

Guy Carpenter Views

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Developments in the European Union's Agricultural Insurance Market



The agricultural insurance market in the European Union is undergoing significant changes. Support mechanisms protecting farmers from global market forces are being progressively dismantled, exposing farmers to the vagaries of the global marketplace and new competitors. Severe weather conditions, recent outbreaks of livestock diseases, and higher quality standards are also creating new agricultural risks.

The complexity of this changing environment combined with developments in technology have resulted in exposures that the EU's traditional risk management tools are not able to address. *Guy Carpenter Views* speaks with John Drakeford, Principal and co-head of Guy Carpenter's Global Agricultural Practice, about how the private insurance industry can respond to the EU agricultural community's growing demand for sophisticated insurance and reinsurance products and services.

The Changing Market Structure

Guy Carpenter Views: Can you briefly describe the current structure of the European agricultural market? How is this structure changing? What impact are recent changes expected to have on the need for risk management products and services?

John Drakeford: Since the 1960s, the Common Agricultural Policy (CAP) has set all of the rules, regulations, and support mechanisms for agriculture in all member states of the European Union (EU). Through such measures as export restitutions and import subsidies, CAP has assured EU farmers a base price for their products and has shielded them from external competition. Over the last decade, the CAP system has become untenable both financially and politically. Critics cite such problems as the length of time it takes for compensation payments to be made, the discouragement of private insurance solutions, the disincentive for farmers to implement risk management methods, and structural weaknesses in the agricultural sector caused by CAP's production-based subsidies. These problems in combination with pressure both from within the EU and from external sources such as the World Trade Organization, world markets, and competing countries have forced CAP to implement reforms that will increase the EU's exposure to the global marketplace and new competitors. CAP support mechanisms remain in place for the time being. However, the progressive dismantling of these protective measures will expose European farmers to the full force of world market volatility, changing technology, restrictions on input, and new legislation. As farmers become less able to turn to CAP for protection, agricultural insurance programs should become increasingly desirable as a means of recovering losses.

Current and Evolving Exposures

GCV: What are the categories of risks with which EU farmers are currently most concerned?

JD: Price risk and production risk are the two exposure categories that are significant to any agricultural community.

Price risk is the danger that output prices will fall and input prices will rise. Up to this point, CAP policies have mitigated the volatility of EU agricultural prices.

Production risk is the danger of both decreased output and the inability to meet consumer requirements. Historically, this risk category related primarily to yield and was caused by such factors as unfavorable weather conditions, plant and livestock diseases, insects, and pollution. Now, though, consumers' demand for quality has become an increasingly important source of this exposure.

GCV: Please describe some of the market trends that are causing these risk categories to fluctuate. In what ways do these fluctuations signal opportunities for the development of new risk management products and tools?

JD: As CAP reforms are implemented and EU farmers are exposed to the vagaries of global market forces, price risk will inevitably increase. In addition, rising quality requirements, climate changes, and the continuing fear of another major disease outbreak will likely create an upsurge in production risk.

The growing use of technology and the gathering pace of rationalisation also results in new and unfamiliar exposures even as it signals new opportunities for European farmers.

Given the many new sources of price and production exposures, the market will be ripe for sophisticated insurance and reinsurance products and services that can help manage these risks.

Primary Insurance Product Trends

GCV: The member states of the EU differ in many respects from one another—for example, in terms of weather, geography, and economic development. What impact have these variations had on each state's risk profile and insurance product development?

JD: The types and extent of agricultural risks vary widely among the EU member states, as do the tools developed to cope with these exposures.

CAP guidelines have given each EU member state great freedom in responding to its unique risks, with the result being a proliferation of products that differ considerably from state to state in terms of structure, coverage, complexity, and degree of state aid.

GCV: What are some of the primary insurance products that the member states have developed? How are they structured, and what do they cover?

JD: All member states have some forms of agricultural insurance solutions available. Some private market products have reached maturity and are widely offered; however, they are largely targeted toward single perils such as hail.

Hail coverage has traditionally been offered for all types of produce, and it is still the most popular private insurance product in Europe. In some regions, this coverage has expanded to include other specified natural perils.

In a limited number of regions we are now seeing the development of more sophisticated insurance instruments, such as multiple peril crop insurance (MPCI), which cover a wide spectrum of losses including drought, flooding, windstorm, frost, and disease. Historically viewed as complicated and expensive, MPCI products have not generated much market interest. However, farmers who have become more knowledgeable about risk are now encouraging the development of these policies. Despite this, the inherent volatility and unpredictability of certain weather events means that the private insurance market tends to be reluctant to underwrite this type of cover without government aid.

Insurance solutions that are designed to cover a combination of production and price risks are still very much in their infancy.

GCV: How are these primary insurance products priced?

JD: Premiums for these primary insurance products are traditionally based on historical loss history developed by crop and by area. However, owing to a potential for variation in hail activity and the yields achieved across entire regions and at times contiguous areas, there is a significant diversity of premium rates.

Coverage for New Exposures

GCV: Is coverage provided under any of these policies for such livestock diseases as BSE (Bovine Spongiform Encephalopathy, also known as "Mad Cow" Disease) and Foot and Mouth? Will these diseases continue to be covered when policies are renewed?

