MULTI-PERIL CROP INSURANCE: CHALLENGES AND OPPORTUNITIES

Australia is one of the few developed nations without major MPCI policies, but recent federal and NSW government support is fuelling hope that the product is finally about to take off.

by David Barbeler

"Farmers are tyre kickers," explains Latevo International's Andrew Trotter, "they like to have a good, long hard look at things for a year or two before jumping in."

When it comes to the multi-peril crop insurance (MPCI), farmer wariness is just one of the many challenges facing the market. And to be fair, who can blame them? After all, any household being asked to fork out $50,000 for an average insurance premium wants to make sure they're getting their money's worth.

It doesn't help that several waves of MPCI products have come and gone over recent decades, giving rise to "bad connotations", says Trotter. However, there is renewed optimism from insurers and farmers alike that the product will finally take hold in the Australian market.

That's because governments are starting to throw their support behind the concept. In March, Deputy Prime Minister and Minister for Agriculture, Barnaby Joyce, announced farmers could claim a one-off rebate of up to $2,500 on the cost of getting advice on an insurance policy covering threats to productivity.

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The NSW government also recently ordered a review of MPCI incentive measures by the Independent Pricing and Regulatory Tribunal.

The draft IPART review, released in July, found MPCI was unlikely to displace government assistance, such as concessional loans and household support payments, during drought periods. But it did find that providing an upfront subsidy for this insurance could play an indirect role in increasing crop farmers' self-reliance in drought.

NSW REVIEW DELVES INTO MPCI

The key issues of stamp duty waiver, premium subsidy and the role of multi-peril crop insurance (MPCI) in the NSW drought strategy were hotly debated at a public hearing held last month by the NSW Independent Pricing and Regulatory Tribunal (IPART) in Sydney. As part of the state government's drought strategy to assist farmers, IPART had developed a framework for evaluating drought programs to allow for a consistent assessment of whether they were effective, efficient, equitable and complemented Commonwealth initiatives. MCPI is one of a number of measures being reviewed under this framework. IPART had made draft findings was that MPCI could play an indirect role in increasing crop farmers' self-reliance during droughts but it was unlikely to displace government assistance. Its reasoning included that existing products are offered on a year-by-year basis and that 80 per cent of current government assistance was to livestock farmers. It also said that waiving the 2.5 per cent stamp duty was considered to be too small to encourage uptake of MPCI.

On a more positive note, IPART said that providing a subsidy for annual premiums was likely to help increase uptake and complies with the drought framework. While welcoming the NSW government's initiative, many disagreed with the recommendation that the stamp duty waiver would not encourage uptake. Some pointed out that it was contradictory to apply a compensatory measure such as a premium subsidy and then imposing stamp duty on that. Many also noted that stamp duty was a real barrier to farmers' uptake of MPCI.A few also debated the effectiveness of a premium subsidy. Those opposed argued that it would destroy innovation, while others agreed that a subsidy would increase uptake of MPCI and help farmers be more self-reliant. However, an insurer questioned the step-down approach to subsidisation, saying that once the subsidy drops, there might be a reduction in participation. Importantly, it was pointed out that IPART's approach in considering MPCI as an adjunct to the drought assistance framework, rather than as an integrated part of any response, biased its recommendations in the negative direction. The insurer suggested that when you start considering that there may be offsetting government revenue opportunities then aspects of the analysis would become more positive. Further, product design could also answer some objections IPART had, such as providing a product for livestock cover, or providing MPCI over a longer term. Comment on the draft closed on 15 August and IPART is set to report back next month.

"This is a monumental opportunity for brokers," says Trotter, chief executive of leading MPCI provider Latevo International and an established voice in the industry.

"Two of the biggest brands in the country – the Australian federal government and the NSW government – have now put their weight behind this concept."

David McKinnis from Steadfast agrees MPCI has enormous potential. After all, Australian Bureau of Statistics figures show that the combined value of winter crops wheat, barley, canola and oats for the 2014-2015 financial year was $11.6 billion.

