

## **Credit in agriculture. In the perspective of the Banking law, financial market law, insurance law.**

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### **1. Premise**

The incessant climate change and the requests for certainty of food supplies, known as "food security", require us to think of tools that allow agricultural companies to sustain their activity over time.

Credit to agriculture, and the related guarantees, undoubtedly represents the main instrument for implementing the mission of agricultural entrepreneurs. Over time, the provision of credit to agricultural businesses has presented connotations and problems linked to the characteristics of agricultural activity: the length of the production cycle that strengthens the value of the duration and sustainability of relationships over time, including credit; the meta-financial nature of financing operations projected to achieve functions external to relationship between Banks and Farmers, an expression of the social function of agricultural activity; the interaction between public and private that continues even in the current reduction of public interventions and that puts the credit to agriculture partly out of the logic of the credit market; the close link with the system of guarantees partly justified by public subsidies and partly by the long-term sustainability requirements of the credit relationship, not only real and personal but also insurance guarantees.

Even the current interactions between the primary, secondary and tertiary sectors have not eliminated these features which, on the contrary, are reinforced by some present dynamics that lead to a renewed interest in the theme of credit to agriculture.

Around these themes develops the discourse aimed at rethinking agricultural credit and its meta-financial function in terms of adequacy and sustainability.

### **2. Peculiarities of credit in agriculture**

When we talk about the provision of credit in agriculture we refer to a sector of the credit market characterized by significant peculiarities (public footprint, meta-financial connotations, general "contractual weakness" of the investor subject) that still characterize this area.

Agricultural credit has a regulatory public footprint that distances it from the logic of the market, so that the attention of funding bodies, rather than on the company's credit history, is centered on the presence on the applicant's part of the financing of those formal requirements leading to the enjoyment of benefits provided by special legislation.

In addition to this profile in more recent times, however, there is a change in the requests for access to credit that are often accompanied by an advisory and service request. This is also due to the emergence of specific

needs of the agricultural market characterized, especially in Italy, by the presence of small and medium enterprises that lack an adequate organizational and entrepreneurial development. Furthermore, most agricultural enterprises are not equipped with those organizational, administrative and accounting tools that should allow the achievement of the minimum standards that the banks require with the introduction of the reform of the Capital Agreement (better known as Basel 2 and lastly Basel 3).

The developments of consultancy in this field should lead agricultural entrepreneurs to overcome that cultural aptitude to receive public contributions that has moved them away from a sensitivity towards marketing logics and towards the perception of both domestic and foreign competition, etc.

Because of this last aspect, with reference to credit in agriculture, we often talk about meta-finance: credit is associated with non-financial but political motivations and is often accompanied by instruments that encourage the use of credit. In this sense, there are subsidies of a source that is often different (national and / or regional), which take the form of a significant reduction in the interests that farmers pay to the banks for the loans received (interest subsidies), or in a co-participation of the facilitating party to the amount to be financed (capital subsidies). We still remember the public contributions that are substantiated by capital grants, non-repayable loans or in the form of co-financing of investment projects presented by agricultural companies and consistent with regional strategic objectives. Credit institutions often propose financial solutions, more or less effective, with temporary support (advances of the "Common Agricultural Policy" or the European Union rules aimed at the development of the agricultural sector in a uniform manner throughout the Community. From now on then CAP) or definitive (loans to cover the funding of the "Rural Development Program" or , in Italy the programming document drawn up by the Regions to implement the objectives of the Rural Development, one of the pillars of the CAP. From now on PSR from the Italian Rural Development Program) of the farmers who are making use of public contributions .

Agricultural credit is also characterized by being a special purpose loan whose specificity is linked to:

i) the technical forms: there is an operating credit of management aimed at satisfying the financial needs connected to the production cycle; an endowment operating loan intended to cover financial commitments for permanent stocks and the necessary production facilities.

ii) the characteristics of the productive activity of the financed company. Banking activities aimed at the primary sector concern not only the granting of credit but also technical solutions: investment services (eg deposits or asset management services) and ancillary services (eg insurance and social security services).

