“Achieving Outcomes by Building Capability”

The AgriBusiness Group™

United Wheatgrowers Compulsory Levy

Cost Benefit Analysis

Prepared for United Wheatgrowers

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Executive Summary

United Wheatgrowers (UW) have the ability under the Commodity Levies (Wheat Grain) Order 2014 to levy all wheat growers for the purposes of providing disaster relief insurance. The insurance must have the attributes of a flat rate, with no excess and no specification of a minimum loss. This levy order is due for renewal in 2019. As part of the renewal exercise United Wheatgrowers must carry out a poll of all Wheatgrowers to gain their approval for the compulsory levy.

The purpose of this report is to provide information for wheat growers to make a decision on the merit of a levy by proving the costs and benefits of the insurance scheme. This paper outlines a review of the current situation as to the insurance cover which is analysed in a qualitative cost / benefit framework.

It is impossible to directly compare the insurance offered under the Untied Wheatgrowers scheme with other directly comparable schemes because the UW scheme is for the costs of production and does not recompense for the full market value of the crop grown.

Cost and Benefit Summary

Costs	Benefits
Conditions	
Limited to the costs of production.	Provision of a very wide range of perils.
	No minimum loss.
	No excesses applied before loss is calculated.
Significant range of exclusion clauses across the various perils covered.	Minor exclusions listed.
	Payment for the insurance is not made until the grower makes delivery of grain
Cost	
	A lower level of insured value but at a lower insurance premium rate or cost.
Continuity	
	Has always been available at a relatively stable cost.
Compulsion	
Those with alternative belief systems or those that would prefer to self insure could be disadvantaged by the compulsory nature of the scheme.	The low cost of the scheme, at 0.8% of the market value of the product, will not cause any financial discomfort.

Cross subsidy	
	The variability of our climate and the frequency of occurrence of extreme events would indicate that no farmers could claim that they are not subject to extreme climatic event risks therefore there is no apparent cross subsidy.

The UW insurance is limited to coverage of the costs of production but is unique in its range of perils and specific conditions offered. It is significantly different from any other commercial crop insurance product in the marketplace in that it has a much wider cover as well as a much narrower range of conditions and exclusions.

The insurance is able to be offered at a low cost due to the advantages of the capped liability to the cost of production, high degree of spread of risk that it offers the insurer and the relatively low administrative cost of the scheme.

1 Introduction

1.1 Background

United Wheatgrowers (UW) have the ability under the Commodity Levies (Wheat Grain) Order 2014 to levy all wheat growers for the purposes of providing disaster relief insurance. The insurance must have the attributes of a flat rate, with no excess and no specification of a minimum loss. This levy order is due for renewal in 2019. As part of the renewal exercise United Wheatgrowers must carry out a poll of all Wheatgrowers to gain their approval for the compulsory levy.

United Wheatgrowers (NZ) Ltd spends the levy solely on disaster relief insurance and the administration cost of this insurance. This disaster relief insurance is a unique scheme run by wheat growers for wheat growers. Only wheat insurance schemes that meet the following conditions will be purchased:

- Provide a flat rate cover with no excess and no minimum loss
- Where the premium is paid on delivery of the product, and only on the tonnage delivered.

The level of cover is based on the cost of production and will be set at slightly below the lowest expected value of wheat grain.

The purpose of this report is to provide information for wheat growers to make a decision on the merit of a levy by proving the costs and benefits of the insurance scheme. This paper outlines a review of the current situation as to the insurance cover which is analysed in a qualitative cost / benefit framework.

United Wheatgrowers have provided disaster relief insurance for their members for several decades. For the coming growing season this is provided through their insurance agent Farmers Mutual Insurance which levies wheat growers currently $3.75/tonne (excl GST).

1.2 The Analytical Framework

It is impossible to directly compare the insurance offered under the Untied Wheatgrowers scheme with other directly comparable schemes because the UW scheme is for the costs of production and does not recompense for the full market value of the crop grown. However there are two insurance schemes which can be considered as broadly comparable which both insure the wheat crop for the difference between the amount that it is insured for under the UW scheme and either the market value or an agreed amount. This additional value of insurance is insured across a different range of perils and conditions than that offered under the UW policy. A general comparison has been made with these two insurance options.

This analysis has been carried out across the following advantages and disadvantages of the UW insurance scheme:

- Conditions
- Cost
- Continuity
- Compulsion
- Cross subsidy.