"This is quite a big untapped market, and there's no doubt insurance brokers have a big role to play here," the manager of rural and regional brokers and authorised representative groups says.

THE NEED FOR MPCI

A farmer's livelihood can be destroyed by about 20 risks. A short list of those covered by Latevo include flood, hail, wind, frost, lightning, excessive rain, temperature stress, snow, hurricane, cyclone, tornado, fire, pests and plant disease – a significant expansion from the three risks currently covered under most crop insurance policies (hail, fire and less often, frost).

As it stands, less than a handful of insurers – including ProCrop (partnered with CGU), Primacy (powered by Allianz) and CelsiusPro – have dared to enter the MPCI market.

Yet the need for more advanced MPCI models has never been greater: as the Centre for International Economics (CIE) noted in its cost benefit analysis to the NSW government, "current climate variability statistical forecasts are likely to be less useful as a result of climate change".

Victorian Farmers Federation Grains Group President Brett Hosking agrees climate variability is a farmer's biggest risk.

"Our most valuable input is rainfall in the Australian grains industry. And it's something we have no control over whatsoever. So, I think MPCI has got a real role to play," he says.

But increasingly extreme and unpredictable weather won't just mean extra costs for farmers, it could also place additional strain on the public purse, says Innovative Risk Transfer Director David Blackett.

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The crop insurance specialist says it would be "monumentally wasteful" for governments to keep giving hand-outs to entire areas of farmers located in drought or flood declared regions.

"The problem with a government bail-out is there is no correlation between actual loss and what people get paid, and I think the private sector for MPCI can provide that benefit where the government can't," Blackett says.

Latevo's Trotter adds that crop markets in Canada, the USA, Brazil and much of Europe have long standing insurance schemes for this very reason.

"They know that if they support the farmers, it gives a kick to productivity and also when disaster strikes the communities aren't left high and dry," he says.

RISKS AND CHALLENGES

Insurers might be keen to see a sharp uptake, but they still have to tread carefully. That's because one of the biggest challenges facing them is an information imbalance.

"Unlike most (insurance) buyers, the farmer probably knows more about his risk than you do as an underwriter – and as long as that is the case, he is going to make money out of you," says Blackett.

"But we're now getting to the point where that asymmetry of information is eroding rapidly. So, with better weather data and a more sophisticated approach to modelling farmers' activities, I believe that we can actually rate MPCI."

Then there is moral risk, adds Blackett, when a farmer may stop spraying for pesticides because he has purchased comprehensive MPCI cover, for example.

"The moral risk is very high with crop insurance and so there needs to be a sharing of that risk," he warns.

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Insurers have also realised that one-size-fits-all policies will send them bust, fast. So they're increasingly carrying out individual assessments of each farm and farmer.

HOW MPCI TURNED ONE FAMILY'S FORTUNES AROUND

Game changing. That's how the Mace family describes their 2014 multi-peril crop insurance (MPCI) claim against drought. The Mace family – which includes Alistair, 30, brother Stuart, 28, and their parents Harry and Bindy – grow winter cropping grains and pulses in Nindigully, southern Queensland. Alistair first heard about MPCI at the Profarmer marketing road show in September 2013. There were about 30 growers at the meeting and he recalls that the general consensus was that it all sounded a little "too good to be true". However, the Mace family looked into it further and after following up with Latevo, decided that MPCI was the right way forward. "We just couldn't afford to take the risk of losing the season's income," explains Alistair.

