Guidelines for Value Chain Contract Farmer Financing

Agricultural Credit & Microfinance Department

State Bank of Pakistan

Contents

1. Introduction

Small farmers dominate agricultural landholding patterns in Pakistan, where financial exclusion remains alarmingly high. Farmers, particularly the small landholders are facing problems in accessing finance from the banking sector due to their inability to provide collateral acceptable to banks. Hence, they are forced to rely on informal sector to meet their agri. credit requirements. These factors also limit the ability of small land holding farmers to boost their farm productivity due to lack of access to yield enhancing inputs like improved seed & fertilizers and information on how to get credit to finance investment in agri. production and development activities. Moreover, they commonly lack ability to market their produce at competitive rates which restrict them to invest in land improvement. Consequently, small and marginalized farmers are unable to deliver the volume and quality of produce that commercial buyers, retailers, processors and other agri-business firms require, which in turn limits the development of markets for agricultural produce.

Contract Farming assumes an extensive number of arrangements along the value chain link small-scale farmers to some type of market as a way to supporting them to become successful independent commercial farmers in the long term in a developing country context. The farmers can be linked to markets by either formal or informal contracts as a result of some type of arrangement with a buyer who adds value to the raw commodity in some way (processing, storage, marketing). Contract Farming is being adopted in many developing countries including India, Thailand, Indonesia, Malaysia, Vietnam, Philippines and Cambodia. The Contract Farming is also being practiced in Pakistan for the production of Sugarcane, Maize Tobacco, Potato, rice, etc.

For ensuring provision of formal credit to small and marginalized farmers, value chain contract financing schemes are being offered by banks to help to over-come these obstacles with mutual benefit for all stakeholders involved. The introduction of value chain contract farmer financing scheme will enable farmers to avail financing from banks backed by processor's guarantee and in return buyers/processors may get assurance of getting required quantity and quality of agricultural produce. Such schemes are a more integrated form of contract farming, whereby agribusiness has greater control over smallholder production. Small land holder producers offer means of production i.e. their land, labor and expertise in return for a package of inputs and extension services. Well-placed investments that facilitate demand-driven credit schemes that have the potential to effectively help stakeholders in acquiring credit and inputs they require to improve productivity.

Objectives

The objectives of the value chain contract farmer financing are:

- To enhance outreach levels by extending credit to contract farmers including landless/marginalized small farmers who lack capital and insufficient collateral to qualify for financing from banks.

- To facilitate financial institutions to design products, develop lending capacity and generate diversified loan portfolio of agri. financing.

- To cater to the unmet demand of small farmers, mitigating the risk of banks by utilizing & strengthening the existing farmers-processor relationship by introducing alternative delivery channels.

- To provide short term financing to processors, aggregator guarantors during procurement season.

- To provide sustainable financial services, mutually beneficial for farmers, processors, and banks/DFIs by reducing cost of doing business and post disbursement monitoring.

2. Value Chain Contract Farmer Financing

Value Chain Contract Farmer Financing schemes are broadly defined as binding arrangements between banks and agri. value chain actors including producers, processors, aggregators, traders through which a farmer or group of farmers ensures supply of agricultural products to individual firms. In other words, the contract farmer financing scheme replaces the traditional collateral requirements with trade agreements by facilitating coordinated commercial relations between lead firm, banks and farmers leading to a vertical integration of the agricultural value chain.

Contract farmer financing mechanism refers to a system whereby a central processing and exporting unit purchases the harvests of individual farmers, and the terms of the purchase are arranged through contracts. The terms of the contract vary and usually specify how much produce the contractor will buy and at what price. Contract farmer financing scheme embodies a range of initiatives taken by private and public firms to secure access to smallholder produce. The contractor often provides credit inputs and technical advice. Contracting allows adequate allocation of risks between producer and contractor; the farmer assumes the risk of production while the contractor is assigned with the risk of marketing. The success of such an arrangement relies on the farmer's commitment to provide a specific commodity in quantities and at quality standards as determined by the purchaser besides the commitment of the company to support the farmer's production and to purchase the commodity.

