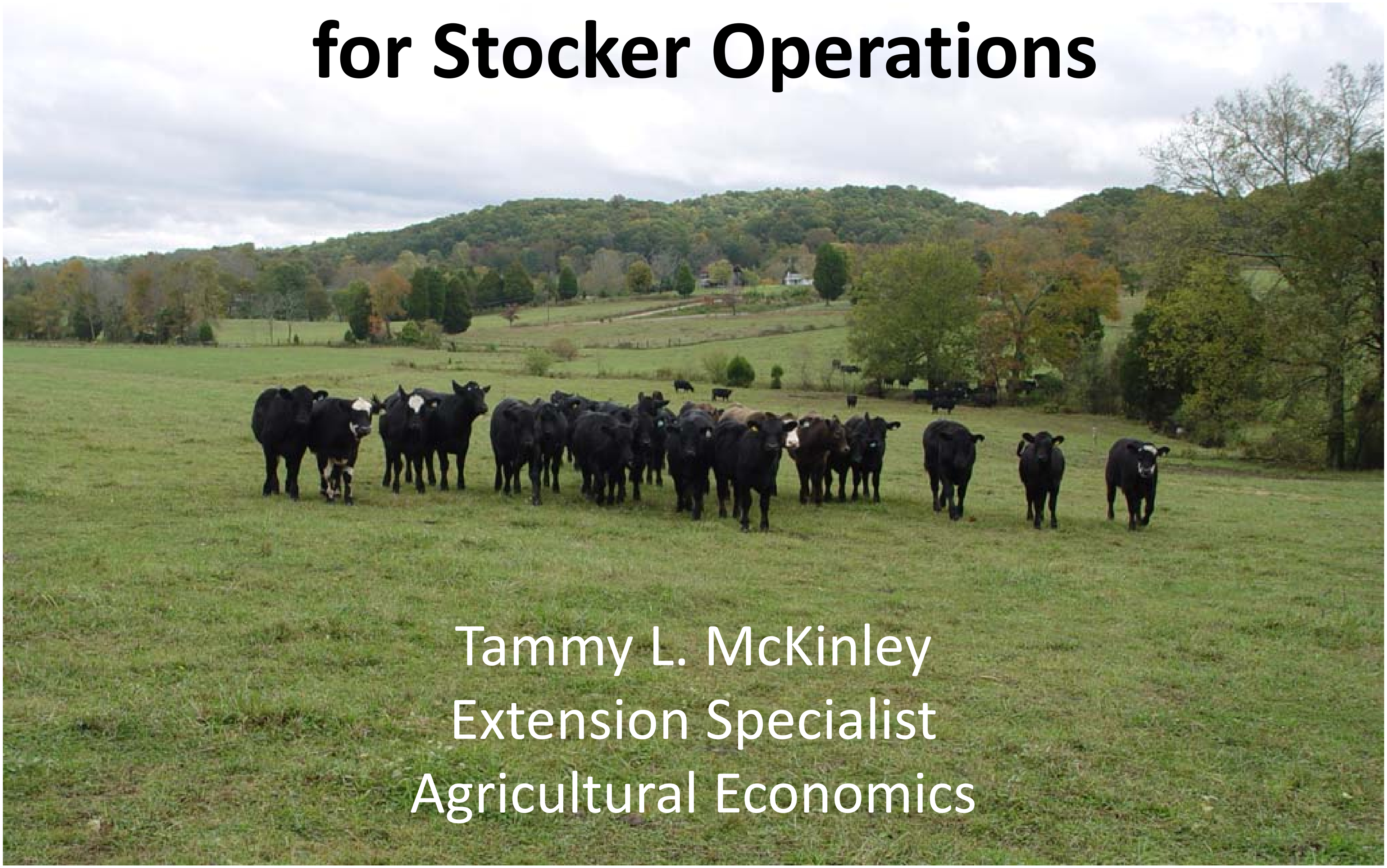
Livestock Risk Protection Insurance for Stocker Operations



