



Agricultural Finance and Risk Management in ECA

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“ECA Agricultural Finance and Risk Management Study” is a fresh look at the region

- An analysis of the region’s agricultural finance/risk management needs, and the corresponding array of the most appropriate financial and risk management instruments in order to accelerate growth in the agricultural and agribusiness sectors.
- The growing demand for these instruments has been accentuated by the recent significant increase in prices for agricultural commodities.



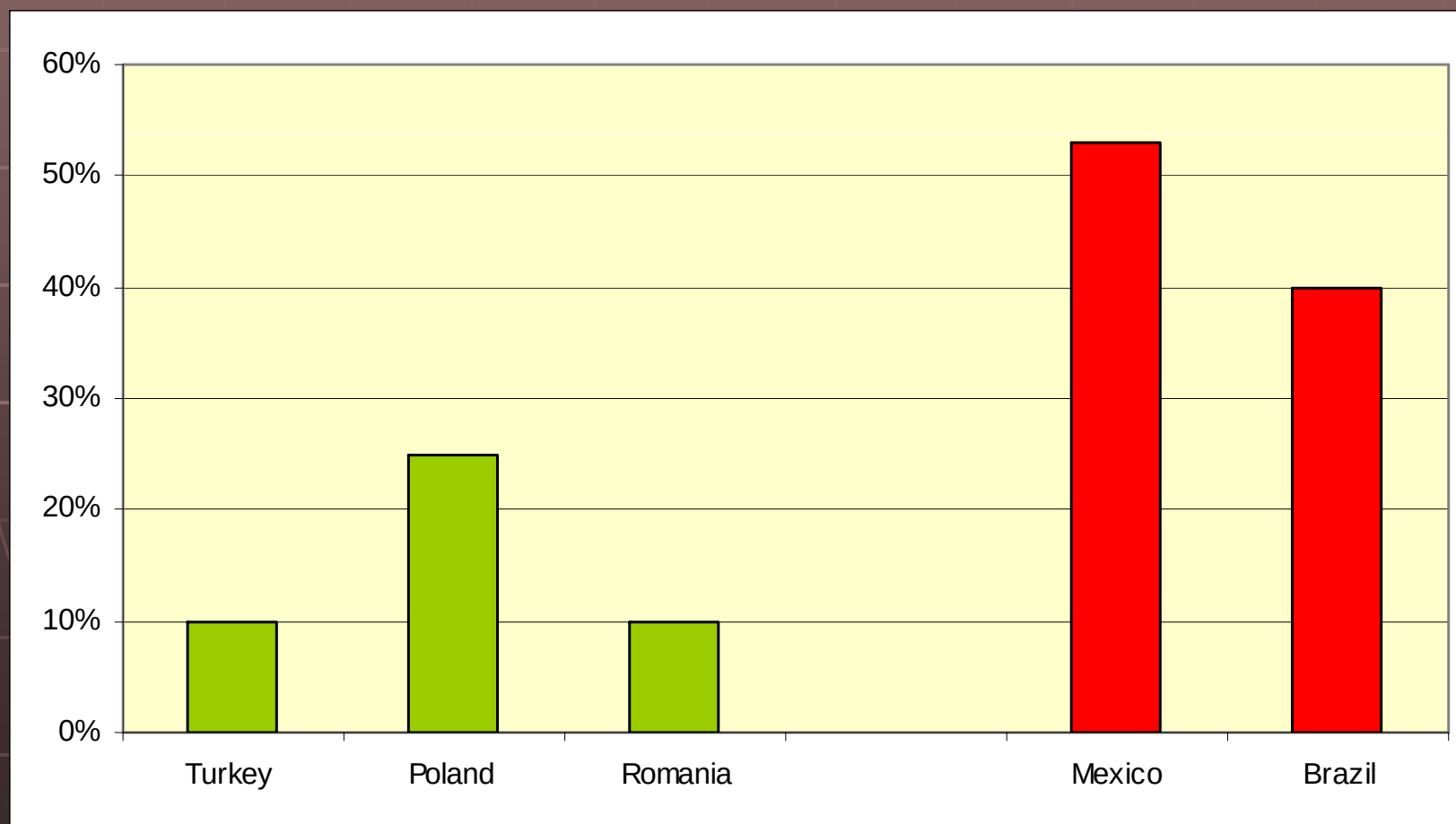
Agricultural Finance Issues

- Liquidity is growing in banking sector, yet
- Lending for agriculture continues to be limited, because:
 - Returns for producers not guaranteed (climatic risks, price fluctuations)
 - Agriculture continues to be considered risky by lenders
 - Many well-known risk management tools do not exist, or limited