Instead, the characteristics of the funding body, characterized by a specialty that is structural (in terms of capital, shape, governance) and legislative, no longer matter in the current universal bank model. The Italian banks could not, under the past model of the 1936 banking law, freely grant this form of "special" credit, there were authorized financial entities such as special credit institutions and special sections of ordinary credit companies.

Agricultural credit also finds a specific regulatory recognition within the Consolidated Banking Act (Legislative Decree 385/1993 from now on TUB).

The Article 43 of the TUB establishes that "the agricultural credit has as its object the granting, by banks, of financing destined to agricultural and zootechnical activities as well as to those connected or related to it", or "farm tourism, handling, conservation, transformation , marketing and enhancement of products, as well as other activities identified by the ICRC ”.

From the text it can be seen that the legislator includes in the category "agriculture", also those operators who are upstream and downstream of the agricultural production process. In this respect, it seems more correct to speak of credit to the agricultural supply chain.

With regard to agricultural credit instruments, art. 43 of the TUB indicates as instruments the agricultural bills which must show the purpose of the loan and the guarantees that assist it, as well as the place of the financed initiative. These tools are added to those that, in the validity of the law of 5 July 1928, were identified as the main instruments of agricultural credit, that is, the loan and the opening of simple credit, to which was added the opening of a credit account. In the text of the law the links with the agricultural activity and the relevance of the finalization of the financing are evident .

It must be said that, for the aforementioned reasons, the agricultural entrepreneur finds himself having to express his financial needs according to more complex and complex procedures than the simple request for a loan: from investment and liquidity management instruments, to insurance instruments and risk coverage also thanks to derivative contracts.

### **3. Credit Insurance**

While maintaining the aforementioned specific characteristics, the credit to agriculture has undergone transformations due primarily to regulatory interventions in the credit field.

The aforementioned Basel 2 agreement ratified in 2004 includes a series of rules aimed at ensuring the financial stability of banks. Starting from this agreement the banks have had to pay more attention in particular in assessing the "quality" of their debtors according to the concept of operational risk defined as "the risk of losses resulting from inadequate internal processes, human errors, deficiencies in operating systems or because of external events ”. In other words, there are risks other than credit or insolvency risk of the counterparty and the typical market risk.

The prudential regime introduced by Basel 3 and the CRR regulation «REGULATION (EU) No. 575/2013 OF THE EUROPEAN PARLIAMENT AND OF THE COUNCIL of 26 June 2013 relating to prudential requirements for credit institutions and investment firms and which amends the regulation ( EU) n. 648/2012 (from now on CRR) is linked to the new international accounting standards. The criterion for assessing receivables, both operating and financing, is based in Italy, according to the rules contained in the civil code in art. 2426, at the

"estimated realizable value" expression which means the sum that is deemed to be able to be collected based on the information available on the debtor's financial situation. Rating systems are normally used.

On the basis of the national accounting principles the credits must be classified on the basis of their origin, nature of the debtor and maturity. The write-down of the receivables to bring them back to the presumed realizable value is put in relation to the debtor's fulfillment or to default hypothesis. On this point the financial statements must be adapted to international accounting standards and in particular lastly to IFRS9.

The International Accounting Standards Board (IASB), the body responsible for issuing international accounting standards, issued in December 1998 the IAS 39 Accounting Principle with the aim of defining the principles for the recognition, measurement and financial reporting of financial instruments and non-financial. Various changes have been made over time taking into account the continuous changes in the markets, the birth of new financial instruments. The 2007 crisis led the IASB to issue the IFRS 9 standard which in particular innovated at the point of recording and evaluating financial instruments and which came into force in 2009. The new rules will have to be adopted from January 2018.

