsured by the USDA's Risk Management Agency.

**Crop yield insurance.** Also known as Actual Production History (APH) yield, crop yield insurance pays indemnities to producers when yields fall below the producer's insured yield level due to most natural causes. Crop yield insurance is subsidized by the USDA's Risk Management Agency.

## D

**Disaster payments.** These are direct payments to farmers on an emergency basis when crop yields are abnormally low due to adverse growing conditions. During the 1970s, there was a "standing" disaster payments program, with payments made without declaration of a disaster area. Regular payments ceased after 1981, but since then ad hoc disaster payments have been specially approved by the U.S. Congress on a number of occasions.

**Dollar Plan of Insurance.** The Dollar Plan of Insurance lets you select one of several dollar amounts of insurance per acre prior to planting. For vegetable crops, fresh market corn, fresh market tomatoes (Florida only), and peppers are insurable under the Dollar Plan of Insurance.

## E

**Enterprise diversification.** Diversification is a way to generate income from different crops and/or livestock activities that are not closely related in price, so that low income from some activities would likely be offset by higher income from others.

## F

**Fixed Dollar Plan of Insurance.** The Fixed Dollar Plan of Insurance provides protection against declining revenues due to damage that causes a loss of yield and there is no price increase in the market. The pilot Chile Pepper program is based on the Fixed Dollar Plan of Insurance and is available in Cochise County, Arizona, and in Hidalgo and Luna Counties, New Mexico.

**Forward contract.** This is an agreement between two parties (such as you and someone who buys your products) that calls for delivery of, and payment for, a specified quality and quantity of a commodity (such as a particular crop) at a specified future date. The price may be agreed upon in advance, or determined by formula at the time of delivery or other point in time.

**Forward pricing.** This is when you agree on a price or a pricing formula for a commodity that will be delivered at a later date. "Forward pricing" is used broadly here to refer to both hedging with futures or options, and forward contracting.

**Futures contract.** This is an agreement to buy or sell a commodity of a standardized amount and quality during a specific month in the future, under terms established by the futures exchange, at a price established in the trading pit at the commodity futures exchange.

**Futures option contract.** This is a contract that gives the holder the right, though not the obligation, to buy or sell a futures contract at a specific price within a specified period of time, regardless of the market price of the futures contract when the option is exercised. Options provide protection against adverse price movements.

## G

**Group Risk Income Protection (GRIP).** GRIP is based on the experience of the county rather than on individual farms, so APH is not required for this program. A GRIP policy includes coverage against potential loss of revenue resulting from a significant reduction in your county's yield or the commodity price of a specific crop.

**Group Risk Plan (GRP).** Like GRIP, GRP coverage is based on the experience of the county rather than on individual farms, so APH is not required for this program. GRP protects you in the event that your county's average per-acre yield or payment falls below your trigger yield.

**Guarantee.** Also called "yield guarantee" or "insurance guarantee", this is a promise of payment. In this context, it means the amount of money you will be paid in the event of a loss, according to the terms of your crop insurance contract.

## H

**Hedging.** Hedging uses futures or options contracts to reduce the risk of adverse price changes prior to an anticipated cash sale or purchase of a commodity.

## I

**Income Protection (IP).** IP is a revenue product that, based on your APH, protects you against a loss of income when prices and/or yields fall. While IP is similar to CRC, it does not have the increasing price function of CRC.

**Indemnity.** This is the compensation, or money you receive for qualifying losses paid under an insurance policy. The indemnity compensates for losses that exceed the deductible, up to the level of the insurance guarantee.

## L

**Leverage.** Financial leverage refers to the use of borrowed funds to help finance a farm business. Higher levels of debt, relative to net worth, are generally considered riskier. The optimal amount of leverage depends on several factors, including farm profitability, the cost of credit, tolerance for risk, and the degree of uncertainty in income.

**Liquidity.** Liquidity refers to your ability to generate cash quickly and efficiently in order to meet financial obligations. Liquidity can be enhanced by holding cash, stored commodities, or other assets that can be converted to cash on short notice without incurring a major loss.

**Loan Deficiency Payments (LDPs).** These payments protect producers of several major commodities against revenue losses due to low prices.

## M

**Marketing contract.** This is a contract between you and a processor or handler that establishes a marketing outlet and a price (or a formula for determining the price) for a commodity before harvest or before the commodity is ready to be marketed.

**Multiple Peril Crop Insurance (MPCI).** MPCI was established in the 1930s to cover yield losses from most natural causes. MPCI operated on a somewhat limited basis up through the early 1980s, when a private/public partnership was established. At that point, insurance availability was greatly expanded and premium subsidies increased in hopes of replacing the disaster payment program. Major reforms legislated in 1994—introduction of a low-cost CAT (catastrophic) coverage level, increased premium subsidies, and a requirement that participants in other farm programs obtain crop insurance—increased participation to over 200 million acres, covering the majority of acres of major field crops planted in the United States.

## N

**Non-Insured Crop Disaster Assistance Program (NAP).** Crop insurance is not available for all commodities. NAP provides financial assistance to producers of many of these commodities if they experience a qualifying yield loss.

## P

**Premium.** The amount of money you pay for risk protection. Option buyers pay a premium to option sellers for an options contract. Similarly, the person who buys an insurance policy pays a premium in order to obtain coverage.

**Production contract.** An agreement between you and a processor that usually details the production inputs supplied by both you and the processor, the quality and quantity of a particular commodity that is to be delivered, and compensation that you will be paid. In return for giving up control over decision making, you are often compensated with a price premium or lower market risk.

## R

**Revenue Assurance (RA).** Revenue Assurance provides coverage to protect you against loss of revenue caused by low prices, low yields, or a combination of both.

**Reinsurance.** A method of transferring some of an insurer's risk to other parties. In the case of Federal crop insurance, USDA's Risk Management Agency shares the risk of loss with private insurance companies that deliver policies to producers. Private reinsurance also exists. In this case, a private reinsurer assumes responsibility for a share of the risk, in return for a share of the premiums.

**Revenue insurance.** Revenue insurance, a cousin to MPCI, was introduced after the 1994 reforms and has become the most popular form of insurance in some areas. Whereas crop insurance covers only yield losses, revenue insurance pays when gross revenue (yield times price) falls below a specified level. These programs are subsidized and reinsured by the Risk Management Agency.

**Risk.** Uncertainty about outcomes that are not equally desirable. Risk is an important aspect of the farming business. The uncertainties of weather, yields, prices, government policies, global markets, and other factors can cause wide swings in farm income. Risk management involves choosing among alternatives that reduce the financial effects of such uncertainties.

## S

**Subsidy.** Money given by the government to help producers function.

## T

**Trigger yield.** Under GRP, farmers receive payments any time the actual county yield drops below the trigger yield that the farmer chooses. The trigger yield can be 90, 85, 80, 75, or 70 percent of the expected county yield, which is based on the county's yield history since 1962. Expected county yields are adjusted for upward trends.

## U

**Uncertainty.** Lack of sure knowledge or predictability.

## Y

**Yield.** The amount of something, especially a crop, produced by cultivation or labor.

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