ECA region falls behind comparator economies in the use of financial products

Agricultural Lending to Ag. GDP- far less than some comparators





Approach Used

- Conduct country assessment and clusters according to the degree of development of overall economy, financial sector sophistication, including agricultural finance, land markets, agribusiness sector, availability of agricultural risk management instruments
- Select agricultural finance products which are widely used in other regions, but non-existent or limited in ECA
- Identify opportunities for deployment of the products to resolve needs for agricultural finance in the ECA countries



Countries in ECA Region are at different stages of advancement in the agri/rural finance sector(1)

■ **CATEGORY A:**

- Underdeveloped financial sector (little liquidity; poor skills; very limited outreach, etc.);
- Unfavorable Policy Environment;
Ex. Tajikistan

■ **CATEGORY B:**

- Shallow but growing financial sector (ample liquidity in the short-term market, but limited liquidity in the long term markets; reasonable basic banking skills, but limited agribusiness lending skills, including limited menu of products for financial sector);
- Favorable policy environment
Ex. Kyrgyz Republic, Armenia, Georgia, Azerbaijan



Countries in ECA Region are at different stages of advancement regarding agri/rural finance (2)

■ CATEGORY C:

- Robust Financial Sector, although rural/agribusiness outreach falls short of comparator nations
- Potential for Development of Risk Management systems

Ex. Turkey, Russia, Kazakhstan, Ukraine

■ CATEGORY D:

- Similar to Category C, except that they have greater access to EU funds and support

Ex. EU members



Agricultural Finance Products Reviewed

- Commodity Exchanges
- Index-based weather insurance
- Structured Finance in agriculture
- Credit guarantees



Commodity Exchanges

for price risk management of agricultural commodities

- Advantages:
 - Improve market access while reducing transaction costs;
 - Help make more informed production and investment decisions;
 - Opportunity to manage exposure to price volatility through instruments such as futures and forward contracts;
 - Help establish links with capital markets in order to create new financing mechanisms
- There are over 200 commodity exchanges active in ECA region, but:
 - Most of these exchanges play rather insignificant roles in their economies- agricultural volumes, particularly in futures contracts, are quite low
 - They are poorly integrated with their countries' financial systems
 - Very few sophisticated ones are in Hungary, Romania, Russia and Turkey



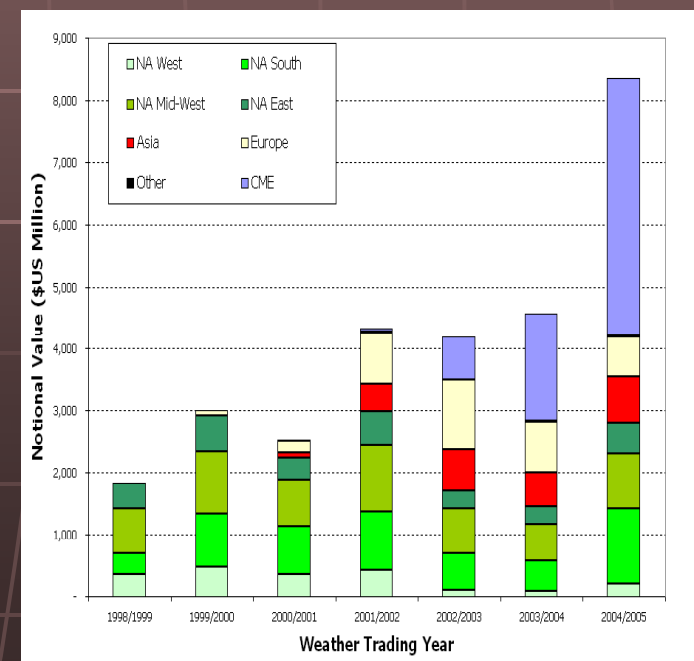
Index Based Insurance for production risk management for farmers

- Claims settlement is based on a weather, average crop yield or livestock mortality indices
- Indemnifications are triggered by pre-specified patterns of the average indices

