New insurance product a valuable risk management tool

GRAEME JENNINGS

A new risk-management tool, available for the first time this year, will make it possible for SA growers to guarantee themselves a level of income from their 2014 cropping programs.

The new 'tool' is 'revenue insurance' being offered by Latevo, an Australian company with its roots in Canada and under-written by international insurance giant Allianz.

The company launched a similar product in Canada about three years ago, according to National Manager Justin Simpkins.

At first glance this is multi-peril crop insurance, but the Latevo product targets income and takes account of price as well as production.

Given the income-based structure it seems likely growers will see it as 'drought insurance'; something many would consider the holy grain of crop insurance in Australia.

Farmer organisations have long sought access to multi-peril crop insurance for their members but multiple enquiries over more than 30 years have considered it to be impractical in the Australian environment without financial support from government or involvement of a global insurance under-writer.

The Latevo product uses the underwriting mechanism; the involvement of Allianz spreading risk across an international base.

Mr Simpkins suggests that any grower interested in revenue insurance contact the company soon, so they can have protection in place before they start seeding.

"There is more involved in revenue insurance than in insuring a house or a header, for example," he said, "and the application and approval process takes time.

"We go through a formal process that begins with an expression of interest from the farmer and moves on to a production and income audit of the previous five seasons; a process similar to the heath check required when purchasing life insurance.

"Identifying the revenue figures might take a few hours for growers who don't have this information readily to hand, but it is essential to the insurance program and the information is a valuable management tool in its own right. And because our product is based on solid actuarial calculations and grower figures are scrutinised by an independent accounting firm as part of the process, we require the information in a specific format that meets our needs.

JUSTIN SIMPKINS.

"In most circumstances a grower could expect to receive a quotation and letter of offer three to four weeks after providing the relevant income assessment information."

The revenue insurance concept, which Mr Simpkins describes as a 'safety net' for growers, was born out of 30 years of trial and error in the Canadian agricultural insurance market ."This revenue-based product is similar to one that has been available in Canada for three years, supporting improved farm management and profitability," he said.

"It unlocks access to working capital and introduces competitively-priced catastrophic risk mitigation, an option that is relevant to Australia's variable climatic conditions.

"And because it is based on revenue and not yield, it is more than just insurance.

"Revenue protection insurance protects a grower's equity by protecting cash flow. A negative cash flow results in a loss of equity, and in the current financial environment losses due to drought, frost or other peril can reduce farm equity below a level acceptable to a financier."

The product is designed to maintain cash flow by guaranteeing revenue.

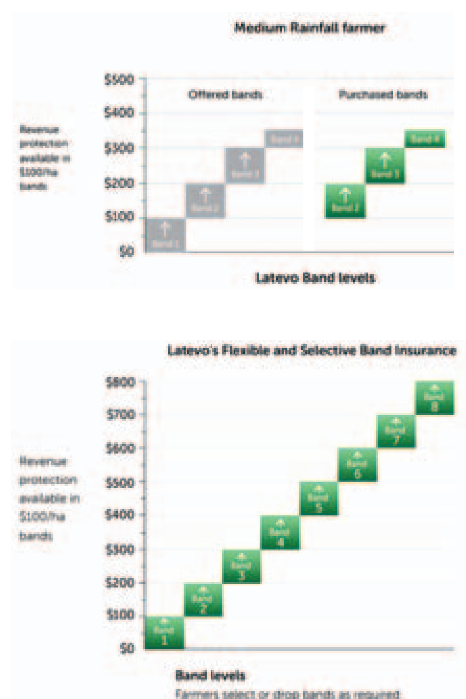
"This provides a new way to ensure cash flow and access to additional working capital," Mr Simpkins said.

"The support of the banks has been very positive. Westpac has indicated it will consider crop revenue insurance as an asset in its own right, with the other banks due to announce their positions in the New Year.

"Cover of this type is effectively a guarantee of revenue, which enables the grower to go to a banker and negotiate on the basis of an assured income for the year, which has the potential to reduce the risk profile of farmers so the banks will be able to provide access to more working capital at a lower cost."

Because it insures revenue, not yield, the Latevo insurance is available only as a whole-farm product.

"There is no potential to, for example, insure only the canola or the wheat. The calculations on which it is based have been made on the basis of risk across



REVENUE INSURANCE A BREAKTHROUGH

Multi-peril crop insurance, which Latevo's new Australian product re-interprets as revenue insurance, is a well-established risk-management option overseas, with many governments subsidising multi-peril crop insurance for their growers.

In the US, for example, the Government subsidy for multi-peril crop insurance equates to around 60% of the premium and between 2007 and 2011 averaged $US5,220 million a year, according to a 2012 National Rural Advisory Council report on the feasibility of agricultural insurance for weather-related production risks in Australia.

Multiple studies and enquiries have identified a need for Australian governments to subsidise the cost of multi-peril crop insurance as a major impediment to providing this type of protection for Australian growers, with at least three studies discounting it as not viable or feasible without government subsidisation of premiums or under-writing of risk.

Other issues identified as impeding access to multi-peril crop insurance in Australia include reservations about the 'volatility' of Australia's weather, concerns about the commercial viability of such a product because of the relatively small number of dryland grain producers in Australia and the lack of ability to spread risk in the face of a national drought, for example.

A Federal Government review of the potential for multi-peril crop insurance in 1999 and 2000 identified strong grower demand for such insurance but, like other enquiries before it, identified little chance of such insurance being made available in Australia, partly because of anticipated low grower uptake due to the availability of government drought relief and mechanisms such as Farm Managed Deposits (FMDs).

