Crop Loan Insurance in Pakistan

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Agriculture is the backbone of Pakistan's economy contributing 21% to the GDP and employing more than 40% of the labor force. Despite such a heavy contributor to the economy with a large proportion of population employed in agriculture, the institutional credit outreach remains thin.

The Central Bank of Pakistan (SBP) is working closely with financial institutions to develop a market driven rural finance market. An important initiative in this regard was the introduction of a market-based crop loan insurance scheme in 2008. This was a daunting task as many such initiatives in the past few decades fizzled because they required a cohesive commitment from all stakeholders and a consensus on a common framework. In 2006, SBP formed a task force to come up with a comprehensive crop loan insurance framework. This was comprised of representatives from banks, insurance companies, farmer organizations, central bank, and the government. There were interminable debates amongst the task force members as it involved

making some tough decisions in the strategic interest of the rural finance market. It was a long drawn process, taking almost two years to come up with a market driven conceptual framework and implement the first ever crop loan insurance scheme in Pakistan.

There were many challenges involved in coming up with a feasible crop loan insurance framework. Cost of insurance, premium collection mechanism, claim trigger, role of government, reinsurance treaties, willingness of farmers to pay for insurance, perils to be covered, and lack of recorded historical data to evaluate probability of calamities, etc. were a few of the salient stumbling blocks to moving forward and implement this important initiative.

It has been more than four years since crop loan insurance was first implemented and it has gradually been strengthened by the active participation of banks, insurance companies, and farmers along with targeted government support. Salient features of the crop loan insurance scheme are as follows:

• Crop loan insurance is mandatory for farmers requesting a loan from a financial institution for any of the five major crops: wheat, rice, sugarcane, cotton, and maize.

• Banks are required to collect the insurance premium on behalf of the insurance company

• Aggregate liability of the insurance companies is limited to 300% of collected premiums

• Calamity declaration by the Revenue Department, Government of Pakistan is the trigger point for payment of claims, followed by overall and specific farm surveys by the insurance company. In case there is a loss of more than 50% in terms of area yield outcome, the insurance trigger is activated. Amount of insurance cover is limited to the loan amount.

• The multi-peril insurance covers excessive rains, flood, draught, hailstorm, frost, crop related viral and bacterial attacks, and damage by locusts

• The framework also defines a maximum ceiling on the rate of premium to be charged from a farmer

The scheme is market-based, however the federal government pays the premium for small/subsistence farmers. The implementation of the crop loan insurance framework has benefited all stakeholders. Banks have been able to mitigate credit risk in calamity-affected areas; insurance companies have found a new avenue to grow their businesses and introduce the

concept of insurance to the "deeper-in-the-pyramid" audience. Government has been able to avoid repeated "across the board" remission announcements and farmers benefit from maintaining a healthy credit worthiness and avoiding falling into default.

Although there have been so many advantages of a market driven crop loan insurance product, there are challenges that still remain. Most important amongst these challenges is the mandatory nature of the product: if a farmer gets a bank loan for any of the major crops, the loan has to be insured. This may have discouraged certain farmers from entering the formal credit sector thus having a negative impact on the outreach. It also poses a challenge for the banks as some farmers get the loan insured the first time but do not pay the premium when the loan is renewed. This is a problem in regions where farmers have seen a calamity in the last four years and benefited from the product. This issue could be resolved through variable premium pricing and then gradually moving into a non-mandatory regime.

The trigger point has been defined as the calamity declaration by the federal government. As the experience is gained, it is important for the industry to come up with a more efficient and logical trigger as individual farmers could possibly loose out despite crop failure if the calamity declaration is not issued. Government support by picking up the bill for small farmers has been beneficial, however it is not being done in a structured manner thus resulting in delays and operational issues thereby discouraging banks from targeting smaller farmers.

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Overall, the claims have amounted to much less than premiums collected. Claim-to-premium ratio has remained at approximately 50%. As a result, more insurance companies are now offering crop loan insurance products. There are about 10 insurance companies offering crop loan insurance as compared to only 4 in 2008.

With a successful track record of more than four years, the market now understands the crop loan insurance phenomenon, premiums have been steadily growing, and the claim ratios have remained enticing enough to make sense for both farmers and insurance companies to deepen the market. The time has come to reevaluate market realities and take the crop loan insurance product to a more mature level.

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