



2/05/2016

Dear Jessica Robinson,

### **Submission to IPART Multi Peril Crop Insurance Information Paper**

IAG welcomes the opportunity to provide a submission to the IPART review on drought assistance.

IAG is the parent company of a general insurance group with controlled operations in Australia, New Zealand, Thailand, Vietnam and Indonesia, employing more than 15,000 people. Its businesses underwrite over \$11.4 billion of premium per annum, selling insurance under many leading brands, including NRMA Insurance, CGU, SGIO, SGIC, Swann Insurance and WFI in Australia. The company also has interest in general insurance joint ventures in Malaysia, India and China.

IAG is the largest rural insurer in Australia and has extensive knowledge of rural insurance through its WFI and CGU brands, and as such is aware that Multi Peril Crop Insurance (MPCI) would have a beneficial impact on this sector. This is why IAG is supportive of any attempts by Governments, both State and Federal, to facilitate this market.

#### **Executive Summary**

- IAG notes that Government has a number of measures available to support primary producers in times of drought
- An infant insurance market offering 'drought' insurance is emerging in the Australian market
- There are significant economic, health and social benefits to Governments and the community through the provision of such insurance:
  - MPCI would provide existing farmers with improved financial security and farming sustainability
  - MCPI would assist in reducing credit risk for financiers, with an option for financiers to provide lower interest rate loans to farmers who purchase MPCI, boosting farm investment
  - MCPI would assist in alleviating financial pressures on farmers and help to ease mental health issues
  - MPCI would help improve economic stability of rural communities through enhanced farming sustainability
  - MCPI would assist young people to enter the agricultural industry sector by improving certainty of income
- MPCI can be viable in the Australian market, subject to appropriate Government support to overcome the key impediments of geographical risk concentration and chronological risk.
- A successful MPCI scheme will require broad national coverage to overcome geographical risk concentration, across a broad range of crop types and through limiting adverse-selection risk. NSW as the most populous state, has the opportunity to lead by example in this new market.
- The primary barrier to MPCI uptake is cost – particularly in regions where the risk is significantly higher. Like all similar schemes around the world this can be alleviated through a Government scheme of premium subsidies and the removal of government charges including stamp duties on insurance

premiums. The cost of these Government support actions would be balanced or exceeded by the savings achieved from the reduction or removal of Government drought and financial farmer support programs.

### **What sources of information should IPART have regard to when assessing the measures?**

A broad consultation process would allow IPART to benefit from the input of the many stakeholders in this area. As Australia's leading rural insurer, IAG would contribute to this process and would provide access to internal subject matter experts to assist IPART in assessing options and measuring outcomes. IAG is committed to a transparent sharing of our extensive knowledge to assist IPART.

This would not only provide greater depth of analysis, but would also allow IPART to understand the technical aspects of such a scheme from an operational viewpoint as well as the financial requirements of a sustainable MPCl scheme.

This aspect of the program should not be overlooked, particularly with regard to reinsurance and ensuring that the product is financially viable in the Australian market.

Furthermore, IPART should understand how successful MPCl programs have been established in overseas jurisdictions.

To that end, IAG proposes that IPART should engage with experts on MPCl from outside Australia, specifically the United States, something which IAG can facilitate.

### **What are the barriers to the offering and uptake of MPCl in NSW?**

IAG acknowledges that there are a number of impediments to the provision of MPCl not just in NSW, but nationally.

IAG is committed to investigating the best ways to overcome these obstacles, whether it is through innovative product development or through Government regulatory assistance. Two key barriers to offering MPCl relate to geographical risk concentration as well as the cost of the scheme, both of which the Government can assist insurers to overcome and there are a number of other key areas to be addressed:

#### **Market knowledge of the product**

While MPCl has been used extensively in a number of foreign markets for some period of time now, its relative newness in Australia means that there is a lack of understanding of what exactly MPCl is, how risk is rated and what event coverage is included.

IAG is committed to increasing knowledge and understanding of the product through training seminars for farmers and the broader insurance market.

Although, insurers who develop MPCl products are naturally incentivised to explain their value to prospective customers and brokers, it would be expected that industry and community groups would also raise awareness of the product.

#### **Market volatility**

MPCl is heavily dependent on prevailing weather conditions which in turn means that it is an extremely volatile market, similar to other markets that are exposed to higher levels of natural peril risk. We have seen the results of this volatility in some of our other farm insurance products, with the volatility significantly impacting on the ability to provide these products at accessible premium rates. Results for these products can be made available privately.

