



**Matt Brand**  
**Chief Executive Office**

**Ref:2316mb**

6 May 2016

Dr Peter Boxall  
Chairman  
Independent Pricing and Regulatory Tribunal  
PO Box K35  
HAYMARKET POST SHOP NSW 1240

By email: [ipart@ipart.nsw.gov.au](mailto:ipart@ipart.nsw.gov.au)

Dear Dr Boxall,

***RE: Multi-peril crop insurance incentive measures***

NSW Farmers welcomes the opportunity to provide the Independent Pricing and Regulatory Tribunal's (IPART) with feedback in response to its information paper it released as part of its assessment of multi-peril crop insurance (MPCI) incentive measures.

As you would be aware, NSW Farmers made submissions to IPART's development of the NSW Drought Program Framework. To the extent that this submission continues to outline our position on drought policy it has been appended so that it is on the record for IPART's evaluation.

With regard to the role that MPCI plays within drought policy, NSW Farmers specifically supports investigation into the design of MPCI products and the role of government to facilitate the development of a market for such products. However, in the context of an integrated approach to drought policy it is important to acknowledge that there are limitations to the role of insurance. Specifically, as a result of the systemic risk and moral hazard associated with the insurance of farm businesses in prolonged drought conditions, it is unlikely that MPCI policies would be made available in these circumstances or at least at premiums commercially affordable by these businesses.

NSW Farmers also cautions against any approach which would focus too closely on the availability of insurance markets as the solution to all of the economic and regional development problems created by drought. For example, proposals that would seek to reduce the assessment of whether a farmer has made reasonable steps to prepare for drought to the question of whether they have taken out a MPCI

policy underestimate the range of drought preparedness strategies available to farmers.

Such an approach would be likely to distort risk management strategies towards insurance, regardless of whether it was the most appropriate option for that business. This in turn would stifle the development of innovation in the on-farm management of climatic risk.

However, MPCl has the ability to play an important role in providing farm businesses as a risk management option with the potential capacity to:

- Promote profitable operation of farming businesses in favourable seasons, facilitating financial consolidation;
- Facilitate appropriate seasonal financing of operations, reducing the requirement to fund working capital against land values managing risks to farm business equity; and
- Protect necessary reinvestment in farming businesses against further downturn during drought recovery.

On this basis it may be seen that government measures that facilitate the adoption of MPCl may assist as a component of drought policy to meet the following objectives of the Intergovernmental Agreement on National Drought Program Reform:

- *'assist farm families and primary producers adapt to and prepare for the impacts of increased climate variability';* and
- *'encourage farm families and primary producers to adopt self-reliant approaches to manage their business risks'.*

#### Barriers to the uptake of MPCl by farmers

Australian farms face risks associated with both the production and marketing of their outputs. Production risks faced by farmers include the uncertainty created by the potential adverse impact of growing seasons, disease and pests on the quantity and the quality of produce. Production risks are then compounded by the marketing risks of uncertainty over price paid for inputs and received for produce. The Australian Farm Institute (AFI) has identified Australian crop production as having the highest volatility globally both in terms of production and the value of production. Likewise, agriculture also has had the highest volatility with regard to annual value of output in the Australian economy for a period that has extended over forty years.<sup>1</sup> Noting that despite this volatility and a continuing deterioration in terms of trade Australian farmers were able to maintain profitable outcomes, AFI concluded that the Australian farmer is a formidable manager of risk.

Australian farmers utilise a number of production and financial risk management strategies as part of managing the risks posed by drought. Commonly utilised strategies for managing production risk in cropping enterprises include the decision to not plant, to vary the application of inputs or varieties grown or to alter the commodity mix between cropping and livestock production. Livestock businesses implement both supplementary and containment feeding strategies or reduce

---

<sup>1</sup> Mick Keogh, 'Including risk in enterprise decisions in Australia's riskiest businesses' (Paper presented at the 56<sup>th</sup> Annual Conference of the Australian Agricultural and Resource Economics Society, Fremantle, February 2012), 2.

stocking densities through either destocking or agisting. With respect to managing the financial risks of drought, farmers have demonstrated a capacity to self-insure through maintaining high equity levels, using Farm Management Deposits and other cash and investments, or through additional debt.

