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Dr Peter J Boxall
Chairman
Multi-peril crop insurance incentive measures
Independent Pricing and Regulatory Tribunal
PO Box K35,
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Review of multi-peril crop insurance incentive measures draft report response

Dear Dr Boxall,

Thank you for the opportunity to respond to IPART's draft report into the Review of multi-peril crop insurance (MPCI) incentive measures. We will respond by addressing and providing feedback on each finding of the report.

The draft report has seven findings:

Multi-peril crop insurance could play an indirect role in increasing crop farmers' self-reliance during droughts.

Innovative Risk Transfer agrees with this draft finding, given the framework of IPART's review and the current MPCI policies in the market.

However, we strongly believe that the currently available MPCI policies are not commercially sustainable, nor do they offer a viable drought risk transfer mechanism for farmers. We believe that alternative policy approaches could provide viable drought risk transfer which would be attractive to farmers and, as a consequence, increase farmers' self-reliance.

Multi-peril crop insurance is unlikely to displace government assistance, such as concessional loans and farm household support payments during droughts.

Again, Innovative Risk Transfer agrees with this draft finding, within the boundaries of the current review and MPCI product scope. Particularly given that 80 percent of all drought assistance measures are provided to livestock producers.

An upfront premium subsidy complies with the drought framework.

Innovative Risk Transfer agrees with this finding in the context of IPART's draft report. Furthermore, we believe a premium subsidy would stifle innovation and remove any commercial imperative to limit insurer costs. Any multi-peril insurance policy must be self-sustaining, for both insurers and farmers.

As with findings 1 and 2, we believe that the right MPCI product can, over time, have a direct role in both increasing farmers' self-reliance during droughts and displace government assistance for all but the most extreme and prolonged drought situations. There may be benefit in short-term subsidies to generate a sustainable premium pool. However, the product must ultimately stand alone.

A 5-year stamp duty waiver on insurance premiums does not comply with the drought framework, because it would not be effective in achieving its objectives. In addition, it is not complementary with the upfront premium subsidy, which would be more effective in achieving the same objective.

We disagree with this finding. This measure would not be complementary if no upfront premium subsidy is to be provided — the likely outcome from this review. If the goal of government is to support self-reliance, why make it harder by taxing it? In our view this is not good public policy.

In terms of effectiveness, the issue is not the extent to which a waiver of the stamp duty would increase the uptake but to what degree it would inhibit the uptake of MPCI. To answer this question, we need to contextualise the amount of stamp duty involved, as 2.5% seems a low percentage but in the context of MPCI it is not.

- Allianz have indicated that the average premium is about $25,000 and the stamp duty is about $625 — this is equivalent to the amount this farmer is likely to be paying for their public liability premium.
- The Centre for International Economics (CIE) have estimated that only 5-6 additional policies would be purchased during a five-year waiver of stamp duty. We believe this is an overestimate and that the number of additional policies purchased if there was a waiver of stamp duty would be nil. However, in our experience, the number of policies that would *not* be purchased due to stamp duty would be at least a factor of 10 times their estimate of additional policies purchased.
- As MPCI is currently not purchased by the majority farmers, the argument that waiving stamp duty for five years would cost $400,000 is not justifiable.
- As has been highlighted, the purchase decision by farmers will be highly dependant on the costs of the insurance. We would aim to keep the costs down to 22.5% of the premium. The addition of a 2.5% stamp duty would increase these costs by 11.1%.
- When the farmer is assessing the value of the MPCI product there is a significant difference between a 77.5¢ in the dollar return from the insurance to a 75¢ in the dollar return on the insurance — 2.5% may

sound like a small amount but in a price sensitive decision making environment it can make all the difference between purchasing or not purchasing the product.

We understand the gravity of waiving stamp duty and, given our belief that they are unsustainable, are not advocating that the waiver be granted for existing MPCI policies. However, if a drought cover was available that provided a direct displacement of government assistance, then a permanent exemption from stamp duty would be good public policy.

The NSW Farm Business Skills Professional Development Program does not comply with the drought framework, but can be redesigned to comply by removing the overlap between it and the Commonwealth Managing Farm Risk Program.

In combination with the Draft Recommendation – that the NSW Farm Business Skills Professional Development Program be redesigned to exclude the preparation of financial and production data from being eligible for a rebate, we agree with this finding subject to additional clarification. If the intention is to simply remove the overlap with the federal government program, then this is appropriate. Extending the redesign to remove any other benefit of the program would be counterproductive.

In addition, it would be helpful to clarify if training in risk modelling and risk transfer techniques was considered a business skill and covered under the NSW Farm Business Skills Professional Development Program. The greatest impediment to the uptake of a drought insurance is the level of costs in the premium. If, in the initial stage of the life cycle of these products, the education of farmers in the pricing and coverage provided by a drought insurance could be recovered from a government program, then the overall cost of the policy could be significantly reduced.

Additional weather stations comply with the drought framework.

We agree that additional weather stations will be beneficial. Impartial sources of information are important for accurate underwriting.

Sharing information with insurers does not comply with the drought framework because it would not be effective in achieving its objectives.

We agree with the draft finding that this would not be effective in achieving its objectives. There is unlikely to be a strong correlation between drought relief payments made by the New South Wales government and claims that would be paid under a MPCI policy. This information would therefore not be appropriate for MPCI pricing.

Conclusion

The New South Wales government is examining MPCI against the Drought Program Evaluation Framework to explore the potential for MPCI to help achieve the aims of the NSW Drought Strategy.

We recognise that this limits the discussion about the value of MPCI within these parameters. However, the overall potential value of MPCI to farmers, the broader agricultural community and government should not be overlooked.

Innovative Risk Transfer is of the view that MPCI, as it currently stands, is not an effective method of drought mitigation, nor the most effective way to minimise farmers' reliance on government assistance during drought episodes, whether prolonged or cyclical.

A properly designed agricultural multi-perils insurance (AMPI) could, however, become a very effective drought mitigation tool if it is adapted in two main ways: it becomes a multi-year, not annual, product; and it is extended to cover livestock and other agricultural sectors, not just selected winter crops.

Kind regards,

David Blackett
Managing Director