

Livestock Risk Protection (LRP)

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Is There Risk In The Cattle



Is There Risk In The Cattle



LRP Is Price Risk Protection

- Establishes A Floor Selling Price For Livestock
- Pays Producers If A Regional/National Cash Price Index Falls Below A Set Price
 - Does Not Guarantee A Cash Price received
- Covers Feeder Cattle, Fed Cattle & Swine

What Is LRP

- LRP Can Be Viewed As “Price Insurance”
- LRP Is A Risk Management Tool
 - Protects Against Catastrophic Price Declines
 - NOT Designed To Enhance Profit

Who Can Participate?

- All Owners Of Eligible Livestock In LRP States
- Once Enrolled, Producers Have The Right But Not The Obligation To Purchase Coverage
- Livestock Has To Be In A State Offering LRP
 - Owners Can Be In Other States

Where Do You Buy LRP Insurance?

- Available Through Crop Insurance Agent System
- Agent Locator Tool On USDA Website
 - <http://www3.rma.usda.gov/apps/agents/>

LRP Policy, Provisions & Forms

- Application Forms
- Substantial Beneficial Interest (SBI)
- Basic Policy
- Specific Coverage Endorsement (SCE)
- Claim Form

Single Peril Insurance

- Policy Provides Protection Against Price Declines During Insurance Period
- Policy Does Not Cover Any Other Peril, Including Mortality, Condemnations, Physical Damage, Disease, Individual Marketing Decisions, Local Price Aberrations, Poor Performance, Or Any Other Cause Of Loss Other Than Stated

Substantial Beneficial Interest (SBI)

- Must Have At Least 10% Interest
- A Spouse Of An Applicant/Insured Will Have Substantial Beneficial Interest In The Applicant/Insured Unless Spouse Proves:
 - The Insured Class Is In A Totally Separate Farming Operation
 - Spouse Derives No Benefit From The Farming Operation Of The Applicant/Insured

Limitations On Number Of Head Insured

	Fed Cattle	Feeder Cattle
Per Specific Coverage Endorsement	2,000	1,000
Per Crop Year July 1-June 30	4,000	2,000

- Covered Livestock Counted In Crop Year When Coverage Is Purchased

Eligible Cattle

- Feeder Cattle
 - Includes Dairy & Brahman Breeds
- Fed Cattle
 - Steers & Heifers
 - Select Or Higher, Yield Grade 1-3
 - Weight: 1,000-1,400 lbs.

Actual Ending Value (AEV) Feeder Cattle

- CME Feeder Cattle Cash Index Price
 - National Average Cash Market Price
 - 650-850 lb. Steers
 - Reported Index Is 7-Day Average
- http://www.cme.com/trading/dta/hist/cash_settled_commodity_prices.html
- If Insuring Heifers Or Different Weight Range, LRP Insurance Contract Still Indemnified On CME Index (650-850 lb. Steer Price)

CME Feeder Cattle Index™

- Used To Cash Settle Feeder Cattle Futures
- A 7 Day Weighted Average Of USDA Reported Prices From A 12 State Region: Colorado, Iowa, Kansas, Missouri, Montana, Nebraska, New Mexico, North Dakota, Oklahoma, South Dakota, Texas & Wyoming
- Prices From Auctions, Video & Internet Sales And Direct Trades

Actual Ending Value (AEV) Fed Cattle

- 5-Area Weekly Weighted Average Direct Slaughter Steer Price
 - TX/OK, KS, NE, CO, IA/MN
 - 35-65% Choice Steers, Live Weight Basis
 - FOB Feedyard
- Represents National Average Cash Price
- AMS-USDA Report LM_CT150.txt
 - http://www.ams.usda.gov/mnreports/lm_ct150.txt
- If Insuring Heifers, LRP Insurance Contract Still Indemnified On 5-Area Steer Price

5 Area Weekly Weighted Average Direct Slaughter Cattle

Texas/Oklahoma/New Mexico; Kansas; Nebraska; Colorado;
Iowa/Minnesota feedlots for week ending 2/8/2007

