

Chapter 3

How Does Livestock Risk Protection Insurance Work?

In this chapter, you will learn:

- definitions of LRP terminology;
- how to access Coverage Prices, premium rates, and ending values from USDA;
- which indexes are used by USDA to determine if an indemnity would be paid;
- how to calculate total LRP premiums; and
- how to collect an indemnity for LRP coverage.

3.1 Introduction

Chapters 1 and 2 discussed the basic provisions of LRP insurance and provided a general overview of the program. The first chapter covered the general requirements of the program such as what livestock are eligible, states where LRP is available, annual insurable limits for LRP, and available endorsement lengths. Chapter 2 discussed other limitations of the program and outlined the advantages and disadvantages of LRP. This chapter covers how to establish insurance protection for livestock. First, it familiarizes readers with important terminology associated with LRP. Then, price reports that are used to evaluate cash price levels to determine if indemnities will be paid are discussed. Next, the chapter covers how to look up endorsement lengths, Coverage Prices, and premium rates. Finally, an example of calculating premiums and indemnities is provided.

3.2 Terminology

To fully understand LRP, it is important to be familiar with the terminology unique to the program. These terms are essential in understanding how to purchase LRP coverage, what levels of protection are available, and how much the price protection will cost. These terms include:

- **Expected Ending Value (EEV)**—The expected national or regional cash index price for a specific commodity at a future date. It depends on expected future price levels and on the endorsement end dates. EEV is the price level that USDA estimates the cash price index will be on the ending date of the LRP contract and is the basis for the LRP insurance coverage level.
- **Coverage Price**—The actual level of price protection covered by LRP ranging from 70 percent to 95 percent of EEV. The Coverage Price is the

selling price insured, or floor price. If the cash market index price (defined below) is lower than the Coverage Price on the insurance end date, an indemnity is paid to make up the difference.

- **Rate**—The price of coverage. The rate is a percentage of the value of insured production, and it is used in calculating the premium cost of the price protection. Rates will be higher for higher coverage levels. USDA adjusts EEV, Coverage Prices, and Rates each day LRP is available.
- **Cost per cwt**—The premium cost of LRP coverage on a per hundred weight basis. Cost per cwt is calculated by multiplying Coverage Price by the Rate for that coverage level. Cost per cwt can be incorporated into break-even price level calculations as discussed in Section 1.9.
- **End Date**—The date the insurance coverage expires. The end date is the day on which an indemnity is determined. This is the only date the insurance coverage has value because the coverage cannot be lifted or offset prior to the end date. End date is found by adding the endorsement length to the effective date (the date coverage is purchased).
- **Actual Ending Value (AEV)**—The cash index price on the end date of coverage. These values are reported by USDA after the end date is reached. The AEV is compared to the Coverage Price to determine if an indemnity is due. The indexes used to determine AEV are discussed in Section 3.4. Feeder cattle, fed cattle, and swine each use a different index to determine AEV.
- **Indemnity**—The amount paid by the insurance policy if AEV is less than the Coverage Price. The indemnity is calculated by subtracting AEV from the Coverage Price.

To summarize, coverage is purchased by selecting the endorsement length with an end date closest to the projected marketing date of the livestock. EEV is the USDA-RMA expectation of national cash price levels on that ending date. Coverage Prices (the floor prices) ranging from 70 percent to 95 percent of EEV are available with varying premium rates. Based on individual producers' needs or risk preferences, different levels of coverage can be selected. The cost per cwt (Rate multiplied by Coverage Price) is available along with the actual end date of coverage. Finally, after the end date is reached, AEV will be determined for

each endorsement length. An indemnity will be paid if AEV is less than the Coverage Price.

3.3 USDA Web Site

The USDA Risk Management Agency maintains a Web site that provides endorsement lengths, EEV, Rates, Cost per cwt, End Dates, and AEV each day when LRP is available. The site lists all the endorsement lengths available on a particular day with varying levels of coverage (70 percent to 95 percent) for each length. Also, dates and prices are archived since the program's inception. The Web site is available at www3.rma.usda.gov/apps/livestock_reports/lrp_select_criteria.cfm.