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Acknowledgements

- Original presentation by Dr. Walt Prevatt, Auburn University

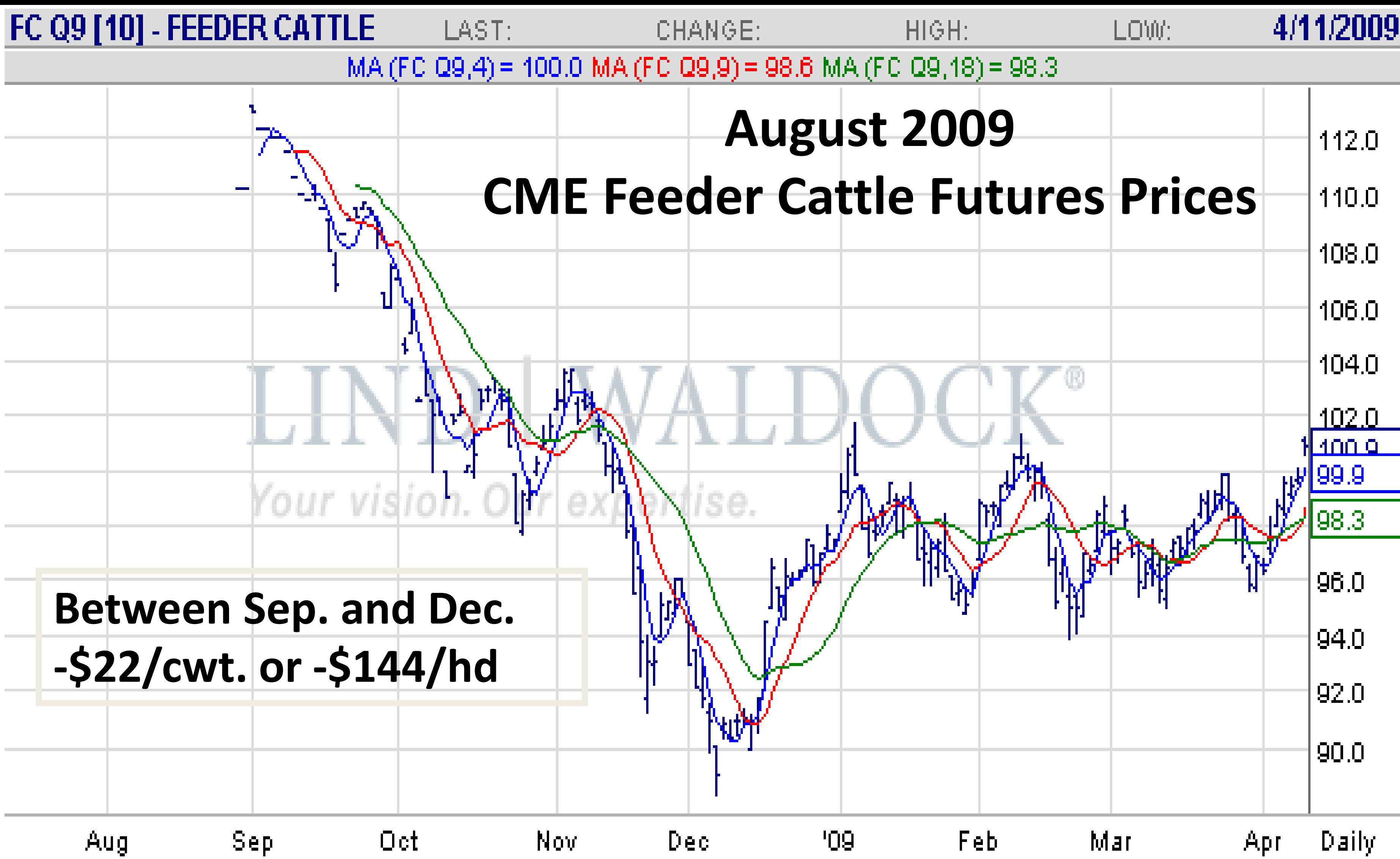
- Special thanks to Dr. Emmit Rawls and Randall Shaw of Southern AG for their many contributions to this presentation

Why Should You Care About LRP?

