



# CHEESE REPORTER

Cheese Reporter Publishing Co. Inc. © 2011  
2810 Crossroads Drive, Suite 3000  
Madison, WI 53718-7972  
(608) 246-8430 • Fax (608) 246-8431  
<http://www.cheesereporter.com>

**DICK GROVES**  
Publisher/Editor  
e-mail: [dgroves@cheesereporter.com](mailto:dgroves@cheesereporter.com)  
608-316-3791

**MOIRA CROWLEY**  
Specialty Cheese Editor  
e-mail: [mcrowley@cheesereporter.com](mailto:mcrowley@cheesereporter.com)  
608-316-3793

**KEVIN THOME**  
Advertising & Marketing Director  
e-mail: [kthome@cheesereporter.com](mailto:kthome@cheesereporter.com)  
608-316-3792

**BETTY MERKES**  
Classifieds/Circulation Manager  
e-mail: [info@cheesereporter.com](mailto:info@cheesereporter.com)  
608-316-3790

**REGULAR CONTRIBUTORS:**  
Bob Cropp, Neville McNaughton,  
Rice Dairy, Dan Strongin, John Umhoefer  
You can e-mail our contributors at:  
[contributors@cheesereporter.com](mailto:contributors@cheesereporter.com)

The Cheese Reporter is the official  
publication of the following dairy associations:

**California Cheese & Butter Association**  
Lisa Waters,  
1011 Pebble Beach Drive, Clayton, CA 94517

**Central Wisconsin Cheesemakers' and  
Buttermakers' Association**  
Jim Mildbrand, PO Box 160  
Greenwood, WI 54437

**Cheese Importers Association of America**  
204 E St. NE, Washington, DC 20002

**Eastern Wisconsin Cheesemakers' and  
Buttermakers' Association**  
Barb Henning, Henning's Cheese  
21812 Ucker Road, Kiel, WI 53042

**International Dairy-Deli-Bakery Association**  
Carol Christison, P.O. Box 5528,  
Madison, WI 53705

**Missouri Butter & Cheese Institute**  
Terry S. Long, 19107 Factory Creek Road,  
Jamestown, MO 65046

**Nebraska Cheese Association**  
Ed Price, 3104 Nebraska, Fremont, NE 68025

**New York State Cheese Manufacturer's Assn**  
Kathryn Boor, 11 Stocking Hall,  
Cornell University, Ithaca, NY 14853

**North Central Cheese Industries Association**  
Lloyd Metzger, SDSU, Box 2104,  
Brookings, SD 57007

**North Dakota Cheese Makers' Assn**  
Chuck Knetter, Box 309, Medina, ND 58467

**Ohio Swiss Cheese Association**  
Darlene Miller, P.O. Box 445,  
Sugar Creek, OH 44681

**South Dakota State Dairy Association**  
Howard Bonnemann, SDSU, Box 2104,  
Brookings, SD 57007

**Southwestern Wisconsin  
Cheese Makers' Association**  
Myron Olson, Chalet Cheese Coop,  
N4858 Cty Hwy N, Monroe, WI 53566

**Wisconsin Association for Food Protection**  
Les Lamb  
PO Box 620705, Middleton WI 53562

**Wisconsin Cheese Makers' Association**  
John Umhoefer, 8030 Excelsior Drive,  
Suite 305, Madison, WI 53717

**Wisconsin Dairy Products Association**  
Brad Legreid, 8383 Greenway Blvd.,  
Middleton, WI 53562

## GUEST EDITORIAL COMMENTS



**BRIAN W. GOULD**

Associate Professor, Department  
of Agricultural and Applied  
Economics,

**UNIVERSITY OF  
WISCONSIN-MADISON**



**VICTOR E. CABRERA**

Assistant Professor, Department  
of Agricultural and Applied  
Economics,

**UNIVERSITY OF  
WISCONSIN-MADISON**

### LGM-Dairy: A Viable Margin Risk Management Program

In the December 2, 2011, issue of the *Cheese Reporter*, John Umhoefer, executive director of the Wisconsin Cheese Makers Association, provided a summary of his organization's position as to where efforts in changing US federal dairy policy should be directed. In that editorial he stated that the 2012 farm bill should "Develop a producer-funded margin insurance program executed by USDA." (see [www.cheesereporter.com/Umhoefer/umhoefer.htm](http://www.cheesereporter.com/Umhoefer/umhoefer.htm)).