LIVE FOB BASIS - Beef Breeds						
	Head count	Weight Range	Price Range	Avg Weight	Wtd Avg Price	
STEERS						
Over 80% Choice	2,209	1,200-1,475	89.00-92.50	1,380	91.02	
65 - 80% Choice	5,461	1,260-1,475	89.00-92.50	1,383	91.13	
35 - 65% Choice	38,375	1,135-1,450	88.00-92.50	1,288	91.65	
0 - 35% Choice	3,039	1,220-1,375	88.00-92.00	1,297	91.78	
Total all grades	49,084	1,135-1,475	88.00-92.50	1,303	91.73	
HEIFERS						
Over 80% Choice	3,516	1,175-1,375	88.00-92.00	1,308	90.56	
65 - 80% Choice	5,803	1,070-1,360	90.00-92.50	1,257	91.06	
35 - 65% Choice	23,383	1,050-1,350	90.00-92.50	1,166	91.84	
0 - 35% Choice	72	1,150-1,150	92.00-92.00	1,150	92.00	
Total all grades	32,774	1,050-1,375	88.00-92.50	1,197	91.56	

Coverage Availability

- Coverage Available About 5pm To 9am CST
 - Available Sat Morning Until 9am, But Not Sun, Mon & Holidays
- Coverage Initiated With Specific Coverage Endorsement (SCE)
 - No Limit On Number Of SCEs
- Producers Have Flexibility On The:
 - Timing Of Purchase
 - Time Length Of The SCE
 - Number Of Head Covered

LRP Is A Pilot Program

- Risk Management Agency
- Pays Insurance Commission – 5 Percent
- Pays Administrative Cost
- Pays 13% of Premium Cost
- Pays Agents Less Than Crop Insurance
- Agent Has Incentive To Sell Higher Coverage Prices
- Premium Must Be Paid Up Front
- The Check/money Must Be Good

Let's Work Through The Math

Insured Value and Premium Computation

- The Insured Value = Number of Head multiplied by the Target Weight (live weight, in cwt.) multiplied by the Coverage Price multiplied by Ownership Share. The Insured Value is rounded to the nearest whole dollar.

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)
70	X	7	X		X		=	

LRP Coverage Prices, Rates, and Actual Ending Values - Report for 10/15/2007
USDA subsidizes 13 percent of total LRP premium

State	County	Endowment Length	Commodity	Type	Practice	Crop Year	Ed. End. Date	Coverage Price	Coverage Rate	Rate	Cwt Per Cwt	End Date	Actual End. Year
4-TENNESSEE	WEA ALL COUNTIES	13	FEEDER CATTLE	810 STEERS WEIGHT 2	810 NO PRACTICE SPECIFIED	2008	113.810	\$111.870	0.869000	0.022750	2.889	01/14/2008	98.091
4-TENNESSEE	WEA ALL COUNTIES	13	FEEDER CATTLE	810 STEERS WEIGHT 2	810 NO PRACTICE SPECIFIED	2008	113.810	\$108.870	0.866200	0.018441	2.038	01/14/2008	98.091
4-TENNESSEE	WEA ALL COUNTIES	13	FEEDER CATTLE	810 STEERS WEIGHT 2	810 NO PRACTICE SPECIFIED	2008	113.810	\$107.870	0.849000	0.014411	1.556	01/14/2008	98.091
4-TENNESSEE	WEA ALL COUNTIES	13	FEEDER CATTLE	810 STEERS WEIGHT 2	810 NO PRACTICE SPECIFIED	2008	113.810	\$101.870	0.809000	0.008008	0.884	01/14/2008	98.091
4-TENNESSEE	WEA ALL COUNTIES	13	FEEDER CATTLE	810 STEERS WEIGHT 2	810 NO PRACTICE SPECIFIED	2008	113.810	\$89.870	0.878300	0.005002	0.560	01/14/2008	98.091
4-TENNESSEE	WEA ALL COUNTIES	13	FEEDER CATTLE	810 STEERS WEIGHT 2	810 NO PRACTICE SPECIFIED	2008	113.810	\$87.870	0.868800	0.004075	0.458	01/14/2008	98.091
4-TENNESSEE	WEA ALL COUNTIES	17	FEEDER CATTLE	810 STEERS WEIGHT 2	810 NO PRACTICE SPECIFIED	2008	113.851	\$102.300	0.800100	0.010702	1.183	02/11/2008	
4-TENNESSEE	WEA ALL COUNTIES	21	FEEDER CATTLE	810 STEERS WEIGHT 2	810 NO PRACTICE SPECIFIED	2008	113.371	\$102.020	0.809800	0.010428	1.370	03/10/2008	

Insured Value and Premium Computation

- The Insured Value = Number of Head multiplied by the Target Weight (live weight, in cwt.) multiplied by the Coverage Price multiplied by Ownership Share. The Insured Value is rounded to the nearest whole dollar.

