

Margin Protection Program Tools Available

On August 28, United States Department of Agriculture (USDA) Secretary Tom Vilsack announced the final details of the Margin Protection Program (MPP) for dairy. Replacing the MILC, Dairy Product Price Support and Dairy Export Incentive Programs, the voluntary MPP provides dairy producers the opportunity to purchase insurance against catastrophically low milk price-feed cost margins.

In summary:

- MPP is based on an income over feed cost (IOFC) margin using national average prices for milk, corn, soybean meal and alfalfa hay.
- Producers may opt to insure between 25% and 90% of their base production.
- The basic insurance of \$4.00/cwt. margin costs an annual \$100 administrative fee. Higher levels of insurance can be purchased for predetermined premiums.
- Each year producers can change their level of coverage the amount of base production insured.

MPP indemnity payments are not tied to the IOFC margins for each dairy. The indemnity payments are based strictly off the national average income over

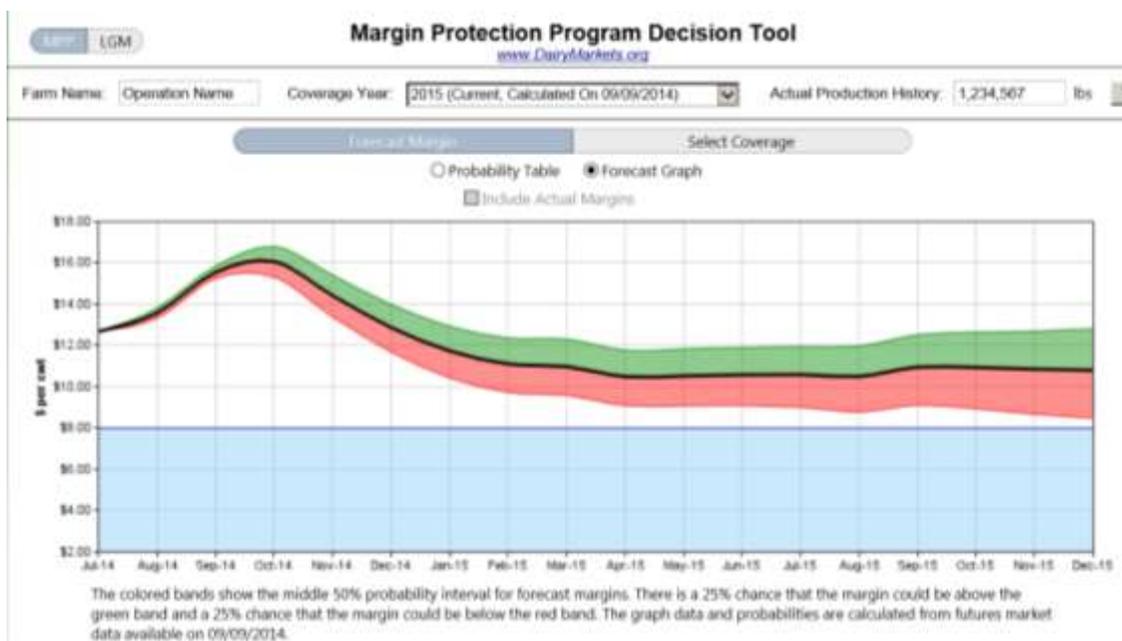
feed cost, which may be higher or lower than the margins on individual dairies. The details of the program's enrollment process and insurance provisions can be found at USDA's Farm Service Agency (FSA) web site, <http://www.fsa.usda.gov/FSA/>.

Analytical Tools

Online analytical tools are available to help producers make decisions about MPP enrollment. Two of the most popular tools use different approaches. The FSA Margin Protection Program Decision Tool is available on the FSA web site and was developed in conjunction with several agricultural universities. This analyzer is periodically and automatically updated with futures prices for milk and feed costs to project monthly IOFC for the next MPP enrollment year. The analysis also includes tables showing every month's probability of having national average margins below the available insurance coverage options. In addition, producers may enter the pounds of their base production and the percentage of production they choose to insure. The analyzer shows the fees and premiums, expected indemnity payments and expected net returns for each level of available coverage.

