

# **Philippine Country Study** **On** **Microfinance**

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**FINAL DRAFT**  
**October, 2006**

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## The Philippine Microfinance Industry

In June 2005, key officials of CordAid, Hivos, ICCO and Oxfam Novib decided to form an alliance to provide support to emerging microfinance institutions using a sector approach. As a result, a network organization known as MicroNed was established in early 2006. MicroNed is primarily tasked to strengthen and coordinate the joint contribution of Development Finance Organizations (DFOs) in the Netherlands to the microfinance sector. Specifically, MicroNed assistance will focus on national microfinance sector interventions that are geared and focused on the establishment of an enabling environment for the growth and development of emerging microfinance institutions<sup>1</sup> in selected countries, of which the Philippines is one.

This study will be used as a basis by MicroNed and the country coordinator (i.e. ICCO) in identifying the priority needs of the microfinance sector in the Philippines. Chapter 1 provides a general overview of social, economic and political situation in the country while Chapter 2 discusses briefly the Philippine Financial System. Chapter 3 describes the Philippine Microfinance Sector and provides discussion on the current policy environment for microfinance, the demand and supply of microfinance services and the key players involved in the sector. Specific needs of the key players at the sector-wide level are identified in this section. Chapter 4 identifies and describes the various supporters of the Philippine microfinance industry at the meso level. Specific gaps that need priority attention are also identified in this section. And finally, Chapter 5 provides the conclusion and specific recommendations for the development and formulation of the country sector development strategy paper for the DFOs.

### 1 The Philippines: General Overview

#### *Geographical location*

The Philippines is an archipelago in Southeast Asia bordered by Bashi Channel on the North, Sulu and Celebes Sea on the south, the Pacific Ocean on the East and South China Sea on the West. It has 7,107 islands with a total land area of 300,000 square kilometers. The three major island groupings in the country are named Luzon, Visayas and Mindanao. The Philippines is divided into 17 administrative regions, 79 provinces, 117 cities, 1500 municipalities and 41,975 barangays.

#### *Economic Growth*

The Philippine economy slowed down in 2005 registering a growth in gross domestic product of only 5.0 percent compared to a 6.2 percent growth in 2004. The slow down in the growth of domestic production is mainly attributed to a major decline in the growth of the agriculture sector (from 5.3 percent in 2004 to only 1.8 percent in 2005) and a slight decline in the growth of the services sector. The significant decline in the growth of agricultural sector is due to the combined effect of unfavorable weather conditions and the high cost of commercial fertilizers while the slight decline in the services sector is mainly attributed to a negative growth in the land and water transport sector due mainly to increasing oil prices. The industry sector was mainly propelled by an improvement in the mining and quarrying and manufacturing sub-sectors posting a growth of 9.3 percent and 5.3 percent respectively. Remittances from Overseas Filipino Workers (OFW) during the year amounted to about US \$10.7 billion significantly contributing to the growth in the country's gross national product. This has greatly shielded the country from the threats of soaring world oil prices and a relatively sluggish growth of export during the year. Per capita gross national product for the year was posted at about P67,800 (US \$1,200).

On the demand side, personal consumption expenditures continued to be the major contributor to the country's gross domestic product posting a 4.9 percent growth in 2005. Government expenditures on the other hand, remained weak contributing only 0.2 percentage points to overall growth due mainly to the government's austerity measures to curb the increasing budget deficit.

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<sup>1</sup> MicroNed will focus on sectoral interventions while individual MicroNed members may opt to provide direct assistance to retail MFIs. MicroNed members will complement MicroNed assistance with loans, guarantees or equity participations where possible and appropriate. To implement MicroNed assistance in the priority countries, each MicroNed member was assigned as MicroNed coordinator in specific countries. ICCO was assigned as the country coordinator for the Philippines.

### *Population and Employment*

The population of the Philippines continues to rise. The latest census which was conducted in 2000 reported that total population was 76.5 million. Latest projection show that the population is at the 85 million mark in 2005<sup>2</sup>. In terms of employment, latest available statistics show that the unemployment rate was still posted at 11.4%, still high by the neighboring country standards. The underemployment rate in 2005 rose to 21.0% of those employed compared to only 17.5% in 2004. This shows that the improvement in economic growth is not able to create sufficient jobs for a fast-growing labor force. This situation resulted in an exodus of workers overseas. In 2005, nearly 1 million workers left for jobs abroad, considering that the total number working overseas was already over 8 million in 2004. As indicated earlier, this has provided the country a sizable amount of remittance income that had cushion the country from the negative impact of increasing crude oil prices. The country, however, pays a high price in terms of loss of knowledge and skills, and high social costs.

