PERSPECTIVES

Market Advisor

▶ by **Tim Petry,** *North Dakota State University Extension Service*

Price risk management for cow-calf producers

In a previous "Market Advisor" column I ended with the following paragraph.

"During the increasing phase of the cattle price cycle (2010-2014), prepricing tools in risk-management strategies for cattle to be sold in the future are usually less effective. That has been the case the last several years, especially for producers selling calves and yearlings. Yet during the decreasing phase of the price cycle (now), those strategies tend to work better. Of course, seasonal price patterns are very important in developing marketing plans. The worldwide market environment that the entire livestock industry now operates in will likely continue to cause more price volatility than in past cycles."

LRP and RMA

It is common for cow-calf producers in North Dakota to sell most of an entire yearly calf crop on one market day in the fall. So, an entire year's income is dependent on the market that day. Reality really set in for the 2015 calf crop with prices as much as $100 per hundredweight (cwt.) lower than 2014. Hindsight shows that a marketing plan with a prepricing strategy would have been quite successful.

There are fewer prepricing tools available for cow-calf producers since there is not a futures-market contract or futures-market options for calves. Smaller producers are also limited in tools available because they may not have truckload-size lots of the same weight and grade of calves to sell.

A relatively new price risk-management tool available to cattle producers is Livestock Risk Protection (LRP), offered by the USDA Risk Management Agency (RMA). LRP was designed to insure against declining market prices. It functions similarly to futures market put options, except that the insurance contract is purchased from an approved crop insurance agent instead of a futures market broker. It is available to cattle producers in 38 states. A list of those states and approved crop insurance agents is available at *www.rma.usda.gov/livestock.*

LRP contracts may be especially useful for producers with smaller numbers of cattle to be insured against price declines, because no minimum number is required. The maximum number that can be insured in a crop year (July 1-June 30) is 2,000 feeder cattle. LRP is also available for fed cattle with a 4,000-head-per-year maximum. Feeder-cattle coverage is available for beef steer calves less than 600 pounds (lb.) and from 600 lb. to 900 lb.

Additional contracts for beef heifers less than 600 lb. and 600 to 900 lb. are also available; along with less than 600 lb. and 600 to 900 lb. predominantly dairy cattle or predominantly Brahman cattle. Contracts for each market class may be available for maturity dates 13, 17, 21, 26, 30, 34, 39, 43, 47 or 52 weeks in the future. Note that on a given day, not all contract lengths may be available.

LRP insurance is market-based, so coverage prices and premiums change daily. Producers select coverage levels that range between 70% and 100% of an expected price, similar to futures-market options strike prices. Coverage prices and premiums are posted daily on the RMA website at *www3.rma.usda.gov/apps/livestock_reports.*

RMA subsidizes the premiums by 13%, so the actual cost is lower than shown in the table online. Beginning producers receive an additional 10% premium subsidy. Policies can only be purchased after coverage prices are posted, which is after 3 p.m. CT and are available until 9 a.m. CT the next day. Premiums are paid to the agent before the contract is submitted. At the end of the insurance period, if the actual ending value is below the coverage price, an indemnity will be paid for the difference between the coverage price and actual ending value.

For calves sold in the fall during the 2006-2009 decreasing phase of the cattle price cycle, indemnity payments were paid on LRP contracts. During the increasing phase of the price cycle from 2010-2014, producers received higher prices in the cash market and no indemnity payments were paid. 2015 was the first year of this decreasing phase with significant indemnity payments paid for calves marketed in the fall marketing season.

Producers must submit a one-time application for LRP coverage with the crop insurance agent before purchasing actual contracts.

Not enough space exists in this column to explain all the details of LRP. More information is available at the RMA website. LRP presentations are available on my website at *www.ag.ndsu.edu/livestockeconomics/presentations.*

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