

Livestock Risk Protection Insurance for Feeder Cattle

The following information is an overview of Livestock Risk Protection insurance. Livestock Risk Protection insurance (LRP) became available in Tennessee on July 1, 2007. LRP provides single-peril price risk coverage for future livestock sales. Producers can use LRP as a risk management tool. LRP covers feeder cattle, finished cattle and market hogs. It is sold primarily by the same vendors which sell crop insurance. The livestock must be in Tennessee for the insurance to be written in Tennessee. Since rules for this insurance are subject to change, producers should always check for current rules and regulations before using LRP.

The USDA Risk Management Agency (RMA) introduced LRP in 2002 in a selected number of states as an alternative for protecting future price levels for hogs and cattle. The LRP coverage provides price risk protection by paying producers if a national cash price index drops below the insured price level. The coverage works similar to a put option by allowing the producer to set a floor price while keeping the opportunity to benefit from rising prices. The producer pays a premium for this protection. This information will focus on using LRP for feeder cattle.

- LRP feeder cattle Coverage Prices are based on the futures and options prices for feeder cattle.
- LRP only offers price protection. No other peril such as death or poor performance is covered.
- The policy does not guarantee a cash price received, but does guarantee the right to collect an indemnity payment based on average market prices.
- Basis risk, the uncertainty of the difference between the producers actual cash price for the cattle and the Feeder Cattle index, must be considered.
- Producers must complete an enrollment application with a certified agent. Enrollment establishes the right but not the obligation to purchase coverage. There is no cost to the producer to enroll.
- Coverage for feeder cattle is divided into two weight classes – less than 600 pounds and 600 to 900 pounds. Steers, heifers and Braham and dairy breeds in both weight classes can be insured.
- There is no lower limit to the number of cattle that can be insured. This makes LRP more attractive to smaller producers who do not have enough cattle for a 50,000 pound futures or options contract.
- There are upper limits of 1,000 head per Specific Coverage Endorsement and 2,000 head per crop year which runs July 1 through June 30.
- LRP also offers some flexibility in the length of coverage offered. An end date as close to the market date as possible should be selected. The cattle can be sold up to 30 days before the end date and any time after the end date.
- LRP is a risk management tool. It is not designed to increase profits, but to prevent large losses should prices drop significantly.
- Coverage prices for LRP are set by the RMA in contrast to the negotiated prices for futures and options.
- LRP insurance premiums are set after the futures and options markets close for the day.

These premiums, once set, are guaranteed for that day and will not change. Premiums are cheaper when prices are high and increase when prices decline.

- LRP can only be purchased when the futures and options markets are closed.
- USDA provides a subsidy of 13% of the total premium cost. Producers do not pay any commission or administrative fees.
- LRP is also different from futures and options in that coverage cannot be lifted. Once the coverage is purchased, it will remain in place until the expiration date.
- The CME Feeder Cattle Cash Index Price is used as the Actual Ending Value for feeder cattle insurance. This index represents a national average comprised of representative feeder steer prices reported across the U. S. The index price is a seven-day average of sales of 700 to 849 pound Medium and Medium/Large Frame #1 steers.

Example

Obtaining Coverage: On August 29, a producer decided to cover his price risk on 25 500 pound steers that he had raised. He plans to sell them in April weighing 750 pounds. The LRP contract with an end date closed to his projected selling date is the 34-week endorsement that ends April 22. The Expected Ending Value (EEV) for these steers for the 34-week endorsement is \$113.85. This is the RMA estimate for the Feeder Cattle Cash Price Index on April 22. The producer selects a Coverage Price of \$92.00/cwt. or 80.8% of the EEV. The premium rate is 0.011098. Every dollar of insurance costs \$0.011098. To calculate the cost per hundredweight, multiply \$92 by 0.011098, for \$1.021. Since the premium is subsidized by 13%, the producers actual cost is \$0.888 per hundredweight. The producer wished to insure 25 750 pound steers or 187.5 cwt. The insured value is 187.5 cwt. times \$92.00 or \$17,250. The total premium is calculated by multiplying \$17,250 x 0.011098 x .87 = \$166.55. Remember, that once the coverage is purchased, it will remain in place until the expiration date.

Market Stays Above Coverage Price: In April, the CME Feeder Cattle Cash Price Index was \$95.00. Since the coverage price was \$92.00, no indemnity payment will be made. Cattle are sold through regular market channels for \$90.00 (minus \$5.00 basis). Net price after paying for insurance is \$88.98 (\$90 sale price - \$1.02 insurance cost).

Market Falls Below Coverage Price: In April, the CME Feeder Cattle Cash Price Index was \$85.00, the LRP coverage would pay \$7.00 per cwt. (\$92 Coverage Price - \$85 Index Price) or \$1,312.50. Cattle are sold through regular market channels for \$80.00 (minus \$5.00 basis). Net price after collecting an indemnity payment is \$85.98 (\$80 sale price - \$1.02 insurance cost + \$7.00 indemnity payment).

The following web sites provide additional information on Livestock Risk Protection Insurance:

Tennessee Beef Cattle Improvement Initiative

<http://www.tnbeefcattleinitiative.org>

University of Nebraska

<http://livestockinsurance.unl.edu>

USDA Risk Management Agency

<http://www3.rma.usda.gov/apps/livestock-reports/main.aspx>