

Check for Understanding
Chapter 5

1. The equation for calculating minimum expected selling price (MESP) is:
MESP = _____ - _____ + _____
2. T F Because LRP creates a price ceiling, producers using LRP cannot benefit from price rallies.
3. If a producer wants to purchase LRP coverage with a total premium of \$2.00/cwt, how much is the producer's portion of the premium? _____
4. If a producer purchases LRP insurance with a coverage price of \$55.50/cwt and a producer premium of \$1.50/cwt and expects LRP basis to be \$2.00/cwt at the end of coverage, what is the producer's MESP? _____
5. The equation for calculating ASP is: ASP = _____ + _____
6. T F If no indemnity is paid on LRP coverage, the net on LRP is equal to the cost of the premium.
7. T F The MESP for an LRP hedge is the lowest possible ASP a producer can receive.
8. If a producer receives a higher ASP than MESP, what factor caused the higher ASP?
 - a) AEV was higher than coverage price at the end date
 - b) LRP basis strengthened relative to expected
 - c) LRP basis weakened relative to expected
 - d) a or b could cause a higher ASP than MESP
 - e) a or c could cause a higher ASP than MESP
9. What conditions can cause suspension of LRP sales?
 - a) At least four of the underlying CME futures contracts settle at daily limits for two consecutive days
 - b) An event occurs that USDA deems significantly changes market conditions
 - c) Daily underwriting capacity is exceeded
 - d) all of the above
10. T F LRP insurance has advantages and limitations relative to other hedging strategies that must be considered when deciding if it is a useful program for a given operation.

Answers to “Check for Understanding”—Chapter 5

1. $MESP = \text{Coverage Price} - \text{Producer Premium Cost} + \text{Expected LRP Basis}$
2. False. LRP creates a price floor, allowing producers to benefit from price rallies.
3. \$1.74/cwt. Producer premium = 87% of Total premium ($\$2.00/\text{cwt} \times 0.87$)
4. \$56.00/cwt. $MESP = \$55.50/\text{cwt} - \$1.50/\text{cwt} + \$2.00/\text{cwt}$
5. $ASP = \text{Cash price} + \text{Net on LRP}$.
6. True.
7. False. ASP can be lower than MESP if basis is weaker than expected.
8. D. ASP can be higher than MESP if prices increase or if basis is stronger than expected.
9. D.
10. True.