Latevo Farmers Mutual

**Latevo Farmers Mutual Limited**
ABN 53 632 567 090

PO Box 8045
GRIFFITH EAST NSW 2680

p: 02 6964 7111

e: admin@latevomutual.com.au

# Drought Solution Package & Working Capital Solution In Summary

**Background:**
Approximately 18,000 broadacre farmers in Australia are currently experiencing a **"working capital crisis"** that will force them to reduce crop planted area, inputs and even some from their land in the coming week/months. The areas of northern New South Wales, south west Queensland, Eyre Peninsular in South Australia and north and eastern wheatbelt of Western Australia are among the hardest hit.

https://www.theguardian.com/australia-news/2020/mar/14/they-would-have-been-slaughtered-coronavirus-crisis-causes-capital-freeze-for-australian-business

> *"It is my estimation that as much as 10% of the WA wheatbelt may not be put to its highest and best use due to deficiencies of working capital.*
>
> *In addition, perhaps 10% more land will be farmed at sub-optimal level due to financial constraints that will be expressed through lower crop hygiene costs and lower plant nutrition expenditure. Hence yields will be compromised.*
>
> *The combined effect of insufficient working capital is lower grain tonnage, less farm income and margin, fewer exports and reduced employment in regional areas.*
>
> ***Paul McKenzie, Managing Director, Agrarian Management Consultants to Agriculture, 16 March 2020, by email***

Farmers are also currently experiencing creditors charging up to 17% penalty interest on outstanding debtor amounts – amounts many farmers simply can not afford to repay because of the financial hardship they have endured in recent years due to floods, fire and drought.

An immediate **stimulus package** must be provided to these struggling farmers or, for many, they will be lost from the sector at the same time the Federal Government is endeavouring to see farm productivity in Australia increase to A$100 billion by 2030.

**Primary Proposal:**

1. In November 2019, the Federal Government announced that $1.2 billion of interest free loans would be offered to farmers and small business via the Regional Investment Corporation (RIC) to help deal with the challenges of severe drought.

2. $200 million of RIC's $1.2 billion of interest free loans could be transferred to a separate Trust Fund that is jointly managed by LFM and RIC or "ringfenced" within RIC.
3. The $200 million Limited Liability Trust Fund would provide a **Federal Government guarantee** to cover potential future claims of LFM members in a shortfall season.
4. Our advice suggests that those funds could be reallocated via a simple regulation amendment.
5. Farmers would then have access to working capital from traditional and non-traditional lenders due to the increased security that could be taken over their crops in the form of farm income protection contracts.
6. Greensill Capital (UK) Limited will provide a A$2 billion lending facility secured by the proceeds of the farm income protection contract. (Refer letter from Greensill). Rapid deployment of Greensill funds is possible with a 6-8 week build out and then on an on-going 10-day application to settlement process for farmers.
7. Greensill is offering an 'end-farmer' interest rate in the vicinity of 5%-8% (subject to LFM credit assessment of the individual farmer) as opposed to existing interest rates of between 12% to 16% for unsecured pre-crop finance.
8. The fee for the farm income protection contract is paid to LFM out of the working capital loan provided to the farmer by Greensill.
9. Farmers pay back the working capital loan provided by Greensill.
10. LFM pay back the $200 million limited liability government guarantee to the Federal Government over a 10-year period out of its annual surpluses.
11. In the event of protection fees being lower than potential claims ("shortfall"), LFM will have access to the $200m Limited Liability Trust Fund to pay a percentage of farmers' income protection contracts.
12. Latevo Farmers' Mutual model has been an established service provider since 2014.
13. The LFM model is independently rated to return a 25% ongoing surplus such that it can capitalise itself. Modelling suggests in 85% of seasons the Mutual will return a surplus and in 15% of seasons it will run a shortfall to keep premiums affordable to farmers.
14. All surpluses remain in the Mutual or disbursed to Members – they are not paid to any global reinsurer.
15. The move to a Discretionary Mutual from Latevo's previous insurance model has seen a marked improvement in the reduction of "moral hazard".

**Option 2 (for consideration if the Federal Government wants to stop its circa $26 billion spend that has occurred to the sector since 2000):**

1. Agriculture faces the same cultural barriers to the uptake of risk as the private health insurance market experienced pre-Medibank Private.
2. Short term, farm income protection contract rebates will be required if the Federal Government want to encourage farmers into managing their own risk.
3. All farmers can be covered as the LFM model individually assesses each farmer. The more successful farmers receive more income protection cover as they can demonstrate a better financial performance during the five-year period that is assessed.
4. The Federal Government would always be required to provide farmers access to the Farm Household Allowance (FHA).
5. If the Federal Government directed a rebate scheme at Farm Income Protection, it would be able to replace all ad hoc payments under a "Hand Up" not a "Hand Out" style rebate program.
6. Any stimulus must only be short term and the program needs to be designed to demonstrate an exit strategy to any rebate.