To access pricing information from the USDA Web site, follow these steps (after steps 1-4, click the "Next" button):

1. Select a date—When purchasing coverage, the relevant date is the current date. If looking up an AEV from a prior date, select the date on which coverage was initially purchased from the drop-down list. AEV will be posted after the end date is reached.
2. Select a state—This is the state in which the livestock to be insured are located (see Section 1.4).
3. Select the commodity—This selects whether coverage is for swine, fed cattle, or feeder cattle (see Section 1.3).
4. Select the type of livestock—This page selects a sub-class for the covered livestock. For swine and fed cattle, there is only one type. However, for feeder cattle, there are a total of eight types. There are steers, heifers, Brahman breeds, and dairy breeds, and each group is divided into two weight classes. Weight 1 and Weight 2 represent feeder cattle weighing less than 600 pounds and 600 to 900 pounds, respectively.
5. Click the "Create Report" button.

The USDA pricing page will look like *Figure 3.1*.

The columns of most interest are labeled on the table. The columns include:

- Column 1—State selected. Remember this is the state where the livestock are located, not necessarily the state where the applicant/insured resides.
- Column 2—Available endorsement lengths. Note that, on a given day, not all possible endorsement lengths (as discussed in Section 1.8) will necessarily be available. If there is not enough market

data (e.g. futures and/or options contracts traded) to determine EEV and premium rates, certain endorsement lengths may not be available. For example, the endorsement lengths with end dates longer than six months away may not be available because the options market for deferred futures contracts may be thinly traded. As a result, there may not be enough market information to generate LRP data for endorsement lengths corresponding to the deferred futures and options contracts.

Column 3—Commodity. This lists whether the insured livestock are swine, feeder cattle, or fed cattle.

Column 4—Type of commodity. This column indicates the sub-class in which the livestock are classified. Columns 3 and 4 in *Figure 3.1* indicate that this pricing page is for Weight 2 feeder steers (weighing 600 to 900 pounds). For fed cattle, there is only one type, steers and heifers, under which all fed cattle are insured. Swine do not have a type designation, and all barrows and gilts are insured under the same contract.

Column 5—EEV. This column lists the USDA expectation of future cash prices on the End Dates for each available endorsement length. These expectations are based on futures and options markets.

Column 6—Coverage Price. These prices are the actual price levels that can be protected with LRP. Column 6 is a function of the coverage level multiplied by EEV (Coverage Price equals EEV multiplied by Coverage Level).

Column 7—Coverage level. This is the percentage of EEV insured, ranging from 70 percent to 95 percent.

Column 8—Coverage Rate. This is the premium rate and is used to calculate the cost of the LRP Insurance.

Column 9—Cost per cwt. This is calculated by multiplying Coverage Price by the Rate. The Cost per cwt listed on the Web site does *not* incorporate the 13 percent government subsidy. To calculate the producer's Cost per cwt, multiply Cost per cwt listed on the Web site by 87 percent.

Column 10—End date. This is the date on which the coverage expires, or the date which the indemnity is determined.

Column 11—AEV for each endorsement length. The AEV is posted after the end date is reached.

LRP Coverage Prices, Rates, and Actual Ending Values - Report for 02/17/2005
USDA subsidizes 13 percent of total LRP premium.