In general, a new model for the classification and measurement of financial instruments is introduced and a new criterion for assessing expected losses and for recording hedging instruments.

Another element that has had a significant impact on the agricultural credit market is climate change and other risk factors (price volatility, distortions in the food supply chain), which characterizes the profitability of agricultural activity and that the bank providing the loan must take into account in the assessment of credit quality.

Considering the negative impact that natural events can have on agricultural production, in fact, the presence of insurance coverage can be a useful tool for translating the relative risk that is part of the assessments of the debt quality of the agricultural entrepreneur.

Useful synergies between credit and insurance coverage are envisaged: these could favor access to credit and the need for access to credit could lead to a spread of coverage.

Although national legislation contains mechanisms to promote coverage, the spread of insurance coverages is not high. In Italy the Legislative Decree no. 102/2004 excludes, for all productions and events included in the national insurance plan, the possibility of activating compensatory interventions, or the allowances granted (ex post) for an adverse event. The use of insurance instruments, therefore, should be an indispensable measure for the agricultural entrepreneur, who intends to guarantee himself in advance against compromising the company's income due to adverse events. There are also support agencies for insurance companies that should facilitate insurance. The ISMEA (Institute of Services for the Agricultural Food Market) carries out insurance services through the management of a Reinsurance Fund and of the Agricultural Risks Database, in order to favor the diffusion of new The Reinsurance Fund provides for the compensation of agricultural risks covered by facilitated insurance policies, allowing the diffusion of innovative policies in agriculture. The same body coordinates and manages the activity of the Italian

Consortium of co-reinsurance against natural disasters in agriculture, set up to promote the introduction of innovative insurance into the agricultural market through the sharing of risks between the Consortium's institutions (insurers and reinsurers). However, there are still some critical issues in the sector.

The main critical factor in the spread of agricultural risk insurance coverage can be identified in the cost of the premiums, which, however, is linked to the reduced distribution of the policies. We are witnessing a vicious circle: the cost of the prizes reduces the palatability of the products and their distribution, but the latter, in turn, negatively affects the cost of the prizes. The fact that there are still many areas of the agricultural sector that are not covered by the insurance, prevents from reducing the risk / reward ratio through risk pooling. Moreover it is difficult for agrarian consortia, which usually stipulate collective insurance contracts, to which various farmers can join, have power in negotiations with insurance companies in order to lower the premiums. It is therefore necessary to think about insurance products that can attract even those farmers who see a reduced risk, for example because they carry out other activities besides the agricultural one, or because the type of crop they exercise is unlikely to reach such percentages of damage as to trigger the covers facilitated.

A further instrument to contain premiums could be found in the adoption of risk management tools by farmers and in the relevance of the same in the conditions of insurability set out in the policy. In this regard, for example, consider the forecast - among the conditions of coverage - of the fact that the insured farmer has adopted a crop differentiation or particular tools to reduce their vulnerability. Among the technical instruments to contain risk we cannot forget, in addition to agricultural management tools such as crop diversification, also financial instruments that can be used both to reduce uncertainties linked to fluctuations in the price of products in the agri-food sector, both to cover losses related to adverse weather events as in the case of CDs weather derivatives.

The major driver of agricultural risk insurance coverage remains, in our opinion, the link between credit instruments and insurance instruments. In short, it is a matter of foreseeing, as has been happening for a long time in the field of real estate mortgages, facilitation formulas for access to agricultural credit, in the event of stipulation of an insurance contract. We recall that the connection between loan agreements and policies has been subjected to detailed regulation aimed at protecting customers, above all in terms of costs and the effectiveness of guarantees. It is also clear that there is a functional link - economic before legal - between these contracts. The adequate coverage of the agricultural risk also entails a greater guarantee with respect to the default that the agricultural enterprise may encounter due to adverse events that may have affected production. A greater interpenetration between the credit market and the insurance market in the agricultural sector could thus lead to new virtuous synergies fundamental for the development and growth of production, synergies which should also be taken into account in the evaluation of the negotiation links between banking and insurance contracts in agriculture strongly distinct from the links between mortgages and consumer credit policies . As seen agricultural credit natural events, the subject of subsidized insurance

