

Nigerian Sustainable Banking Principles

Agriculture Sector Guideline

FINAL VERSION

July 2012

Glossary of Terms and Abbreviations

Term or Abbreviation	Definition or Explanation
Bank	A Nigerian: (a) money deposit Bank; (b) discount house; or (c) development Bank signatory to the Nigerian Sustainable Banking Principles Joint Commitment Statement.
Business Activities	The provision of financial products and services to clients including, but not limited to: corporate finance, investment banking (corporate advisory, structured lending and capital, trading), equity investments, project finance, project finance advisory, structured commodity finance, small and medium business lending, retail banking, trade and leasing, and other forms of direct lending.
CBN	Central Bank of Nigeria
E&S	Environmental and Social
E&S risks	The potential E&S issues associated with a client or engagement that may imply exposure to risk and accordingly may need to be taken into account when making business and risk management decisions.
E&S impacts	Any change, potential or actual, to (a) the physical, natural, or cultural environment, and (b) impacts on surrounding community and workers, resulting from a business or business activity to be financed. E&S impacts may be temporary or permanent, involving reversible or irreversible changes on the environment or society. Environmental risks can include changes to the atmosphere, water and land due to human activities (e.g. greenhouse gases, pollution, changes to habitats, etc.). Social risks can include impacts to a client's workforce as well as the surrounding community (e.g. occupational health and safety, human rights and labour standards, land disputes or resettlement, corruption, etc.).
E&S opportunities	New business opportunities arising from meeting E&S challenges such as development of clean or renewable technology, job creation and community development. Taking account of E&S issues in making a business decision, could also lead to potential benefits to the client or the Bank providing financial services to the client.
GHG	Greenhouse Gas (e.g. sulphur oxides (SO _x), nitrogen oxides (NO _x), gases with Particulate Matter-10 (PM10))
IFC	International Finance Corporation
NIRSAL	Nigerian Incentive-Based Risk Sharing System for Agricultural Lending
Principles	Nigerian Sustainable Banking Principles
Sustainable Banking	We define sustainable banking as an approach that recognises the role of Banks in driving long-term economic development in Nigeria that is not only economically viable, but also environmentally responsible and socially relevant.

The Nigerian Sustainable Banking Principles: Agricultural Sector Guideline

1. Introduction

This Guideline has been designed to complement the **Nigerian Sustainable Banking Principles** whilst focusing on the agriculture sector.

The objectives of this Guideline are to:

- Assist Banks in the identification and management of complex E&S risks associated with the provision of financial products and services to the Nigerian agriculture sector;
- Provide additional sector-specific guidance to supplement the Nigerian Sustainable Banking Principles Guidance Note;
- Ensure that Banks adopt relevant international standards and best practices in the management of E&S risk; and
- Strategically position agriculture as an attractive, rewarding and sustainable business opportunity..

Given the large proportion of the population that depends on agriculture as a source of livelihood, it is clear that agriculture is a practical means of reducing poverty, unemployment, food insecurity, whilst providing raw materials for industries and export in the medium to long term. Research suggests that if the agricultural growth targets set by the Federal Government are met, the country will have 9.5% annual growth in the sector and 8% GDP growth in the next 10 years¹.

A Bank that actively lends and invests in this sector can use its financial intermediation and client relationships to influence the sustainable development of agriculture. It is intended that this guideline will establish the minimum standards for Banks to ensure that financial products and services provided to the sector are both socially and environmentally sustainable.

Nigeria's agricultural sector, which by 2010 contributed about 42% of GDP and employed about 60% of working population, is severely underfunded and underinvested with only 2% of all formal credit flowing to the sector. Agricultural lending accounts for approximately 1.4% of formal lending, and has been on the decline since 2006. This situation is partly explained by the fact that banks typically perceive agriculture as a high-risk investment due to their limited understanding of and lack of confidence in the sector². In response to this challenge, the CBN, the Bankers' Committee, and the Federal Ministry of Agriculture & Rural Development have recently developed NIRSAL, which ultimately seeks to create incentives and encourage the growth of formal credit to the entire agricultural value chain.

NIRSAL is expected to be a catalyst for innovative risk management strategies, long-term financing for agribusiness, job creation for new entrepreneurs, and established market participants in the agribusiness sector. An increase in formal credit flows into agriculture will be achieved by improving the capacity of financial intermediaries to provide credit, refocus credit provisioning on integrated value chains, and establishment of a differentiated guarantee mechanism to share credit-related risks in the value chain.

¹ <http://www.ifpri.org/sites/default/files/publications/nssp02.pdf>

² Nigerian Incentive-based Risk Sharing System for Agriculture Lending (NIRSAL): Transforming value chains for expanded agricultural lending in Nigeria, Monitor Group, July 2011.