In its 2012 report on the issue the National Rural Advisory Council found that, in other countries, multi-peril crop insurance is not commercially viable without significant and on-going government support and that the cost of un-subsidised premiums is beyond what most farmers are willing to pay.

"NRAC concludes that, given the volatility of Australian agriculture, the projected increase in climate variability and insufficient data to underpin agricultural insurance, there is no evidence this situation would be different in Australia and in fact may be more pronounced," the report says.

The various enquiries and studies carried out in the past 30 years or so also pointed to 'moral hazard', 'adverse selection' and 'systemic risk' as risks inherent to this type of insurance.

'Moral hazard' relates to the risk that growers who insure their cropping incomes might have less incentive to manage and market their crops well and not do everything possible to maximise crop performance and yields; a risk that seems likely to be negligible given the mind set of most growers and the fact that, in the case of the Latevo product, each year's performance impacts on the five-year average income and so the level of cover available the following year.

'Adverse selection' is the risk that growers will take out insurance only if they believe the odds of a payout are better than those the premium is calculated on and is the major reason most crop insurance schemes fail, according to Associate Professor Greg Hertzler, principal research fellow in Agricultural and Resource Economics at the University of Sydney.

"Farmers know more about their farms than the insurance company so can make decisions that advantage them against the insurer."

Latevo's revenue insurance product addresses that, at least in part, through the requirement for an audit of the recent cropping income of each grower seeking cover and the provision of coverage only for an entire cropping programs, not some crops or sections of the program.

'Systemic risk' relates to the ability to spread risk within the farming system.

Fire and hail, for example, affect only a few farmers at a time but widespread drought or price changes affect all or at least large parts of the cropping 'system'. According to Associate Professor Greg Hertzler, principal research fellow in Agricultural and Resource Economics at the University of Sydney, it is unlikely any crop insurance program could have survived the recent droughts in Australia.

While many of the historic studies identified the need for government support as the main impediment to making multi-peril crop insurance available to Australian growers, several identified involvement of an international insurance under-writer a possible alternative to government subsidy and that is the structure that has made the Australian Latevo product possible.

The company's partnership with Allianz addresses the 'systemic risk' issue and makes it viable to offer this type of insurance in Australia, where widespread drought has the potential to see a high percentage of insured growers making claims, said Justin Simpkins.

The company is also aiming for a broad geographic spread of clients to within Australia to spread 'local' risk. Seasonal conditions in Queensland, for example, are likely to often be quite different from those in SA in any given year.

For more information visit www.latevo.com or phone 1300 528 386.

a full cropping program," Mr Simpkins explained.

Payouts are triggered by the effects of a natural peril such as frost or lack of rain claims are calculated on the difference between the farm's actual income and the insured income level.

Coverage is offered in $100/ha bands, which enables each grower to customise his policy so it is appropriate to the risk profile of the farm.

"The 'band' structure enables the product to be matched to income levels across all the widely different rainfall zones and productivity levels in Australian farming," Mr Simpkins said. "It also opens the way for individual farmers to customise it to their individual needs and circumstances.

"Each grower can select more or less of the bands up to the limit determined by the five-year average of cropping income.

"Some will opt for a level of cover that will just cover production costs. Others will look to guarantee a margin of profit.

"Being able to buy particular bands of cover also opens up options to balance the cost of protection against the grower's calculated level of risk or to reduce the up-front cost while maintaining a targeted level of cover, albeit at risk of a lower payout in some circumstances.

"For example, a grower who takes up an offer to buy coverage for all the bands up to $500, assuming his average justifies that, is assured of $500/ha if all his crops are wiped out by flood or fire and generate no income.

"If the same farmer decided not to pay for $0 to $99 coverage he would receive only $400/ha because he did not insure for losses in that range; a decision that means he has effectively 'self insured' for any losses at that level. That means he would receive $100/ha less if all his crops were destroyed or failed completely.

"In a scenario in which the same farmer has an average income of $150/ha for the season he would receive $350/ha pay out whether or not he paid the premium for the $0 to $99 band because the $150 average income from the cropping program means the bottom band is irrelevant in this situation.

"It is up to the individual grower to work through those issues in light of factors such as his cost of production, level of profitability and the reliability of the district in which he is farming.

"The flexibility provided by being able to drop lower bands has the potential to make this product very attractive to producers in more reliable medium and high rainfall districts who do not need insure down to a zero dollar return."

The company's approach to payouts is based on its experience with Canadian growers and the revenue insurance product it offers there, Mr Simpkins explained.

"Immediately after harvest each grower insured with us provides a declaration of his harvest tonnages and estimates of the quality and prices for each of his crops. That gives him and us a guide as to whether or not he is likely to make a claim under the policy.

"If those post-harvest estimations indicate he is well above the threshold income level, no further action is required.

"If they indicate the per-hectare income is likely to be close to the threshold level we have the figures, including price estimations, reviewed by an independent third party. If that review indicates the income from the crops is likely to below the trigger point we pay 30 to 50% of the anticipated final figure to maintain cash flow for the enterprise and ensure the grower and his family have money to live on.

"The situation will be re-assessed as at June 1 in light of the income from grain sold from the current harvest and the value of any grain yet to be sold.

"The value of any grain still in storage at that time is assessed by a third party and the balance of the claim will be paid before June 30."

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