coverage, have a direct impact on the ability to honor the debt by the agricultural company as they affect the production tools in agriculture and reduction of the risks inherent to the production and market activities. However, it would be necessary to reach levels of adequacy and economic-individual sustainability of the awards. We recall that in Italy a limitation in the pricing of mortgage-related policies is found in the application of the anti-usury law (l. 108/1996) and by the relative circulars of the Bank of Italy that quantify the interest rate for the purpose of the limit of the usurious rate also taking into account the costs of the policies.

Based on the instructions of the Bank of Italy (B.I.) issued on 29 July 2016, the calculation of the Global Effective Rate ( the indicator that represents the total cost of the loan, determined based on the law on usury in Italian Tasso effettivo globale TEG) must also take into account:

"insurance or guarantee costs intended to ensure the total or partial repayment of the credit or otherwise protect the creditor's rights, if the conclusion of the contract concerning the insurance service is concurrent with the granting of the loan or mandatory to obtain credit or to obtain it under the contractual terms offered, regardless of whether the policy is stipulated through the lender or directly by the customer. Credit insurance (the so-called CPI - Cost Protection Insurance or PPI - Payment Protection Insurance) and insurance coverages for theft and fire have been considered to be connected with the loan, and therefore included in the calculation of the TEG, even in cases where the beneficiary of the policy does not is the creditor institution."

#### **4. Sustainable finance in agriculture**

The regulation of the interest rate in loan contracts is based on an idea of individual sustainability or the ability of the contracting parties to sustain the commitments undertaken over time.

The term sustainability has long entered the legal language both in terms of eco-sustainability and in terms of social sustainability.

However, the same idea can be projected at the level of individual relationships with direct effects on the market. A credit institution that does not adequately govern the sustainability of individual contractual relationships with its customers represents a threat to the entire financial system since the crisis of contractual relationships in place could generate a default which, given the interrelations between the various financial market players, may have repercussions on the financial market globally by generating systemic crises.

Hence the importance of a "product governance" oriented to the adequacy and appropriateness of the products with respect to the interests and profiling of their customers in order to prevent the stipulation of contracts that may be unsustainable over time generating situations of credit distress and impaired loans. This does not exclude ex-post controls by the relevant supervisory authorities and by the same magistracy that may / must be carried out starting from the governance rules ordered to avoid that unsustainable

contracts are stipulated which as such may lead to poor performance with relapses on the single report and, for the reasons given, on the system.

The prudential rules for managing risks relating to the provision of credit cannot remain at the pure level of corporate compliance and Bank of Italy controls, but it is important to find, as rules of conduct ordering relations between private parties (the Bank and customers) , a response in the rules of private law with respect to the contract that has been concluded without compliance with adequate standards of product governance. Moreover, we do not forget the value of the private enforcement of the provisions on the subject as a tool to implement the deterrent capacity of the public enforcement represented by the intervention of the supervisory authority.

The concept of the use of civil proceeding due to the violation of rules providing for the intervention of the Supervisory Authority has been applied in the field of competition law, but can be invoked in general as a tool to strengthen the deterrent function of the law and of the public intervention.

Violations of the EU antitrust rules (Articles 101 and 102 of the TFEU- Treaty for the functioning of the European Union), such as cartels or the abuse of a dominant market position, are not only harmful to the economy and to consumers in general, but they can also cause concrete damage to individual customers and competing companies.

The Court of Justice of the European Union (C-295/04 - C-298/04,) has established that every citizen or company is entitled to full compensation for damages caused by the violation of EU antitrust rules.

However, the Commission noted that in practice most victims find an obstacle to operating their rights in the national rules on compensation for damage.

