WORLD BANK GROUP

AgriFin
Agriculture Finance Support Facility

The Role of Bankers Associations in Facilitating Agricultural Financing

The Case of the Honduran Association of Banking Institutions (AHIBA)

KNOWLEDGE NOTES

MAY 2015

Introduction

Financing agriculture is a challenging endeavor, with a multitude of factors that act as disincentives for banks in expanding their outreach to agricultural enterprises and farmers. Challenges include the higher transaction costs that come from working with rural and often remote borrowers; increased risks, ranging from high levels of agricultural price volatility to adverse weather events damaging production; and uncertain political and regulatory environments that can cause market disruptions. Despite these challenges, a growing number of banks and other lending institutions are investing in technology, processes, risk management instruments and people so as to develop the means for managing and overcoming such challenges. However, even with such efforts, a number of regulatory barriers can often continue to make it difficult to provide additional financing to the agricultural sectors in developing countries. This short note considers the role that bankers associations can play in improving the enabling environment by working with regulatory agencies to assist banks in expanding their lending to agriculture. This paper considers the role that the Honduran Association of Banking Institutions (known by its Spanish-language acronym, AHIBA) played in improving the regulatory environment for lending to agricultural in Honduras.

Overview

Banking regulations exist largely to ensure prudential behavior by banks, so as to protect depositors and avoid systemic risk that would arise from bank failures. Regulations in each country are often derived from global regulatory norms, with appropriate adaptations for local market conditions. This raises two sets of challenges for banks in developing countries: firstly, the existing regulations drafted to ensure prudential banking may hamper lending to the agricultural sector; secondly, regulations required to facilitate agricultural lending, by overcoming institutional barriers in developing countries, may be absent. In short, regulations that exist may hinder agricultural lending, while "missing" regulations could also be hamper lending. On their own, individual banks are unlikely to have the capacity, resources or influence to address these barriers directly with the regulatory authorities; this is generally only something that can be achieved by collective actions. However, such collaboration is often problematic bearing in mind the fiercely competitive nature of the financial sector in many, if not most, countries. As such, a significant role exists for banking associations, as the representative of multiple banks within an environment, to play a key role in addressing agricultural lending barriers with the regulatory authorities. While most banking associations already actively facilitate dialogue around regulatory issues between their membership and regulators, this dialogue can often exclude matters relating to the specificities of agricultural financing. As this case study illustrates, however, with proper focus from both banking associations and their members a number of enabling environment barriers can be tackled with coordinated and well considered action.

It is commonly stated that regulations ostensibly put in place to ensure banking sector stability are also a significant barrier to the expansion of agricultural lending in developing countries. Generally these discussions focus upon the collateral and provisioning requirements for loans as defined in the banking sector regulations. Collateral requirements are often noted to be untenable for farmers and smaller agribusinesses operating in developing countries, as the collateral that they have may not satisfy the requirements of the banking regulations. As such, a bank making a loan to an individual or enterprise that cannot provide appropriate and sufficient collateral will be required to make an up-front provision for the loan, significantly raising the cost of lending to that client.

However, rather than dwell only on the barriers to existing lending caused by banking regulations, one should also consider the institutional gaps that exist within a country and the opportunities for the introduction of new legislation that might dramatically expand the ability of banks to lend to the agricultural sector. New regulations can directly address some of the institutional constraints that exist in developing countries. Such regulations include: a) the ability for banks to take non-traditional (non-land) collateral as security for loans; b) legislation to enable mobile payments and agency banking approaches as solutions to the challenge of servicing remote rural populations; and c) legislation to facilitate the use of alternative means for securing loans to agricultural customers based on the commodities they trade.

Collateral—Many agriculture clients in developing countries do not have immovable properties that can be leveraged as collateral to access loans from formal financial service providers. Other movable assets such as farm equipment, receivables, and livestock and crops can be considered to secure loans. Laws that permit the use of these assets as collateral, along with the availability of well-managed and easily-accessible collateral registries, can greatly facilitate lending. Bankers Associations can lobby for such a regulatory environment to promote alternative means for collateralized lending in agriculture finance, e.g., warehouse receipt instruments and collateral management systems.

