



An Overview of Canada's Business Risk Management Programming

International Conference on Agricultural Insurance
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Purpose

- To provide an overview of the core Business Risk Management (BRM) programs in Canada.



The facts on Canada's agriculture industry...

- Canada's agriculture industry contributes over 8 percent of the Canadian Gross Domestic Product (GDP) of which 2.2% is derived from primary production
- As the fourth largest exporter of agri-food products in the world, the value of Canada's exports have doubled since 1990 to \$26.5 billion in 2004
 - Major markets include the US, the European Union, Japan, Mexico and China
- There are five major commodity sectors in Canada produced for both export and domestic markets. As a percentage of farm cash receipts, these are
 - Grains and Oilseeds (34%), Red Meats (27%), Dairy (12%), Horticulture (9%), Poultry and Eggs (8%)

In 2005, the total farm cash receipts for Canadian farmers was \$36 billion



The global economy – increased competition, lower commodity prices...

- The global economy has radically transformed the sector:
 - Technology and productivity improvements have led to sustained, long-term price declines
 - Fuelled by liberalized trade and intense competition from low-cost producing countries
- In this environment, farmers need to focus on profitability
 - Develop the capacity to produce innovative high-value food and non-food products that stand above the competition
- Canada has adopted a policy vision for the 21st century
 - Policies and programs that support growth, diversification and value-added activity and encourage risk mitigation



The Canadian approach to programming has evolved over time..

Safety Net Programs
Mid-1980's

Commodity Focus

Price Based

Provincial/Regional

Trade Distorting

Policy Transition



BRM Programs
Current

Whole Farm

Income/Margin Based

National Framework

Trade Neutral/Decoupled



With a number of factors driving the need for change...

- From a policy perspective, the commodity-specific and price support programs of the past were expensive, production distorting and did not focus on producer profitability
- Internationally, the WTO was a significant event
 - Key changes were necessary to ensure programming was in compliance
- On the domestic front, Canada faced considerable deficits during this period
 - solving it required a reduction in expenditures of which agriculture had to share



Canada shifted to BRM programming: nationally-available, decoupled whole-farm programs.

- An approach that focuses on enhancing farm profitability through risk mitigation, adaptation and considering a farm's future potential. Under BRM there are two main programs:

1. Canadian Agricultural Income Stabilization Program (CAIS)

- Combines stabilization and disaster assistance into a single permanent program

2. Production Insurance (PI)

- Provides a range of new products beyond traditional Crop Insurance



The CAIS Program

- Helps producers protect their farm operations from income declines beyond their control
- Provides stabilization and disaster assistance under one permanent program
- Offers more broad and effective income protection for both newly established farms and those experiencing back to back disasters
- Continues to provide assistance based on “whole farm” income, rather than commodity-specific support



How it works.....

