



Supplemental Coverage Option (SCO) Insurance Policy Mechanics for 2022

Dr. Michael Deliberto

Assistant Professor

Louisiana State University Agricultural Center

Department of Agricultural Economics & Agribusiness

The optional Supplemental Coverage Option (SCO) endorsement provides additional coverage for a portion of an individual producer's underlying crop insurance policy deductible. The basic operational mechanics of the SCO endorsement follows or 'mirrors' the coverage of the underlying policy. If the producer purchases a yield protection policy, then SCO covers yield loss. If the producer purchases a revenue protection policy, then SCO covers revenue loss. The amount of coverage depends on the liability, coverage level, and approved yield for the underlying policy.

Unlike a traditional crop insurance policy, SCO differs from the underlying policy in how a loss payment is triggered. SCO pays an indemnity on an area basis, and an indemnity is triggered when there is a county level loss in yield or revenue. SCO is triggered when the county/parish average revenue or yield falls below 86% of its expected level. The full amount of the SCO coverage is paid out when the county/parish average revenue falls to the coverage level of the underlying policy. Payments are not affected by whether the producer receives an indemnity from the underlying policy.

It is possible for the producer to experience an individual loss on the farm but not receive an SCO payment, or vice versa. The dollar amount of SCO coverage is based on the percent of crop value covered. The Federal government pays 65% of the premium. The exact cost of the policy premium depends on the crop, county/parish reference, coverage level selected, and the type of coverage chosen (yield or revenue protection).

ARC and PLC elections may impact eligibility for choice crop insurance products. Growers that elect PLC have the option of purchasing SCO through their Approved Insurance Provider; if a grower elects ARC, then the farm is ineligible for SCO on their planted acres. An option for coverage underneath ARC is the Enhanced Coverage Option (ECO). ECO may be added regardless of program election. If a farmer who grows upland cotton chooses to enroll seed cotton base acres in PLC or ARC, then they will become ineligible for Stacked Income Protection Plan (STAX) on their planted cotton acreage.

This report contains an estimate of the Louisiana projected insurance price as of February 3, 2022. The final insurance projected price will be announced on February 15, 2022. Projected (or expected) area yields, individual farm actual production history (APH), actual farm yield, actual area yield, and actuarial data premium rate are assumed for purposes of SCO program operation.

Information contained in the following tables denote price declines from projected insurance price levels coupled with decreases in the actual area yields with respect to the expected area yields across the cotton, corn, soybean, and long grain rice crops in Louisiana for the 2020 crop year.

Table 1. SCO illustration for cotton (left) and corn (right).

1. Determine the underlying RP liability and expected value			
Proj. Insurance Price	\$1.00	Proj. Insurance Price	\$5.81
Harvest Insurance Price	\$0.85	Harvest Insurance Price	\$5.25
Farm's APH	950.0	Farm's APH	180.0
Expected Crop Value ^{1/}	\$950.00	Expected Crop Value	\$1,045.80
2. Determine SCO range of coverage			
Area Loss Trigger	86%	Area Loss Trigger	86%
Underlying Policy Coverage ^{2/}	70%	Underlying Policy Coverage	70%
SCO Coverage Range	16%	SCO Coverage Range	16%
3. Calculate SCO policy protection			
Expected Crop Value	\$950.00	Expected Crop Value	\$1,045.80
SCO Coverage Range	16%	SCO Coverage Range	16%
SCO Protection	\$152.00	SCO Protection	\$167.33
4. Calculate the revenue loss (if any)			
Final Area Yield	950.0	Final Area Yield	160.0
Harvest Price	\$0.85	Harvest Price	\$5.25
Final Area Revenue	\$807.50	Final Area Revenue	\$840.00
Expected Area Yield	1000.0	Expected Area Yield	175.0
Max of Ins. Period Prices	\$1.00	Max of Ins. Period Prices	\$5.81
Expected Area Revenue ^{3/}	\$1,000.00	Expected Area Revenue	\$1,016.75
Percent of Exp. Area Revenue ^{4/}	80.75%	Percent of Exp. Area Revenue	82.62%
5. SCO payment factor			
Area Loss Trigger	86%	Area Loss Trigger	86%
Percent of Exp. Area Revenue	80.75%	Percent of Exp. Area Revenue	82.62%
SCO Coverage Range	16%	SCO Coverage Range	16%
SCO Payment Factor ^{5/}	0.328125	SCO Payment Factor	0.211489
6. Calculate the SCO indemnity payment			
Indemnity per acre	\$49.88	Indemnity per acre	\$35.39
7. SCO Premium			
Price Volatility	0.15	Price Volatility	0.15
Coverage Range	16%	Coverage Range	16%
RMA Act. Data ^{6/}	0.2566	RMA Act. Data	0.2281
Total Premium	\$39.00	Total Premium	\$38.17
FCIC Subsidized Portion ^{7/}	\$25.35	FCIC Subsidized Portion	\$24.81
GRW Portion of Premium	\$13.65	GRW Portion of Premium	\$13.36
GRW Indemnity Less Premium	\$36.22	GRW Indemnity Less Premium	\$22.03

Table 2. SCO illustration for soybeans (left) and long grain rice (right).