Index vs. Traditional Yield Based Insurance

Index Based Insurance (Weather)	Yield Based Insurance
Coverage for deviation in rainfall index and coverage for economic losses due to less than or more than normal rainfall	Coverage for drought and floods-extreme situations
Low / Negligible administration costs	High administration costs, high loss ratios
Calculation of rainfall index is transparent and fully objective	Claim settlement basis is non-transparent
Immediate claim settlement	Lengthy settlement process
Reinsurance is available	Reinsurance is limited

Weather Derivatives Market Growing

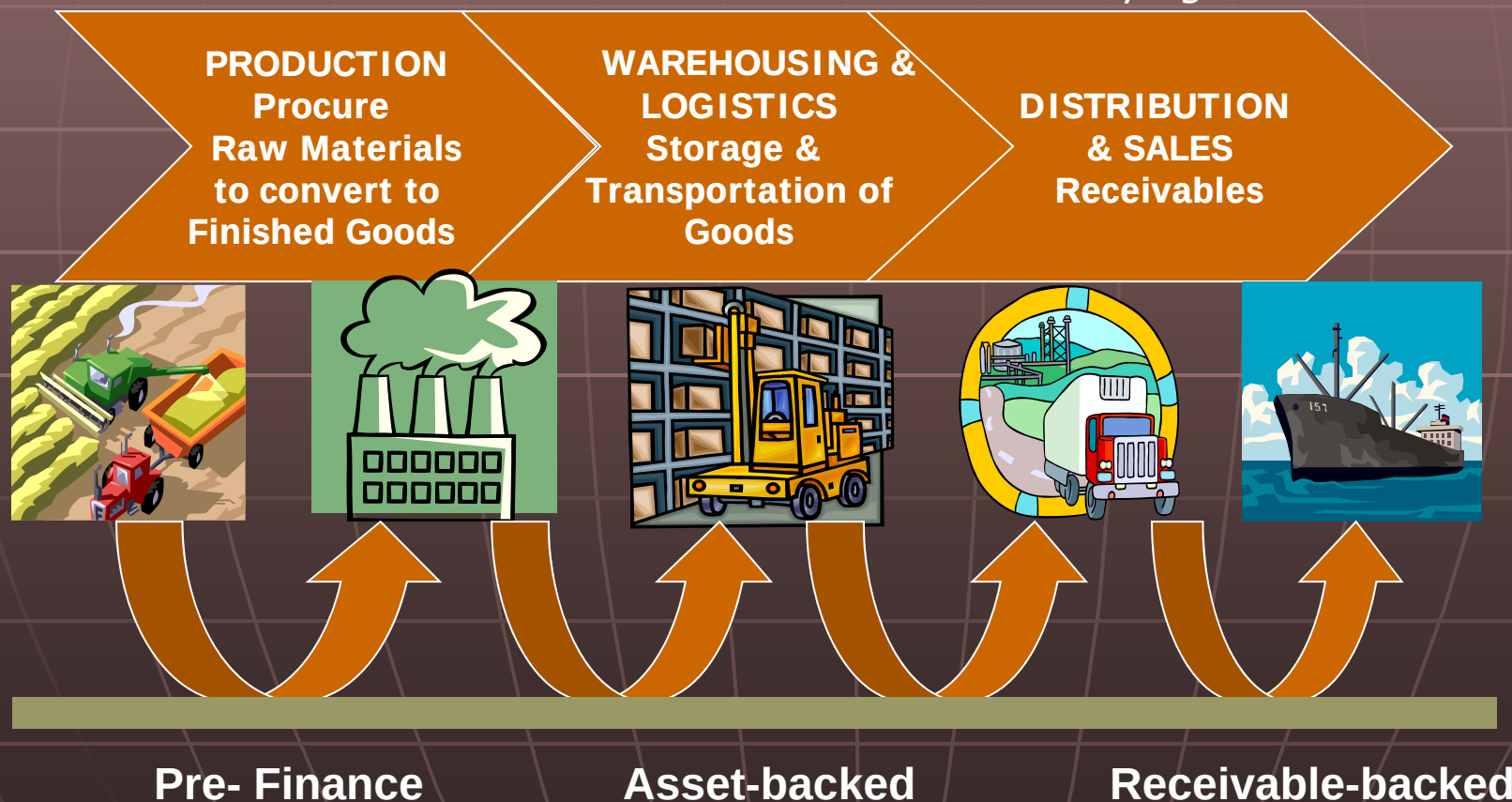




Structured Finance Instruments

finance integrated agricultural value chains
from producer to consumer

Structured finance is the art of transferring risks in financing from parties less able to bear those risks to those more equipped to bear them in a manner that ensures automatic reimbursement of advances from the underlying assets.