Various forms and instruments of product financing have been used for centuries, and often credit is provided in kind, such as in the form of seeds and fertilizer. Various approaches have been tried out to expand farm trade credit in both developing as well as developed countries. The product financing instruments are not new; rather, what is significant is the way an agri. value chain (Ag VC) system can build up on and improve these instruments because of the stronger linkages and the availability of improved information and communication.

These financing arrangements have been further divided into following four instruments;

1. Trader credit
2. Input supplier credit
3. Marketing company credit
4. Lead firm credit
5. *Arthi or* Intermediary

These instruments are different in the way they are used in agricultural value chain framework, which describe a typical way of extending financial services. Each of these instruments has many features in common, however, there exist some differences in their application.

3.1. Traders Credit

Trader credit is a traditional form of finance that is prevalent in informal and fragmented Agricultural Value Chains. In these systems, traders, or sometimes trader-farmers, play a critical role in connecting farmers to markets, while providing farmers with funds for production, inputs, harvesting or other needs such as family emergencies, etc. Trader credit is provided by one party to another party in a sales transaction. The loan can be made in cash or in kind, and the terms can be short-term or seasonal. The transaction may involve an input (such as seeds, pesticides, fertilizer) or product (such as grains or horticultural products), to another party. Traders are therefore able to advance funds with the guarantee that the harvested crops will be available to them for resale according to the price that is set at the time of financing or at the market price available at that time.

The funds used by local traders can be generated from variety of sources like: equity of trader, financing from banks, wholesalers or processors who advance them for procurement of agri. produce from farmers. Trader-farmer agreements usually tend to be informal in nature while there are also various examples of formal agreements between the value chain actors. Quicker provision of credit, technical assistance and market linkages through traders may lead to initial cooperation among farmers that can be the basis for a more formal structure.

3.2. Input Supplier Credit

Input-supplier credit is defined as short-term working capital finance to growers delivered in kind and generally in the form of seasonal loans. Input credit is a common form of in-kind financing to farmers at all levels in informal and fragmented value chain both in developing and developed countries. Input supplier credit enables farmers to realize cash flow benefits in view of access to supplies i.e. seed, fertilizer, agro-chemicals or even equipment for production when required. Relationships between farmers and input suppliers are often temporary and price-driven compared to contract financing schemes.

Due to weaker interest of financial sector and unorganized value chains, input suppliers, traders, agro-processors and agri-business play an important role in financing to farmers. Traditionally, input supplier and trader credit had been the only two options available to farmers. Input supplier is often relationship based and these supplier or crop buyers will only extend inputs directly to farmers with whom they have long term relationship. Provision of inputs to farmers is much more risky since the crop failures make credit repayments difficult. An advantage of supplier led finance is that it can reduce the farmer's transaction cost as well as secure increased sales of input suppliers. However, it ties the farmer to a particular supplier and limits the search for better input price conditions. In addition, they often provide their client with technical advice, since they are dependent on the outcome of the production by the farmers.

3.3. Marketing Company Credit

The marketing companies like seed, fertilizer, pesticide companies and agri. exporters, provide advances either directly to growers for their input purchase from local suppliers or by lending to traders or aggregators. Credit is provided by marketing and agro processing companies to smallholder producers under contract financing schemes through written or verbal contracts for farm inputs and services with an understanding of guaranteed delivery of agri. produce of specified quality at a pre-determined or market price. The choice of the channeling of financing varies in accordance with the most secure intermediary.

The marketing company provides required inputs and technical expertise. The company may or may not directly manage the financing. For example, in Pakistan, various companies like Rafhan Maize, Nestle, Engro Foods and Lays, Tobaccos and Sugar mills are offering inputs like hybrid seed, packing material & transportation to the farmers with an agreement to procure their produce at the time of harvest.

3.4. Lead Firm Credit

A lead firm is the driver of agricultural value chain and is typically a large retailer, exporter or agro-processor which is a recognized key market actor in a range of agricultural produce. Under these value chain linkages, a tripartite agreement between farmer, bank, and the lead firm is to be executed, whereby a large private firm (i.e. lead firm) provides technical assistance and market linkages to small holders, who also take benefit from access to finance from financial institutions to upgrade their inputs and production methods. It is often in the form of contract farming with a buy-back clause, provides farmers with finance, technical assistance & market access, and ensures quality & timely products to the lead firm.