State	County	Endorsement Length	Commodity	Type	Practice	Crop Year	Expected End Value	Coverage Price	Coverage Level	Rate	Cost Per CWT	End Date	Actual End Value
NEBRASKA	998 ALL COUNTIES	13	9801 FEEDER CATTLE	810 STEERS WEIGHT 2	997 NO PRACTICE SPECIFIED	2005	98.919	\$92.079	0.939800	0.919959	1.005	05/19/2005	
NEBRASKA	998 ALL COUNTIES	13	9801 FEEDER CATTLE	810 STEERS WEIGHT 2	997 NO PRACTICE SPECIFIED	2005	98.919	\$92.079	0.939800	0.907949	0.718	05/19/2005	
NEBRASKA	998 ALL COUNTIES	13	9801 FEEDER CATTLE	810 STEERS WEIGHT 2	997 NO PRACTICE SPECIFIED	2005	98.919	\$88.079	0.890300	0.906779	0.597	05/19/2005	
NEBRASKA	998 ALL COUNTIES	13	9801 FEEDER CATTLE	810 STEERS WEIGHT 2	997 NO PRACTICE SPECIFIED	2005	98.919	\$86.079	0.870100	0.905600	0.482	05/19/2005	
NEBRASKA	998 ALL COUNTIES	13	9801 FEEDER CATTLE	810 STEERS WEIGHT 2	997 NO PRACTICE SPECIFIED	2005	98.919	\$84.079	0.849900	0.905032	0.423	05/19/2005	
NEBRASKA	998 ALL COUNTIES	13	9801 FEEDER CATTLE	810 STEERS WEIGHT 2	997 NO PRACTICE SPECIFIED	2005	98.919	\$82.079	0.829700	0.904460	0.366	05/19/2005	
NEBRASKA	998 ALL COUNTIES	13	9801 FEEDER CATTLE	810 STEERS WEIGHT 2	997 NO PRACTICE SPECIFIED	2005	98.919	\$80.079	0.809500	0.903890	0.309	05/19/2005	
NEBRASKA	998 ALL COUNTIES	13	9801 FEEDER CATTLE	810 STEERS WEIGHT 2	997 NO PRACTICE SPECIFIED	2005	98.919	\$78.079	0.789300	0.903320	0.252	05/19/2005	
NEBRASKA	998 ALL COUNTIES	13	9801 FEEDER CATTLE	810 STEERS WEIGHT 2	997 NO PRACTICE SPECIFIED	2005	98.919	\$76.079	0.769100	0.902750	0.195	05/19/2005	
NEBRASKA	998 ALL COUNTIES	13	9801 FEEDER CATTLE	810 STEERS WEIGHT 2	997 NO PRACTICE SPECIFIED	2005	98.919	\$74.079	0.748900	0.902180	0.138	05/19/2005	
NEBRASKA	998 ALL COUNTIES	13	9801 FEEDER CATTLE	810 STEERS WEIGHT 2	997 NO PRACTICE SPECIFIED	2005	98.919	\$72.079	0.728700	0.901610	0.081	05/19/2005	
NEBRASKA	998 ALL COUNTIES	17	9801 FEEDER CATTLE	810 STEERS WEIGHT 2	997 NO PRACTICE SPECIFIED	2005	99.656	\$83.830	0.871300	0.906806	0.591	06/16/2005	
NEBRASKA	998 ALL COUNTIES	17	9801 FEEDER CATTLE	810 STEERS WEIGHT 2	997 NO PRACTICE SPECIFIED	2005	99.656	\$84.830	0.851200	0.905647	0.479	06/16/2005	
NEBRASKA	998 ALL COUNTIES	17	9801 FEEDER CATTLE	810 STEERS WEIGHT 2	997 NO PRACTICE SPECIFIED	2005	99.656	\$82.830	0.831100	0.904769	0.395	06/16/2005	
NEBRASKA	998 ALL COUNTIES	17	9801 FEEDER CATTLE	810 STEERS WEIGHT 2	997 NO PRACTICE SPECIFIED	2005	99.656	\$80.830	0.811000	0.903761	0.304	06/16/2005	
NEBRASKA	998 ALL COUNTIES	21	9801 FEEDER CATTLE	810 STEERS WEIGHT 2	997 NO PRACTICE SPECIFIED	2005	100.404	\$93.580	0.913800	0.918380	0.757	07/14/2005	
NEBRASKA	998 ALL COUNTIES	21	9801 FEEDER CATTLE	810 STEERS WEIGHT 2	997 NO PRACTICE SPECIFIED	2005	100.404	\$91.580	0.893700	0.913966	0.644	07/14/2005	