Preliminary Conclusions

- Specific products
 - Credit Guarantees
 - Structured Finance – Romania Case Study

- Engagement opportunities and overall product tailoring



Credit Guarantee Schemes

can help increase access to finance for credit constrained agricultural producers by overcoming information asymmetries and lack of collateral

- Results are inconclusive:
 - Often design problems
 - Based on wrong objectives
- Should be treated as means to solve credit constraints (not ends) and need to be accompanied by general measures to attain:
 - Open, competitive banking sector
 - Dynamic and expanding business sector
 - Favorable business environment
 - No government-supported distortive measures



Credit Guarantee Schemes

can help increase access to finance for credit constrained agricultural producers by overcoming information asymmetries and lack of collateral

- Need to be designed well:
 - Result in new loans and productive investments by those not reached by financial services previously
 - Lenders retain significant part of the risk, loan appraisal is made by lenders
 - Government's role- more on set up costs and less on risk assessment and recovery
 - Pricing- risk based pricing, penalties for high loan loss
 - Risk Management for Guarantee Schemes- via re-insurance, portfolio securitization and loan sales
 - Auxiliary services and risk management instruments for borrowers



World Bank Group Guarantees

help mobilize private sector funds and beneficial for sectors in early stages of reform, larger and/or riskier operations

- Wide possibilities for application if done properly
- World Bank provides:
 - Partial Risk Guarantees – IBRD & IDA
 - Partial Credit Guarantees and Policy Based Guarantees – IBRD Only
- IFC provides
 - Full/Partial Credit Risk Guarantees
 - Risk sharing facilities
- Bank Group acts together in various projects by sharing risks: e.g. Joint IDA IFC SME Pilot Program for Africa



Structured Finance Instruments

Lessons from Romania Case Study

- Structured Finance products used for selected companies;
- In order to mainstream, measures should focus on judicial, financial and agriculture sector specific improvements such as:
 - Contract enforcement
 - Development of credit bureaus with a broad information base
 - Consolidating fragmented agricultural land
 - Increasing competitiveness of agricultural sector
 - Establishing agricultural risk insurance
 - Increasing quality and standards for main commodities
 - Encourage alliances between retail sector and agricultural producers
- Once the structural improvements within financial and agricultural sector is made, structured finance instruments come forward.



Engagement Opportunities – Sector Environment

- Assist countries in implementation of structural changes to their:
 - Agricultural Sector:
 - Improvement in agricultural land management
 - Productivity improvements
 - Access to markets, extension and information
 - Promotion of integrated value chains
 - Investments in infrastructure, transport and product quality
 - Financial Sector:
 - Competitive financial sector with various actors serving different market segments and variety of financial products
 - Adequate financial infrastructure with sufficient credit information institutions
 - Adequate laws on contract enforcement and collateral use



Engagement Opportunities

– Product-specific

- Products should be tailored for the development level of each country cluster
- The finance products should complement each other to facilitate access to finance in the agricultural sector
- Specific engagement opportunities will be detailed in the report



Different agricultural finance and risk management products are needed in each country category

■ CATEGORY A:

- Basic TA and credit lines for seasonal loans for farming needs and investment loans

■ CATEGORY B:

- Semi-Advanced TA and credit lines for seasonal loans for farming needs, investment loans (long-term), leasing, transaction finance, factoring, credit guarantees, trading/info exchange platform

■ CATEGORY C:

- Advanced TA for seasonal loans for farming needs, investment loans (long-term), leasing, transaction finance, factoring, credit guarantees
- Advanced TA and lending for risk management, including forward contracts, warehouse receipts, index- based agricultural insurance, commodity exchanges, other more complex types of structured finance

■ CATEGORY D:

- Same as above in Category C



Next Steps

- Integration of the new products in the Country Partnership Strategies (CPS)
- Identify potential partnerships between the donor organizations for:
 - comprehensive sectoral reforms
 - integration of the new products into the agricultural finance systems where such opportunities have been identified