Let's remember a few basics of managing feeder cattle market price risk…

- The long-run average returns are highest in the cash market
- Long-run average returns will be reduced when using any type of price protection when compared to the cash market
- Price protection allows you to protect against a *catastrophic* low market price event that may jeopardize your ability to continue farming

Why Should You Care About LRP?



Why Should You Care About LRP?

- A lot of money is at risk in the stocker enterprise:
  - Calf purchase cost (say \$300 - \$500 per head)
  - Grazing cost (say \$50 - \$150 per head)
  - Feed cost (say \$50 - \$150 per head)
  - Vet. & Med. cost (\$10-\$20 per head)
  - Overhead cost (\$50 - \$100 per head)
  - Labor cost (\$10 - \$30 per head)
  - Miscellaneous cost (\$xx - \$xx per head)

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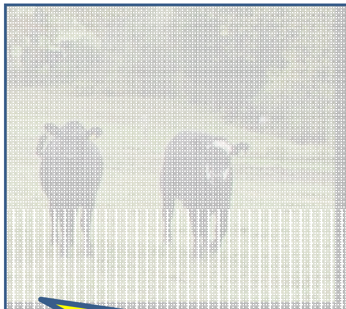
  - Labor cost ($10 - $30 per head)
  - Miscellaneous cost ($xx - $xx per head)

Let's say, total cost is between $500 and $800 per head

If you run 60 head,
that's between $30,000 and $48,000



Why Should You Care About LRP?

You can buy a pickup for that amount of money!

- A ... in the stocker enterprise:
  - ... $500 per head)
  - S... $150 p... head)
  - ...ed c... 450 - ...50 per head)
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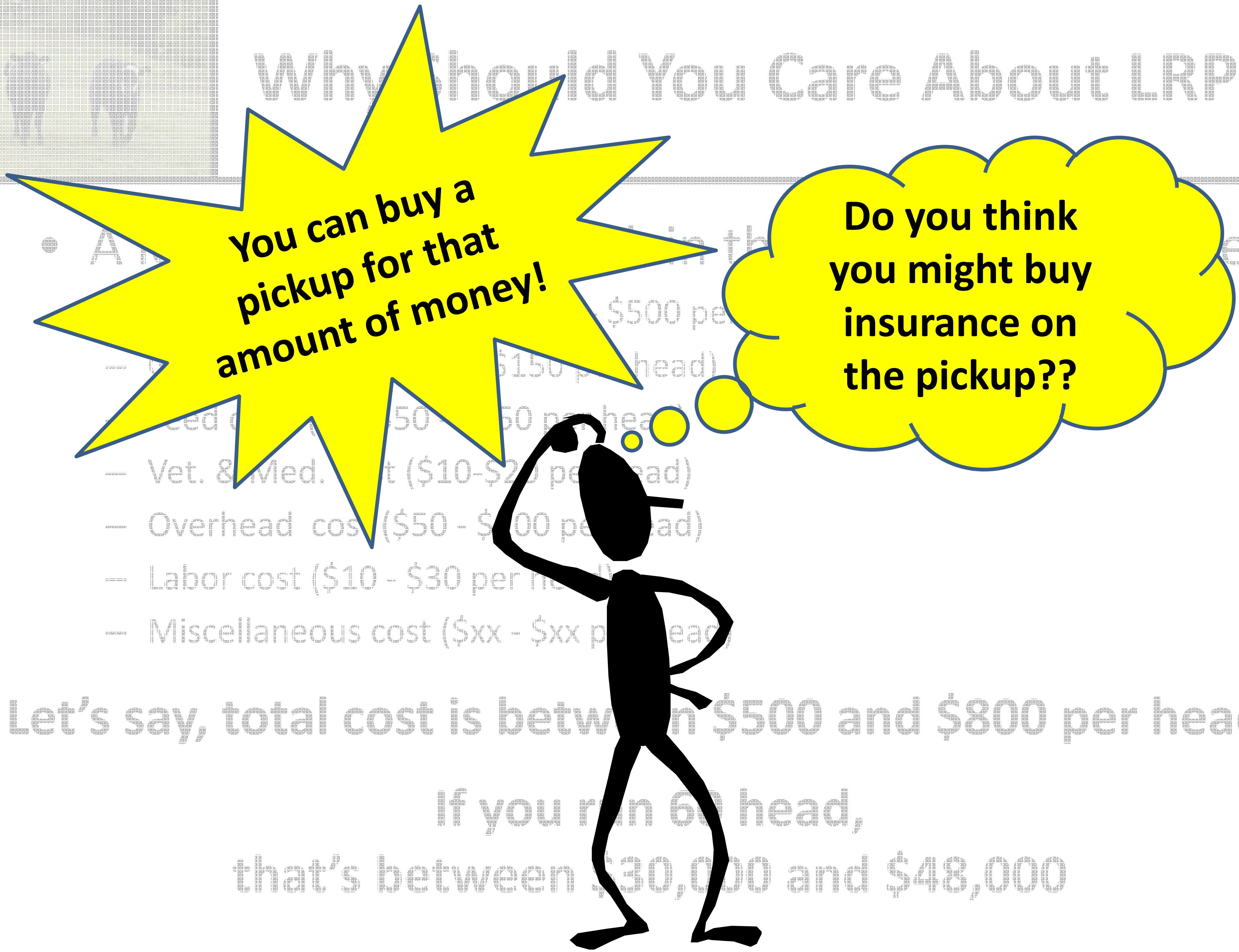