### *Poverty Situation*

Despite the positive growth in the Philippine economy during the years 2004 and 2005, poverty continues to be a major concern. The country's economic growth is not sufficient to cater to the economic demands of its increasing population. The rise in unemployment also contributed to the current poverty situation in the country. Latest available statistics (2003) on poverty incidence reported that 24.7 percent of Filipino families are below the poverty threshold. This translates to about 3.9 million families that are considered poor. The National Statistical and Coordination Board (NSCB) reported that in 2004, annual per capita poverty threshold is P13,113 (US\$234)<sup>3</sup> for the whole Philippines with P15,001 (US\$268) in urban areas and P12,431 (US\$222) in rural areas.

The foregoing information on the economic growth and poverty situation in the Philippines shows that there is a huge market for microfinance in the Philippines. Almost a fourth of the total families in the Philippines leave below the poverty line and are therefore potential clients of microfinance. In view of this, the development of a vibrant, viable and sustainable microfinance sector is crucial in making sure that the poor have access to the needed financial service.

## **2 The Philippine Financial System**

The Philippine financial system is comprised of formal and informal sub-systems<sup>4</sup>. The formal system is comprised of institutions that are supervised and regulated by the Bangko Sentral ng Pilipinas (BSP) which includes the banks and non-bank financial institutions while the informal system is comprised of the savings clubs (e.g. Rotating Savings and Credit Associations (ROSCA), moneylenders, trader lenders, input suppliers etc.). The banks are categorized into universal banks, commercial banks, thrift banks, rural and cooperative banks while the non-banks institutions are categorized into those with quasi-banking functions and those that do not have any quasi-banking function. The category of banks is based on the type of services they are allowed to provide and the amount of capitalization required. For instance, universal banks are allowed to engage in various types of financial transactions and other allied undertakings while the rural banks are limited to only savings and credit services. Rural banks are also not allowed to engage in foreign exchange transactions unless given a special authority by the Monetary Board.

As of March, 2006, there are about 20,013 offices of financial institutions in the country. These include head offices, branches and extension offices of the banks and non-bank institutions. Of this number, more than half are offices of non-bank institutions (Table 1). Of the total banking offices, fifty-six percent (56%) are offices of universal and commercial banks while about 26 percent (26%) are offices of rural and cooperative banks.

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<sup>2</sup> Based on the projections of the Inter-Agency Working Group on Population, NSCB web page.

<sup>3</sup> With a per capita threshold of Php13,113 (US\$234), a family of five has to earn more than P65,565 (US \$1170) annually to be out of poverty. P56.01 to US\$ was used for conversion, based on the latest 2005 Socio Economic Report published by the National Economic and Development Authority (NEDA).

<sup>4</sup> Llanto and Alip, "Overview of the Emerging Microfinance Industry," in Regulatory Architecture for Microfinance in Asia, Asian Productivity Organization, 2006.

**Table 1. Total No. of Financial Institutions in the Philippines<sup>5</sup>**

TYPE OF FINANCIAL INSTITUTIONS (FIs)	End-December 2005			End-March 2006		
	Total	Head Office	Head Office	Total	Head Office	Head Office
<b>BSP SUPERVISED/REGULATED FIs</b>	<b><u>19,968</u></b>	<b><u>6,951</u></b>	<b><u>13,017</u></b>	<b><u>20,013</u></b>	<b><u>6,971</u></b>	<b><u>13,042</u></b>
<b>I. BANKS</b>	<b><u>7,670</u></b>	<b><u>879</u></b>	<b><u>6,791</u></b>	<b><u>7,672</u></b>	<b><u>872</u></b>	<b><u>6,800</u></b>
A. Universal and Commercial Banks	<u>4,318</u>	<u>41</u>	<u>4,277</u>	<u>4,318</u>	<u>41</u>	<u>4,277</u>
Universal Banks	<u>3,683</u>	<u>17</u>	<u>3,666</u>	<u>3,717</u>	<u>17</u>	<u>3,700</u>
Private Domestic Banks	<u>3,257</u>	<u>11</u>	<u>3,246</u>	<u>3,291</u>	<u>11</u>	<u>3,280</u>
Government Banks	<u>414</u>	<u>3</u>	<u>411</u>	<u>414</u>	<u>3</u>	<u>411</u>
Branches of Foreign Banks	<u>12</u>	<u>3</u>	<u>9</u>	<u>12</u>	<u>3</u>	<u>9</u>
Commercial Banks	<u>635</u>	<u>24</u>	<u>611</u>	<u>601</u>	<u>24</u>	<u>577</u>
Private Domestic Banks	<u>487</u>	<u>9</u>	<u>478</u>	<u>488</u>	<u>9</u>	<u>479</u>
Subsidiaries of Foreign Banks	<u>132</u>	<u>4</u>	<u>128</u>	<u>97</u>	<u>4</u>	<u>93</u>
Branches of Foreign Banks	<u>16</u>	<u>11</u>	<u>5</u>	<u>16</u>	<u>11</u>	<u>5</u>
B. Thrift Banks <sup>6</sup>	<u>1,293</u>	<u>84</u>	<u>1,209</u>	<u>1,312</u>	<u>85</u>	<u>1,227</u>
C. Rural and Cooperative Banks	<u>2,059</u>	<u>754</u>	<u>1,305</u>	<u>2,042</u>	<u>746</u>	<u>1,296</u>
Rural Banks <sup>7</sup>	<u>1,951</u>	<u>710</u>	<u>1,241</u>	<u>1,933</u>	<u>702</u>	<u>1,231</u>
Cooperative Banks	<u>108</u>	<u>44</u>	<u>64</u>	<u>109</u>	<u>44</u>	<u>65</u>
<b>II. NON-BANK FINANCIAL INSTITUTIONS</b>	<b><u>12,288</u></b>	<b><u>6,063</u></b>	<b><u>6,225</u></b>	<b><u>12,331</u></b>	<b><u>6,090</u></b>	<b><u>6,241</u></b>
A. With Quasi-Banking Functions*	<u>31</u>	<u>12</u>	<u>19</u>	<u>31</u>	<u>12</u>	<u>19</u>
B. Without Quasi-Banking Functions*	<u>12,257</u>	<u>6,051</u>	<u>6,206</u>	<u>12,300</u>	<u>6,078</u>	<u>6,222</u>
<b>III. OFFSHORE BANKING UNITS</b>	<b><u>10</u></b>	<b><u>9</u></b>	<b><u>1</u></b>	<b><u>10</u></b>	<b><u>9</u></b>	<b><u>1</u></b>