NEBRASKA	998 ALL COUNTIES	21	9801 FEEDER CATTLE	810 STEERS WEIGHT 2	997 NO PRACTICE SPECIFIED	2005	100.404	\$89.580	0.873600	0.911230	0.531	07/14/2005	
NEBRASKA	998 ALL COUNTIES	21	9801 FEEDER CATTLE	810 STEERS WEIGHT 2	997 NO PRACTICE SPECIFIED	2005	100.404	\$87.580	0.853500	0.909603	0.418	07/14/2005	
NEBRASKA	998 ALL COUNTIES	21	9801 FEEDER CATTLE	810 STEERS WEIGHT 2	997 NO PRACTICE SPECIFIED	2005	100.404	\$85.580	0.833400	0.908285	0.305	07/14/2005	
NEBRASKA	998 ALL COUNTIES	21	9801 FEEDER CATTLE	810 STEERS WEIGHT 2	997 NO PRACTICE SPECIFIED	2005	100.404	\$83.580	0.813300	0.907239	0.192	07/14/2005	
NEBRASKA	998 ALL COUNTIES	21	9801 FEEDER CATTLE	810 STEERS WEIGHT 2	997 NO PRACTICE SPECIFIED	2005	100.404	\$81.580	0.793200	0.905982	0.089	07/14/2005	
NEBRASKA	998 ALL COUNTIES	26	9801 FEEDER CATTLE	810 STEERS WEIGHT 2	997 NO PRACTICE SPECIFIED	2005	100.813	\$93.990	0.932300	0.921343	2.005	08/18/2005	
NEBRASKA	998 ALL COUNTIES	26	9801 FEEDER CATTLE	810 STEERS WEIGHT 2	997 NO PRACTICE SPECIFIED	2005	100.813	\$91.990	0.912500	0.916882	1.553	08/18/2005	
NEBRASKA	998 ALL COUNTIES	26	9801 FEEDER CATTLE	810 STEERS WEIGHT 2	997 NO PRACTICE SPECIFIED	2005	100.813	\$89.990	0.892600	0.914068	1.265	08/18/2005	
NEBRASKA	998 ALL COUNTIES	26	9801 FEEDER CATTLE	810 STEERS WEIGHT 2	997 NO PRACTICE SPECIFIED	2005	100.813	\$87.990	0.872800	0.912456	1.004	08/18/2005	
NEBRASKA	998 ALL COUNTIES	26	9801 FEEDER CATTLE	810 STEERS WEIGHT 2	997 NO PRACTICE SPECIFIED	2005	100.813	\$85.990	0.853000	0.911106	0.955	08/18/2005	
NEBRASKA	998 ALL COUNTIES	26	9801 FEEDER CATTLE	810 STEERS WEIGHT 2	997 NO PRACTICE SPECIFIED	2005	100.813	\$83.990	0.833100	0.910001	0.840	08/18/2005	
NEBRASKA	998 ALL COUNTIES	26	9801 FEEDER CATTLE	810 STEERS WEIGHT 2	997 NO PRACTICE SPECIFIED	2005	100.813	\$81.990	0.813300	0.908662	0.702	08/18/2005	
NEBRASKA	998 ALL COUNTIES	30	9801 FEEDER CATTLE	810 STEERS WEIGHT 2	997 NO PRACTICE SPECIFIED	2005	100.678	\$92.030	0.914100	0.925839	2.278	09/15/2005	
NEBRASKA	998 ALL COUNTIES	30	9801 FEEDER CATTLE	810 STEERS WEIGHT 2	997 NO PRACTICE SPECIFIED	2005	100.678	\$90.030	0.894200	0.918749	1.688	09/15/2005	
NEBRASKA	998 ALL COUNTIES	30	9801 FEEDER CATTLE	810 STEERS WEIGHT 2	997 NO PRACTICE SPECIFIED	2005	100.678	\$88.030	0.874400	0.915233	1.241	09/15/2005	
NEBRASKA	998 ALL COUNTIES	34	9801 FEEDER CATTLE	810 STEERS WEIGHT 2	997 NO PRACTICE SPECIFIED	2005	100.528	\$90.040	0.895600	0.922257	2.004	10/13/2005	
NEBRASKA	998 ALL COUNTIES	34	9801 FEEDER CATTLE	810 STEERS WEIGHT 2	997 NO PRACTICE SPECIFIED	2005	100.528	\$88.040	0.875700	0.919378	1.705	10/13/2005	
NEBRASKA	998 ALL COUNTIES	39	9801 FEEDER CATTLE	810 STEERS WEIGHT 2	997 NO PRACTICE SPECIFIED	2005	99.900	\$84.000	0.940900	0.947128	4.430	11/17/2005	