Decisions to purchase insurance to indemnify against the financial risks of drought are taken in the context of farmers understanding how to use these well known risk management devices; as well as the comparative costs.

#### *Cost of insurance*

Feedback from NSW Farmers' members on the entry of new MPCl products to the market place has been that the current cost of premiums is prohibitive, particularly in comparison to alternative risk management approaches. This feedback is consistent with the evidence received by the National Rural Assistance Commission as part of its study in 2012 and more recently by the NSW Government's Multi-Peril Insurance Summit.

Discussions NSW Farmers has had with its members and insurance providers have indicated farmers currently consider the commercial value of a MPCl product to be around five percent of insured amount. While premium rates remain higher than this level, it is likely that MPCl will only be considered attractive to farms with a higher risk profile. Therefore, resolving the perceived affordability of MPCl is a critical element to managing adverse selection within the insured risk pool.

#### *Comparative cost of MPCl against other risk management options*

As part of the AFI analysis of the risks faced by Australian farmers, it identified the increased accumulation of debt and debt servicing requirements as a result of farm consolidation, particularly in the grain sector, has reduced the financial sustainability of many businesses. This led to the conclusion that for medium-sized broadacre farms it was no longer appropriate to utilise historical views of equity levels as a measure of long term financial viability.

The implication of this observation is that traditional risk management strategies may have potentially high but largely hidden costs. For example, while high equity is a valid short and medium term strategy in managing risk, it may also constrain further business development through debt financing. Further, the real cost of self-insurance only becomes measurable when a production catastrophe occurs. Likewise, commodity diversification may lead to opportunity costs through a less productive use of land.

The hidden nature of these opportunity costs may hinder rational behaviour by farmers in the selection of risk management strategies; particularly with regard to the purchase of MPCl over traditional risk management opportunities.

In addition to designing initiatives with the aim of reducing the upfront cost of MPCl products, measures that assist farmers to evaluate their commercial viability relative to other risk management strategies may assist in overcoming existing demand barriers.

Opportunities exist for IPART to undertake a more detailed price sensitivity analysis to better establish the cost of premiums that are considered commercially prohibitive to purchasing insurance by farmers. This work would both inform IPART's work in developing measures to reduce the upfront cost of premiums, as well as inform the risk management of farmers.

#### Measures to reduce upfront cost of MPCl in NSW

NSW Farmers welcomes the consideration of the Government to waiving the revenue it collects from the potential stamp duty raised for MPCl premiums. In accordance with stage three of the Drought Evaluation Framework, NSW Farmers recommends that any stimulus provided from forgone stamp duty revenue be ranked against other the options designed by IPART to facilitate lower MPCl premiums.

In considering the different options available to the NSW Government to reduce the cost of MPCl premiums, NSW Farmers recommends that IPART consider a number of the initiatives proposed by the scoping study undertaken prior to the NSW Multi Peril Insurance Summit by Deloitte. These options include:

- Reinsurance assistance, backing and the provision of a "stop loss" guarantee with partial indemnification funded through forgone stamp duty revenue; and
- The development of a standardised product framework.

In addition to the options collated by Deloitte, NSW Farmers proposes a measure to assist underwriters of MPCl reduce the administration cost associated with loss assessment and the implementation of controls to manage the moral hazard of fraudulent claims. This measure could consist of an investment that leverages existing agriculture industry R&D for crop yield prediction and translates it into information that can be used to target resources for claims management in the most efficient manner.

NSW Farmers would also support government investments in the development of actuarial models to underpin Australian MPCl products to reduce basis risk; however any such measure must maintain the confidentiality of any business data.

Lastly, NSW Farmers believes opportunities exist for the Government to consider the use of a commercial Public Private Partnership model to stimulate the market for MPCl. The model for such an approach may be found in the actions of the Commonwealth in the establishment of the Primary Industries Bank of Australia.

Yours sincerely,

A black rectangular redaction box covering the signature of Matt Brand.

Matt Brand  
**CHIEF EXECUTIVE**