*\*Non-bank financial institutions with quasi-banking functions consists of investment houses and financing companies engaged in the borrowing of funds from 20 or more lenders for the borrower's own account through issuances, endorsement or assignment with recourse or acceptance of deposit substitutes for purposes of relending or purchasing receivables and other obligations.. Regulation of non-bank financial institutions without quasi-banking functions have recently been transferred to the Securities and Exchange Commission (SEC) in accordance with Section 130 of the New Central Bank Act (RA 7653)..*

Source: Supervisory Data Center, Supervision and Examination Sector, BSP Website

The total resources of the banking sector amounted to Php 4.3 trillion pesos as of December, 2005. About 89 percent of this came from universal (56 percent) and commercial banks (16 percent). The rural banks and the cooperative sector, on the other hand, put in a measly 2.7 percent of the total resources (Table 2).

<sup>5</sup> The data in this table only includes the total no. of financial institutions being supervised and regulated by the Bangko Sentral ng Pilipinas.

<sup>6</sup> Include Microfinance oriented banks

<sup>7</sup> Include Microfinance oriented banks

**Table 2. Market Share based on Assets,  
By type of Bank, Dec. 2005**

Type of Bank	Total Assets (in billion pesos) Dec. 2005	% Share	Growth Rate 2004-2005
<b>A. UNIVERSAL AND COMMERCIAL BANKS<sup>8</sup></b>	<b><u>3,856.806</u></b>	<b>89.3</b>	<b>6.6</b>
1. Universal Banks	3,160.572	73.2	8.0
a. Private Domestic	2,436.051	56.4	5.2
b. Government Banks	521.619	12.1	17.1
c. Foreign Banks <sup>9</sup>	202.902	4.7	21.8
2. Commercial Banks	696.235	16.1	0.9
a. Private Domestic	335.125	7.8	7.9
b. Foreign <sup>10</sup>	361.110	8.4	(4.9)
<b>B. THRIFT BANKS<sup>11</sup></b>	<b><u>346.027</u></b>	<b>8.0</b>	<b>13.3</b>
<b>C. RURAL AND COOPERATIVE BANKS</b>	<b><u>116.579</u></b>	<b>2.7</b>	<b>15.1</b>
1. Rural Banks	109.078	2.5	14.9
2. Cooperative Banks	7.501	0.2	17.1
<b>ALL BANKS</b>	<b><u>4,319.412</u></b>	<b>100.0</b>	<b>7.3</b>
Domestic	3,738.858	86.6	7.8
Foreign <sup>12</sup>	580.554	13.4	4.5

Source: Supervisory Data Center, Supervision and Examination Sector, BSP Website

The foregoing shows that the banking sector in the Philippines is largely dominated by the big universal and commercial banks both in terms of resources and in terms of the number of offices. This explains why in the past, especially in the 80s and in the 90s, banking regulations were mostly concerned with providing guidelines for large and medium scale lending. Banking regulations and supervision techniques then were somehow biased against small and micro scale lending (e.g. requiring collaterals for loans).

