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What is Livestock Gross Margin Insurance for Dairy (LGM Dairy)? In basic terms, it is a livestock insurance program designed to allow dairy producers to insure the difference between the value of milk produced and the related feed costs for their dairy cows, or gross margin. It goes without saying that currently this “gross margin” is negative in most if not all cases, but in good times and bad, the LGM Dairy policy allows producers to profit from positive market developments (rising milk prices and decreasing feed costs), while insuring against the recently common market problems of falling milk prices and increasing feed costs. The details of the plan require some intense review (read on for more), and a good working relationship with an insurance agent. To illustrate this point, consider that LGM Dairy policy sales are open only one day a month, the last Friday that is a business day of each month. Preparations and decisions can be made in the weeks leading up to this date so that the decision can be made quickly when the sales period opens. To find your nearest agent, visit the following site:

www3.rma.usda.gov/apps/agents

First we'll look back at the creation of the LGM Dairy policy. In 2007, the Federal Crop Insurance Corporation approved Livestock Gross Margin Insurance for Dairy (LGM Dairy). Available since August 2008, the program is an additional livestock insurance tool following the previously designed Livestock Gross Margin programs for beef cattle and swine. To calculate insurance premiums and margin levels, LGM Dairy utilizes commodity futures prices and historical basis values for feed and milk. An insurance indemnity payment would be due to the producer if the actual gross margin at the end of the insurance period is less than the expected gross margin guaranteed in the insurance contract. The details get complicated when calculating the actual gross margin and expected gross margins, the key figures in the insurance policy. At the risk of sounding like a broken record, the complexity of these calculations make it crucial to work with an insurance agent well before deciding to implement coverage.

The LGM Dairy program covers milk produced by dairy cows located in 31 states, including the following Western states: Montana, Wyoming, Colorado, Utah, Arizona, and Nevada. (For a full list of states, visit the livestock insurance information website at the following address: www.rma.usda.gov/livestock). LGM Dairy policies are based on twelve insurance periods during a given year, though only the last 11 months in an insurance period are covered because gross margins cannot be insured in the first month of an insurance period. For instance, if a producer wished to insure October 2009 production, the policy must be established no later than August 2009. Once entering coverage in this example, gross margins could be insured for each period leading up to July 2010.

An important point to remember is that actual milk prices received do not enter into the gross margin calculations. The actual milk price used in the calculations according to policy guidelines, “is the simple average of the daily settlement prices of the CME Group Class III milk futures contract for the month during the actual price measurement period”. Further, the price measurement period is defined as “the three trading days prior to the second to last trading day of the month”. Expected milk price is based on the average of the milk futures contract price for the covered month.

New on July 1st will be the flexibility to use one's own feed prices to calculate expected feed costs for the LGM Dairy policy. Until this option was added, expected feed costs for LGM Dairy coverage were calculated using corn and soybean futures and basis. In this step, a producer's feed consumption is converted into units of corn and soybean equivalents for the LGM Dairy policy calculations.

As you've seen by now, LGM Dairy has a lot of moving parts. With the proper analysis tools though, these options and calculations can be made quickly and easily, easing the decision of when or whether to implement LGM Dairy coverage. For those of you with commodity market experience, LGM Dairy

amounts to a package of milk put options combined with grain and protein (corn and soybean) call options. In this sense, a key benefit to LGM Dairy coverage over traditional commodity market coverage is the flexibility of quantity, allowing for small and large dairies alike to insure their gross margin.

To be sure, there are many more details to learn about LGM Dairy insurance coverage, but I hope this piece has helped in relaying a basic understanding of the principles within the policy. As with any insurance program, premiums will vary depending on deductible levels chosen and every producer must make their own decisions as to whether the coverage and premiums are worth the money. Your local insurance agent and the information on the Risk Management Agency website will help in understanding the program in further detail. www.rma.usda.gov/livestock

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