What Is LRP Insurance?

LRP (Livestock Risk Protection) insurance for feeder cattle is a **"single peril insurance policy"** intended to provide protection against a *price decrease*.

What Does LRP Insurance Not Do?

LRP does *NOT* protect against

death

disease

quarantine

etc.

LRP is *NOT* designed to enhance profit!

What Is LRP Insurance?

LRP (Livestock Risk Protection) insurance for feeder cattle is a **"single peril insurance policy"** intended to pro

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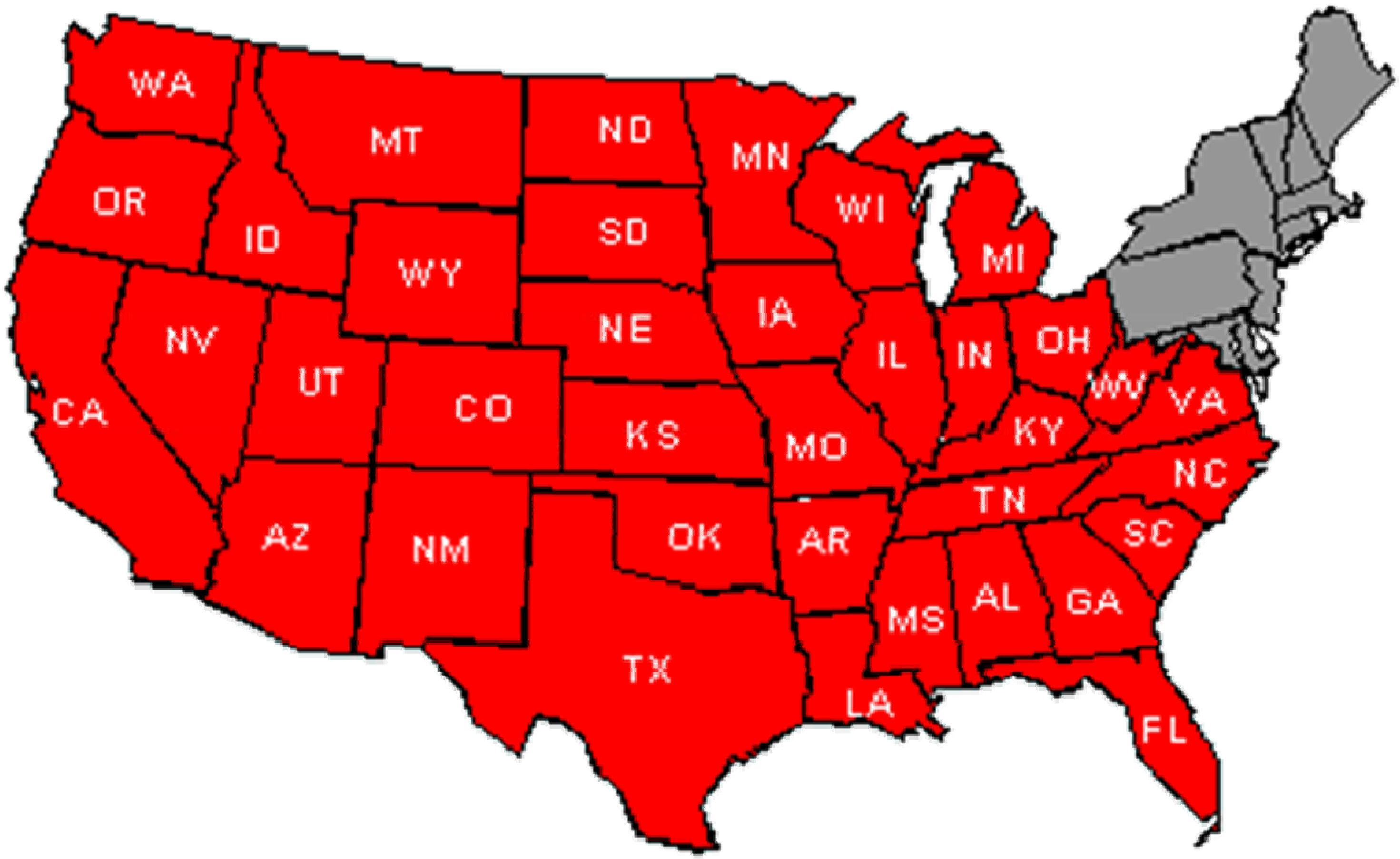
LRP only protects against a <u>catastrophic</u> price decrease!