To counteract these concerns, IAG suggests that, comparable to farmer's access to the Farm Management Deposits Scheme (FMDS), insurers be provided with an

arrangement that would allow them to 'bank deposits' in profit positive years for use in years of losses.

This option is currently unavailable to insurers as a result of accounting and tax regulations.

### **Chronological anti-risk selection**

Currently many farmers only take out MPCl if they believe the overarching climatic conditions are going to be poor, either due to drought or another natural peril, creating a significant adverse-selection risk for insurers. The increasing accuracy of long range weather forecasts has contributed to and assists this behaviour.

While insurance is typically offered on an annual basis, farmers' adverse-selection would concentrate chronological risk to such a degree that annual policies may be difficult to provide.

To remedy this, many overseas jurisdictions either:

- a) make the purchase of such a product compulsory, or
- b) allow financial institutions to provide finance at differential interest rates to those who have purchased MPCl (as such institutions know that in the event of poor climatic conditions loan repayments will be supported by insurers), or
- c) Tie the availability of government assistance programs to the purchase of MPCl products

IAG is committed to developing an innovative MPCl product to encourage continuous participation by farmers but Government support in this area will be required.

### **Geographical anti-risk selection**

In order to sustainably offer an MCPI, insurers need a wide geographic spread of risk to reduce the chance of systematic risk.

In order to obtain the required geographic spread a national market, supported by State and Federal Governments including a premium subsidy scheme, is necessary, otherwise premium affordability will limit farmer take up rates and/or participation continuity.

A national scheme would not only provide consistency for insurers and farmers, but it would spread risk more effectively which would reduce premiums and provide greater incentives for insurers to enter the market.

Furthermore, premium subsidies would enable and encourage more farmers to buy the insurance cover and this would enable more widespread take up and participation continuity.

### **Drought Assistance and/or Farm Management Deposit Scheme are possible insurance substitutes**

The financial assistance given by the Federal Government in terms of the Drought Assistance Program and the Farm Management Deposit Scheme may act as substitutes, deterring some farmers from taking up MPCl. To establish a successful MPCl scheme, Governments will need to reconsider providing such substitutes.

### **What issues should IPART take into account when designing a measure to reduce the upfront cost of multi-peril crop insurance premiums?**

There are a number of issues that must be considered when designing a measure to reduce the upfront cost of taking out MPCl. Some can be easily addressed while others will require Governments to work with insurers to effectively design a scheme that delivers on all intended outcomes.

### **Subsidy to reduce upfront cost of MPCI premiums**

Subsidised MPCI premiums would improve their affordability, increasing the uptake of the product and providing the necessary geographic risk diversity that insurers will require. Premium subsidisation is a more efficient means of protecting NSW farmers from natural perils compared to normal disaster assistance schemes, particularly if the MPCI scheme is national, as risk is shared over a larger geographic area.

### **Stamp Duty Waiver**

IAG supports the removal of stamp duty on MPCI premiums. The removal of stamp duty would have an immediate and direct positive impact on premium affordability and would not incur administrative costs for the Government. Furthermore, the Financial Industry Council of Australia (FICA) commissioned Access Economics in 2008 to review State taxes and especially to assess their impact on economic efficiency. The resulting report detailed a quantitative analysis of the efficiency of individual taxes and a number of revenue neutral tax reform scenarios. The efficiency rankings reported that state stamp duty on motor vehicles and insurance are amongst the least efficient of taxes, generating significant deadweight losses. The report is available at: <http://www.niba.com.au/tax/resource/Article13.pdf>

### **Upfront assistance with fees Farm Business Skills Professional Development Program**

The recently launched Government “Managing Farm Risk Programme” will assist the participation in MPCI. Not all insurance companies charge an upfront fee for risk assessment, and there is considerable potential for the scheme to be misused by third parties with:

- a) little or no benefit reaching the farmer, and
- b) no increase in MPCI participation

Premium subsidies would be a far more efficient way of assisting farmers.

### **Conclusion**

IAG is firmly of the view that MPCI is a viable product in the Australian market, especially if the Government addresses the regulatory and structural impediments to the operation of a successful scheme. There are significant economic benefits to the Government, not only in terms of direct budget impacts but also in terms of increased productivity of farms and improving economic stability in rural communities.

To provide the best product, it is important that the Government work with insurers to ensure that the best possible outcomes are achieved, and IAG would like to provide assistance.

Yours sincerely,

Stuart Chapman,  
EGM