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)
70	X	7	X	107.97	X	100	=	52,905

Insured Value and Premium Computation

- The Total Premium = Insured Value multiplied by the Rate. Total Premium is rounded to the nearest whole dollar.

Insured Value (Dollar)	X	Rate (.xxxxxx)	=	Rounded Total Premium (Dollar)
52,905	X	.014411	=	762

Insured Value and Premium Computation

- The Subsidy = Total Premium multiplied by the Subsidy Rate. The subsidy percent is 13 percent. Subsidy is rounded to the nearest whole dollar.

Rounded Total Premium (Dollar)	X	Subsidy (Percent)	=	Rounded Subsidy (Dollar)
762	X	.130	=	99

Insured Value and Premium

Computation

On October 15, 2007
 The Producer Premium = Total Premium minus the Subsidy. Producer Premium will always be a whole number.

Rounded Total Premium (Dollar)	-	Rounded Subsidy (Dollar)	=	Producer Premium (Dollar)
762	-	99	=	663

Insured Value and Premium

Computation

On October 15, 2007
 Projected Minimum Sale Price

Coverage Price (Dollar)	-	Basis (Dollar)	-	LRP Cost (Dollar)	=	Projected Minimum Sale Price (Dollar)
107.97	-	3.00	-	1.35	=	103.62

LRP Indemnity: Falling Market

- 1/14 If Feeder Cattle Price Index is below \$107.97, Indemnity Will Be Paid

- 1/14 Feeder Cattle Price Index is 98.01

Coverage Price \$107.97
 - Actual Ending Value 98.01
 Indemnity Per Cwt. \$ 9.96

 490 cwt. x \$9.96 = \$4,880.40

LRP Indemnity: Falling Market

- 1/14 Actual Sale Price \$95.01

Total Sale Value (490 cwt. X \$95.01) \$46,555
 + Indemnity 4,880
 Total Sale Value + Indemnity \$51,435
 - LRP Premium Cost 663
 Actual Sale Value \$50,772

 Actual Sale Price / cwt. \$103.62

Verification of Ownership

- Upon Company Request Or Request Of Any USDA Employee, Insured Must Provide Documents Verifying Ownership Of Insured's Share Of Livestock Identified In SCE



Verification of Ownership

- Documents Proving Ownership
 - Bills Of Sale From Previous Owners Or Others
 - Financing Documents Covering Insured Livestock
 - Written 3rd Party Statements
 - Feed Suppliers Or Veterinarians
 - Must Have Visited The Farm Or Ranch, Visually Identified The Livestock & Can Attest To Insured's Ownership

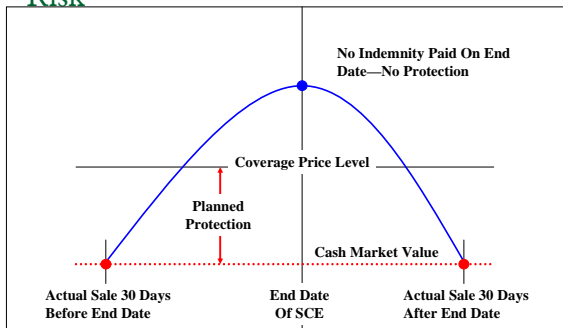
Maintenance Of Ownership

- Ownership Must Be Maintained Until 30 Days Before End Date
- If Any Portion Of Insured Livestock Is Disposed Of Prior To Last 30 Days Of Coverage, Then
 - That Portion Of The Coverage Will Terminate
 - No Indemnity Will Be Paid For That Portion
 - No Premium For That Portion Will Be Refunded

30-Day Marketing Window

- Production Factors May Necessitate Selling Before Or After SCE End Date
- LRP Insurance Only Has Value On End Date
- Livestock Sold Before Or After End Date Still Only Indemnified On End Date
- Selling Before Or After End Date May Have Risk Or Reward Depending On AEV

End Date vs. Actual Sales Date – The Risk



End Date vs. Actual Sales Date – The Risk (cont.)