The season started off well enough, with good planting rains and above-average crop establishment. But conditions soon started to dry out and yield potential slipped. The Mace family harvested everything they could, but with such low yields their grain revenue per hectare was significantly below their insured amount, which enabled them to claim against their MPCI policy. With their cover, the Mace family and their bank knew they would be guaranteed an income, which went a long way in getting them through one of their toughest ever production years. That's because the model ensures that if grain growers experience a bad season, they can at least break even and start the next year in exactly the same financial position as they did the year before. "This has the potential to be the biggest fundamental change we will make to the way we are going to farm," says Alistair. The family says they now treat MPCI as a necessary input. "If you put it into a gross margin, the premium costs less than a contract header – and we had one of the more expensive policies in Australia," he says. "The majority of policies were less than a fallow spray. For us the cost worked out to be $29/ha to guarantee an income of $329/ha. "What's more, with the insurance in place, we had the confidence to sell our grain forward early in the season to take advantage of better prices. So the higher prices we were able to achieve more than offset the cost of the insurance." And while there's no shortage of growers who are still hesitant to take out MPCI cover, Alistair points out that the runs are now on the board. "There have been large payouts to growers in peril, which should boost interest and confidence," he says.

"One farmer may plant his crop three weeks later than his neighbour, for example, so there's so much variation in the same environmental conditions due to individual management approaches," Trotter explains.

"Without individual assessments, we wouldn't be able to operate. It's a long and a hard road to do it. We all hate it – one by one, who wouldn't? But that's what it's going to take."

FEASIBILITY

So after the failed attempts of seasons past, is there enough demand to make MPCI feasible? Well despite the challenges, insurers and farming groups alike believe so.

"There will be growers who say 'nah that's not for me' – you know, the ones who are already well established and have good equity," says Victorian Farmers Federation (VFF) Grains Group president Brett Hosking.

"But those young guys who are trying to expand and grow at a rapid pace – it's a perfect product for them."

However, Innovative Risk Transfer's Blackett, who has more than 24 years' experience in general insurance and risk management, believes the way MPCI products are currently structured make them unfeasible.

"Insurers are offering annual policies, and nowadays drought can be foreseen months in advance," he explains.

"Therefore farmers are going to want to buy insurance when there is a drought coming, and not buy it when there isn't a drought coming."

Insurer ProCrop has just experienced this first hand. In 2015 – its second year in the

MPCI market – it wrote in excess of 85 policies across Victoria and South Australia.

Yet because most of their clients were based in western Victoria, where grain producers suffered one of the driest springs on record, they received claims from more than 80 per cent of their clients.

"In Victoria, it was a disaster as you know," product manager Bob Smith told the ABC.

"We paid a lot more than what we received in premiums."

This is why Blackett argues that because drought is a multi-season risk, policies must at least straddle that risk period.

"Insurers are going to need to provide multi-year MPCI policies, and I am not the only person that has come to that conclusion," he says.

THE WAY FORWARD

So if the appetite is there, for both farmers and insurers, how can they best connect? Many believe state and federal governments should continue to step up to the plate.

"Farmers need government nudge policies to change their behaviour. They think 'dad has never bought it, so why should I?," says Trotter.

VFF's Hosking says IPART's premium subsidy recommendation is a great start.

"Insurers don't want to spend millions of dollars developing a product that nobody buys. So if we've got these incentives in place that will ensure some uptake, then I think we'll see insurers play and test the market," he says.

WAFarmers CEO Stephen Brown adds: "I don't think the MPCI market is going to get full government assistance. But if we could simply get things like stamp duty on the policy abolished by state governments, that would be an enormous help – just to get it going for three years."

As it stands, there isn't a whole lot of action being taken by other state governments, yet. Up in Queensland, Katter Party MP Robbie Katter believes MPCI could be the saviour of the Australian rural industry, but the Palaszczuk Government is yet to take decisive action on the issue.

"Agriculture is a game of snakes and ladders, and the snakes will always be there to tear your crop down," the Mount Isa MP said.

"This just takes the snakes out of the snakes and ladders game."

Yet with two of Australia's largest governments now on board, as well as farmer advocacy groups, optimism abounds.

The only fear is that uptake won't occur quick enough, resulting in insurers putting MPCI in the too-hard basket once more. Enter brokers, who have as important a role as anyone out on the paddock.

"If we don't get some volume shortly, the insurers will take their cricket bat, go home and that'll be the last chance we'll ever have," says WAFarmers' Brown.