Where Is LRP Available?



LRP is available in 37 states

What are the Basics of LRP?

Item	LRP–Feeder Cattle
Type of cattle	Heifers, Steers, Brahman, or Dairy
Weight Classification	Less than 600 Lbs. 600 - 900 Lbs.
Coverage Levels	70-100%
Coverage Price	Varies Daily
Endorsement Length	13 weeks to 52 weeks (4 week intervals)
Subsidy	13 Percent
Ending Value Based On….	CME Feeder Cattle Price Index
Max. Cattle Covered Per Submission	1,000 Head
Max. Cattle Covered Per Crop Year	2,000 Head

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Item	LRP–Feeder Cattle	LRP-Fed Cattle
Type of cattle	Heifers, Steers, Brahman, or Dairy	Heifers or Steers
Weight Classification	Less than 600 Lbs. 600 - 900 Lbs.	10 – 14 Cwt. Yield Grade 1- 3
Coverage Levels	70-100%	70-100%
Coverage Price	Varies Daily	Varies Daily
Endorsement Length	13 weeks to 52 weeks (4 week intervals)	13 weeks to 52 weeks
Subsidy	13 Percent	13 Percent
Ending Value Based On….	CME Feeder Cattle Price Index	AMS 5-area weekly average direct slaughter cattle report
Max. Cattle Covered Per Submission	1,000 Head	2,000 Head
Max. Cattle Covered Per Crop Year	2,000 Head	4,000 Head

More Details

- All livestock owners may use LRP
- Livestock to be covered must be in state offering LRP insurance
- Available through Crop Insurance Agent System
  - http://www3.rma.usda.gov/apps/agents
- Must submit application to participate prior to purchasing LRP Insurance
- Coverage prices may be selected between 3:30 p.m. and 9:00 a.m. Central Time (after and before trading on CME)

More Details

- Payment of premium must be made when you purchase the LRP insurance
- Price adjustment factors based on sex, breed and weight are applied to expected and actual ending values
- The actual ending value on date coverage ends is the CME Feeder Cattle Index multiplied by appropriate price adjustment factor

Price Adjustment Factors (PAF)

End Weight	Steers Weight 1	Heifers Weight 1	Brahman Weight 1	Dairy Weight 1
< 600 Lbs.	110%	100%	100%	85%

End Weight	Steers Weight 2	Heifers Weight 2	Brahman Weight 2	Dairy Weight 2
600-900 Lbs.	100%	90%	90%	80%

What are the Steps to Use LRP?

