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Mr Paul Morris
Chair, Agricultural Competitiveness Taskforce
Department of the Prime Minister and Cabinet
CANBERRA ACT 2600

Dear Mr Morris,

CROP INSURANCE IN AUSTRALIA – A REPORT CARD

On 2nd December 2014 in Sydney, Strategis Partners convened the *Symposium on the Future of Crop Insurance*, which brought together over 60 people from all States of Australia to listen to experts and users of Crop Insurance.

The attached paper presents a summary of the Symposium's findings, as a report card on the state-of-play. A key theme explored at the Symposium is that reducing uncertainty in crop production need not be costly for business — for farmers, for insurers, or for governments. But systemic change is needed.

Paper at a Glance

When it comes to Crop Insurance, Australia can do better.

It's been talked about for over 30 years in Australia. But today we still do not have a well-functioning agricultural insurance market. Not enough producers insured; not enough commodities covered; not enough insurance products matched to customer needs.

There are big knowledge gaps. Many insurers don't understand agriculture that well, many producers don't understand insurance, while Governments respond to drought with costly but often poorly targeted drought assistance.

The way forward involves:

- Producers, agri-bankers and farm advisers increasing their knowledge of the role of insurance;
- Governments using 'nudge' policies to encourage producers to adopt insurance; and
- Insurers investing more in agricultural insurance product and market development.

Big benefits will flow if we get crop insurance right. It is a tool to power Australian agriculture's potential.

Yours sincerely



Jay Horton
Managing Director

CROP INSURANCE IN AUSTRALIA – A REPORT CARD

Submission to the Agricultural Competitiveness Taskforce
12 December 2014.

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1 CROP INSURANCE SYMPOSIUM

The Symposium on the Future of Crop Insurance held in Sydney on 2nd December 2014, brought together over 60 of Australia's experts and practitioners of Crop Insurance. A dozen speakers provided a wealth of insights on agricultural risk management and crop insurance. The day was highly interactive with the audience probing the speakers on their topics.

This paper presents Strategis Partners' summary of the Symposium's discussion, as a report card on the state-of-play around crop insurance.¹

A key theme explored at the Symposium is that reducing uncertainty in crop production need not be costly for business – for farmers, for insurers, or for governments.

1.1 We can all do better

Agriculture is Australia's riskiest economic sector, possibly becoming more risky over time; so better risk management is essential for Australian agriculture.

Mick Keogh, Executive Director of the Australian Farm Institute, explained that current risk management strategies have potentially high, but largely hidden costs, and that there are political and productivity costs associated with inefficient risk management systems. He also explained that the deregulation of government support measures over the last decade has contributed to Australian agriculture's heightened risk profile.

The Hon. Rick Colless, member of the NSW Legislative Council, explained that the NSW Government spent \$400m on drought assistance from 2002-03 to 2010-11.

1.2 The Insurance of Drought or the Drought of Insurance?

Participants at the Symposium heard that many farmers underestimate their level of risk, so they are reluctant to buy insurance, lacking the understanding or right advice to purchase the insurance cover they need. Many producers do not believe they get value for money for their insurance dollar. Insurers do not always have the solutions that producers need. Other farmers face difficulties obtaining the appropriate level of cover for their needs.

Taking and managing risk is part of what producers must do to create farm profits. But without insurance cover, producers 'punt the season' and take excessive risk, according to Coonamble grain producer, David Taylor. They may also be hesitant to forward sell their crop due to potential impact of a production problem. Lacking confidence, producers get locked into inferior grade spreads.

Investment is the key to unlocking the full potential of Australian agriculture. To provide investors and farmers with the risk management framework they need, innovative insurance products are needed.

However, some producers did purchase the insurance cover they needed in 2014. Andrew Trotter of Latevo International recounted the company's experience with their 2014 pilot program of Multi-Peril Crop Insurance. He explained that 2014 has been one of the worst seasons across Eastern Australia due to a lack of rainfall and extreme frosts, on a par with the bad seasons of 2002, 1982 and 1967. Of the 29 Latevo policyholders in 2014, seven have claimed on their policy, triggered by trading at a loss this season. The largest payout of \$994,000 will go to a Southern Queensland grain farmer.

¹ Here is the link to the papers presented at the Symposium:

<http://www.strategispartners.com.au/symposium-papers/>

2 THE WAY FORWARD

Mick Keogh recommended that a unified industry approach is required, incorporating all of agriculture not just crop enterprises.

2.1 Roles for Government

Establishing agricultural insurance markets is one of those wicked problems. The solution requires wise policy making by Governments to avoid crowding-out the market, while putting in place the institutional foundations to enable insurance markets to function effectively.

All insurance markets are in the end, political constructs, in the sense that regulations and Government incentives define them. In many cases it is only the provision of a government backstop that makes it economically viable for the insurance industry to provide adequate coverage at affordable prices. Think health insurance, workers' compensation, social security, superannuation, home mortgage insurance, and compulsory motor vehicle insurance. These institutions are ultimately determined in the realm of politics.

