THE NIGERIAN INCENTIVE-BASED RISK SHARING SYSTEM FOR AGRICULTURAL LENDING (NIRSAL)

INTRODUCTION

1. The agriculture sector is central to Nigeria's economy, accounting for 42 percent of GDP and providing 60 percent of employment. However, the sector only represents 1 percent of exports.
2. Over the past 3 decades, growth in the agricultural sector has slowed down and today it is under-performing.
3. Nigeria has the potential to produce enough food to feed itself, lower the cost of food imports, and become a major food exporter.
4. Nigeria needs to tackle some of its major challenges in order to transform its output potential, e. g. limited use of fertilizer and high yielding seeds, poor funding of research and development, and under-financing of the agricultural value chains.
5. Of these challenges, financing is one of particular importance to the Central Bank. Nigeria's agricultural sector is under-financed. Currently, agricultural lending represents only about 2 percent of the total lending of banks in Nigeria. This performance is below the level of other developing countries like Kenya, which registers 6 per cent.
6. There are several reasons why banks do not lend to agriculture such as a limited understanding of the agricultural sector; poor pricing of agricultural risk; limited pools of loan officers with experience lending to farmers; rigid credit assessment processes; and limited channels for distributing agricultural credit.

NIRSAL IS A NEW APPROACH TO BOOST AGRICULTURAL LENDING

1. NIRSAL is a new approach that tackles together the agricultural value chains and the financing value chain.
2. The agriculture value chains and the financing value chain are inter-dependent. In moving agricultural financing forward in Nigeria, fixing the financing value chain without addressing the agricultural value chains would be a futile exercise.

3. **NIRSAL breaks with tradition by doing three things at once:**

   a) **Fixes the agricultural value chains**, so that banks can lend with confidence into cohesive and complete value chains; and

   b) **Encourages banks to lend into the agricultural value chains** by offering them strong incentives and technical assistance.

   c) **Engages in active market access development** in partnership with key buying groups, states, private investors, farmer groups and processors

4. **NIRSAL is based on five pillars that aim to "de-risk" agricultural lending and lower the cost of lending for banks.** USD 500 million is divided across the pillars.

   - **Risk-sharing Facility (USD 300 million**). To break down banks' perception that agriculture is a high-risk sector, NIRSAL will share their losses on agricultural loans.

   d) **Insurance Facility (USD 30 million).** The facility's primary goal is to expand insurance products for agricultural lending from the current coverage to help reduce credit risks and increase lending across the entire value chain. NIRSAL therefore champions the entrance of new private sector insurance providers into the market in partnership with the National Insurance Commission, expanding the coverage of existing products provided by the Nigerian Agricultural Insurance Corporation (NAIC), and piloting and scaling new products, such as weather index insurance, new variants of pest and disease insurance etc.

   e) **Technical Assistance Facility (USD 60 million).** NIRSAL will equip banks to lend sustainably to agriculture. At the same time, it will equip producers to borrow and use loans more effectively, and produce more and better quality goods for the market.

   f) **Holistic Bank Rating Mechanism (USD 10 million).** This mechanism rates banks based on two factors: the effectiveness of their agricultural lending and its social impact.

   g) **Bank Incentives Mechanism (USD 100 million).** To complement NIRSAL's first three pillars, this mechanism offers banks additional incentives to build their long-term capabilities to lend to agriculture.

IMPLEMENTATION

- NIRSAL and its five pillars will be administered by a Non-Banking Financial Institution (NBFI) and used to encourage banks and insurance companies to lend to and insure agricultural value chains.

- At the national level, the NBFI will administer the five NIRSAL pillars. It will report to a Board of Directors chaired by the CBN. The Board will have ultimate decision-making and strategy-setting responsibility for the Fund. The CEO of the NBFI will be responsible for NIRSAL's overall implementation and for maintaining relationships with key stakeholders.

WHAT IS NEEDED TO MAKE NIRSAL WORK

- **Financial support** from the Ministry of Finance, state governments and donors to fund the insurance and technical assistance facilities.

- **Policy reforms**
    - **To support agricultural lending:**
        - Deregulation of the agricultural insurance industry to open access to private insurance companies and pave the way for innovation.
    - **To support agricultural value chains**
        - Shift the fertiliser subsidy from a focus on consumption subsidies to a focus on production subsidies. Furthermore, shift to a private sector-led fertiliser import system to improve the efficiency and effectiveness of the fertiliser subsidy programme. Fertiliser distribution should include the scale-up of voucher-based programmes run through private-sector companies and agro-dealers.

- Increase competition in the foundation seed production market, and attract new entrants;
- Establish staple crop-processing zones to drive import substitution, with enabling fiscal policies such as tax breaks, and no import tariffs for agricultural equipment;

- **Robust implementation arrangements and institutions,** including a non-banking financial institution (NBFI) to manage NIRSAL's five pillars centrally.
- **Stakeholder support** from the full range of stakeholders across both the agricultural and agricultural lending value chains.

NIRSAL HAS A WIN-WIN VALUE PROPOSITION FOR EACH OF ITS KEY STAKEHOLDERS:

- **Central Bank of Nigeria:** Increase in lending to agriculture from 1.4 to 7 percent of total bank lending within 10 years, with NIRSAL becoming economically self-sustaining.
- **Banks:** A "game change" in agricultural lending offering risk sharing, capability building and the opportunity to lower transaction costs in loan origination and distribution
- **Agricultural producers**: Increased access to lending and interest rates close to single-digit levels.
- **Ministry of Agriculture:** A stronger agricultural sector with more integrated value chains, enhanced food security, fewer imports, and higher productivity.
- **Ministry of Finance:** A stronger economy with additional agricultural GDP growth, higher employment, reduced expenditure on food imports, higher tax revenue from the agricultural sector, competitive exports and a more diversified economy.
- **State governments:** An improved agricultural economy at state level creating more employment, less poverty, enhanced food security and higher tax revenue from a better-performing, well-financed sector.

HOW NIRSAL IS DIFFERENT FROM OTHER CBN SCHEMES

- Previous schemes have encouraged banks to lend but had no clear strategy on how to fix the agricultural value chains to make lending effective. **NIRSAL addresses both the agriculture and agricultural financing value chains together.**
- Previous schemes have focused on just one size of producer and/or one segment of the value chain. **Lending must span the value chain and all sizes of producer**.
- NIRSAL will be managed and implemented by a Non-Banking Financial Institution and not the CBN.
- Interest drawback provided every 90 days to improve loan repayment compliance
- No limit on the maximum or minimum size of loans

MEASURES OF SUCCESS FOR NIRSAL:

- Generate an additional USD 3 billion of bank lending within 10 years to increase agricultural lending from the current 1.4 to 7 percent of total bank lending.
- Increase lending to the "pooled" small farmer segment to 50 percent of the total (typically, banks do not reach these producers individually but through "pools", i.e., aggregating mediators, such as MFIs and cooperatives).
- Reach 3.8 million agricultural producers by 2020 through pooling mechanisms such as value chains, MFIs, and cooperatives.
- Reduce banks' break-even interest rate to borrowers from 14 to 7.5-10.5 percent.