September 25, 2003

NEW TOOL FOR SWINE AND CATTLE PRODUCERS

Many people have used Multi-Peril Crop Insurance (MPI) and Crop Revenue Coverage (CRC) in crops. Nebraska was in a pilot program this year where a few cattle producers participated in LRP (Livestock Revenue Protection). LRP is a revenue insurance program that is reinsured and subsidized by the Federal Crop Insurance Corporation.

In participating states, the Livestock Risk Protection program allows producers of fed cattle, feeder cattle and swine to purchase price insurance. Originally offered only in Iowa, the LRP-swine program recently was expanded to include Nebraska, Kansas and eight other states. In June 2003, LRP was expanded to include feeder and fed cattle in selected states including Nebraska.

The LRP contracts, in some respects, are similar to put options. You put a floor in on your price. Producers establish the coverage level, price, premium and length of coverage. Feeder cattle producers select insurance periods from 21 to 52 weeks, depending on the market expectations. Coverage levels are 70 percent and 95 percent of an expected end value. The Chicago Mercantile feeder cattle price index is used to measure cash feeder price to determine whether an indemnity will be paid when feeder cattle are sold.

There are a couple of advantages of LRP insurance compared to put options. An option contract is based on 50,000 pounds or 67 head of 750 pound feeder steers. LRP can fit producers with smaller herds. Another advantage is thirteen percent of the premium is paid by the government, the remainder is paid by the producer. Another subsidy covers the administration of the insurance contracts and agent commission.

Talking to Sharon Kastanek, a certified LRP insurance agent in Wilber, agents need to be certified to sell LRP. The contracts were not that hard to write. Because the Risk Management Agency limited risk or exposure to 2 million dollars in the pilot region, only one contract was written locally through the Saline State Insurance Agency. The contract was written on calves in July and the producer wanted to limit price risk in case the border opened up in Canada. Because of several large swine contracts written in Iowa, no further contracts are being written on cattle in Nebraska at this time, however, a call on Thursday, September 25th, indicated that $96,000 of coverage had become available which will most likely be used up very quick. Sharon expects a larger amount of coverage to be available in January of 2004 for cattle and swine coverage in Nebraska.

Producers will need to check if LRP is cheaper than a put option on a given day. In an example in our NebFact sheet about LRP, the cost for the insurance on a feeder steer example was around $1.15 per cwt this past July. The LRP insurance program reduces the downside price risk for cattle producers, but it does not eliminate all risks. The LRP insurance program does not cover sickness or death of the cattle or the possibility of rising feed costs. Further, producers are also subject to basis risk (the risk that basis declines relative to their forecast used to create their expected minimum sale price).

The value of the LRP insurance contracts to cattle producers will depend on the premiums for the contracts relative to other risk management tools, including put options. The LRP program provides another choice for price risk management, and may be especially useful for producers with small operations. For further information, keep a heads up after the first of the year and contact your local crop and livestock insurance agent. Read NF03-583, "Livestock Risk Protection Insurance for Cattle: A New Price-Risk Management Tool," available by calling our office at 821-2151. You can also go to the world wide web directly at http://www.ianr.unl.edu/pubs/farmmgt/nf583.htm or visit our home page at: www.saline.unl.edu and click on "Farm and Ranch" and look under "Livestock."

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