Price Risk Management and LRP Insurance

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If 2020 has taught a person anything, it is to expect the unexpected, or maybe it has taught a cattle producer to prepare for the worst and hope for the best. The 2020 marketing year has been tough for all classes of calves, feeder cattle, and finished cattle. Most of this situation has been due to and fueled by the coronavirus pandemic that gutted many markets early in 2020. Despite the cause of cattle prices declining for most classes of cattle, the situation again points to the need to evaluate price risk management strategies and to implement those strategies when profit goals can be achieved.

Many cattle producers with large operations can utilize futures and options markets. These markets tend to be the most flexible method of pricing cattle and tend to be inexpensive. However, they have their own set of risk and challenges. The only alternative for small producers is Livestock Risk Protection insurance (LRP). This product was once cost prohibitive and inflexible, but several changes have occurred.

There are several key changes to LRP that have made it a more attractive and palatable product for small and large cattle operations. The first change is increased premium subsidy rates. The new rates are 35 percent subsidy when covering 95 to 100 percent of the expected value of the animal: 40 percent subsidy for 90 to 94.99 percent coverage level; 45 percent subsidy for 85 to 89.99 percent coverage level; 50 percent subsidy for 80 to 84.99 percent coverage level; and 55 percent subsidy for 70 to 70.99 percent coverage level. These rates have been increased a second time from the original 13 percent subsidy when the program started.

The premium subsidy is probably the change to the program that will turn the most heads, but it may not be the most important. Head limits have increased to 12,000 head of feeder cattle in a year. This could be important for the largest producers, but it will be unimportant to most cattle producers. Another key change was modifying the ownership requirement from 30 days to 60 days. In other words, a producer can sell his/her cattle as many as 60 days prior to the day the insurance comes due and the insurance is still valid. If cattle are sold more than 60 days prior to the insurance maturing then the insurance policy is void. The last change of importance, which was actually a change instituted in the previous set of changes, is that premiums are not due until the end of the insurance period. Thus, there is no reason to pay on the front end.

As was previously stated, the increased premium subsidy rate is probably the most glamorous change since it directly influences the cost of the product. However, the subsidy rate is not what is important. What is important is how much it costs to protect a specific value of an animal, and what a person feels they can afford to pay to protect that value. This same thought process has always applied to the options market, because the options market and LRP are set up similarly. However, the higher subsidy rates for LRP now makes LRP a lower cost method of setting a price floor on feeder cattle than is offered by the options market in most instances.

It is evident this article does not provide strategies of how to utilize LRP or what coverage levels to select. However, its purpose was to make producers aware of the changes to LRP and stress the importance of managing price risk in the cattle business. The changes to LRP have made it a more lucrative product today than it was just a few months ago. The Tyson fire in August of 2019 and the coronavirus pandemic have provided sufficient evidence of the importance of price risk management in the cattle business.

This information is sure to fall on a few deaf ears, but it will also reach a few producers who see the value in managing price risk. Price risk management does not have to be utilized every year or on every set of cattle, but it should be evaluated every year and on every set of cattle. It may take evaluating the opportunities several times. If a producer is interested in learning more then it may be good to talk to a local crop insurance provider to see how they can assist with LRP.