Larger lead firms sometimes offer finance and technical assistance with costs embed in the price of the product. They operate on the basis of contracts, such as contract farming. Lead firm financing is a service package and is classified as a financial instrument only because of the prevailing nature of the commercial relationship. It combines credit for specific use, guaranteed markets, fixed/market price or price parameters, technical assistance and strict standard and delivery commitments. Financing can typically be used only for specific use mentioned in the mutually agreed contracts but the source of the finance can be from lead firm itself or through an external arrangement with a third party; bank or other financial institution.

3.5 *Arthi* or Intermediary

The *Arthi* remains the largest source of informal credit for agriculture. *Arthis* has a strong binding relationship with the farmers to lend the segment considered risky and not credit worthy by banks. The *Arthi* lends unsecured loans to farmers that are well known to him or come through a reliable reference. He does not rely on traditional collateral that the banks typically demand such as passbook. The *Arthi* manages his risk well by using indigenous tools like identifying the right borrower, ascertaining his credit needs accurately, and finally controlling the farmer's cash flows by binding the farmer to sell the produce through him. In case of genuine default due to loss of crop due to natural calamity, *Arthi*, rolls over or extend the loan for the next term to allow the farmers to cultivate the upcoming crops.

Arthi role may be enhanced by introducing 'intermediary' between bank and clients for facilitating in provision of banking and value added services such as access to latest farming techniques, use of modern farm equipment, efficient use of inputs that can help increase productivity. The intermediary, like the *Arthi*, would help manage the bank's risk by referring the genuine clients, correctly assessing his credit needs, ensuring proper utilization, facilitating and managing cash flows through crop's sale proceeds or guaranteed markets. The role may further support borrowers in providing risk mitigation support by covering loan under crop loan insurance.

4. Guidelines for Value Chain Contract Farmer Financing

Currently banks are relying on traditional collateral based lending approaches and are hesitant to adopt best practices in agri. finance. Similarly, majority of smallholder, tenant farmers are experiencing difficulties in obtaining credit for purchase of inputs, therefore, to enhance required and good quality produce, they are compelled to meet their financial requirements through informal credit at exorbitant interest rates. Contract farmer financing allows farmers access to formal credit for inputs purchase of input for carrying out crop and non crop activities through lien guaranteed by the agri. processor. In addition to provision of formal credit through bank, there are a number of value added services including provision of quality input, extension services, technical support, transportation, ensured marketing and price, usually offered by the processors, aggregators on the mutually agreed terms and conditions.

Introduction of guidelines for value chain contract financing will provide an opportunity to small & marginalized farmers to invest in enhancing their productivity; availing inputs facilities, adopting new technologies & hybrid seeds, insurance coverage for their crop/non- crop activities and assured market of their produce at the time of harvest, etc. On the other hand, such mechanism and contracts will attract many buyers and processors who are looking for assured supplies of agri. produce for sale or processing. This arrangement facilitates buyers/ processors including tobacco companies, sugar mills, milk processors, meat processor, rice mills, cotton ginning mills, seed processors, aggregators, to develop portfolio of preferred suppliers, full utilization of their plant capacity and business resources, facilitate in developing backward/forward market linkages that are cornerstone of market-led, commercial agriculture. Well-managed contract farming is considered as an effective approach to help solve many of the market linkage and access problems for small farmers by cementing the relationship as pre agreed terms and conditions.

These guidelines cover financing to borrowers involved in agri. production both crop and non-crop activities under the explicit guarantee of processors, input suppliers, marketing companies, aggregators, lead firms, traders, exporters, stockiest, etc. and its value addition/processing as per prudential regulations for agri. financing. Banks may adopt these guidelines in the present form or develop product program aligned to their organizational & operational needs and market characteristics, subject to compliance with SBP Prudential & other Regulations for agricultural financing. the guidelines may benefit in terms of:

- capitalization on the relationship between buyers and sellers by financial intermediation and guarantee mechanism.
- reduced credit risk by utilizing already available inter-dependent and mutually beneficial model.
- strengthened accessibility of farmers to secure markets.