- Contact your local crop insurance agent who sells LRP insurance
- Submit an application
- Select the type and weight of feeder cattle to insure
- Select an endorsement length
- Select the coverage level

What are the Steps to Use LRP?

- The insurance agent submits a Specific Coverage Endorsement (SCE) to RMA on-line for you between 3:30 p.m. and 9:00 a.m. Central Time
  - The premium is due immediately – not later
- A return notification will be sent acknowledging that your SCE has been received and accepted
- After the policy end date, submit an indemnity claim if warranted
  - When covered price is more than actual ending value

How Does LRP Insurance Work?

Let's Do the Math

LRP – Feeder Cattle Example

- Assume today's date is August 4, 2010.
- A stocker operator in S.W. Virginia plans to market 60 head of BWF feeder steers weighing 800 lbs the week of March 2, 2011 (30 weeks).
- The stocker operator is concerned that feeder cattle prices may decrease.
- He contacts his local crop insurance agent to evaluate the LRP-Feeder Cattle Insurance policy.

Calculation of Insured Value

Number of Head (whole number)	X	Target Weight At End Date (cwt. per head)	X	Coverage Price (as shown on Actuarial Document)	X	Insured Share (x.xxx)	=	Insured Value (Dollar)
60	x	8.00	x		x		=	

You select the coverage price using the LRP report that adjusts for type and weight of feeders, endorsement length and coverage level (70-100%)

USDA subsidizes 13 percent of total LRP premium

* See notes at bottom of page

State	County	Endorsement Length	Commodity	Type	Practice	Crop Year	Exp. End Value	Coverage Price	Coverage Level	Rate	Cost Per CWT	End Date	Actual End Value
51 VIRGINIA	998 ALL COUNTIES	13	0801 FEEDER CATTLE	810 STEERS WEIGHT 2	997 NO PRACTICE SPECIFIED	2011	114.924	$111.950	0.974100	0.022394	2.507	11/03/2010	
51 VIRGINIA	998 ALL COUNTIES	13	0801 FEEDER CATTLE	810 STEERS WEIGHT 2	997 NO PRACTICE SPECIFIED	2011	114.924	$109.950	0.956700	0.017126	1.883	11/03/2010	
51 VIRGINIA	998 ALL COUNTIES	13	0801 FEEDER CATTLE	810 STEERS WEIGHT 2	997 NO PRACTICE SPECIFIED	2011	114.924	$107.950	0.939300	0.012682	1.369	11/03/2010	
51 VIRGINIA	998 ALL COUNTIES	17	0801 FEEDER CATTLE	810 STEERS WEIGHT 2	997 NO PRACTICE SPECIFIED	2011	114.554	$112.830	0.985000	0.028140	3.175	12/01/2010	
51 VIRGINIA	998 ALL COUNTIES	17	0801 FEEDER CATTLE	810 STEERS WEIGHT 2	997 NO PRACTICE SPECIFIED	2011	114.554	$110.830	0.967500	0.021682	2.403	12/01/2010	
51 VIRGINIA	998 ALL COUNTIES	17	0801 FEEDER CATTLE	810 STEERS WEIGHT 2	997 NO PRACTICE SPECIFIED	2011	114.554	$108.830	0.950000	0.016420	1.787	12/01/2010	
51 VIRGINIA	998 ALL COUNTIES	17	0801 FEEDER CATTLE	810 STEERS WEIGHT 2	997 NO PRACTICE SPECIFIED	2011	114.554	$98.830	0.862700	0.005656	0.559	12/01/2010	
51 VIRGINIA	998 ALL COUNTIES	21	0801 FEEDER CATTLE	810 STEERS WEIGHT 2	997 NO PRACTICE SPECIFIED	2011	113.940	$112.220	0.984900	0.031091	3.489	12/29/2010	
51 VIRGINIA	998 ALL COUNTIES	21	0801 FEEDER CATTLE	810 STEERS WEIGHT 2	997 NO PRACTICE SPECIFIED	2011	113.940	$110.220	0.967400	0.024787	2.732	12/29/2010	
51 VIRGINIA	998 ALL COUNTIES	21	0801 FEEDER CATTLE	810 STEERS WEIGHT 2	997 NO PRACTICE SPECIFIED	2011	113.940	$108.220	0.949800	0.019460	2.106	12/29/2010	
51 VIRGINIA	998 ALL COUNTIES	21	0801 FEEDER CATTLE	810 STEERS WEIGHT 2	997 NO PRACTICE SPECIFIED	2011	113.940	$98.220	0.862000	0.007972	0.783	12/29/2010	
51 VIRGINIA	998 ALL COUNTIES	26	0801 FEEDER CATTLE	810 STEERS WEIGHT 2	997 NO PRACTICE SPECIFIED	2011	113.485	$107.090	0.943600	0.021888	2.344	02/02/2011	
51 VIRGINIA	998 ALL COUNTIES	30	0801 FEEDER CATTLE	810 STEERS WEIGHT 2	997 NO PRACTICE SPECIFIED	2011	112.681	$106.280	0.943200	0.024482	2.602	03/02/2011	
51 VIRGINIA	998 ALL COUNTIES	34	0801 FEEDER CATTLE	810 STEERS WEIGHT 2	997 NO PRACTICE SPECIFIED	2011	112.400	$106.000	0.943100	0.025472	2.700	03/30/2011	