That is why in 2013 the Commission proposed a directive to remove the main obstacles to effective compensation and to ensure minimum protection for citizens and businesses, anywhere in the EU. At the end of the ordinary legislative procedure, the 2014/104 / EU directive on actions against damage caused by the antitrust entered into force on 26 December 2014.

A complementary measure to the directive is the Commission's recommendation on collective redress, which called on Member States to introduce collective redress mechanisms by 26 July 2015, including actions for damages.

Over time the civil law doctrine has questioned itself about the effects, according to private law, of the violation of rules of conduct present in the regulations on Public Authorities controls. The proposed remedies of so called "private enforcement" (intending as the private law remedies in case of violation of norms requiring public enforcement) are: the responsibility for failure to adopt standards of good faith in the formation of the contract (so called precontractual good faith), nullity for violation of imperative norm, resolution for non-fulfillment of the duties raising from contract.

Thus responses in the case of unsustainable products can also be found in the application of general principles of contract law in the civil code. The respect of the rules on the so called product governance

conduct, as said above, imposes that in the financial market there will be no contracts that are not adequate with respect to the interests of customers. In the case of credit supply contracts the main inadequacy is given by the non-sustainability of the expected economic commitments.

In this perspective, sustainability can become a key to understanding the merit of contracts, which finds its main regulatory recognition a merit related to the whole dynamic of the relationship.

### **5. Credit in Agriculture and meta-finance**

The European Council Regulation No. 1698 of 20 September 2005 on support for rural development identified a programming system that provided for the formulation and articulation of the intervention strategy from the community level, through the development of Community Strategic Guidelines, to the national one with the National Strategic Plan, to then arrive at the definition at the regional territorial level of the RDP.

The 2005 Regulation was repealed by EC Regulation 1305/2013 which starts from the need to intervene so that the CAP is combined with a rural development policy to accompany and integrate the direct payments and market measures provided for by the same CAP, thus contributing to the achievement of the objectives of this policy set out in the Treaty on the Functioning of the European Union (hereinafter "TFEU").

It is clear that the achievement of the objective of rural development cannot be sufficiently achieved by the Member States, especially in view of the wide disparities between the various rural areas and the limited financial resources available to the Member States, especially with regard to current state of the enlarged Union.

The intervention of the Union on the basis of the principle of subsidiarity enshrined in Article 5 of the Treaty on European Union is deemed fundamental, while respecting the principle of proportionality. The Union intervenes through the European Agricultural Fund for Rural Development ("the EAFRD") and the interventions it co-financed should be consistent and compatible with the support provided by the other instruments of the CAP.

Each Member State is required to draw up a single national rural development program for its entire territory, or a series of regional programs, or both a national program and a series of regional programs, in order to define a strategy for achieving concrete objectives that relate to the Union priorities in the field of rural development, a strategy that is at the same time adapted to national contexts and complementary to other Union policies, in particular the agricultural market policy, the cohesion policy and the politics common fisheries policy. However, Member States have the possibility to include in the rural development programs thematic sub-programs that respond to specific needs in areas of particular importance as well as to: young farmers, small farms, mountain areas, the creation of short supply chains, the women in rural areas, climate change mitigation and adaptation to them and biodiversity.

This is a system of interventions that aims to finance targeted projects that can have direct repercussions in terms of protecting the health of consumers. As stated in the regulation at recital 14 "Union or national quality schemes for agricultural and food products, including farm certification schemes, offer consumers