Sustainable agriculture requires increased funding for land acquisition, good quality seeds and fertiliser, research and development, extension services, irrigation systems, storage facilities, processing machinery and infrastructure (roads and power). Channelling resources and funding for such activities and other transformational avenues are the means through which financial institutions can drive and sustain changes in the agricultural sector, whilst gradually reducing funding for activities that impact negatively on the environment and society.

2. Scope and Applicability

This Guideline covers the provision of financial products and services for the agriculture sector including, but not limited to, Business Activities relating to the agribusiness value chain contained in the approved NIRSAL framework.

This Guideline **applies** to all lending instruments, project and structured commodity finance, equity and debt capital market activities, retail banking and advisory services provided to new and existing clients in the agricultural sector. The extent to which the Principles apply will depend on the level and nature of agriculture sector Business Activities financed by a Bank. Retroactive application of E&S requirements under this Guideline is not required for existing clients. The Guideline and its E&S requirements will, however, apply to any additional new facilities or services for existing clients.

This guideline may not be appropriate for application to some agriculture sector financial services such as asset management or non-agriculture related insurance or in the cases where there may be limited opportunity for a Bank to influence a client's E&S performance. A Bank must clearly indicate which financial products or services have been excluded from the application of the Guideline in a sector-specific approach as part of its Sustainable Banking policy.

3. Agriculture Sector E&S Issues and Sustainable Agriculture

As stated previously, agriculture accounted for 42% of GDP and 60% of employment in Nigeria in 2010. With an average growth rate of 5% per annum, the sector has been a major source of employment growth. However, there is still enormous potential in the sector that needs to be unlocked. Beyond increased food security and higher incomes for the rural population, a better performing agricultural sector that supports the growth of productive agribusiness is imperative to drive economic growth and stability in the country. It would aid the creation of small and medium enterprises, whilst being able to produce a broad spectrum for increased production of food and cash crops.

Along the agricultural value chain in Nigeria, there are a number of recurring challenges that continue to hinder the growth of the sector. Among these are the high cost of farm inputs especially seeds and fertiliser, inefficient procurement and distribution systems for critical inputs, poor access to credit for farmers, weak extension services, huge post-harvest losses due to poor storage. Some other challenges are limited value addition to raw products and low investment in research and development, poorly structured markets, weak infrastructure and a discriminatory land tenure system. The above issues continue to keep agricultural productivity low, with high wastage and below optimal contributions to export earnings.

In order to realise the full potential of the sector, it is increasingly recognised that agribusiness should be conducted in a sustainable manner. Sustainable agriculture entails taking into consideration the environment and natural resource base, making use of natural resources in an efficient manner, whilst at the same time providing a sustainable source of income for the farmer and addressing food needs. Furthermore, it takes into account numerous social issues such as economic use of water resources, health and safety of labour, in particular women

and children, as well as community and land use issues. For a more comprehensive list of E&S issues, please refer to **Appendix 1**.

Agricultural activities such as land preparation, planting, nurturing and harvesting, affect the environment in several ways. For example, one of the main causes of deforestation today is the clearing of land for crops, which increases the rate of soil erosion. Often, land is cleared through burning, which emits harmful gases into the atmosphere; the land can also suffer from nutrient depletion thereby reducing the yield that can be realised from planting.

Agriculture affects the climate through the production of greenhouse gases (carbon dioxide, methane, nitrous oxide). The types of chemicals and pesticides used can lead to soil contamination, ground water and air pollution if poorly managed. As the crops are harvested and prepared for further processing, issues such as the disposal of agro-processing waste (effluents, solid waste) and sources of energy used in agro-processing become key sustainability issues.

Sustainable agriculture is not only limited to environmental considerations but also to socioeconomic issues. Agriculture is typically associated with positive impacts such as increased employment opportunities for the rural population, higher incomes, improved food security and strengthened local economic linkages. However, there are also potential negative social impacts that need to be considered if agriculture is to be practiced in a sustainable manner. Examples include social conflict with agricultural settlers and/or agro-processing companies, land ownership conflicts, increased land values and rents, community health risks, increased burden on women and children, labour issues (child labour) and loss of farm income to production of cash crops

Water Resource Related Issues

Irrigation is the application of water to crops through artificial means. All crops require water to grow and thrive: however, knowing how, when and how much water to use is imperative for maximising yields whilst minimising the impact on the environment. The irrigation system should provide supplemental water when rainfall is not sufficient to maintain plant health, while protecting water resources and the environment. An effective irrigation system involves a planned system of crop irrigation that concentrates on efficient water use and distribution, minimizing runoff or deep percolation and soil erosion.