At the Symposium John Thomson from RSM Bird Cameron proposed a number of policies for Governments to consider as a way of strengthening the foundations of agricultural risk management:

- \$5000 Drought Preparedness Grants to 'nudge' producers to get insurance cover
- Refundable Tax Offset Premium Deduction Incentives
- Concessional loans for "100% No Plant" insurance policies
- 200% Stop Loss to encourage unlimited Re Insurance Capacity and confidence for Investment Capital.

Governments can play a lead role in building early warning systems and the data and information infrastructure to help deal with the emerging risks, including the projected increase in climatic variability.

CSIRO's Dr Michael Robertson explained that crop yield forecasting is improving. Over 600 growers now use 'Yield Prophet', a paddock-level modelling tool that is managed by the Birchup Cropping Group.

2.2 Roles for Industry Players

Market development also requires innovation on the part of insurers to develop the right products. Queensland grain farmer Peter Thompson explained that in his region producers are seeking affordable insurance to cover their cost of production.

One approach is that producers should be asking more of their insurance suppliers. Cost-effective insurance requires that insurers design products that control for adverse selection and moral hazard (i.e., carelessness and excessive risk taking) through appropriate underwriting; risk-based pricing and claims adjustment.

For example, the insurance product of Latevo International minimises adverse selection and moral hazard through its farm audit process, which reviews the Farm Financials (last 5 years), the Crop Production Plan and the Grain Marketing Plan.

More agricultural insurance products are needed. Here are some recent innovations:

- Multi-peril crop insurance, for example from Latevo International, address farmers' concerns over commodity price and yield risks
- Index-based insurance products, for example YieldShield and CelsiusPro, facilitate an objective, fast and cost-effective loss-settlement.

Brian Stamper of Willis Re explained that there is plenty of capital available globally to re-insure Australian agriculture.

Farm Advisers can play a key role in explaining to the Farmer the best insurance options. Agri-Banks also have a role to ensure their clients are properly insured.

2.3 Ag Risk Exchange: A Community of Practice in Agricultural Risk Management

Developing an Australian Community of Practice in agricultural risk management is an essential step forward. To remedy gaps in knowledge and to build resources for agricultural risk management, Strategis Partners is launching in 2015 a web-platform called ARX; short for Agricultural Risk Exchange.

In planning their enterprise, farmers often face situations of overwhelming choice, information overload, and information uncertainty. No more so is this the case in purchasing insurance. They are balancing multiple goals, including avoiding regret, satisfying the conditions required for bank credit, appearing prudent to others, maintaining a relationship with insurance agents, and avoiding premium payments that are too high – all in addition to reducing their chances of a catastrophic loss.

To assist on these decisions, ARX will be a place for exchanging know-how on agricultural risk management, providing education and training in risk management. Its initial focus will be Crop Insurance. But ARX will expand to cover all forms of risk management across all commodity sectors, with a range of services to its members:

- **ARX Resources** will provide tools and data for risk analysis and decision-making. Governments will have a forum for policy updates, and producers will have access to training material; for example on getting the right insurance cover.
- **ARX Focus Groups** gives members the ability to share agricultural risk management practices and learn how to apply them better as they interact regularly.
- **ARX Marketplace** will provide producers, farm advisers, financiers, and insurers with market intelligence that drives new risk management business opportunities. It aims to help members stay on top of developments, and enhance their ability to respond with new offerings.

Over the coming months Strategis Partners will be calling on industry and governments to participate in ARX; by way of membership, sponsorship, and knowledge resources.

3 BIG BENEFITS WILL FLOW IF WE GET IT RIGHT

3.1 Benefits for Producers

Greater farmer confidence as a result of investing in Crop Insurance is a key behavioural change observed by Symposium speakers, including Sam Davies of Landmark Services, Mark Martin of MarketAg and Coonamble grain farmer David Taylor. There is a direct link between agricultural productivity and farmer confidence. It lifts producers' confidence to invest in measures to maximize crop yields, try new things and make more money.

The urge of producers to 'punt the season' is reduced.

Producers benefit through crop insurance in the following ways: Higher productivity through crop specialisation is how a producer can respond, given increased insurance cover. With higher productivity, farm profit margins improve.

Mark Martin of MarketAg observed that crop-marketing strategies could be improved with insurance, since farmers would have the confidence to increase the percentage of forward-sold grain using derivatives.

Effective risk management enhances a producer's reputation. Effective risk management reduces the volatility of farm earnings; it thereby reduces the costs of financial distress.

3.2 Benefits for Insurers, Bankers and Farm Suppliers

Strategis Partners estimate that some \$20 billion of Australian agri-commodity income at risk in any one season can be covered through insurance – across broadacre crops, sugar cane, cotton, rice, beef cattle, dairy, sheep, wool and horticulture. This huge market for insurers remains virtually untapped.

New entrants such as Latevo International and CelsiusPro are demonstrating the power of innovation to change the competitive landscape in agricultural insurance.