2 Analysis

2.1 Features of the UW Policy

There are some important elements or features of the current insurance policy offered that make it unique in the market:

Perils:

The range of perils covered is an exhaustive list of disaster events which could occur.

Geographic Coverage:

The coverage is for any area in New Zealand where wheat is grown apart from the exclusion for frost protection for areas that are considered to be frost prone.

Period:

The period of cover is from when a crop emerges from the soil; or 1 November whichever is the later, with an extension for re-sowing of immature crops that fail. (It is noted that in some situations insurance cover prior to crop emergence can also be provided typically for flood damage not however resulting from a rain event).

Limit:

There is a limit of $225 per tonne on the amount insured for the defined events specified. This is chosen to reflect the nature of the insurance policy as a disaster relief scheme and therefore covers what are estimated to be the actual costs of growing the crop. The ability to top up insurance cover to a higher or full market value is provided by other insurance products in the market.

Excesses or Minimum loss:

There are not any exclusions, excesses or minimum loss requirements before payments are made.

Premium Collection:

Levies are collected at the point of sale of the wheat by the merchant or purchaser of the grain for an administrative collection fee of 5% of the levy. The net proceeds of this are forwarded to United Wheatgrowers who pay the premium in instalments based on crop volume predictions.

Growers selling wheat grain or value-added processed product to anyone other than collection agents are required to pay the levy directly to United Wheatgrowers (NZ) Ltd on a two-monthly basis. This process involves filing the Foundation for Arable Research levy form and completing the appropriate wheat sections.

2.2 Conditions

The various perils covered and conditions, limits and exclusions of the two policies are shown in the attached Table 1 in the Appendix. Table 1 has been created for the purposes of pointing out the significant differences between the United Wheatgrowers and the other crop insurance policies in the marketplace. The table is an attempt to list the important elements of the policies available. Because of the complex nature of policy documents, it may not completely portray the elements accurately.

The most significant differences in features are:

The extent of coverage.

The extent of coverage under the United Wheatgrowers policy is limited to the costs of production and does not recompense full market value loss.

The range of perils offered.

The alternative crop insurance products have a lesser comprehensive range of perils specified as being covered under the policy.

Minimum losses.

The other products have specifications that minimum losses of 30% must be experienced before the cover becomes valid.

Excesses apply.

The other policies have cover excesses which vary across the range of perils and vary between stipulated percentage excesses or lower stipulated $ value excesses.

Exclusion clauses.

The other policies have a significant range of exclusion clauses across the various perils covered.

In summary, the UW insurance scheme and policy as offered by Farmers Mutual Insurance is limited to coverage of the costs of production but is unique in its range of perils and specific conditions offered. It is significantly different than any other commercial crop insurance product in the marketplace in that it has a much wider cover as well as a much narrower range of conditions and exclusions.

Payment terms for insurance

Payment for the UW insurance is not made until the grower makes delivery of grain – this can be upto 12 months after harvest.

2.3 Cost

It is difficult to compare the United Wheatgrowers insurance scheme with other crop insurance policies. A comparison of the cost of cover with the two alternative schemes is shown in Table 1.

Table 1: Comparison of the cost of insurance alternatives.

	UW	FMG	AonAgri
Cost	3.75	11.62	12.80
Proportion of insured value.	1.4%	2.6%	2.9%

Therefore the policy covers a lower level of insured value with a more attractive set of coverage and conditions but at a lower insurance premium rate or cost.

There appear to be a number of reasons for the cost competitive nature of the premium including:

- The compulsory nature of the policy affords the insurer the advantages of achieving a large market for the product without any competitive element in delivering that product. The ability to cover the whole wheat crop offers a degree of spread of risk as well as economies of scale.

- The cover limit of $225 per tonne limits the insurer's total potential liability which gives some degree of risk relief to the insurer.
- The national coverage gives the insurer a geographic spread of risk which evens out exposure to localised risk.
- The administration of the scheme is simple and cost-effective with the merchants collecting the levies and therefore the insurer only having to deal with one client, United Wheatgrowers, to insure the whole of the national wheat crop. In addition any assessment of claims is undertaken by members of the United Wheatgrowers Electoral College – this `peer' review of claims from other farmers means that there is a good level of understanding of claim issues and very little dispute in settling claims.