- assured supply, reliability in procurement of desired quality produces for the agribusiness buyers.
- provision of opportunity for lower input costs due to improved planning and economies of scale.
- improved technical support and extension services enabling farmers to enhance productivity.
- auto liquidation of farmer's liability from marketing loan/seasonal loan to processor

4.1 Tripartite Agreement

This arrangement is classified as a financial instrument only because of the prevailing nature of the commercial relationship. It combines credit for specific use, guaranteed market, fixed prices or price parameters, technical assistance, and strict standards of delivery commitments. Under this arrangement finance is arranged by the bank, guaranteed by the driver firm. The successful implementation of contract financing scheme is based on the relationship between the parties involved in the arrangement to promote their business mutually. The type of agreement may be formal or semi-formal ranging from written legal documents to well defined memorandum of understanding (MOUs). Financing contracts can facilitate transactional transparency and help build the trust between the partners that is so critical to long-term success. Contractual terms and conditions depend largely on the scale of the size of investment. They may be open-ended or structured to fit seasonal crop requirement or specific calendar period or volume of produce. Contract may also include input supply, extension services, other support services and repayment terms. However, all such contracts should clearly and unequivocally set out the terms of payment and price of produce, quality and quantity.

Under this tripartite arrangement, buyer (Agri. processor, trader, farmer's association, marketing company, exporter, aggregator), financial institution (Bank) and agri. producers (farmers/cultivator, farmers' organization) reach to an agreement on certain terms & condition, specified roles and responsibilities to carry out the contract. This agreement may include mutually agreed arrangement between agri. processor and farmer for withdrawal of loan limit in parts, needed for purchase of input or any other services as defined in the eligible items. For efficient use of loan facility, these withdrawals will be based on the nature of crop and type of business. Clearly defined terms and conditions and understanding of obligation would develop a strong relationship at each level.

Roles and responsibilities at borrower, lead firm and bank level are defined as under:

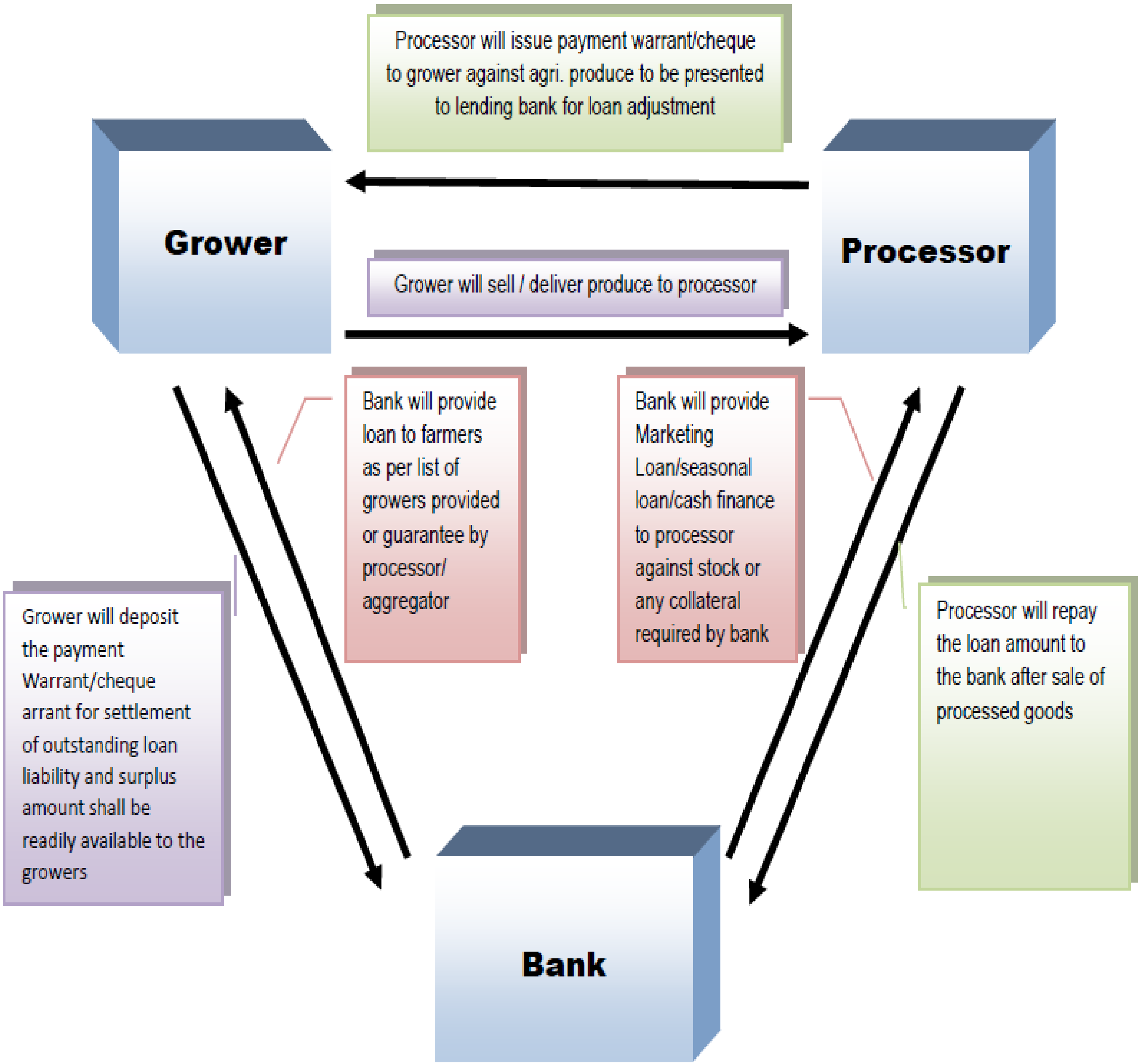
4.2 Roles and Responsibility of Stakeholders under Value Chain Contract Farmer Financing