- If Sold Early, May Receive Cash Price Below Coverage Level
 - If Prices Rise, No Indemnity Paid On End Date
- If Sold Late & No Indemnity Paid On End Date
 - Prices May Drop & Receive Cash Price Below Coverage Level
- On Average, Little Change In Price Relative To 30 Days Ago
 - Risk Of Large Decreases & Increases

Change In AEV Relative To 30 Days Ago (2001-2004)

	Average (\$/cwt)	Largest Decrease (\$/cwt)	Largest Increase (\$/cwt)
Swine AEV (CME Index)	-0.19	19.10	12.64
Fed Cattle AEV (5-Area Price)	0.22	25.56	18.57
Feeder Cattle AEV (CME Index)	-0.05	15.26	6.72

No Lifting LRP Coverage

- LRP Is Insurance Policy, Not Derivative
- LRP Cannot Be Sold Back To Recover Premium
- Coverage Cannot Be Lifted Once In Place
- Entities With Collateral Interest May View Favorably
- Lenders May View LRP Favorably



Indemnity Payment

- If Indemnity Is Due To You
 - Insurance Company Will Issue Letter Of Probable Loss
 - You Must File Claim Form Within 60 Days
 - Indemnity Will Be Paid Within 60 Days Of Submission Of Claim Form
- Indemnity Payment Taxable On Cash Basis
 - Income Applies To Tax Year It Is Received
- LRP Premiums Are Tax Deductible

Producers LRP Advantages

- LRP Premiums Are “Fair” But They Are Priced Similar To “Market Value” And Little (No) “Effective” Producer Subsidy
- Flexible Contract Size
- Flexibility To Incremental Minimum Price A Few Head At A Time

Producer’s LRP Advantages

- Premiums Are Tax Deductible, Not True When Producers Mix Speculative With Hedging In Their Futures Account
- Commission On LRP Are Paid By RMA
- May Receive Better Loan Terms On LRP Insured Cattle

Producer’s LRP Advantages

- Producers May Purchase LRP On Calves: Later Retain Ownership Through Back Grounding & Insure; Later Retain Ownership Through Fattening & Insure
- Under The Above Scenario Producers Would Have 3 LRP Contracts On The Same Calves, Or They Could Purchase Fewer LRP Contracts But With Later Expiration Dates
- Orders Are Filed At The Stated Premium

Lender’s LRP Advantages

- Lenders May Prefer LRP Over A Put To Cover Loan Collateral
- Producers Can Not Cancel The Coverage
- Legally LRP Is Insurance, So Lenders Can Take A Security Interest In The Contract
- Purchased From A Crop Insurance Agent

Insurance Company Issues

- There Is Only One Private Reinsurance Company For LRP
- The Losses Will Be Highly Correlated And In A Falling Market There Will Be Large Indemnity Payments
- The Annual LRP Experience Will Generate Either Very Large Underwriting Gains Or Very Large Underwriting Losses

Suspension Of Sales

- Sales Will Be Suspended When:
 - At Least 4 Of The Underlying CME Live Cattle Futures Contracts Settles At The Daily Price Limit For Two Consecutive Days
- Sales Will Be Resumed When:
 - There Have Been Two Consecutive Days Without There Being 4 Or More Of The Underlying CME Live Cattle Futures Contracts Settling At The Daily Price Limit

Suspension Of Sales

- Sales Can Be Suspended If An Event Occurs During Or After Trading Hours Deemed To Significantly Change Market Conditions On Which LRP For That Day Was Rated
 - News Report
 - USDA Announcement
 - Other Events

LRP Compared To Hedging Or Options

- | | |
|--|--|
| ■ Advantages | ■ Disadvantages |
| □ No Need To Establish Brokerage Accounts | □ Paperwork Can Take A While |
| □ Can Insure Animals On Individual Basis | □ Can't "Lock-In" Price |
| □ "Guaranteed" Availability For Price Protection For Far-Off Futures Contracts & Months When Futures Are Not Available | □ Can't Exercise or "Sell Back" Contract If Market Goes UP |
| □ May Be Less Expensive For Deferred Months | □ May Be More Expensive For Nearer Months |

