Price Risk Management for Cow-Calf Producers: Part 7

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Cow-calf producers use various strategies to manage price risk, including futures and options. Livestock Risk Protection (LRP) is a type of livestock price insurance that typically costs less than a put option. LRP makes payouts (indemnities) that replace the income that is lost due to a price decline. For cow-calf producers interested in the price risk management and income benefits of LRP, this article discusses a few key policy details.

Some preparation is necessary before purchasing an LRP policy. A producer first must sign up for LRP with an insurance agent, before committing to purchasing an LRP "endorsement" (the formal term for an LRP policy). LRP costs (premiums) and coverage prices can change on a daily basis, based on futures markets. LRP endorsements are only available for purchase from around 3:30 p.m. (when RMA posts updated coverage information online) to 9:00 a.m. central time. LRP endorsements may not be available for purchase on federal holidays or days when futures markets are closed. Having a trusted and knowledgeable insurance agent is especially important given the limited periods available for LRP purchase. Making a LRP purchase decision requires that a producer must be able to assess the daily costs and coverage prices and actually purchase an endorsement within a short period. An insurance agent can work with producers to determine acceptable levels of LRP costs and coverage prices in advance. The insurance agent must also be committed to help a producer purchase an LRP endorsement outside of typical business hours and on short notice.

The length of time between when an LRP endorsement begins (the purchase date) and ends (or the intended sale date) is called the "endorsement length". The minimum endorsement length is 13 weeks or approximately 3 months. The maximum endorsement length currently available for feeder cattle is 34 weeks, or about 8 months. Current LRP endorsements available for purchase for feeder cattle vary from ending in June (13 weeks) to ending in November (34 weeks). Because expected or futures prices are less likely to change over a short period, short endorsements have both lower premiums and expected payouts. Likewise, long endorsements have higher premiums and expected payouts. For example, the October futures price in July is likely to be closer to the actual October price than the October futures price in March. In other words, an unexpected decline in October prices is more likely to occur in March than July.

Flexibility is important for many cow-calf producers: for example, selling earlier than planned or feeding calves longer than planned, based on local corn and forage prices and availability. LRP allows producers to maintain some of this type of flexibility. Producers cannot sell their livestock earlier than 60 days before the end of their LRP endorsement and still be eligible for an indemnity. However, producers are not required to sell their livestock at the end of the endorsement period. Before purchasing an LRP endorsement, a producer should understand and be comfortable with this restriction.

Like any insurance policy, LRP has many policy details or characteristics that a producer needs to consider and discuss with their insurance agent.

For more information, please contact the local K-State Research and Extension Office

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