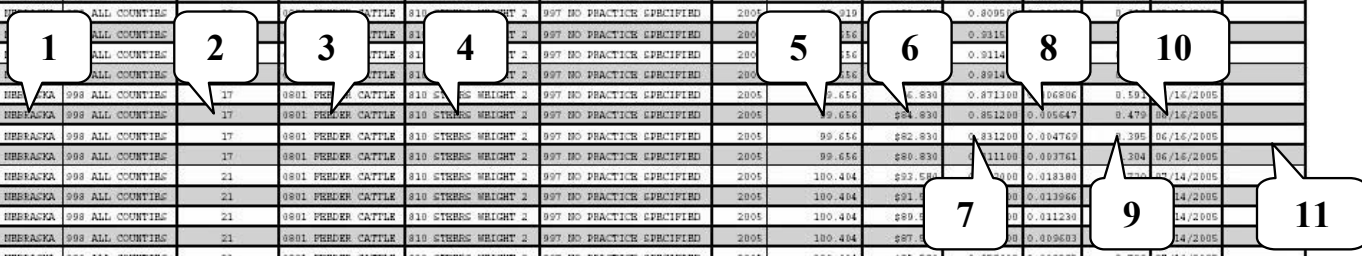


Figure 3.1 USDA Pricing Page

3.4 Actual Ending Value

Actual Ending Value (AEV) is determined by a national or regional cash index that is based on cash prices received by producers in large-volume markets. Thus, AEV is generally representative of the cash price a producer would receive for livestock sold anywhere in the U.S. However, livestock markets in some geographic areas result in cash prices more closely related to the broadly representative index price if those areas are weighted more heavily in the index. In calculating the cash index, selected regional or national cash markets are used to calculate a volume weighted average price. Both the information used in calculating the index and the actual index itself are publicly available. Swine, feeder cattle, and fed cattle LRP insurance each use a different cash index to determine AEV.

Swine AEV

The AEV for swine is a two-day volume weighted average of the “Negotiated” and “Swine or Pork Market Formula” national net prices. This information is published daily by the USDA Agricultural Marketing Service (AMS) in the LM_HG201 report, available online at www.ams.usda.gov/mnreports/lm_hg201.txt. The AEV is the average of the current and previous day’s “Negotiated” and “Swine or Pork Market Formula” prices weighted for the number of head.

The swine AEV is equivalent to the Chicago Mercantile Exchange Lean Hog Cash Index, which uses the data from the USDA-AMS report discussed above. This source for the information is convenient because the prices are already a two-day volume weighted average. Therefore, the CME Lean Hog Cash Index is the AEV for LRP insurance, and is available online at www.cme.com.

Fed Cattle AEV

The LRP Fed Cattle AEV is the 5-Area Weekly Weighted Average Direct Slaughter Steer Price for steers grading 35 percent to 65 percent choice sold FOB feedyard on a live weight basis. The areas included are Texas/Oklahoma, Kansas, Nebraska, Colorado, and Iowa/Minnesota. This price information is published weekly by USDA-AMS in the LM_CT150 report, available online at www.ams.usda.gov/mnreports/lm_ct150.txt.

When insuring fed heifers, the insurance contract is still indemnified on the 5-Area steer price. This is important because the price differential between fed heifers and steers must be considered when calculating expected sales prices. Fed heifers are not included in the 5-Area steer price, so the AEV may not be as representative of actual fed heifer prices. However, the price differential for fed heifers and steers is generally fairly small. USDA-AMS does report a 5-Area heifer

price, but fed heifers are still insured against the steer price.