Calculation of Insured Value

Number of Head (whole number)	X	Target Weight At End Date (cwt. per head)	X	Coverage Price (as shown on Actuarial Document)	X	Insured Share (x.xxx)	=	Insured Value (Dollar)
60	x	8.00	x	106.28	x	1.000	=	51,014

Calculation of Premium

Insured Value (Dollar)	X	Rate (.xxxxxx)	=	Rounded Total Premium (Dollar)
51,014	x	.024482	=	1,249

Calculation of Premium Subsidy

Rounded Total Premium (Dollar)	**X**	**Subsidy** (Percent)	**=**	**Rounded Subsidy** (Dollar)
1,249	x	0.13	=	162

Calculation of Producer Premium

Rounded Total Premium (Dollar)	-	Rounded Subsidy (Dollar)	=	Producer Premium (Dollar)
1,249	-	162	=	1,087

$1,087/60 head =
$18.12/head

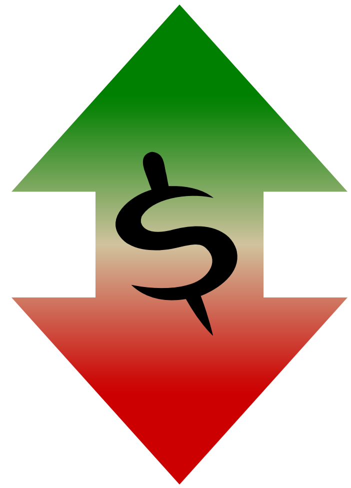
Calculation of Producer Premium

Rounded Total Premium (Dollar)	-	Rounded Subsidy (Dollar)	=	Producer Premium (Dollar)
1,249	-	162	=	1,087

You pay $1,087 to insure you receive a minimum of $51,014

Reminder

Feeder cattle prices move in *<u>one</u>* of two directions!



