USDA Announces Major Changes to Feedlot Insurance Program

Changes to USDA's Livestock Gross Margin transform the product

Introduction: USDA's LGM-Cattle (LGM) is an insurance product that protects against the loss of the gross margin. Put another way, LGM is an insurance product that works similar to the cattle crush, attempting to insure the spread between the two major input costs (feeder cattle and corn), and the market price of cattle. LGM protects against the decline of slaughter cattle prices (output), or the increase in feeder cattle or corn prices (inputs).

Background: Recent changes to LGM have reduced the cost significantly. Historically, USDA didn't offer any premium subsidy; however, now it offers up to a 50% premium subsidy.

Those who own cattle that are being finished for slaughter are eligible for LGM. Expected gross margins are set for each month. Expected margins are determined based upon futures prices. Actual gross margins are calculated after the insurance period ends using settlement prices. Actual producer costs are not utilized.

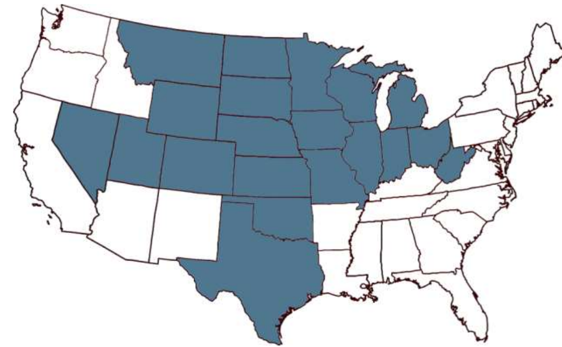
Producers can choose to insure up to 11 months ahead. When producers choose to insure cattle in multiple months, the projected and actual margins will be aggregated together to determine potential indemnities. Producers insure their cattle for the month(s) they intend to have cattle ready for slaughter.

On the days that USDA offers LGM for sale, USDA will post the expected gross margin for each month. Then, after the month is complete, the actual gross margin will be posted. Payments are made when the insured gross margin, which is the expected gross margin minus any deductible, falls below the actual margin.

For example, if the expected gross margin is $300 per head and a producer chooses a $50 deductible and the actual gross margin ends up being $200 per head, the payment to the producer would be $50 per head.

The following information provides an overview of key LGM-Cattle features.

Eligible States: Producers and insured cattle being finished must be located in the following states: CO, IL, IN, IA, KS, MI, MN, MO, MT, NE, NV, ND, OH, OK, SD, TX, UT, WV, WI, and WY.



Premium Subsidy: USDA insurance products make risk management more affordable through discounted premiums. The level of LGM's subsidy is based upon two factors: first, whether livestock are insured in at least two different months, i.e. pooled; and second, the level of deductible chosen impacts the level of subsidy.

Deductible	Pooled Coverage Subsidy	Unpooled Coverage Subsidy (1 head in another month)
$0	18%	0%
$10	20%	0%
$20	23%	0%
$30	27%	0%
$40	31%	0%
$50	36%	0%
$60	43%	0%
70-$150	50%	0%

Types of Operations: There are two types of operations for LGM for Cattle. The type of operation chosen impacts the formula used to establish the gross and actual margins.

- **Yearling Operation**: An operation that purchases yearlings and feeds them until slaughter. The yearling formula assumes a producer is buying 750-pound feeder cattle and feeding them 50 bushels of corn for 5 months, and then slaughtering them at 1,250 pounds.

- **Calf Finishing Operation:** An operation that purchases 550-pound calves and feeds them until slaughter. Calf finishing assumes a producer purchases feeder cattle at 550 pounds, feeds them 52 bushels of corn for 8 months, and then slaughters them at 1,150 pounds.

When purchasing insurance, USDA allows a producer to determine which category they want to utilize to insure their livestock.

Insurance Periods:

- 12 annual insurance periods that run 11 months each
- No cattle can be insured the first month following coverage being put into place.
- Coverage begins one full calendar month and one day following the insurance sales closing date.

Example: If a producer signs up in January, the earliest month that would be covered for the sale of livestock would be March. The latest month they could cover livestock would be December.

Sales Period: Currently, LGM sales only take place between the time that markets close on the last Friday of the month and Saturday evening at 8 pm Central. Exceptions exist due to holidays. LGM has been approved to be sold weekly in the near future.

Pooled Coverage: When production is pooled, i.e. when a producer has insured cattle in multiple months, then the expected and actual margins are aggregated together to determine if an indemnity is due.

Actual Marketing Requirements:
Producers must market a minimum of 75% of target marketings (number of head insured) during the 11-month insurance period. This rule discourages over insuring, yet also provides some flexibility for producers.

Deductibles: At sign up, USDA will post the expected margin for each of the 11 months available to insure. Producers may select deductibles from $0 to $150 per head of cattle, in $10 per head increments. For example, if the expected gross margin is $200 and a producer chooses a $50 deductible, indemnities will be triggered once the margin falls below $150.

Premium: One advantage of LGM is that the premium isn't due until the end of the insurance period.

Key Issues: After conducting rigorous analysis, I am confident that LGM is a good product that should be strongly considered. However, it's worth noting that there are four issues that should be addressed:

- **Outdated Weights**: LGM was created when cattle slaughter weights were less than they are now, so formulas being used are somewhat outdated. To better align with today's actual weights, LGM's cattle weights should be updated.

- **One Policy Per Month**: Currently, a producer can only lock in one policy per month so if one wants to protect the margins from multiple months, one needs to aggregate coverage.

- **Monthly Sales Period**: Currently, sales are only one day a month which makes purchases challenging, especially with the one policy per month currently allowed.

- **Livestock Risk Protection (LRP):** As of right now, one can only utilize either LRP or LGM, but not both. LRP is a recently improved price risk product.

Conclusion: LGM is different than anything producers have utilized. It has similarities to the cattle crush, but significant differences exist. It's important to take the time to both understand LGM and find an agent that understands LGM. LGM is a complex product and understanding its historical performance up front is necessary to ensure its proper utilization.

About the Author: From 2013-2017 Brandon Willis oversaw USDA's insurance programs as the Administrator of the Risk Management Agency. Prior to that, he served as a Senior Advisor to the U.S. Secretary of Agriculture Tom Vilsack. He owns Ranchers Insurance LLC, an insurance agency that specializes in LGM. He can be reached at brandon@ranchersinsurance.com.