Stakeholder Roles & Responsibility	
Value Chain Actors: Agri. Processor, Trader, A*rtis*, Marketing company, Exporter, Aggregator, Intermediary	• Being the lead driver, take the initiative to establish commercial relationship with farmers by providing finance through a third party, i.e. bank/financial institution. • Identify potential, genuine and trustworthy growers for borrowing from bank. • Provide list of bonafide farmers with details, such as, name, CNIC, land holding, crop cultivation etc. to the bank along with letter of recommendation. • Contact with bank for lending to his contract farmers. • Facilitate bank in processing of loan applications. • Offer guarantee to bank/DFI for covering exposure against its contract grower's. • Prepare mutually agreed terms and conditions including crop to be cultivated, loan period, quantity, quality, etc. • Monitor proper utilization of loan • Procure agri. produce as per the agreed terms and conditions and at the mutually agreed price. • On receipt of produce from grower, the processor will issue a warrant / cheque in the name & loan account of borrower for the settlement of outstanding loan. • To ensure timely repayment to the bank, the processor may avail Marketing Finance/Cash finance/running finance at the time of purchase of Agri. produce from growers.
Financial Institution/ Bank	• Open Processor and farmer's account at the branch, meeting all KYC requirements. • To obtain e-CIB report of guarantor and contract farmers. • Obtain sale contracts made between lead firm, i.e, guarantor and farmer. • Complete loan applications of farmers along with proof of cultivation, i.e, Khasra Gardwari or any other authentic document provided by the revenue department. • Complete legal formalities for charge creation on current/fixed assets suitable and acceptable in case of limited company to secure the total advance/limit assigned.

	• Verification of cultivation/business • Devise operational modalities to release the sanctioned loan limit/ sub limit to contract growers based on input or business requirement of the borrowers, i.e. release of loan amount sanctioned, in lump sum or in parts with the concurrence of guarantor and farmer. • As Processor/Lead firm may not be an entity rated by credit rating agency, therefore, banks are encouraged to assign internal credit risk ratings to processor/lead firm. • Provide short term Running/ Seasonal finance to processor, Arti, guarantor for procurement of agri. produce from growers and swift payment to the contract farmers. • Bank will carry out proper due diligence process and appraisal to evaluate, maintain and enlist processors, stockiest, input suppliers, etc, at their end. • Bank may devise joint control mechanism over withdrawal by the guarantor processor and Contract grower. • Facilitate Contract growers in case of any credit guarantee or refinance scheme announced by the GoP. • Facilitate Crop Loan Insurance Scheme and Livestock insurance scheme for borrowers, • Provide a list of borrowers to banks in case of non-payment on due date/ repayment date for follow-up.
Contract Farmers	• Understand the contract and its terms and conditions. • Provide necessary documents or any other requirement for opening bank account. • Divulge necessary information including details of crop cultivated area/non farm activities like poultry, dairy, fishries for estimation of credit requirement/limit. • Provide proof of cultivation. • Adhere to the contractual obligations. • Deliver agreed quantity and quality of produce at the agreed price and time to the lead firm. • Repay bank loan for settlement of their accounts. • Maintain record of receipts/vouchers. Payments, statement etc

