Livestock Gross Margin Insurance for Dairy. By Dennis Kauppila, UVM Extension, August, 2008

Crop insurance has become a well-used tool for farmers. Especially the basic CAT, catastrophic coverage. Insurance exists as a protection from disasters- nobody is hoping to make a claim on their auto, fire or life insurance policy. Farmers with crop insurance make a claim and can receive a settlement for prevented planting, hail, drought, floods and other disasters. Crop insurance covers the costs of growing a crop, not many farmers can afford to buy enough insurance to cover the potential value of a crop had it been sold.

Now we have a pilot program, Livestock Gross Margin Insurance for Dairy Producers. Dairy farmers can buy insurance to lock in a margin between milk price and feed costs for up to 11 months in the future. This margin is what would pay other farm expenses, like labor, repairs, the mortgage, and family living needs. The insurance covers the margin, if milk futures prices fall and grain futures prices climb. It combines dairy options with grain options. And, like most all insurance policies, there is a deductible.

Futures markets estimate the prices of commodities in the future. Premiums for Gross Margin Insurance are based on the difference between futures prices for Class III milk and those for corn and soybean meal. The contract prices on the futures market are the current, best estimate of commodity prices for some future date. The difference, or margin, is what you insure.

August 2008 was the first time that this policy became available. It is available each month for up to 11 months in the future, with a one month lag in coverage. You can buy coverage for only 1 month or as many as 10 months at a time. It is available from most crop insurance agents. It is available on the third to last business day of the month, using an average of prices reported on the previous 3 days. You can insure as little milk as you wish, and as much as 24 million pounds per year. You multiply hundredweight of milk for each month times the Class III futures price (adjusted by your state's basis) to estimate income.

Estimating feed costs is more complicated. You must convert forages and grain into corn and soybean meal equivalents, using tables that estimate energy and protein. Then you multiply corn and soybean meal equivalents fed per month by the futures prices for those commodities. The difference between estimated milk income and estimated feed expense is the Gross Margin that you will insure.

Lastly, you can choose a deductible to the gross margin insured. Like any insurance deductible, you lower your premium when you accept more risk. You can buy a deductible in $0.10 per hundredweight increments up to $1.50.

This Gross Margin Insurance for Dairy is a pilot program to try to get a crop insurance policy suitable for dairy farmers. The cost of this insurance is less than buying put options on milk and call options on feed. But remember, it is an insurance policy, not a brokerage account. It insures you against unexpected changes in price. The futures market reports the expected changes in price. This insurance does not cover livestock death or disease; it covers the margin between milk price and feed price.

I am sure that we will be hearing and learning more about this insurance in the future. It is not for everybody. It is for those who want to pay to insure a margin. It is complex. You can find more information on the web. Try the University of Wisconsin's Understanding Dairy Markets page, select LGM-Dairy, http://future.aae.wisc.edu/lgm_dairy.html. Or try the Pennsylvania Center for Dairy Excellence, select Producer, then select 'Better manage my on-farm risk,' http://www.centerfordairyexcellence.org/index.php/risk.html.