The Risk Transfer

Volume 3, Spring Cotton Issue

Spoilt for choice

Rural Affinity has just introduced the first indemnity policy since the mid-1990s, so in this issue of our newsletter we discuss the pros and cons of an Indemnity policy against an Agreed Value policy.

Back in the mid-1990s, GIO introduced the first Indemnity policy for cotton crops in Australia. This was good for cotton growers but ultimately proved bad for insurers, as it was too difficult to rate properly. As a consequence, Agreed Value policies have come to dominate the cotton crop hail insurance market—until now.

Indemnity policies seek to place you in the same financial position as you would have been had the loss not occurred. This means that the basis of settling a claim is determined after the loss, based on the facts at that time.

Agreed Value policies agree what the policy will pay from the outset.

Agreed Value Cotton Policies

Agreed Value cotton policies have asked you to agree certain figures up front. Figures like the bale value, yield, in-crop growing and post growing cost savings are nominated by you. These are called "Agreed Value" policies as you are agreeing up front what you will be paid in the event of a claim—your actual income and costs are not considered.

Many growers like this basis of cover, as they know exactly what they will be paid and there is little room for argument. Insurers certainly like it as it makes it easier to rate different sum insured and cost saving options. This also gives growers the flexibility to tailor the cover to suit their needs.

As any grower who has claimed under an Agreed Value policy knows, there is nothing wrong with it as long as you nominated realistic sum insured and cost saving figures.

Hybrid Cotton Policies—Sum Insured

Some facilities give you the ability to insure on a declared yield basis subject to a cap of 25% above the yield you nominate. Under these policies, the sum insured is based on your declared actual yield or what you would have produced if you did not have a hail loss. If you don't breach this cap, the insurers are indemnifying you for your actual yield loss—but not your actual bale value loss.

Hybrid Cotton Policies—Cost Savings

Up until last season, Primacy was the only facility to offer an Indemnity basis to cover your in-crop cost savings. Rural Affinity will be offering this Indemnity basis of

Special points of interest

IRT is now licenced to provide a full range of general insurance products, not just crop. If you want your farm insurance placed properly talk to us.

We are pleased to welcome Michelle Prendergast to our team. Michelle is based in Goondiwindi and is ready to come out to see you.

Our strategic alliance with Cotton Growers Services continues to go from strength to strength. We are in the final phase of training Laura in Hillston, Mat in Warren and Geoff in Goondiwindi to be our Authorised Representative. Once trained, they can provide advice on your crop insurance requirements.

IRT with CGS give clients a full insurance broking and consulting service including policy placement, claims and risk management.

cover for in-crop costs this season as well. Some see this as the best cover but we see little real value in it—unless you are growing conventional cotton.

With the advent of Bollgard II, the major uncertainty in your in-crop costs has been capped at the technology licence fee. Other costs vary little so any difference between what you actually save and the agreed value you nominate for the in-crop cost savings at the beginning of the season are relatively small. However, the difficulty in rating these covers still exists and this is reflected in the high price paid for these variable cost savings policies.

Our view remains that this added cost makes these policies poor value for Bollgard II growers.

Indemnity Cotton Policy—Sum Insured

This season Rural Affinity is offering a market value option to insure your bale price. When added to the variable yield option, it provides you with the ability to insure your income on an Indemnity basis for the first time in quite a while. Both the variable yield and market value option run up against the old rating difficulty issue but by setting realistic caps on both these you can minimise the rating penalty.

After the bale price fluctuation experienced last season, we see great value in this market value option.

Our recommendation

If you want a production costs based cover then the Agreed Value policy will still be attractive as it provides the best value.

If you want to insure for your income loss then an Indemnity policy is what you need. The trick will be to minimise the uncertainty for insurers and therefore the rating penalty they will apply.

Provided you are growing Bollgard II cotton, the yield and price and therefore your income will vary to a far greater extent than your in-crop costs. So if you want a good value Indemnity policy for your crop income this season we recommend the variable yield and market value options with agreed in-crop cost savings. The choice is yours.

Let battle commence

No battle plan survives the first contact with the enemy.

Growing cotton is a battle between the adaptability and ingenuity of the grower on one side and the ever-changing seasonal weather, pest and market conditions on the other. Like a battle plan, a grower's cotton plan for the season rarely survives planting.

Last season saw an unusually hard fought battle with the markets. Good bale prices drew many growers into committing early only to see flooding reduce expected yields. Markets continued to rise, exposing many growers to significant risk if hail further reduced yields below that already committed. The prospect of having to buy cotton for hundreds of dollars more than contracted resulted in many having to increase their sums insured and pay dearly for it only to have the market drop and the risk recede.

As with armies, we are always equipped to fight the last war. The market value option would have been very useful last season as it helps minimise the risks of a rising market. If you are seeking an Indemnity sum insured, the defensive flexibility of the market value option can also handle whatever the market throws at you this season.

Innovative Risk Transfer
Pty Limited

ABN 33 093 837 631

Australian Financial Services Licence 252978

Suite 1.02, 460 Pacific Hwy, CROWS NEST NSW

PO Box 310
BROADWAY NSW 2007

Enquiries
P: 1800 648 794
F: 02 9009 0655
E: info@risktransfer.com.au

David Blackett
0417 235 634
david@risktransfer.com.au

Michelle Prendergast
0447 444 322
michelle@risktransfer.com.au

Ingrid Argo
0438 615 740
ingrid@risktransfer.com.au

Sarah Padgett
02 9460 8791
sarah@risktransfer.com.au

CGS
COTTON GROWERS SERVICES PTY. LTD.

Authorised Representatives, Crop only

CGS	292677
John Ash	294357
Alex Brooker	328677
Anne Coote	340339
Kerri Jocumsen	294356
Susie McCutcheon	328678
Pat McGuinness	332663
Hanco Naude	390308
Carol Sanson	306257
Danni Stanton	390310
Andrew Stewart	294358
Peter White	390309

Contact your nearest CGS Authorised Representative with your crop insurance enquiries or contact us direct.