JD: Prior to 2001, it had been more than 30 years since the last major outbreak of Foot and Mouth in Europe was combined with government compensation for compulsory slaughter. Ninety percent of the EU's livestock farmers concluded that future risk was minimal and that they did not need to maintain insurance coverage for this exposure. Only 10 percent of farmers elected to purchase private sector coverage, as generally premiums were thought to be exorbitant.

Consequently, the private insurance market was not hugely affected by the recent outbreaks of BSE and Foot and Mouth Disease. While a limited number of insurers continue to provide some capacity going forward, we are aware that some EU governments are examining ways that they might assist their farming communities to manage this growing risk.

As a company, we are working very closely with a number of influential organisations, such as the National Farmers Union, to help develop a solution acceptable to UK agriculture. We have also had discussions at the government level in advance of the publication of a white paper on this subject later this year.

The timing of this intervention is very opportune. The UK and indeed other EU farmers are starting to show concern at the lack of private insurance for losses (not covered by government compensation schemes) that could result from future disease outbreaks. The fact also that governments are looking to restructure their support/compensation for farmers should facilitate the private sector's development of products that should find market support.

GCV: Are insurers and reinsurers prepared to offer coverage for such new threats as bio-terrorism?

JD: Livestock markets are generally very cautious about bio-terrorism. However, we have recently obtained terms from a Lloyd's Underwriter for a bio-terrorism cat excess of loss cover protecting a cattle account. In addition, two company markets have recently written a quota share cover (albeit with very limited capacity) protecting a livestock portfolio that includes the perils of both disease and bio-terrorism.

We are not currently aware of this being an issue for crop insurers and reinsurers. Indeed, the US MPCCI policy specifically excludes terrorism.

Growing Demand for Reinsurance

GCV: How would you characterize current market interest in reinsurance coverage? How does the availability of reinsurance affect insurers' willingness to provide coverage? How are reinsurers designing coverage for new exposures?

JD: Reinsurers' opportunities in the European Union have been restricted by the fact that until recently there has been little interest in the development of new insurance products. Insurers, in turn, cite the unavailability of reinsurance as the primary obstacle to the development of private insurance programs.


Providing reinsurance capacity is essential to the facilitation of new private insurance products. Particularly as insurers begin to create coverage for such high volatility exposures as livestock epidemics, extreme weather conditions, and biohazards, the need for reinsurance support will increase.

A number of countries are exploring options for providing risk management tools for farmers, which will in turn lead to an increasing demand for reinsurance. As I mentioned earlier, we are involved in just such a process in the UK.

GCV: Do reinsurers generally follow the fortunes of their clients? Are they implementing other types of limits on reinsurance coverage offered?

JD: Reinsurers generally continue to follow the fortunes of their clients. Programme structures tend to be straight quota share (no event limitations) and/or stop loss on net or gross account. Cat/event coverage is often purchased to protect a livestock portfolio.

GCV: Historically, London was the center of the agricultural reinsurance market. Is this still the case? Are other global reinsurers becoming more interested in this line of business?



JD: We can no longer regard London as the center of the agricultural reinsurance market. In recent years, markets underwriting proportional reinsurance have contracted substantially to one or two offering only very limited capacity. We have also seen a decline in capacity for stop loss/excess of loss reinsurance, albeit far less pronounced than for pro rata. Indeed, we are now beginning to see some new players entering the market for crop stop loss business, which can only be good news for the industry and for those selected markets in London that still have the ability to influence pricing on specialty and capacity risk.

GCV: Is Bermuda playing a role in this market? If not, why not?

JD: Bermuda is a developing market with a limited number of players but with the ability to write large tranches of capacity on selected risk.

Role of Guy Carpenter

GCV: What is Guy Carpenter's role in this market? What are some of the unique capabilities that set Guy Carpenter apart from other brokers in this market?

JD: Guy Carpenter has 75 years of proven performance through innovative delivery of reinsurance solutions. Over the years, we have earned an enviable reputation for powerful, forward thinking ideas.

We are the world's leading reinsurance broker in the agricultural reinsurance sector and can use our core capabilities and specialty skills in this area to help support our insurance company clients in developing innovative products.

Using our unique state-of-the-art quantitative modeling tools and analytical capabilities developed by Guy Carpenter's Agricultural Specialty and InStrat group, we can also help clients identify and thoroughly analyze all of their exposures and evaluate a spectrum of options for mitigating them.

The Future

GCV: Are you optimistic about the growth of this market? What are some of the new opportunities that are likely to develop going forward?

JD: I am very optimistic about the future of the agricultural insurance and reinsurance markets.

In the past, agricultural insurance products have been underutilized in the European Union. Given the changes that are now taking place in this market, however, the timing is right for the introduction of new risk management products that will address the associated risks.

As the private insurance industry begins to introduce insurance and reinsurance products that effectively respond to new and evolving exposures, we expect that such products will increasingly become the risk management tools of choice for EU's agricultural community. In addition, as cedents become more risk aware, opportunities will increase for our specialist services and client support technology, which can help them quantify their exposures and develop the most appropriate reinsurance structure.

We at Guy Carpenter look forward to continuing to play an important role in this process.

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