According to the National Water Resources Master Plan, it is estimated that Nigeria has about 3.14 million hectares of irrigable land. Approximately 1.8 million hectares of this land lie within the Niger-Benue valleys, which contain sufficient water to effectively develop irrigated agriculture without the need to construct large dams.

In spite of this endowment, agricultural activity in most areas of the country is limited to the rainy season, which lasts between 4 and 8 months, primarily due to the wide variation of rainfall. This contributes significantly to the underperformance of farming and the low productivity. However, what is of even greater concern is the grossly sub-optimal utilisation of irrigation potential. Specifically, there exists currently a reservoir capacity in excess of 34 billion cubic metres capable of irrigating more than 500,000ha but only 150,000ha have been developed under formal irrigation out of which only 85,000 ha are actually being irrigated³.

The strategic development and management of irrigation and drainage systems, as well as effective and sustainable irrigation practices are therefore imperative to increase the productivity of agriculture, thereby contributing to national food security and poverty alleviation. Potential solutions could focus on public-private partnerships for the provision of irrigation systems, whereby banks partner with the public and private sector to

³*Irrigation Practice in Nigeria*, (2011), Federal Ministry of Water Resources.

deliver efficient systems to local communities. However, this would also require the creation of an enabling legal and institutional framework, as well as developing capacity for the implementation of such projects.

Key Issues in the Irrigation Sub-Sector

Some of the major issues in the irrigation sub-sector include:

- Substantial investment gap;
- Severely degraded environment in poverty-stricken communities, which places constraints on water retention in root zone where it is needed for healthy crop growth;
- Unutilised and underutilised development potential: too few irrigation schemes have been developed in comparison to the available potential as a result of declining real investment in the sub-sector;
- Insufficient water infrastructure & inadequate operation and maintenance of existing water infrastructure;
- Poor performance of public investment that was in the past “input driven” as opposed to “output led”;
- Low private sector involvement; and
- Poor community mobilisation: the early irrigation projects were developed without the participation of the intended beneficiaries and consequently were too sophisticated for beneficiaries to operate and maintain.

It is envisaged that by unlocking finance for the entire agricultural value chain, some of the key challenges related to irrigation and water issues mentioned above will be adequately addressed, that is, with increased confidence in the overall sector, this could provide incentives for increased investment in the irrigation sub-sector from both public and private sector parties.

Table 1: Agribusiness Value Chain Categories and Potential E&S Risks

Value Chain Category	Category Name	Examples	Potential E&S Risks
Category 1	Preparation & Infrastructure	<ul style="list-style-type: none"> • Land preparation • Developing water bodies/irrigation • Cluster enabling infrastructure 	<ul style="list-style-type: none"> • Land grabbing/conflict • Involuntary physical and/or economic displacement • Higher land values and rents for local communities • Biodiversity loss • Impact on water resources; conflict over water resources • Climate change adaptation/mitigation considerations • Conflict over use of land (e.g. biofuel versus food security)
Category 2	Inputs	<ul style="list-style-type: none"> • Inputs (vaccines, veterinary products, animal feed, embedded power equipment, agricultural machinery, seeds, fertilizer, crop protection, micronutrients, and related 	<ul style="list-style-type: none"> • Genetically modified seeds/crops • Pesticides/chemical pollution • Disposal of agricultural waste • Water supply issues (source)

		material)	
Category 3	Planting, Nurturing & Harvesting	<ul style="list-style-type: none"> • Livestock raising / husbandry lifecycle • Fisheries • Planting • Crop management including weeding / replanting • Harvesting 	<ul style="list-style-type: none"> • Deforestation and soil erosion • Impact on soil structure and fertility • Disposal of animal waste • Greenhouse gas emissions • Local labour (health & safety issues; employment practices) • Animal welfare
Category 4	Storage and Post-Harvest Handling	<ul style="list-style-type: none"> • Storage • Post-harvest handling • Access to markets • Transportation • Logistics 	<ul style="list-style-type: none"> • Waste prevention and energy requirements for storage (renewable) • Consultation with local communities regarding transport links (roads etc.)
Category 5	Processing	<ul style="list-style-type: none"> • Processing across all stages • Packaging companies 	<ul style="list-style-type: none"> • Energy requirements for processing • Prevention and disposal of waste • Health & safety of labour • Employment practices • Food safety/consumer health
Category 6	Distribution	<ul style="list-style-type: none"> • Wholesale downstream distributors (export and domestic) • Specialised services providers 	<ul style="list-style-type: none"> • Energy requirements for transportation

In addition to planned increased lending to the sector, the NIRSAL approach will include on-going stakeholder engagement aimed at modernising agriculture and transforming it into an attractive, rewarding and sustainable business opportunity.