With crop and livestock income insured, up to \$8 billion of additional bank finance could be unlocked for agriculture. This is good for banks, good for farm suppliers, and good for regional economies. Garry Gale from nabAgri explained that any products that reduce risk such as crop insurance appeal to farm lenders.

3.3 Benefits for Government and Regional Communities

With Government stimulus such as through the removal of stamp duties on insurance premiums, introduction of 'no plan' incentives and stop-loss support, social and economic benefits can accrue:

- Stronger regional economies, through reduced volatility of farm earnings
- Reduced demands for public support during drought, including reduced transfer payments.

John Thomson's paper explained that the fiscal impact of the general adoption of comprehensive crop insurance is threefold:

1. A significant reduction in the volatility of taxable incomes flowing from farm businesses;
2. Current and carry forward tax losses substantially reduced or extinguished as a direct result of the receipt of insurance proceeds; and
3. Reduced opportunity for Farm Management Deposits (FMDs) to be used for aggressive tax planning.

4 CONCLUSION

The case for Australian producers, their financiers, insurers and advisers, as well as Governments, to develop a deeper understanding of how to manage agricultural risk exposure through insurance is overwhelming.

The overriding goal now must be to develop individual, organisational and industry capacity to deal with unfolding weather, climate and biosecurity risks.

4.1 Embracing risk as a source of advantage

In conclusion, we must also remember that the original concept of risk, derived from early seafaring ventures, contained a powerful sense of opportunity and reward, not just downside risk and danger.

Successful producers will be those that are best able to develop strategies, which are defensive and focused on avoiding downside risks, together with strategies, which embrace risk and make the most of the opportunities it presents. A bigger menu of uncertainties provides innovators with new opportunities to create upside risk.

With insurance the fear that paralyses initiative is diminished. The Roman Stoic philosopher, Seneca says:

*He who fears nothing is a king. Delivered from fear, man is king of creation; he can dare to venture; the ocean itself obeys him, and he entrusts his fortune to it.*²

² Quoted in Francois Ewald. 1991. "Insurance and Risk", pp. 197–210. From Burchell G, Gordon C, Miller P, Foucault M. 1991. *The Foucault Effect: Studies in Governmentality: With Two Lectures by and an Interview with Michael Foucault*. London: Harvester Wheatsheaf.

APPENDIX 1 ATTENDANCE AT THE SYMPOSIUM

Below is the list of organisations represented at the Symposium on the Future of Crop Insurance, 2nd December 2014 in Sydney.

- ABC Rural
- Achmea
- AgriRisk
- ANZ Bank
- Assefinsure Pty Ltd
- Australian Farm Institute
- Bayer CropScience
- Birchup Cropping Group
- Bureau of Meteorology
- Commonwealth Department of Agriculture
- CSIRO
- Dairy Australia
- Delta Agri
- Department of Environment and Primary Industries, Victoria
- Department of the Prime Minister and Cabinet
- Echo Hills Farming Co
- Envoy Advanced Technologies Pty Ltd
- Fairfax Ag Media
- Grain Corp
- Grain Growers Limited
- Grain Producer, Coonamble
- Grain Producer, Queensland
- Grain Producers Australia Ltd
- GrainFlow
- Hannover Re
- High Commission of Canada
- Insurance Facilitators
- Landmark Farm Services
- Latevo International
- MarketAG
- NAB
- National Rural Insurance Group
- NSW Farmers
- NSW Parliament
- NSW Trade & Investment
- PIRSA, South Australian Government
- Regional Development Australia – Orana
- RSM Bird Cameron
- Rural Affinity
- Rural Finance
- Strategis Partners
- Syngenta Australia Pty Ltd.
- WA Farmers
- Willis Re.

APPENDIX 2

STRATEGIS PARTNERS' RISK MANAGEMENT PRACTICE

Strategis Partners advises clients in Australia and Asia on their toughest and most urgent problems – delivering higher returns through better investment decisions, faster business growth, and superior customer value propositions.

Our clients are in agriculture, commodity processing and supply chain management, food and beverage manufacturing, retailing and distribution.

We serve commodity producers including dairy, tree crops, cotton, grains and pulses, livestock, sugar, wheat and wool.

The Analytics of Risk Management

Since the 1990s consultants with Strategis Partners have practiced the analytics of risk management including Monte Carlo risk analysis, Decision Analysis and Real Option Valuation. Projects realised a wide range of strategic benefits: better decisions on production capacity expansions, more accurate pricing of assets in competitive auctions, all-inclusive cost-benefit analysis of vertical integration decisions, and full value recognition on market entry decisions.

Scenario Planning: strategic logic and imagination for designing better futures

The Strategis Partners Program, *Strategy in the Face of Disruptive Change*, is designed to help companies deal successfully with disruptive change.

Scenarios deal with two worlds: the world of facts and the world of perceptions. Their purpose is to gather and transform information of potential strategic significance into fresh perceptions within, then lead to strategic insights that were previously beyond the team's reach.

For more information, visit:

<http://www.strategispartners.com.au>