guarantees about the quality and characteristics of the product or production process, thanks to the farmers' participation in these schemes, add value to the products concerned and expand their market outlets. "Another objective of the financing is to protect the environment by financing interventions that make the relationship between production and protection of the ecosystem sustainable. The Regulation states in recital 4 that in order to ensure the sustainable development of rural areas, it is necessary to focus on a limited number of objectives: transferring knowledge and innovation in the agricultural, forestry and rural areas; to strengthen the profitability of farms and the competitiveness of agriculture in all its forms in all regions; promote innovative technologies for farms and sustainable forest management; organization of the agri-food supply chain, including the processing and marketing of agricultural products, animal welfare, management of the risks inherent in agriculture, the safeguarding, restoration and enhancement of ecosystems related to agriculture and forests, promoting the efficient use of resources and the transition to a low-carbon economy as well as social inclusion, poverty reduction and economic development in rural areas. In this context it is appropriate to take into account rural areas with different characteristics or with different categories of potential beneficiaries, as well as cross-cutting objectives such as innovation, the environment, as well as climate change mitigation and adaptation to them.

With particular regard to these latter aspects we can speak of "meta-finance" with reference to agricultural credit to highlight how agricultural credit contracts go to pursue further purposes of social utility with respect to the individual economic function, also having as their object general protection interests. of food security, understood both as food safety and as food security, to protect the ecosystem and to develop the rural economy.

By giving particular conditions to access to public subsidies for agriculture, of which we have spoken, it is possible to encourage operators to conduct activities that may favor the aforementioned objectives of general interest.

In this sense it can be said that agricultural credit aims to achieve further objectives than their financial function.

The meta-financial characteristic of agricultural credit, linked, as mentioned, to public interventions that find credit as a lever to direct operators towards certain economic policy choices, end up bringing into the causal scheme of the financing contract the purpose to which it is directed with consequences. in terms of the validity and effectiveness of the contract where it is impossible or unrealized.

Think of the subsidized credit which requires a main financing relationship and a secondary relationship between the financing public institution and the institution that provides the financing with which the public body assumes the debt for the payment of part of the interest. We are in the presence of a unilateral link between these relationships, for which it is assumed that the termination of the financing shop (by declaration of invalidity or by resolution) will lead to the absence of public intervention, but vice versa will not be possible. The loss of public intervention may, however, affect the profile of the financial guarantees

offered by the financed company and be relevant in terms of assessing the modification of the financial conditions of the financed company, as it may justify a withdrawal by the bank to be exercised in any case in compliance with the principle of good belief in the execution of the contract. Even where the possibility of a withdrawal by law or by contract is envisaged, this must comply with the principles of good faith, ensuring that the withdrawal is never exercised in an unforeseen and arbitrary manner in contrast with the reasonable expectation of the counterparty.

## **6. Some conclusive remarks**

The protection of the agricultural enterprise in access to credit finds a particular protection when the obligatory relationship is placed within the norms of the civil code on the obligatory report and on the contract in general.

Add to this that even from the analysis of a recent jurisprudence in the field of contracts between companies, the ordering seems to have recovered a more concrete vision and more distant from abstract classifications as consumer and professional.

The Italian judges seem increasingly oriented towards bridging the regulatory gap between consumer protection and the protection of the professional that stipulates in a market sector different from that of its business (think of the agricultural company that contracts a mortgage with a bank) is found however, in a condition of information asymmetry with problems of protection of one's own negotiating autonomy similar to those of consumers (Cass. SS.UU., 6 maggio 2016, n. 9140 regarding a contract between an insurance company and a professional ). Moreover, in the case of agricultural enterprises it is necessary to keep in mind the social function performed by the company operating in the agri-food sector. In a context in which food security, understood as "access to food" or as the objective of satisfying the food needs of the population, involves many areas (trade, economy, energy, international relations), the access to credit for the agricultural entrepreneur, as an essential tool for agricultural production, becomes an essential tool for the realization of such an objective. In such a broader framework we believe that conflicts between agricultural enterprises and funding bodies and / or institutional guarantors must be read and composed.

The contract between the agricultural company, having regard to the activity carried out by the same in practice, and the credit institution will make the same mission of the agricultural enterprise that will have to be evaluated within the economy of the contract. The finance in agriculture, as specified, is meta finance for which credit is associated with non-financial but political motivations and is often accompanied by instruments that encourage the use of credit.