

Buying protection for volatile milk prices

Stable, a Lloyd's managing general agent (coverholder), is improving access to insurance in the agri-food sector through its parametric risk transfer solutions for farms and food buyers of every size.

Sarah's Dairy Farm in Cumbria, UK has 200 cows. Like any family-run business she borrows money to invest in the future, which while it helps her keep ahead of the competition, puts added pressure on her to make her loan repayments. Her major challenge is the volatility of milk prices, which over the past decade has ranged from 20.4p/litre to 34.5p/litre. This makes it hard to know what the farm's income will be from month to month and, therefore, whether she can keep up the loan repayments.

Market volatility is a major risk for all producers and buyers of agricultural products. Prices can fluctuate by as much as 20% or 30% a year, making it difficult for farmers to manage their businesses and plan their finances, and for commodities investors to gauge investment decisions.

Larger farms mitigate this risk using several strategies including trading options and futures, but these products are out of reach for most small-scale farmers such as Sarah.



The need for new products

With the average size of most farms in the EU being 16 hectares and producers requiring somewhere in the region of 2,000 hectares of land for traditional financial tools to be cost-effective, the cost and complexity mean traditional financial products are not an option for most small-scale and family farms. Currently, only 1.5 percent of farms in the EU are 2,000-hectares or more.

Benefits for customers

Parametric insurance policies offer a lifeline for smaller operators. They differ from traditional policies by paying out compensation when a clearly defined parameter is exceeded. The triggering process relies on independent data from third-party indices and metrics that measure objective parameters such as excessively high temperatures, commodity prices falling below a predetermined value or an earthquake of a certain magnitude. There are several benefits for customers: the buying process is fully automated, claims payments are automatic and, since there is no need for a loss adjuster's assessment, funds can be released quickly.

Tailored to farmers' needs

Stable's UK platform uses third-party, independently verified index prices from the UK Government Department for Environment, Food and Rural Affairs and the Agricultural and Horticultural Development Board to calculate the premiums and claims payable. Parametric insurance indemnifies the policyholder based on an index-based commodity price rather than the individual loss incurred by a business.

For Sarah's Dairy Farm in Cumbria, it was imperative to make a decent profit after borrowing to invest in the farm. However, the volatility of market milk prices meant that Sarah wanted a safety net to protect her investment and ensure she could pay back the loan. Sarah chose Stable's parametric insurance product, which covered her for a fall in milk prices below a certain level. It was just as well she did - during the 11 months covered by Stable's insurance, prices were particularly volatile.

Coming from a farming background, Stable's chief executive, Richard Counsell, understood the limitations of existing insurance policies on offer to farmers and spotted a gap in the market. "Stable is redefining how businesses around the world manage the risk of volatile incomes," he says. "Our parametric insurance expertise enables us to reduce our operational costs, so we can keep premiums attractive to our clients. The added advantage of a fast, clear and automated claims process is really appealing to our global clients."

Faster claims payments

The parametric volatility insurance policy can be purchased entirely online, which can result in cheaper premiums and faster claims processing. Businesses can get a free quote in minutes by selecting the value they want to protect, the length of the protection and the price they want to pay. Because the system uses an index price to trigger payments, claims are paid automatically, keeping costs low, eliminating paperwork for farmers and making the whole process more accessible.

Parth Patel, chief risk officer for Lloyd's managing agent Ascot Underwriting, which underwrites Stable's parametric insurance policies, said: "The Stable platform combines automated claims payment processes with real-time analytics and live exposure management. The partnership between Ascot and Stable enables us to provide our customers with insurance protection that better matches their needs."

For Sarah, it means she can go to sleep at night, not worrying what the milk price might be in the morning.