7. LFM recommends a maximum of $100 million per annum over five years be allocated to a "Premium Rebate Stimulus" program.
8. The "Premium Rebate Stimulus" program would follow a format recommended by the NSW IPART review: https://www.ipart.nsw.gov.au/Home/Industries/Special-Reviews/Reviews/Multi-perilCrop/Multi-peril-crop-insurance-incentivemeasures
9. The funds would be split in a proportion stimulus:

   Year 1 - 50% of your FIP contract or to a maximum of $50K
   Year 2 - 50% or your FIP contract or to a maximum of $50K
   Year 3 - 25% or your FIP contract or to a maximum of $25K
   Year 4 - 25% or your FIP contract or to a maximum of $25K
   Year 5 - 25% or your FIP contract or to a maximum of $25K
   Year 6 - Zero Stimulus
10. A Federal Government initiative to encourage farmers to take out farm income protection contracts would relieve itself of the ad-hoc liability that, since 2000, has cost successive governments circa $26 billion in drought payments.
11. Furthermore, a "Premium Stimulus Package" can be fully offset by making a small change to the Farm Management Deposit Scheme (Refer Appendix VII – Drought Solution Plan - as provided).

**Option 3 (only for consideration if the Federal Government wants a sustainable farm income protection concept to be adopted by all Australian farmers):**

1. The current Future Drought Fund is $3.9 billion and forecast to grow to $5 billion https://www.finance.gov.au/government/australian-government-investmentfunds/future-drought-fund

$100 million annually has been committed to drought related programs.

2. Currently, LFM provides farm income protection contracts to broadacre farmers, of which there are approximately 18,000 in Australia.
3. Should the Federal Government support LFM's proposed Limited Liability Trust Fund initiative, LFM intends to develop similar underwriting protocols for all farmers in Australia (up to an additional 80,000 farmers across Australia) in the sectors of Beef, Sheep, Sugar, Tree Crops, Horticulture and Vineyards over the next five years.
4. To achieve this, LFM would require a Federal Government grant of circa $20 million per annum over five years in order to access the individual farm data and to fund the development of the underwriting proposals to ensure that the farm income protection concept remains sustainable. The circa $20 million per annum grant over five years could be accessed from the $100 million that has been allocated from the Future Drought Fund.

**Attachments:**

1. **Letter from Greensill Capital (UK) Limited re: Farmer Working Capital Line**
2. **Grower letters of support**

**Possible Questions and Answers**

**Q:** How much of the $200 million Limited Liability Trust Fund do you forecast being accessed over the 10-year period?

**A:** The amount will totally depend on the seasonal conditions we experience. The model is rated to make a surplus for approximately 85% of seasons and a deficit for 15% of seasons. We expect the fund balance to increase and decrease on an annual basis depending on the overall farmer uptake of the program and the number of claims made. Our discretionary model allows us to increase the protection fees or reduce coverage and use discretion on claim payments. This model gives us complete confidence that we can pay back the $200 million to the Federal Government at the end of the agreed term.

**Q:** What is the proposed pay-back term of the $200 million 'loan'?

**A:** We are proposing a 10-year limited liability guarantee contract.

**Q:** Why can Latevo's proposal succeed when many other multinational insurers have offered similar insurance/income protection products before and failed to achieve the level of uptake from farmers to make them viable?

**A:** **Latevo's model is completely different from that used by multinational insurers in the past. For example:**

- We base our assessments on individual farmers' data and not the wider district.
- We base our farmer assessments on revenue and not yield.
- We provide three categories of cover within our model compared to a single level that was offered by previous insurers.
- Our pricing is affordable, sitting between $15/ha-$30/ha as opposed to between $45/ha up to $70/ha for previous established insurance providers.
- Our business model adjusts upwards for improved seasons – making it work in good years and in bad years.
- We operate a discretionary mutual model that delivers us the highest level of 'moral hazard' management.

**Q:** How do you propose to secure the level of up-take from farmers in Australia to make your proposal work, especially when others have failed in the past to secure successful up-take levels?

**A:** The opportunity to access working capital from Greensill at highly competitive interest rates will be a major incentive for farmers to 'sign-up'.
WAFarmers and other growers' groups will provide strong distribution and educational support. Their engagement is conditional on Federal Government support.
We must also invest in our own field staff to ensure the program is correctly promoted to growers.

**Q:** How does your proposal minimise the level of risk to the Federal Government?

**A:** Our program is run through a discretionary mutual which gives us greater control over 'moral hazard' and total claim payments.
We will prioritise repayment of the $200 million fund to the Federal Government over the agreed contract period (we're proposing 10 years) by partially reducing claim payments if we have a bad 'run' of seasons.
The flexibility of the mutual allows us to manage any 'risk' to the Federal Government in such a way that would not be possible if we operated in the 'insurance world'.