

Livestock Gross Margin Insurance for Dairy

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Editor's Note: Following is a brief introduction to the Livestock Gross Margin Dairy Insurance policy, a new risk management tool for dairy producers. We plan to include similar information and articles in upcoming issues of the Michigan Milk Messenger.

Uncertain and volatile milk prices and feed costs, create a greater need for effective risk management strategies to prevent potential losses due to prices and cost risks. Livestock Gross Margin (LGM) Dairy Insurance policy is a new risk management tool for dairy producers designed to protect them from a decrease in gross margin by using a bundle option approach to insure a margin on milk produced from dairy cattle. LGM-Dairy essentially provides a ceiling on feed costs and a floor on milk revenue. It's offered through the USDA's Risk Management Agency and became available in August 2008 to allow Michigan dairy producers an affordable way to manage their risk. It is available in other select states as well.

How It Works

The insurance uses milk, corn and soybean meal futures prices to determine an amount of gross margin that the producer insures. Farmers insure a forward looking gross margin for which they expect the market to be in a specified time period. To calculate what the producer insures, they must submit a target marketing report and a target feed report. The target marketing report is the amount of milk, measured in hundredweight, that the producer will insure throughout the chosen time period. The target feed report is the amount of feed equivalents it

takes to produce the milk insured. Feed equivalents are calculated using the producers feed rations and converting them to corn (energy) and soybean meal (protein) equivalents. The producer has an option of using predetermined feed equivalents. Feed equivalents are bounded so feed costs are not under or over insured. Once the contract is in place, the expected gross margin is measured against what actually occurred during the months of contract expiration. The actual gross margin is calculated using futures prices for the same specified target milk hundredweight and feed reported. Once the last month of the contract has expired and, if the actual gross margin is less than the expected gross margin, the producer is paid an indemnity.

LGM-Dairy Insurance Characteristics

A dairy producer can purchase LGM-Dairy in 12 insurance periods a year with a sales closing date of the last business Friday every month and he can insure up to 11 months per insurance period with the first month being uninsurable. He also may insure up to 100 percent of his production throughout the insurance year but cannot exceed farm capacity or 24,000,000 pounds of milk. Plus he has the option of taking a deductible of \$0-1.50 from the hundredweight price which gives a gross margin guarantee for

the insurance period. This allows for a decrease in premium paid and gross margin insured. Similar to buying options, premium is due at the time of purchase. Producers may purchase this policy through a licensed crop insurance agent that has had the LGM-Dairy Insurance training. GreenStone Farm Credit Services has several agents trained to facilitate LGM Dairy Insurance for interested dairy farmers.

How Will LGM Dairy Benefit Dairy Producers In Michigan?

LGM Dairy benefits Michigan dairy producers because it allows them to decrease the downside margin risk exposure and capitalize in upside market prices. Dairy producers can buy this insurance policy every month by choosing a marketing plan that best fits their needs and manages their risk while allowing peace of mind.

For more information on LGM Dairy, contact your local GreenStone Farm Credit Services branch office. Additional information including helpful resources, background material, tools and calculators can be found at http://future.aae.wisc.edu/lgm_dairy.html.