Feeder Cattle AEV

The CME Feeder Cattle Cash Index Price is used as the AEV for Feeder Cattle LRP insurance. This index represents a national average comprised of representative feeder steer prices reported from across the country. The index includes sales of 700 to 849 pound Medium and Medium/Large Frame # 1 steers and is a seven-day average price. The report can be found online at www.cme.com. Relative to the 5-Area steer price, the Feeder Cattle Cash Index does not weight Nebraska feeder cattle prices as heavily. As a result, the AEV for feeder cattle is not as representative of Nebraska prices as the fed cattle AEV is for Nebraska fed cattle. Chapter 4 will discuss the implications of this difference. When insuring feeder heifers, lighter weight cattle, or Brahman and dairy breeds, the same index is used as a base, but an adjustment factor is included. These adjustment factors are discussed in the next section.

3.5 Feeder Cattle Price Adjustment Factors

Feeder Cattle LRP insurance covers a broad range of eligible feeder cattle. However, the Feeder Cattle Cash Index, against which all Feeder Cattle LRP contracts are indemnified, represents a relatively narrow segment of cattle eligible for the program. Substantial variation in the price of feeder cattle typically exists based on differences in weight, sex, and breed. Price adjustment factors help to more accurately reflect the value of cattle not actually represented by the Feeder Cattle Cash Index. The adjustments essentially scale the index up or down to reflect higher or lower values for a particular type of feeder cattle. The factors are applied to EEV, Coverage Price, Rate, and AEV. The price adjustment factors are shown in *Table 3.1* below.

Table 3.1 Feeder Cattle Price Adjustment Factors.

	<i>Steers</i>	<i>Heifers</i>	<i>Brahman</i>	<i>Dairy</i>
<i>Weight</i>	<i>Weight 1</i>	<i>Weight 1</i>	<i>Weight 1</i>	<i>Weight 1</i>
<600 lbs	110%	100%	100%	100%

	<i>Steers</i>	<i>Heifers</i>	<i>Brahman</i>	<i>Dairy</i>
<i>Weight</i>	<i>Weight 2</i>	<i>Weight 2</i>	<i>Weight 2</i>	<i>Weight 2</i>
600-900 lbs	100%	90%	90%	80%

Because the Feeder Cattle Index represents 700 to 849 pound steers, the Weight 2 steer category can be viewed as the base value because it is the group that is

most representative of the index. All the other categories are then adjusted relative to that level. Heifers, Brahman, and dairy cattle of the same weight class sell at a discount relative to steers; therefore, the price adjustment factors lower the index to reflect that difference in value. Conversely, lighter weight steers sell at a premium to heavier steers, so Weight 1 steers are valued higher at a factor of 110 percent. Within the Weight 1 category, heifers, Brahman, and dairy feeder cattle are valued lower than the Weight 1 steer category; accordingly, those categories have price adjustment factors that lower the index relative to Weight 1 steers to more closely reflect the value of those cattle. Feeder bulls weighing less than 600 pounds are insured in the same category as Weight 1 steers. By accessing the coverage pricing page as described in Section 3.3, the price adjustment factors are automatically applied to EEV, Coverage Price, premium, and AEV so no additional adjustments need to be made.

It is important to note that these adjustments are fixed percentages and do not perfectly account for the differences in value between different weights and types of feeder cattle. The price or value of a Weight 1 heifer or dairy calf is not necessarily the same as a Weight 2 steer even though the price adjustment factors might imply so (each having a constant price adjustment factor of 100 percent). In some cases, the adjustment may not be large enough, and, in others, the adjustment could overcompensate for the differential, depending on market conditions. The factors simply lower the differential between actual cash prices of other types of cattle and the index against which the cattle are indemnified. Doing so reduces part of the risk of changes in price spreads between cattle of differing sex, weight, or breed.

3.6 Purchasing LRP—an Example

At this point, it is beneficial to work through an example of how LRP would work for a producer. In other words, what are all the relevant prices and costs to someone who actually purchases LRP? Important aspects include selecting a Coverage Price and calculating producer premiums, both on a per cwt basis and in total. The total premium is important because it is due at the time the coverage is obtained.