Let's assume feeder cattle prices *<u>INCREASE</u>*

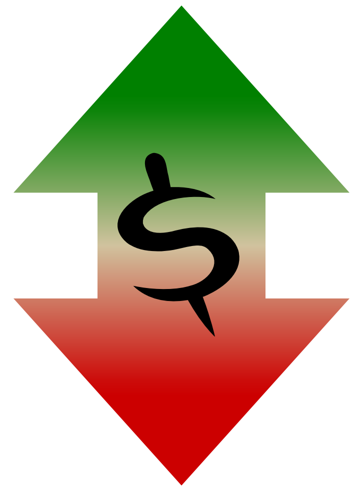
Calculation of Indemnity Payment

CME Feeder Cattle Index *Increases* Above Coverage Price

Item	Insured Value (dollar)	-	Actual Ending Value (dollar)	=	Indemnity Payment (dollar)
Dollars Per Cwt.	$106.28	-	CME FC Index*PAF $115	=	$0
Dollars Per Head	$850.24	-	$920.00	=	$0
Total Dollars	$51,014.40	-	$55,200	=	$ 0

Reminder

Feeder cattle prices move in *<u>one</u>* of two directions!



Let's assume feeder cattle prices *<u>DECREASE</u>*

Calculation of Indemnity Payment

CME Feeder Cattle Index *Decreases* Below Coverage Price

Item	Insured Value (dollar)	-	Actual Ending Value (dollar)	=	Indemnity Payment (dollar)
Dollars Per Cwt.	$106.28	-	CME FC Index*PAF $100	=	$6.28
Dollars Per Head	$850.24	-	$800.00	=	$50.24
Total Dollars	$51,014.40	-	$48,000	=	$ 3,014.40

LRP Insurance Study Results

(examined 20 years of prices)

Net returns on average were $6.50 per head less than when compared with no price protection in the cash market over the 20 year period.

Caleb Bott and Dillion Fuez, Utah State University, May 2010
http://cattlemarketanalysis.org/current.html

LRP for Feeder Cattle

Advantages

- Easy to acquire
- Premiums are subsidized
- Safe to use
- Available in 37 states
- Can insure a specific number of cattle (1 hd. up to a trkload)
- Can insure up to 1,000 feeder cattle per submission, not to exceed 2,000 per crop year (July 1 – June 30)
- No broker fees
- No margin calls
- Lenders can take a security interest in the contract

Disadvantages

- Cannot offset policy
- Cannot convert coverage (such as buy two puts or fence a price)
- Limited coverage for distant time periods
- Can only obtain price protection at below expected end value
- Selling cattle more than 30 days prior to the end of the policy may void the policy
- **Basis risk**
- Suspension of Sales by USDA

Does LRP Fit Your Operation?

- The best way to determine if LRP fits your operation is to sit down with *your crop insurance agent*
- Your agent needs to be LRP trained/approved
- Go through your individual situation
- Your agent can provide you with specific information tailored to your farm business

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Useful LRP Websites

LRP agent locator	http://www3.rma.usda.gov/apps/agents/
LRP premium calculator	http://www3.rma.usda.gov/apps/premcalc/ *(View between 3:30 PM and 9 AM Central Time)*
Endorsement lengths, coverage prices, rates and end dates	http://www3.rma.usda.gov/apps/livestock_reports/main.aspx *(View between 3:30 PM and 9 AM Central Time)*
CME Feeder Cattle Index	http://www.cmegroup.com/market-data/datamine-historical-data/cash-settled-commodity-index-prices.html
AMS 5-area, weekly weighted average for direct slaughter cattle	http://www.ams.usda.gov/mnreports/lm_ct150.txt
LRP study guide	http://livestockinsurance.unl.edu/index.html

Other Price Risk Management Tools for Stocker Operators

- Short Hedge
- Buy a Put Option
- Roll-up Put Options
  - Buy 2 Put Options
- Synthetic Put
  - Short Hedge & Buy a Call
- Fence
  - Buy a Call & Sell a Call
- Forward Contract

Additional Reference Contacts

- Emmit Rawls, University of Tennessee
  - 865/974-7271
- Dillion Feuz, Utah State University
  - 435/797-2296
- Darrell Marks, University of Nebraska
  - 402/472-1796
- Curt Lacy, University of Georgia
  - 229/386-3512
- Walt Prevatt, Auburn University
  - 334/844-5608


THE END
www.TNBeefCattleInitiative.org