In summary it appears that the policy is able to be offered at a low cost due to the advantages of the capped liability to the cost of production, high degree of spread of risk that it offers the insurer and the relatively low administrative cost of the scheme.

At the time of the initial levy order it was mentioned that alternative crop insurance schemes were prohibitive because of cost and that many farmers would be unable to afford them. This does not appear to be the case at present with relatively higher wheat prices meaning that insurance as a proportion of total value of the crop is less than it would have been a number of years ago.

2.4 Continuity

Historically crop insurance availability and premiums have tended to fluctuate according to the occurrence of negative events which have caused significant claims on the insurer. The participation of a number of insurer's in the crop insurance market has tended to even out this activity over time. Premium rates have lifted as a result of increased crop production costs. This would point to the fact that the crop insurance market is relatively fickle and continuity of availability of insurance is an important issue.

Over the years that it has been operating the United Wheatgrowers insurance scheme has always been available to farmers with relatively minor fluctuations in premium rates between years. With the volatile nature of the insurance industry it would appear that the argument that the scheme offers some continuity is valid. However it is difficult to determine whether some other insurers would enter the market with a similar product if the United Wheatgrowers scheme were not available.

2.5 Compulsion

The issue of the compulsory nature of the scheme, as determined by the levy order, is a philosophical argument. There are, no doubt, individuals who have belief systems which object to the requirement for them to be involved in a compulsory scheme. There may also be a number of wheat growers who have a relatively low aversion to risk who would prefer to carry the risk of losses themselves rather than through an insurance scheme.

However the compulsory nature of the scheme appears to offer significant benefits in terms of the features and cost of the policy offered. For those growers who would prefer to manage their own risk position the scheme does not impose significant costs. The current premium is 1.4 percent of the insurance value of the crop under the scheme or approximately 0.8 percent of the market value of the crop. It would not appear that this level of premium would cause any level of financial discomfort for those people that would prefer not to be involved.

In effect the poll on the continuance of the scheme will test farmer opinion on the issue of compulsion.

2.6 Cross subsidy.

There is no doubt that in an insurance scheme of this nature that there will be an element of cross subsidy occurring between participants. Those growers who grow wheat in areas that are subject to some of the significant perils on a regular basis will be the beneficiaries of the scheme whereas others who grow wheat in a much safer climate are not likely to make many claims. However the variability of our climate and the frequency of occurrence of extreme events would indicate that no farmers could claim that they are not subject to extreme climatic event risks. It is significant to note that other insurance policies available to cropping farmers on the market include exclusions for areas that experience frequent events of crop losses.

3 Appendix

Table 2: Listing of the perils, conditions, limits and exclusions of the alternative insurance products.

	United Wheat growers (FMG) **Section 1 Growing Crop**	**FMG Arable Crop** **Section 1 Growing Crop Expanded Perils**	**AONAgri Crop Insurance** **Type A Combined Perils**
Period of Insurance			
From	1st Nov or from the sowing of the crop (whichever is later)		The point of growing.
To	Crop is harvested or insured interest as owner stops (whichever occurs first)		The crop is sold.

Limit of Liability	$225 per tonne. $500,000 on any one property or $10,000,000 for any individual event anywhere in NZ. Max of $11,000,000 in any one season	None	None
GST	Exclusive (includes fire service levy)	Exclusive (includes fire service levy)	Exclusive (includes fire service levy)
Basis of Settlement	Volume of wheat that would have been harvested, or for harvested wheat the volume lost, but for the event.	the yield loss multiplied by: (a) the lesser of the: (i) market value at the date of loss, or (ii) insured value per tonne as specified on the proposal, or (b) where your sum insured is based on the guaranteed contract price, with written confirmation from a certified purchaser, the guaranteed contract price minus any costs you would have incurred had your crop not been damaged. Or If your growing crop of wheat is damaged by, and insured for, windstorm, we will pay $225 per tonne in addition to the amount we will pay under clauses 1.(a)(i) and 1.(b) above and 7. below. 3. If your damaged crop is wheat, we will also deduct any amount you are entitled to receive from the United Wheat Growers (NZ) Ltd statutory insurance scheme.	(a) The loss of *Estimated Yield*, or *Actual Yield,* whichever is the lesser at the time of assessment, less any cartage and other customary preparation expenses not incurred as a result of the loss. (b) The *Insured Value* per tonne as set out in the Proposal, or the *Market Value* whichever is the lesser. (c) The Sum Insured per crop variety itemised on the Proposal during the period of insurance. (d) The amount in excess of any payment *you* receive in respect of Wheat insured under the United Wheatgrowers (NZ) Ltd Scheme up to the *Market Value*, but limited to the *Insured Value* per tonne.
Premium	$3.75 per tonne (incl fire service levy). Paid in deposits on a minimum of 250,000 T: 1) 1st Nov – 25%. 2) 31st March – 75% 3) Balance on actual crop production when audit is completed.	$25 / $1,000 of sum insured plus $1.06 / $1,000 of sum insured Fire Service levy.	2.85 % of the sum insured
Defined Events			