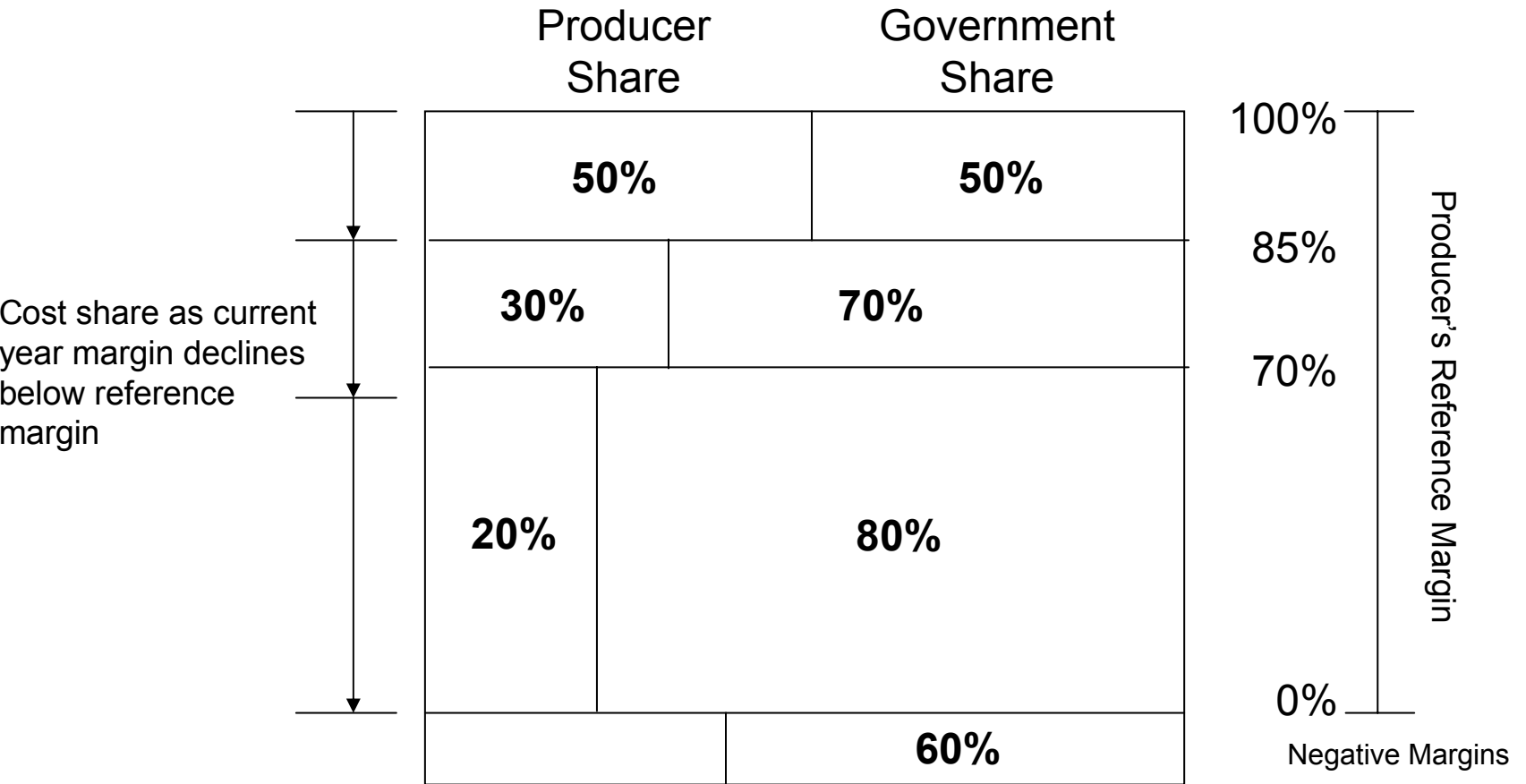
- Income is defined as “production margin”
 - Production margin = allowable farm revenues minus allowable expenses in a given year
- Payments are made to producers when their production margin in the current year income falls below their historical production margin
- Reference margin = “Olympic” average of last five years’ production margins i.e., the highest and lowest years are dropped



- Targeted to need, the amount of assistance available under the program depends on the magnitude of a producer's loss
- Under CAIS, smaller losses are shared equally between governments and producers
- For larger losses, governments cover a greater share of the producer's loss - up to four times the amount absorbed by the producer



Producer / Government Shares





Example

- A producer's production margins for the last five years were:
 - 2000 - \$50,000 (lowest year)
 - 2001 - \$90,000
 - 2002 - \$150,000 (highest year)
 - 2003 - \$110,000
 - 2004 - \$100,000
- Dropping the high and low years and averaging the remaining 3 years gives the producer a reference margin of \$ 100,000
- This is, in effect, the producer's level of support going into the 2005 program (tax) year



- If the producer's 2005 production margin:

declined by \$15,000, a government payment of \$7,500 (i.e., 50% of the loss) would be triggered;

declined by \$30,000, a government payment of \$18,000 (i.e., 60% of the loss) would be triggered;

declined by \$100,000, a government payment of \$70,000 (i.e., 70% of the loss) would be triggered;