Outreach—Regulations that support the development and use of alternative, lower-cost distribution channels can enable banks to expand their operations to rural areas, thereby reducing the transaction costs of lending to farmers and agribusinesses. Branchless banking, agency banking and the use of technological delivery channels for servicing clients are critical to expanding outreach into remote agriculture areas by reducing delivery and transaction costs. The introduction of laws that allow the use of non-bank agents and electronic platforms among others is necessary for banks to expand services to agricultural clients using cost efficient channels.

Alternative means for collateralizing lending—Alongside regulations relating to collateral requirements, the introduction of new regulations and laws that take into account the specificity of agricultural finance are critical to creating a conducive environment for financial institutions to sustainably finance agriculture. For example, sound regulations on warehouse receipts and collateral management arrangements can assist banks in developing innovative loan products that provide finance based upon assets held within a warehouse, safe in the knowledge that the legislative environment facilitates such endeavors.

The Case of the Honduran Association of Banking Institutions (AHIBA)

Financing for agriculture in Honduras is limited. This is mainly due to the lack of collateral by many agriculture producers necessary to secure lending from banks as well as the limited agriculture risk management instruments (such as market information systems, contract farming arrangements etc) available to banks to mitigate and transfer risk. In order to address critical constraints to banks' ability to finance agriculture, AHIBA works closely with leading Honduran banks to promote the adoption of supportive policies and regulations by the government, while also providing technical assistance to its members.

AHIBA is a nonprofit organization founded in 1956 to protect and assist in the development of the private banking system in Honduras. Currently, there are 15 commercial bank members in the association. AHIBA plays a critical role in creating an operating environment that is conducive for its members' agriculture finance businesses, both in the regulatory and non-regulatory arenas. In the regulatory space, it keeps its members informed about policies, laws, decrees and resolutions that have a relevance to agriculture finance. In addition, it plays a policy advocacy role, promoting the introduction and amendment of policies and approaches to agriculture finance. AHIBA, also undertakes studies and facilitates discussions on economic and monetary policy issues relevant to its members. In the non-regulatory space, the association is dedicated to the professional development of its members through training and the promotion of agriculture lending tools.

Policy advocacy—AHIBA plays an active role in strengthening the regulatory framework through policy advocacy work and participation in key policy dialogs on a range of agriculture finance issues. For example, it is working to amend the agricultural sector policy of the National Banking and Insurance Commission (CNBS in Spanish). The CNBS requires banks that provide lending for agriculture to hold more funds in reserves and impose a high provisioning requirement, considering the riskiness of agriculture. Due to this strict policy, a number of banks limit lending to agriculture and in some cases choose to classify their agriculture advances as commercial loans. To address this policy barrier, AHIBA is currently working with the CNBS to reduce the reserve and provisioning requirements and to support the expansion of lending to agriculture by banks.

At the meso level, AHIBA lobbied for the creation a guarantee fund that banks can access to manage risk exposure in lending to agriculture. The National Mutual Guarantee Fund was originally established to guarantee loans made to other priority sectors such as education and housing but, as a result of AHIBA's efforts, the government has expanded the scope of the fund to include agriculture.

Legal reform—Another area of work undertaken by AHIBA focuses on reforming the law and registry governing the use of movable collateral, in collaboration with the Chamber of Commerce, Industry, and Technology. AHIBA played a key role in training banks in movable collateral-based lending[1] and creating awareness about this mechanism among the wider banking industry. Furthermore, as part of the conflict resolution mechanism embedded in the law, AHIBA supported the identification and training of professional referees in charge of the arbitration process for disputes over purchase or sale agreements for agriculture loans. In addition, AHIBA is currently working with the Ministry of Agriculture and other stakeholders to develop a manual on quality standards for agricultural products to be used during the arbitration process.