4.3 Value Chain Contract Farmer Financing Mechanism

The guidelines provide a mechanism for auto liquidation of farmer's liability. In this mechanism, on receipt of produce from grower, the lead firm will issue a payment warrant/ cheque to settle the outstanding loan of borrowers.



4.4 Eligibility Criteria

Individuals/ farmers organizations/cooperatives who are engaged in agri. production activities and have sufficient knowledge, relevant experience and track record besides guarantee by agri. processor, input supplier, stockiest, marketing company, trader, *Artis*, exporter, lead firms etc. shall be eligible to draw loan under contract financing scheme. Further, the bank may also extend marketing/ seasonal loans directly to traders and intermediaries for the procurement of crop or non crop produce. However, being the guarantor of the contract farmers, their role for recommending the borrower, monitoring and repayment of loan has been enhanced and strengthened. Other essential conditions are:

- Customer should be a holder of computerized NIC and fulfill the KYC requirements.
- Farmer with authentic documentary proof of crop cultivation.
- Individual request of customer for the loan.
- Positive cash flow of the farmer & processor
- Customer should not be a defaulter of any Bank/ financial institution. This condition may be relaxed in case the bank & guarantor is satisfied with credit worthiness of the customer and that earlier default was circumstantial and not willful.
- Individual farmers may avail finance from bank backed by processor's guarantee under the contract financing scheme.

4.5 Permissible Financing

VC Contract financing facilities have been designed to meet daily expenses i.e. working capital requirements of the farmers, short to medium term investment for development of land, orchards, nurseries and purchase of farm implements, machinery, etc.

4.5.1 Working Capital Financing

To meet day to day expenses of farmers, banks can provide loan limit for working capital finance for their seasonal requirement which will be renewed upon timely repayment/settlement of the loan and approval by the guarantor. Financing may be provided for the short term/working capital loans under crop and non crop activities as under:

- Seeds/ root-stock and nursery plants.
- Water – Charges for purchase of tube-well water
- Fertilizers and gypsum

- Chemicals, including herbicides, Weedicides, fungicides, detergents, disinfectants and waxes.
- Sprayers
- Farm labour
- Laser leveling charges
- Labor charges for Fruits, vegetables, etc. picking
- Labor charges for fruit/ vegetable sowing / Transplantation of nursery
- Charges for Purchase of diesel & engine oil for tractor
- Charges for purchase of diesel & engine oil for tube-well operation
- Orchards and Nurseries (including all dry fruits, dates and papaya)
- Production Loans for off season vegetables grown in green houses and tunnels
- Herbs / Roots Production on Commercial Basis
- Transplantation Expenses
- Inter Culturing Expenses
- Farm Yard Manure
- Production loan for commercially viable medicinal crops
- Storage, Transportation, Marketing, Grading, Packing and Processing
- Electricity Charges
- Cost of Packing Material
- Raw materials & other operational costs for food processing (value added products)
- Any other item to meet day to day expenses.

Short-term Credit for Non Crop Activities

Livestock

- Feed Lots
- Feeds, raising and veterinary expenses
- Purchase and plantation of animal fodder and feeds
- Concentrate feed stuff like cotton seed, cotton seed cake and other additional expenditure,
- Artificial insemination unit services
- Packing material for meat, milk and other livestock products
- Working capital for milk collection center
- Purchase of feed grinders, tokas, feed mixing machines and feed or milk containers.
- Vaccinations, vitamins and other veterinary medications.