<u>SCO RP (Soybean Example)</u>		<u>SCO RP (LG Rice Example)</u>	
Proj. Insurance Price	\$13.31	Proj. Insurance Price	\$14.44
Harvest Insurance Price	\$12.00	Harvest Insurance Price	\$12.00
Farm's APH	60.0	Farm's APH	60.0
Expected Crop Value	\$798.60	Expected Crop Value	\$866.40
Area Loss Trigger	86%	Area Loss Trigger	86%
Underlying Policy Coverage	70%	Underlying Policy Coverage	70%
SCO Coverage Range	16%	SCO Coverage Range	16%
Expected Crop Value	\$798.60	Expected Crop Value	\$866.40
SCO Coverage Range	16%	SCO Coverage Range	16%
SCO Protection	\$127.78	SCO Protection	\$138.62
Final Area Yield	45.0	Final Area Yield	58
Harvest Price	\$12.00	Harvest Price	\$12.00
Final Area Revenue	\$540.00	Final Area Revenue	\$696.00
Expected Area Yield	50	Expected Area Yield	60
Max of Ins. Period Prices	\$13.31	Max of Ins. Period Prices	\$14.44
Expected Area Revenue	\$665.50	Expected Area Revenue	\$866.40
Percent of Exp. Area Revenue	81.14%	Percent of Exp. Area Revenue	80.33%
Area Loss Trigger	86%	Area Loss Trigger	86%
Percent of Exp. Area Revenue	81.14%	Percent of Exp. Area Revenue	80.33%
SCO Coverage Range	16%	SCO Coverage Range	16%
SCO Payment Factor	0.303625	SCO Payment Factor	0.354224
Indemnity per acre	\$38.80	Indemnity per acre	\$49.10
Price Volatility	0.15	Price Volatility	0.15
Coverage Range	16%	Coverage Range	16%
RMA Act. Data	0.3265	RMA Act. Data	0.1028
Total Premium	\$41.72	Total Premium	\$14.25
FCIC Subsidized Portion	\$27.12	FCIC Subsidized Portion	\$9.26
GRW Portion of Premium	\$14.60	GRW Portion of Premium	\$4.99
GRW Indemnity Less Premium	\$24.19	GRW Indemnity Less Premium	\$44.12

SCO Notes (applies to all SCO crop examples):

^{1/} SCO operates with an underlying RP policy which uses the higher of the insurance or harvest price.

^{2/} The underlying (companion) RP policy is established at 70%.

^{3/} The expected area revenue uses the higher of the insurance and harvest price.

^{4/} The percent of expected area revenue for SCO protection cannot be below the underlying coverage.

^{5/} The SCO payment factor cannot be greater than 1.0.

^{6/} The SCO policy premium rate are assumed.

^{7/} The SCO policy premium is subsidized by FCIC at 65%.

Crop insurance revenue guarantees are shaping up to be at their highest levels in years, and, while that translates into higher premiums, there are new supplemental options that, while pricey, offer an additional layer of coverage that experts say are worth considering. Despite higher premiums for revenue-protection (RP) insurance, there seems to be more interest in shallow-loss crop-insurance products, like SCO and ECO which are usually used in addition to an RP policy.

SCO payments are determined only by county average revenue or yield and are not affected by whether you receive a payment from your underlying policy. So, it is possible for you to experience an individual loss but to not receive an SCO payment, or vice-versa. The dollar amount of SCO coverage is based on the percent of crop value covered. SCO provides area-based coverage on top of their individual Revenue Protection, Yield Protection or Actual Production History up to 86%. The ECO provides area-based coverage for a portion of your underlying policy's deductible in a manner like SCO. ECO uses the same expected and final area yields, projected and harvest prices, and payment factors as SCO, but covers a band from 86 percent (where SCO coverage triggers) up to 90 or 95 percent of expected crop value. Like SCO, ECO is based on your underlying policy plan of insurance. Because ECO covers a relatively shallow level of loss, it could be expected to trigger an indemnity 'often'.

Projected prices for RP policies (used by many corn and soybean farmers) are established by averaging the daily close of the December corn and November soybean contracts throughout mid-February. For Louisiana producers, those are shaping up to be near \$5.81 per bushel for corn, \$13.34 per bushel for soybeans, and \$1.00 per pound for cotton.

Higher guarantees and higher volatility are a driver behind the expected rise in crop insurance premiums. While some growers may consider lowering their coverage levels to reduce the budget impact of the premium, there is caution in that doing so also reduces the amount of coverage the grower has in a prevented planting situation or if yields or prices suffered major setbacks. Premiums for these products are more expensive still, but with crop prices/expenses this high, the ability to cover a greater portion of revenue makes it a potent risk-management tool. ECO and SCO tend to be good choices for farmers that like using options strategies. Since they are based on county yields, they may also be a good choice for farms that tend to strongly reflect their county yields or vice versa. The area component provides a little extra protection against more general economic uncertainties.

Adding the SCO and/or ECO endorsements can further limit risk exposure but will come at high premiums. However, SCO and ECO coverage is at the parish (county) level, meaning that there are possibilities that a farm will have a loss while the parish (county) does not. In addition, SCO and ECO have higher costs, as they will make payments at relatively small declines in prices or yields. Therefore, farmers may wish to consider adding ECO and SCO for additional protection, weighing the costs relative to the risk gains.

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This is for educational purposes only; parameters are likely to change as reported price and yield data are made public by the USDA.



Michael A. Deliberto can be contacted in the Department of Agricultural Economics and Agribusiness at (225) 578-7267 or by emailing mdeliberto@agcenter.lsu.edu.