The National Milk Producers Federation (NMPF)

produced an analysis tool using a different approach. Their Margin Protection Program Calculator (shown on the next page) allows users to enter their own estimates for future milk prices and feed costs. Based on those prices, the calculator determines the expected ration cost and IOFC margin. Then, by entering production levels and electing a coverage percentage, the analysis will show the insurance costs and expected indemnity returns for each coverage level option.



Farm Service Agency tool
http://www.fsa.usda.gov/FSA/pages/content/farmBill/fb_MPPDTool.jsp



National Milk Producers Federation tool
<http://www.futurefordairy.com/mpp-calculator>

Investment Option or Insurance Opportunity?

Producers considering participating in the MPP may opt to view the program as either an investment option or an insurance opportunity. Both of the analytical tools outlined above project the expected net returns for each available level of insurance coverage. Producers may decide to simply select the option with the greatest net return. For example, current futures markets project 2015 national income over feed costs at a high of \$11.50 per hundredweight in January to a low of approximately \$10.00 in August. The same set of futures prices project a 50% probability that the income over feed cost margin will fall between a high of \$12.50 and \$8.50 during the year. Therefore, the projected margins are never low enough to trigger indemnity payments at any level of coverage selected. With limited opportunity for a return on insurance premiums invested, producers may opt to select the \$4.00/cwt coverage for only the cost of the \$100 annual administrative fee. Because the insurance premiums for the different levels of coverage are fixed for the life of the Farm Bill, producers can wait until the end of each enrollment period in order to base their enrollment decision on the most current futures prices available without fear of the premiums changing.

Using MPP to protect specific margins for specific dairies introduces an additional level of complexity to the program. Producers will need to know the historical difference between the national IOFC and the IOFC for their dairy, referred to as basis. For example, milk prices in the Upper Midwest and Northeast tend to be higher than the national average, while feed costs are typically lower. When the national average income over feed cost is \$5.50, the actual margin in those areas could be

approximately \$6.50. Therefore producers wanting to insure a \$5.50 margin on their dairy could do so by enrolling at the \$4.50 MPP level due to their \$1.00/cwt. basis. Conversely, California milk prices are typically lower and feed prices are higher than national averages. Therefore, a California producer wanting to insure a \$5.50 margin for their operation may need to enroll in MPP at \$7.00 or higher.

When attempting to adjust MPP coverage to account for basis, producers must also consider the wide differences in premium rates for varying levels of coverage. For example, moving from \$6.50 to \$7.00 insurance costs \$0.54/cwt. for coverage above four million pounds of milk. And an individual dairy’s basis will not change the amount of payment from MPP when national IOFC margins cause payments to be triggered. Producers may find it to be more cost effective to manage margin risk for their specific levels of IOFC by selecting MPP for maximum returns and using options, futures and forward contracting to account for basis.

Unique to Jerseys

Since the adoption of the MPP earlier this year, producers have asked NAJ what will be the ‘sweet spot’ for Jersey herds given their higher components. Jersey herds wanting to insure a specific margin for their dairy through MPP face an even more complicated basis calculation. The basis between their on-farm IOFC and national average margins is impacted by more than just the differences in regional milk and feed costs. The higher-than-average value of Jersey milk is partially muted by typically higher per hundredweight feed costs. Data published by the California Department of Food and Agriculture for the past several years show Jersey IOFC ranges from \$2.00 to \$2.50/cwt. higher than Holsteins in California.

The MPP and its analytic tools offer producers the opportunity to determine the probabilities that indemnity payments will exceed insurance premiums. From there, producers may want to choose the coverage with the maximum potential returns and to combine MPP other risk management tools to account for their dairy’s basis. For a MPP fact sheet, visit www.fsa.usda.gov/Internet/FSA_File/mpp_dairy.pdf.

The NAJ Equity Newsletter is Published for Supporters of and People Interested In Equitable Milk Pricing