Assume that on October 29, Joe Farmer decides to cover his feeder steer price risk with LRP. Joe is weaning 100 head of steers that he intends to back-ground through February. He anticipates the steers will weigh about 650 pounds when he sells them in February. The LRP contract with an end date closest to his projected marketing period is the 17-week endorsement, which ends on February 25. This end date is within Joe's projected marketing period, but it

provides some flexibility if he needs to move his actual cash sale date forward (the cattle can be sold up to 30 days prior to the end date without voiding coverage, see Section 1.8). After accessing the USDA pricing Web site for October 29, Joe learns that the EEV for Weight 2 Steers for the 17-week endorsement length is \$102.66/cwt. That is the price USDA-RMA estimates the Feeder Cattle Cash Index will be on February 25. Joe selects a Coverage Price of \$92.86/cwt, or 90.45 percent of EEV. The premium rate for that particular coverage level is 0.01526. In other words, every dollar of insured production incurs a cost of \$0.01526. Subsequently, the Cost per cwt is \$1.417/cwt ($0.01526 \times \$92.86/\text{cwt}$). However, recall that 13 percent of the premium is government subsidized. Joe's actual Cost per cwt will be \$1.233/cwt ($\$1.417/\text{cwt}$ multiplied by 87 percent). He decides this is a favorable cost for the level of price protection provided. Because Joe already has a basic policy in place with his crop insurance agent, he simply needs to contact the agent and obtain a Specific Coverage Endorsement. See Appendix 5 for an example of a Specific Coverage Endorsement Form. With the submission of the SCE, Joe *must* include payment for the total premium cost.

To calculate the total premium, first determine the total amount of insured production. Joe has 100 head of steers he expects to weigh 650 pounds, or 6.5 cwt. His total insured production is 650 cwt (100 head multiplied by 6.5 cwt/head). The next step is to calculate the value of insured production by multiplying insured production times the Coverage Price. In this case, the value insured is \$60,359 (650 cwt multiplied by \$92.86/cwt). The total premium rate is determined by multiplying the value of insured production by the premium rate. The total premium for Joe's coverage is \$921.08 ($\$60,359$ multiplied by 0.01526). Finally, Joe only pays 87 percent of the total premium as the rest is subsidized. His portion of the premium is \$801.34.

Once LRP is purchased, recall that the price coverage is in place and cannot be lifted before the end date (Sections 2.3 and 2.6). The end date is the only time the coverage has any value. Once the end date is reached, Joe can determine whether or not an indemnity is due. Assume on February 25, the feeder cattle AEV (the CME Feeder Cattle Cash Index) was

\$101.25/cwt. The AEV is higher than Joe's Coverage Price of \$92.86/cwt, meaning Joe will not receive an indemnity for his LRP coverage. If the AEV had been lower than Joe's Coverage Price (\$92.86/cwt), he would collect an indemnity in the amount of the difference. Assume, for example, that on February 25, the AEV for feeder cattle had actually been \$85.00/cwt. The LRP coverage would pay an indemnity of \$7.86/cwt ($\$92.86/\text{cwt}$ minus $\$85.00/\text{cwt}$). Joe's total indemnity would be calculated based on total insured production; in this case, the total indemnity would be \$5,109 ($\$7.86/\text{cwt}$ multiplied by 650 cwt).

3.7 Indemnity Payments

If, at the end date of LRP coverage, the policy holder has the right to an indemnity (AEV is less than the Coverage Price), the insurance company will issue a letter of probable loss. This letter tells producers that they likely have the right to collect an indemnity on their LRP coverage. To collect the indemnity, the producer must file a claim form with the insurance company within 60 days of the coverage end date. This is a form that indicates the policy holder has a right to collect an indemnity on an SCE. The insurance company then has 60 days upon receipt of the claim form to pay the indemnity. Indemnity payments are considered taxable income which apply to the tax year in which they are received. There is no option to defer the indemnity payments as with crop insurance. See Appendix 6 for an example of a claim form.

3.8 Summary

This chapter explained how the LRP program operates. Whereas the first chapters covered a broad view of the LRP program and its provisions, this chapter showed how a producer uses the program. The chapter covered technical terminology such as EEV, Coverage Price, End Date, and AEV. Additionally, the chapter explained which cash indexes are used to determine AEV. Price adjustment factors for Feeder Cattle LRP were also covered. Finally, an example was presented that included evaluating LRP coverage, calculating premiums, and determining indemnities.