Summary

- Outcome Of LRP Can Be Affected By Price Level & Actual Basis
- Maximum Underwriting Capacity For LRP Insurance
- Sales Can Be Suspended If Markets Trade To Limit On Consecutive Days
- USDA Can Suspend Sales If Significant Event Occurs That Might Affect Markets

Summary

- LRP Is A Relatively New Price Risk Management Tool Available To Cattle Producers
- It Is Price Insurance Not Enhancement
- To Be Eligible Cattle Must Be Located In One Of The Program States
- More Information Is Available At <http://www.rma.usda.gov/livestock/>

Summary

- LRP Does Not Guarantee A Cash Price
- LRP Protects Against A Negative Change In CME Cash Index Price
- LRP Does NOT Guarantee The Basis
- Policy Does Not Cover Any Other Peril

Summary

- Livestock Ownership Must Be Maintained Up To 30 Days Before End Date
- Once Set, LRP Prices & Premiums Are Guaranteed For That Day
- LRP Can Reduce Basis Risk

Sometimes Things Do Not Go Exactly As Planned



LRP Indemnity: Falling Market

- 1/14 Actual Sale Price \$95.01

Total Sale Value (490 cwt. X \$95.01)	\$46,555
+ Indemnity	<u>4,880</u>
Total Sale Value + Indemnity	\$51,435
- LRP Premium Cost	<u>663</u>
Actual Sale Value	\$50,772
Actual Sale Price / cwt.	\$103.62

LRP Indemnity: Falling Market

- 1/14 If Feeder Cattle Price Index is below \$107.97, Indemnity Will Be Paid
- 1/14 Feeder Cattle Price Index is 98.01

Coverage Price	\$107.97
- Actual Ending Value	<u>98.01</u>
Indemnity Per Cwt.	\$ 9.96
490 cwt. x \$9.96 = \$4,880.40	

LRP Indemnity: Rising Market

- 1/14 If Feeder Cattle Price Index is 113, No Indemnity Will Be Paid

Cattle Sell for (490 cwt. X \$110)	\$53,900
- LRP Premium Cost	<u>663</u>
Actual Sale Value	\$53,237
Actual Sale Price / cwt.	\$108.65

Feeder Cattle Put Options - Oct. 15, '07

STRIKE	OPEN	RANGE	HIGH	LOW	CLOSING RANGE	SETT. PRICE & PT. CHGE.
FOR: CATTLE PUT (FUTURES SETT. 113.850 - 5.0)						
JAN08		FDR: CATTLE PUT				
900	----		----		-.25N	-.22 - 2
920	----			*.27A	.27A	-.27 - 2
940	----				-.35N	-.35 UNCH
960	----				-.45N	-.45 - 2
980	0.50		.50	.50	.50	.52 UNCH
1000	0.65		.65	.65	.65	.62 - 2
1020	----			.75A	.75A	-.75 - 2
1040	----			.90A	.90A	-.90 - 2
1060	----			1.10A	1.10A	1.22 - 2
1080	1.45		1.50	1.40	1.40	1.55 - 2
1100	1.90		1.95	1.80	1.90	1.92 - 2
1120	2.60		2.60	2.50	2.50	2.45 - 5
1140	----		3.30B	----	3.12N	3.15 - 2
1160	4.30		4.30	4.30	4.30	4.15 UNCH

Comparison with Put Option

- 10/15 Jan. \$108 Put \$1.52

Strike Price	\$108.00
- Basis	3.00
- Premium	1.52
- Commission & Interest	0.40
	\$103.08

Comparison with Put Option: Falling Market

- 1/14 Jan. Futures = \$98.42
- Jan. \$108 Put Premium = \$9.57
- Sell cattle for \$95.42

Net Price	\$95.42
+ Put Profit	9.57
- Put Cost	1.52
- Commission & Interest	0.40
	\$103.07

Comparison with Put Option: Rising Market

- 1/14 Jan. Futures = \$113
- Jan. \$108 Put Premium = \$0.00
- Sell cattle for \$110

Net Price	\$110.00
- Put Cost	1.52
- Commission & Interest	0.40
	\$108.08

Comparison of LRP and Put Option

- Falling Market
 - Price using LRP \$103.62
 - Price using Put Option \$103.07
- Rising Market
 - Price using LRP \$108.65
 - Price using Put Option \$108.08