- Expenses of labour, electricity and fuel, etc.
- Utensils for animal feeding, calf feeders, bangles, rope/iron chains, etc.
- Distribution cost, transportation charges on farm-milk processing, pasteurization and standardization.
- Financing against deferred payment vouchers of milk processors, sweetshops and meat processors, etc.
- Lending to the farming community to meet their short term livestock credit requirements.
- Any other item related to Livestock day to day expenses.

Poultry

- Purchase of feed, birds/ day old chicks, feed raw material
- Feeds and raising charges
- Poultry medicines, vaccination, vitamin and other medication for poultry birds, saw dust, wood, coal, medicines, water filter cartages
- Packing and storage material
- Expenses of labor, utility bills, fuel for generators & vehicles, transportation/shipment, etc.
- Purchase of poultry utensils/equipments (brooders, drum heaters, drinkers, one/two pan type feeder, small/large feeder, feed trays, laying nests, shifting box, fumigants, water filter cartages, water nipples, PVC pipes, crates, fogger nozzles, chick guards, spray pumps, weighing machines, tubs, etc.)
- Wholesale lending to microfinance banks, microfinance institutions, NGOs, etc. for onward lending to the farming community to meet their short term poultry credit requirements.
- Any other item required to meet day to day expenses for running poultry farm

Fisheries (Inland and marine)

a) Inland

- Fish seed
- Fish feed
- Manuring
- Purchase of fingerlings fish/seed/feed/shrimp post larvae.
- Purchase of inputs like oil cake/rice bran/ composite fertilizers, poultry droppings and other feed materials.
- Purchase of medicines and vitamins
- Consumable items for curing and drying.

- Purchase of diesel for tube well / payment of electricity bills of tube wells/running expenses of tube wells/pumping sets.
- Packing and storage material
- Purchase of nets, boxes, baskets, ropes, shovels, hooks and other accessories, etc
- Cost of excavation and rehabilitation of ponds
- Renting/leasing of ponds and tanks
- Wholesale lending to Microfinance Banks, Microfinance Institutions, NGOs, etc. for onward lending to the farming community to meet their short term inland fisheries credit requirements.
- Any other items related to Inland Fisheries day to day expenses.

b) Marine

- Fuel, ration and ice for marine fisheries
- Processing and canning charges
- Fish waste disposal / management charges
- Biogas plant
- Sulphuric acid generator
- Overhead expenses ,i.e, labour.
- Packing/freezing/processing/cleaning items required for fish processing
- Consumable items for curing and drying.
- Procurement of insulated boxes, purchase of plastic fish crates and plastic baskets.
- Wholesale lending to Microfinance Banks, Microfinance Institutions, NGOs, etc. for onward lending to the farming community to meet their short term marine fisheries credit requirements.
- Any other items, such as mooring charges, other marine fisheries day to day expenses etc.

4.5.2 Term Financing

The scheme encourages banks and lead firms to provide financing to farmers for their working capital/short term loan requirements of crop and non crop activities. However, they may facilitate the farming community by providing term finance for short to medium tenure for eligible items.

4.5.3 Running/Seasonal Finance for the Lead firms

In order to ensure timely payment to growers, bank shall provide short term/seasonal financing facility to agri. processor, aggregator, *Artis,* intermediaries etc. Bank traditionally offers short term marketing finance/ running finance /cash finance facility to traders, processors aggregators etc. against hypothecation or pledge of stock & debtors supported by property as collateral security. By linking this chain of financing, a self liquidity mechanism is put in place, whereby, upon fulfillment of contract obligation between grower and lead firm, the liability will be shifted from grower to lead firm, however, the overall exposure of the bank will remain within the overall exposure limit. Marketing loan would facilitate processor in procurement of agri. produce or non-farm products like poultry, fisheries, livestock etc in peak seasons and swift repayment to banks against farmer's outstanding loan guaranteed by him by issuing a "Payment Warrant" or "Payees Account Cheque" in the loan account of borrowers.

4.6 Loan Limit and Repayment Terms

The loan limit shall be assessed by bank in coordination with the guarantor/lead firm on the basis of financing request, appraisal, cost of production as per indicative credit limits, estimated produces to be sold to lead firm, terms & condition provided in contract agreement, guarantor assessment. The banks should undertake due diligence and market survey to assess the prices of inputs, equipments, vehicles and assets to be financed to contract farmers. Banks in consultation with lead firm may sanction revolving credit limits to the borrowers renewable on the joint request of borrowers duly endorsed and agreed by the guarantor on seasonal basis (based on the crop cycle).