4. Banking Requirements for Agriculture Sector Financing

For all activities that fall within the scope of this Guideline a Bank shall:

1. Conduct E&S risk analysis and assessment of agricultural clients and activities, and ensure that identified risks are adequately monitored and managed.
2. Adhere to local E&S laws, and where possible encourage other internationally agreed standards. See **Appendix 2** and **Appendix 3**.

In addition, and consistent with NIRSAL, a Bank shall:

3. Lend towards the establishment and efficient distribution of fertiliser by supporting fertiliser manufacturing companies in Nigeria that produce/procure and distribute fertiliser, as well as a transparent market-driven fertiliser distribution model.
4. Finance the manufacture and distribution of improved and high quality seeds, by lending to indigenous seed companies and importers of seed varieties.
5. Strive to ensure that farmers are able to procure seeds directly from seed manufacturers, by availing them with adequate finance.

6. With support from industry stakeholders, strive for the establishment of an Agricultural Value Chain Research Development Fund that produces high quality research on the needs of the value chain.
7. Encourage and finance providers of storage facilities for seeds, produce and other value-added products provided that they take into consideration energy efficiency issues.
8. Encourage and finance processors that add value to local products, whilst taking into consideration the E&S impacts of processing operations.
9. Endeavour to lend to farmers whose products have off takers and whose farming practices protect the environment e.g. minimise the use of harmful chemicals/pesticides, efficient use of water resources, adoption of conservation farming technologies etc.
10. While waiting for the reform of the Land Use Act, lend based on short and long leases that do not displace and/or negatively impact on the livelihoods of local communities.
11. Encourage the creation of public-private marketing corporations that provide adequate support to local products.
12. Support the decentralisation of agricultural insurance and encourage the development of a vibrant and competitive market for agricultural insurance by a range of companies.
13. Lend with assistance from NIRSAL (i.e. technical assistance, risk sharing, insurance and incentive pillars).
14. Lend to promote the use of appropriate and sustainable farm mechanisation and irrigation technology in agriculture.
15. Lend to agro-processors and agro-chemical manufacturers that utilise effective methods to reduce, manage and treat the harmful wastes and do not pollute the environment (i.e. nearby water sources, soil, air etc.).
16. Lend to promote the use of waste management techniques that promotes the re-use of waste as inputs into other production processes and not into the environment (e.g. rice husk turned into gas can generate rural electricity).

5. E&S Risk Implementation for Agriculture Business Activities

To meet these commitments and successfully manage E&S issues associated with the provision of financial products and services to the Agriculture Sector, a Bank should refer to the Principles Guidance Note for implementing a robust E&S management system. A Bank should develop a sector specific E&S approach for its Agriculture sector Business Activities as part of its Sustainable Banking policy and E&S management system. A Bank should seek to implement the recommended guidance as detailed in the Guidance Note appropriately. The Guidance Note includes information for developing E&S policies and procedures, as well as, monitoring and reporting E&S risks. The following sections provide sector-specific guidance to be used in conjunction with the Guidance Note.

6. E&S Risk Categorisation of Agriculture Sector Investments

The following information serves to illustrate and support the categorisation of E&S risks for different Agriculture Business Activities. Typically a transaction will be categorised as high, medium or low risk based on the nature of E&S impacts associated with the client's Agriculture Business Activities and the client's ability to manage such impacts. The purpose of categorising the risk of a potential transaction is to guide banks on the degree of E&S due diligence required to inform credit risk approval or underwriting decision-making and the appropriate level of E&S risk management and monitoring oversight that should be applied to the loan.

A **high-risk** transaction is one where activities carry potential significant adverse E&S risks and/or impacts that are diverse, irreversible, or unprecedented.

A **medium-risk** transaction is one where activities carry potential limited adverse E&S risks and/or impacts that are few in number, generally site-specific, largely reversible and readily addressed through mitigation measures.

7. Agriculture Sector Client Engagement and Monitoring

A Bank should engage with its agriculture sector clients to encourage good E&S risk management practices and promote sustainable agriculture best practice. Where some existing clients have not met certain standards due to a number of factors, including legacy assets, they would be expected to develop credible, documented time-bound “action plan” to achieve the required standards over time. E&S conditions or covenants will be included in the transaction documentation, where appropriate, to ensure E&S risks are monitored and on-going compliance is addressed with the client.

8. Agriculture Sector E&S Reporting

A Bank that is active in the agriculture sector will need to monitor and report on its activities consistent with this guideline and the Nigerian Sustainable Banking Principles to demonstrate on-going commitment and progress. . A Bank shall seek to externally report on its progress in a meaningful way. Details of reporting requirements are provided in the Nigerian Sustainable Banking Principles Guidance Note. In addition to general E&S risk reporting guidance provided, Banks should consider international best practices for reporting in the agriculture sector. The Global Reporting Initiative provides detailed reporting guidance on certain activities and E&S risk issues in the agriculture sector.