We thought we should provide some information as to a currently existing program that is being actively used by dairy farm operators for margin risk management. This program is the Livestock Gross Margin for Dairy (LGM-Dairy) insurance program administered by USDA's Risk Management Agency. This program has existed since 2008 and is available for all dairy farms both small and large in all states (except Alaska and Hawaii).

This program is a pilot program that is supported by a combination of producer premiums and direct payments from USDA funds. This program has proven to be so popular that for the last two insurance years the funds have been depleted well before the end of the year.

In 2010/11 the funds were used up by March 2011 with most of the sales occurring after September 2010. In 2011/12 the funds available for this program were used up after only two months of contract offerings.

In spite of the inadequate funding for this program, in 2010/11, 46.2 million hundredweights was insured which represents 2.1 percent of the 2010 US milk production. In 2011 40.6 million hundredweights were insured which is 2.4 percent of 2010 milk production. This latest sales figure occurred again with only two months of funding available.

Given the history of this program the dairy industry could "hit the ground running" if the farm bill would (i) remove LGM-Dairy from its pilot program status, (ii) use the savings from the MILC and Dairy Price Support Program elimination to SUBSTANTIALLY increase the

funding for this program, and (iii) extend the effectiveness of this program by reducing the premium subsidies currently in place.

Many insurance providers have indicated to us that they have customers who would be willing to purchase this insurance with \$0 subsidy. Our research has found that the dairy producer cost of this insurance program is relatively low (even without the premium subsidy) when compared to other margin risk management strategies.

Here at the University of Wisconsin we have an active LGM-Dairy training program for dairy farm operators, insurance providers, agricultural lenders and other educators. We have also developed an extensive website with informational resources regarding LGM-Dairy including online decision support tools.

If you would like more information access the webpage: [http://future.aae.wisc.edu/lgm\\_dairy.html](http://future.aae.wisc.edu/lgm_dairy.html).

We have the foundation of a viable margin risk management program. We don't think we have to reinvent the wheel.

*Editor's Note: Profs. Gould and Cabrera are the co-authors of a recent report, **USDA's Livestock Gross Margin Insurance for Dairy: What is it and How Can it be Used for Risk Management**, which provides a brief overview of the LGM-Dairy program. The following information is taken from that report, which is available at <http://future.aae.wisc.edu/lgm-dairy/lgmdairymanual.pdf>.*

Livestock Gross Margin insurance programs have existed for swine and feeder cattle for more than a decade. These insurance programs are designed to offer protection against declines in livestock feeding margins (i.e., selling price minus feed costs).

For beef cattle, the insurance product pays producers an indemnity when the spread between fed cattle sales value and the costs associated with feeder cattle and corn feed are reduced. With swine, an indemnity is paid based on the relative sale

price of market hogs and the costs associated with the feeding of corn and soybeans.

LGM-Dairy is a natural extension of the cattle and swine insurance programs. The program is a risk management tool that allows dairy farm operators to purchase insurance to protect against unanticipated decreases in their gross margin, or the difference between estimated milk revenue and feed costs or income over feed cost (IOFC).

Under this policy, an indemnity (insurance payment) at the end of coverage period is the difference, if positive, between the anticipated gross margins at contract purchase and actual gross margins.

Under LGM-Dairy, the evaluation of all revenues and feed costs are based on current futures contract settle prices that exist at insurance sign-up. In contrast to the use of traditional futures and options strategies, there are no purchases of futures and options to offset the insurance position.

CME Class III, corn and soybean meal futures and options markets are only used as information sources in the setting of premiums and at the end of the contract, an insurance payment determination. As there are no actual futures markets transactions, there will be no margin calls, should prices move against one's position.

In addition, in spite of the Class III options market being relatively thin, the desired LGM-Dairy contract may be undertaken, regardless of the level of activity in the actual Class III options market.

The contract premiums are established to be actuarially sound in the sense that over the long run, the expected indemnities paid equals the producer premiums. A unique feature of LGM-Dairy is that premiums are not due until the last actual prices can be estimated. This could be 13 months after the contract was purchased.

In contrast, when purchasing futures and options contracts, premiums and other fees must be paid at the time of purchase of these contracts.