The loans provided under contract financing scheme are required to be adjusted along with up to date mark up by the guarantor/lead firm as per repayment schedule after settlement of borrower's produce on seasonal basis.

4.7 Mark up

Banks shall determine mark up rate keeping in view KIBOR and their cost of funds, risk profile of borrower, spread, etc. in line with their credit policy. In order to incentivize, the guarantor/lead firm for monitoring and providing assistance to banks for recovery follow-up, banks may share their income with the guarantor/lead firm, a policy to this effect shall be developed, whereby a certain percentage of the average outstanding performing loan portfolio may be given as commission /incentive.

In terms of Marketing Loan/ Running Finance facility to processors, banks may offer competitive rate for seasonal/short term loans to agri. processor, aggregators etc. The bank, at the time of sanctioning limit to the lead firm, shall allocate limit for fund or non-fund based financing facility as per their requirement.

4.8 Security and Collateral

Under contract financing scheme, banks may provide unsecured financing up to a maximum of Rs 1,000,000/- to individual farmer under the guarantee of lead firm who may be a processor, input supplier, stockiest, marketing company, trader, exporter. However, the bank will secure its financing facility by obtaining acceptable security and collateral only from guarantor. The same security and collaterals may also be used for marketing loan to processors for their short terms/ seasonal financing requirement. The banks financing may be secured against the following securities:

- Charge on agricultural land through passbook system.
- Mortgage of rural, urban or commercial property.
- Hypothecation/mortgage of assets, e.g., building, processing plant and machinery, grading & packaging machinery, generator & refrigerators, vehicles etc.
- Pledge / hypothecation of stock
- Lien on bank deposit
- Farmers Sales contracts
- Any other tangible collateral security acceptable to bank in accordance with SBP Regulation and other laws.

4.9 Insurance

Banks are encouraged to arrange crop insurance coverage of loans for their borrowers. In case of lending for five major crops i.e. wheat, cotton, rice, sugarcane, maize insurance shall be mandatory under Crop Loan Insurance Scheme from sowing to harvest. When financing to non- farm sector banks are encouraged to arrange insurance coverage. Further, other collateral/security is to be insured from reputed insurance company.

It is advisable that banks and respective insurance company should sensitize and educate their farmers/borrowers about the importance of having an insurance cover and also make insurance as an integral part of their respective agri. financing products.

4.10 Loan Monitoring and Recovery Mechanism

Effective loan monitoring and recovery system are critical for ensuring quality of loan portfolios. In case of Contract financing scheme, banks will be supported by the guarantor/ lead firm in monitoring, recovery and follow-up with the individual farmers as they have the main responsibility for financing extended on their recommendation and guarantee. However, banks may support guarantor/lead firm by providing outstanding loan details, repayment date, information regarding delinquent farmers, etc on periodical basis as well as when requested. Banks are encouraged to take necessary measures time to time to ensure recovery of banks dues.

4.11 Compliance with SBP Regulations

Bank shall ensure that financing to agriculture sector under the subject guidelines will be made in compliance with SBP's prudential/ other regulations for Agriculture Financing and other applicable regulations.

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Acronyms & Abbreviations

Agri. VC	Agricultural Value Chain
CLIS	Crop Loan Insurance Scheme
CNIC	Computerized National Identity Card
e-CIB	Electronic Credit Information Bureau
GoP	Government of Pakistan
Herbicides	A chemical agent that destroys plants or inhibits their growth
KIBOR	Karachi Inter Bank Offer Rate
KYC	Know Your Customer
Lead Firm	Driver Firm/ Processor/Guarantor, Aggregators, *Artis*
MoU	Memorandum of Understanding
Marketing Loan	Seasonal/ short term loan
Non-Crop	Other than crop production activities i.e. Livestock, poultry, fisheries etc.
Tripartite	An agreement is tripartite if three parties are involved (bank, farmer, processor/ guarantor)
Weedicides	Substance used to kill unwanted plants

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