Bonding Deferred Payment Contracts

We have received many questions since the article last month outlined the changes in grain licensing law that took effect on August 1st. The topic that has garnered the most questions is the requirement for elevators to offer bonding on deferred payment contracts. This should answer some of the questions we have been receiving.

The first point to remember is that the elevator must offer a bond but that doesn't mean all of the deferred payments will be bonded. The decision on whether to take the bonding lies with the producer, they have the option to purchase a bond or not purchase a bond along with the decision on how much coverage they want to purchase. A simple statement that affirms the producer decision should suffice to meet the requirement to offer the bond. An example on the deferred payment contract could be as such:

I would like to purchase bond coverage for this contract ______Yes ______No _____Initials

The August 1st law changes included a definition of deferred payment contract which is:
"Deferred-payment contract" means a credit-sale contract for which the amount owed for the sale of grain has been established, but the payment is postponed until a later date.

<u>Credit Sale Contract Indemnity Fund</u>
Deferred payment contracts are <u>credit-sale contracts</u> which means they are eligible for coverage by the credit-sale contract indemnity fund. The reimbursement limit from credit-sale contract indemnity fund may not exceed the <u>lesser of eighty percent of the amount owed</u> to that eligible person in accordance with all of that person's unsatisfied credit-sale contracts <u>or two hundred eighty thousand dollars.</u>

A producer that wants bond coverage for their deferred payment contract should be made aware of the amount eligible for reimbursement from the credit-sale contract indemnity fund because it may have an affect on the amount of bond they wish to purchase.

<u>How It Works</u>
It is important to note that the elevator will not be getting in the bond business, the elevator would run a deferred payment bond through an agent licensed to sell those products just like they do for their warehouse or grain buyer bond. Once a producer has decided to purchase bond coverage the approval process is very similar to that of purchasing a grain buyer bond. The producer would fill out an application form and the elevator would submit it along with the deferred payment contract and its financials to their agent who would then forward those on to a surety company for issuance of a bond. The bond premium would be determined by the surety underwriter according to the strength of the elevator financials.

Here is an example:

A producer wants to defer a $100,000 payment and signs a contract to that effect. In the case that they would want bond protection the calculation would be as follows: $100,000 x 80% = $80,000 of protection from credit-sale contract indemnity fund. The $20,000 not protected by the indemnity fund would be the logical amount to cover with a deferred payment bond. At a bond premium of $7 per thousand it would cost the producer $140 to purchase the bond. $20,000 ÷ 1000 = 20. 20 x $7 = $140. This is a simplified example and there may be more charges due to processing and handling.

It is important to note that an elevator does not have an unlimited amount of deferred bonding available to it. The dollar amount of deferred payments an elevator will be allowed to bond is dependent upon the strength of the financial statements. Producers should be aware of the risk they are accepting if their deferred payments are not or can not be covered by a bond.