Fire	✔	✔	✔ excess $250
Lighting	✔	✔	✔ excess $250
Explosions	✔	✘	✔ excess $250
Hail	✔ Occurring before the 15th May	✔ if the loss exceeds 30% of the potential yield Excess 20%	✔ if the damage exceeds 30% of the *Estimated Yield*; Excess 25%
Water	✔ Flood or abnormal drainage occurring before the 15th May unless the flood damage is caused by negligence or the crop being grown in flood prone areas.	✘	✘
Stock	✔ stock not belonging to or under the control of the insured provided the paddock is adequately fenced.	✘	✔ other than livestock owned by *you* or under *your* control, provided that *you* adequately maintain all fences and gates around the insured crop. Excess 15%
Snow	✔ occurring before the 15th May	✘	✔ if the damage exceeds 30% of the *Estimated Yield*; Excess 15%
Frost	✔ certificate that frost was the cause of the loss and that it occurs after the 15th Nov unless the wheat was planted in a frost prone area and samples are taken from the crop to test for frost damage prior to harvest.	✔ after the 15th Nov if the loss exceeds 30% of the potential yield. Excess 20%	✔ if the damage exceeds 30% of the *Estimated Yield*; the frost occurs on or after the 15th Nov. Excess 25%
Vehicle	✔	✔ if the loss exceeds 30% of the potential yield Excess 20%	✔ Excess 15%
Aircraft	✔	✔ if the loss exceeds 30% of the potential yield Excess 20%	✔ Excess 15%
Earthquake	✔	✘	✘
Volcano	✔	✘	✘

Subsidence	✓	✗	✗
Landslip	✓	✗	✗
Windstorm	✗	✓ if the loss exceeds 30% of the potential yield Excess 20%	✓ greater than 75 km / hr, the damage exceeds 30% of the *Estimated Yield*; Excess 25%
Malicious acts or theft.	✗	✗	✓ Excess 15%
Resowing Extension	Available prior to **1st** Nov. Cost of application of fertiliser and fungicides or the cost of cultivation and resowing.	If you suffer a loss within 40 days of planting, we will pay you 80% of the reasonable costs of replanting the damaged area in the same crop.	Loss to growing crops, occurring within forty days of sowing or before 1st November in the year in which they were sown, will be settled on the basis of costs incurred to date of loss.
	Section 2 Storage	**Section 2 Storage**	

Defined event.	Whilst in any building or whilst in transit.	Accidental loss.	✓ whilst in any enclosed building or permanent silo constructed of timber, steel or similar rigid material, or in transit anywhere in New Zealand. Excess 15%. ✓ water damage for harvested crops other than caused by seepage, artesian water, water from any irrigation system, condensation or whilst in transit Excess 15%
Limit of liability	$225 per tonne	The lesser of the: (i) market value at the date of loss, or (ii) insured value per tonne as specified on the proposal,	The *Insured Value* per tonne as set out in the Proposal, or the *Market Value* whichever is the lesser.
Exclusions			
(a)	Inherent vice or improper storage.	There will be an excess of $250 on each loss.	✗
(b)	Weather whilst in a building not fully enclosed	Pests, fungal bacterial viral diseases and nematodes, vermin, bird damage, sprouting, insects.	✗
(c)	Stored in the open.	Mismanagement or failure to apply acceptable horticultural practices.	✗
		Any heating or drying process, natural fermentation, natural heating, or spontaneous combustion.	✗
		Crop in the windrow apart from loss caused directly by fire or hail provided the crop has been insured for these perils.	✗
		Confiscation, nuclear materials, terrorism or war.	✗