Annual CAIS Participation Process

1. Producer receives an Options Notice in January
 - Outlines each producer's reference margin allowing them to indicate a level of protection
2. Select a protection level and pay a corresponding fee by April 30th
3. Report farming income for tax purposes and complete CAIS forms by June 30th of the following year
4. Receive a Calculation of Program Benefits and, if applicable, a payment once the application is processed
 - An interim payment option is available to producers in the fall to allow for more timely access to CAIS benefits



CAIS Payments

- Faced with historic declines in farm income over the past few years, the demand-driven design of CAIS has enabled a considerable response from governments

- CAIS Payments as of October 23, 2006

	2003	2004	2005
CAIS Payments	\$1.529 billion	\$1.389 billion	\$596 million
Number of Producers	74,755	66,532	26,200



Production Insurance

- Has been available for 40 years, operating in all provinces for 25 years
- Voluntary enrollment for producers
- Production Insurance stabilizes a producer's income by minimizing the economic impacts of production losses caused by adverse weather and other insured perils



General Overview

- The program is cost-shared by producers and the federal and provincial governments
- Provincial governments responsible for program design and delivery
- The Federal government contributes a portion of total premiums and administrative costs
 - The federal government also provides a reinsurance arrangement to provincial agencies (5 of which participate in the arrangement)



General Overview

- 10 Provincial Programs in Canada.
- Covers most commercially-produced crops in all provinces (90% of the value of all crops grown in Canada are insurable).
- 65% to 70% of crop acres grown are insured.
- 50% to 55% of Canadian farmers are insured.
- Average coverage level insured across Canada 74%



Production Covered

- Currently, insurance plans exist for grains, oilseeds, forage and horticulture
 - Fresh horticulture and forage are under-represented in some provinces
- Livestock is virtually uninsured at present
 - Plans are being investigated based on livestock mortality
- Additional benefits are available and paid separately:
 - Hail spot loss
 - Perennial plant coverage/tree loss
 - Reseeding
 - Unseeded acreage



Protection Offered

- Includes:
 - commodity specific and basket of crops losses
 - asset loss (livestock and perennial plants) replacements costs o
business interruption losses
 - compensation at market or replacement values
 - quality losses
 - wildlife compensation
- No protection provided for:
 - Market failures or price declines
 - Perils not identified in contracts
 - Financial, intermediary human resource and management risks



Insurance Plan Types

- Multi and Single Peril
- Whole Farm or Basket of Crops Coverage
- Proxy Crop Coverage
- Satellite Imagery
- Weather Derivatives: Rainfall
- Acreage Loss
- Quality Coverage
- Tree and Plants Coverage



How Production Insurance works...

- Under PI, premium payments from producers and governments are pooled together into one fund which is used to pay claims
 - Allows risk for a small number of producers to be spread over all the producers in the program; keeping costs stable and affordable
- Production Insurance is available to all Canadian farmers, landlords and sharecroppers who produce an insurable commodity



How Production Insurance works...

- Producer selects crops and must insure all acres
- Guaranteed a certain level of production
 - Based on farmer's or area's projected yield per acre, or
 - A provincial or regional production value when yields are not used as the basis of insurance



How Production Insurance works...

- Projected yield determined by moving average (5-15 years), may include adjustments for trend and buffering extreme (high/low) yields.
- Farmer's premium based on crop/area/individual risk.
- Farmer selects coverage level - usually 70 - 80% of farmer's projected yield. (50%, 60%, 70%, 80%, 85% and 90% also available)
- For non-yield based programs (i.e., livestock), the farmer insures all production and assumes the first losses based on long term average loss levels for the commodity.



Payment Calculation – Yield Based

- Production Guarantee =
Projected Yield x Coverage Level x Insured Acres
- Production Shortfall =
Actual Production – Production Guarantee
- Payment Amount =
Production Shortfall x Insured Price
- Insured Price – based on a projected or averaged market price for crops, costs of production or replacement values.