Representation in policy dialogue—AHIBA has succeeded in representing the views and interests of its members in different public forums. For example, AHIBA has become a member of the National Agricultural Financing Table, composed of several national organizations interested in improving agricultural financing in Honduras. In this forum, AHIBA contributes to the policy dialogue addressing agriculture finance by representing the interests of its members. AHIBA also represents its members in the Committee of the Agricultural Trust of Millennium Challenge Account /Honduras, where it succeeded in removing restrictions on the use of the government partial guarantee scheme for coffee and livestock value chains.

In addition to their proactive approach in policy advocacy, AHIBA is also dedicated to the professional development of its members by offering business training and the development of lending tools.

Training on agricultural risk management—AHIBA provided training to its members on the use of agricultural price and credit risk management tools. Multiple training sessions were delivered to member banks and other actors in different agricultural value chains as to how to manage commodity price risk. AHIBA has trained loan officers from more than 10 member banks and provided technical assistance and training on new mechanisms for assessing agricultural loans. It also organized workshops to share international experiences on the use of price risk management tools. In addition, AHIBA designed financial education modules for producers in order to improve the bankability of farmers.

Developing risk management tools—AHIBA developed a tool called AgRisk that is used to analyze agricultural clients based on a scorecard system. It combines information on specific characteristics of producers, weather, and production

1 Movable collateral in this case includes farm equipment, livestock, receivables, and stored commodities.

and generates a risk score for any given producer. AgRisk also has the ability to recommend an appropriate interest rate based on the risk profile of a given client. By developing AgRisk, AHIBA introduced its members to a better and more efficient approach to evaluating agricultural loans—moving away from secured loans exclusively to unsecured loans assessing the historical information of a client. In addition, AHIBA provides client assessment services using this tool for banks and cooperatives that do not have the internal capacity to conduct client assessment on their own. By the end of 2013, AgRisk has been introduced to the majority of the members of AHIBA as well as to other institutions including cooperatives, exporters, and development projects. Currently, two banks and two cooperatives are using AgRisk for their client assessments.

Creation of a specialized unit for agriculture finance—Although the move into technical assistance services represented a new activity for AHIBA, it developed an effective strategy to support its members. The strategy culminated in the creation of a special unit within the associations that is charged with providing technical assistance and conducting policy advocacy work on agricultural finance. This is in part an institutional response by AHIBA to the members increasing support in the area of agriculture finance. The unit coordinates all technical assistance including training, advocacy work, and knowledge and information sharing among members. The unit manages partnership programs supporting the association's work on agriculture finance and ensures the sustainability of donor-sponsored activities.

Lessons and Insights

Policy advocacy—AHIBA's experience demonstrates that financial institutions, through their associations, can work with their governments and regulators to improve the regulatory and policy environment for agriculture finance. Through engagement in policy dialogue, bankers associations can ensure that regulators and other government agencies understand agriculture lending principles and reflect them in policy decisions. In the absence of a single entity advocating for agriculture finance, bankers associations can fill this gap by coordinating voices of banks and other actors in agricultural value chains.

Technical assistance—Bankers associations can also play a vital role in the professional development of their members by providing staff training, and by developing tools and resources. Such services are often too costly for banks to acquire on their own but bankers associations have the ability to offer such services at a lower cost, spreading the expense across its membership. Additionally, AHIBA's experience shows that technical assistance services are effective when they are demand-driven. This requires active engagement with members to identify issues, technical barriers, and capacity issues, which can then inform the development of effective technical assistance services.

Peer-to-peer learning—Bankers associations can play a vital role in sharing information and knowledge among peers. Bankers associations provide a useful forum for banks to share experience and information among peers that share similar business models and client segments. Experiences of banks in agriculture lending—as well as the tools and systems they use in their operations—are critical knowledge resources that can be utilized among banks to build skills in this field. The ability of bankers associations to facilitate peer-to-peer learning among members and, if possible, with similar associations across borders, can be a critical support to building agriculture finance lending capacity.

Join AgriFin

https://www.agrifinfacility.org

AGRIFIN

Agriculture Finance Support Facility