Payment Calculation – Non Yield-based

- Production Guarantee =
Production Value X Insured Units x Coverage Level
- Coverage level = (1- Deductible)
 - where the deductible equals the long term average loss level for the commodity
- Actual Production Value =
Production Value x Units Produced
- Payment amount =
Production Guarantee – Actual Production Value



Production Insurance by the numbers...

	2003	2004	2005
Participating Farms	113,689	100,932	100,540
Acres Insured	71,473,340	59,391,816	64,873,549
Value of Contracts	\$8.659 billion	\$7.235 billion	\$ 6.757 billion
Indemnities	\$ 737 million	\$ 852 million	\$577 million



The CAIS and PI connection...

- CAIS and PI address different risks faced by Canadian producers
 - By participating in both programs, producers can take full advantage of protection available of risk management programs
 - As PI indemnities are treated as eligible income in the CAIS production margin, participating in PI provides higher coverage under CAIS
- Two linkages are in place to ensure that producers do not forgo PI:
 - Producers not in PI do not receive CAIS negative margin for insurable losses
 - Producers disadvantaged under CAIS by participating in PI are eligible to receive a payment up to the amount of their premium



Cash Advance Programs

In addition to CAIS and PI, Canada has a suite of cash advance programs that are available as risk management tools for Canadian farmers

The two main cash advance programs are:

1. The Advance Payments Program (APP)
 - a) Facilitates orderly marketing by providing cash advances that allow producers to store the crop and sell it throughout the year to achieve higher returns
2. Spring Credit Advance Program (SCAP)
 - a) Provides cash flow to assist producers with input costs



How the Cash Advance programs work..

- Under the Advance Payments Program, producers are eligible to receive cash advances of up to \$250,000 to assist with orderly marketing
 - The first \$50,000 is interest-free and the interest costs paid by the federal government
 - Cash advances cannot exceed 50% of the anticipated average farm gate price for each commodity
 - The advance is repaid as the crop is sold and within a crop year up to 365 days
- Under the Spring Credit Advance Program, producers can receive an interest-free advance of \$50,000 to help with input costs
 - SCAP advances are secured by a production insurance contract
 - Calculated by multiplying a producer's insured yield by the advance rate
 - The advance must be repaid by December 31st of each calendar year or transferred into an APP advance



Cash Advance Programs by the numbers...

Advance Payments Program	Total Advanced	Interest Costs
2005 Crop Year	\$1.031 billion	\$15.8 million

Spring Credit Advance Program	Total Advanced	Interest Costs
2006 Crop Year	\$1.096 billion	\$4.4 million



Adapting the BRM programs to meet challenges...

- Although the fundamental design principles of CAIS are sound, industry has raised concerns with some features of the program:
 - Complexity and inability of making timely payments relative to need
 - Payments under the program are sometimes not predictable or bankable
- Federal and provincial governments are looking to make significant changes to CAIS in these areas over the coming months, particularly streamlining the administration and making the program more responsive and timely



...with significant changes targeted for 2007.

- Despite key improvements and an expansion of coverage, Production Insurance plans are still not widely available for many horticultural crops and the livestock sector
 - Governments have partnered with industry to undertake a complete review of Production Insurance programming
 - Review to be completed soon
- To bring the cash advance programs in line with today's financial needs, the government is making significant improvements:
 - Expanding coverage to more commodities, increasing limits and interest-free portion



Conclusion

- The shift to programs that are decoupled has proven to be the most effective method of providing support to farmers
 - Has allowed Canada to meet its trade commitments while leaving more money in the farmer's own pocket
 - OECD research shows that price support and input subsidies leak to the supply chain leaving little for farmers
 - For example, 47 cents/dollar gets to the farmer through decoupled while 17 cents/dollar through coupled
- Canada remains committed to business risk management programs that go beyond crisis management and focus on profitability
 - Risk management programs have positioned the sector to adapt to global markets
 - Programs encourage risk mitigation and do not distort market signals