Other than the financial institutions regulated and supervised by the Bangko Sentral ng Pilipinas (BSP), there are two other types of formal financial institutions that is part of the Philippine financial system. These are the credit cooperatives and the microfinance NGOs<sup>13</sup>. The credit cooperatives are registered and legally under the regulation and supervision of the Cooperative Development Authority (CDA) while the Microfinance NGOs are registered with the Securities and Exchange Commission. The credit cooperatives while not licensed as banks are legally allowed to take deposits only from its members. The microfinance NGOs, on the other hand, are not legally allowed nor licensed to take deposits neither from the public nor from its members.<sup>14</sup> It should be noted that statistics on

<sup>8</sup> Adjusted to net off the account "Due from Head Office" with "Due to Head Office" of branches of foreign banks

<sup>9</sup> Refers to assets of foreign bank branches which have been granted universal banking license

<sup>10</sup> Refers to assets of the other foreign bank branches and subsidiaries (commercial banks only)

<sup>11</sup> Includes assets of foreign bank thrift subsidiaries

<sup>12</sup> Refers to assets of foreign bank branches and subsidiaries (both universal & commercial and thrift banks)

<sup>13</sup> Per BSP statistics, these institutions are not counted as part of the Philippine Financial System. However, it is believed that it should be part of the financial system inasmuch as they perform functions that the other recognized financial institutions in the system are doing.

<sup>14</sup> The collection of savings from the members of a microfinance NGOs is currently one of the policy issues being discussed between the BSP, the NCC and the concerned stakeholders. Formulation of an appropriate policy and mechanism to address this is one of the policy commitments under the ADB-funded Microfinance Development Program.

cooperatives engaged in savings and credit services and the micro finance NGOs are not included in the banking statistics published by the BSP.

As shown in the foregoing, the Philippines has more than 20,000 offices of financial institutions. Despite this number, however, majority of the poor still do not have access to financial services. Most of the financial institutions, especially the large universal and commercial banks (which comprise 56 percent of the no. of offices and more than 60 percent of the total banking system's resources), are not inclined to provide financial services to the poor. The poor are perceived as non-bankable. Also, large commercial banks find it very costly to extend very small loans to large number of clients due to large transaction costs involved. The need of the poor to have access to financial services and the reluctance of big commercial banks to meet this need led to the development of the microfinance industry in the Philippines.

### **3 The Philippine microfinance sector**

#### **3.1 The microfinance policy environment**

##### *3.1.1 Where we were before*

Traditionally, banks especially the big universal and commercial banks, cater to big borrowers and are reluctant to provide financial services to small borrowers. Large transaction costs and high risks associated with small scale lending prevent these banks from providing the needed financial services to this market. Hence, in the past, the government was actively involved and has directly intervened in the credit market by allowing non-financial agencies to provide loans to those that belong to the lower income segment of the population. Government then believed that since private financial institutions are reluctant to provide financial services to this market (comprised mainly of the poor), government should come in. The government provided credit funds either directly or through private rural banks at subsidized interest rates. This resulted in the proliferation of directed credit programs in almost all the sectors<sup>15</sup>. This has also resulted in the bankruptcy of a number of rural banks which were used as conduits of cheap government funds<sup>16</sup>. Most of the credit programs implemented at subsidized rates suffered from high delinquency thereby affecting the financial position of the participating rural banks.

In 1993, a group of concerned representatives from both the government and private sector raised the issue of the poor's inadequate access to credit despite government's implementation of several credit programs. In 1994, the National Credit Council (NCC)<sup>17</sup> was created with the main mandate of rationalizing the implementation of directed credit programs and identifying alternative delivery mechanisms for the effective and efficient provision of financial services to the poor.

To execute its mandate, the NCC conducted several studies<sup>18</sup> that assessed and reviewed government's policies and framework for the provision of credit services to the poor. The NCC also conducted an inventory of all credit programs implemented by government where it was found out that there were about 186 directed credit programs implemented by about 20 government non-financial agencies. The studies revealed that the government is a poor creditor. Most of the 186 directed credit programs were both inefficient and ineffective resulting in large fiscal losses on the part of the government. The studies also reported that these credit programs suffer from poor program management, large default rates, political intervention, and inefficient program operations resulting in high costs. Despite the proliferation of government directed credit programs and the large amount of government budget that have been earmarked for these programs, the studies and anecdotal evidences showed that the poor or the supposed target beneficiaries of directed credit programs still do not have access to credit.

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<sup>15</sup> In the 70s and the early 80s, there was a credit program for each agricultural commodity that is being promoted by the government. Hence, there was credit program for rice, for corn, livestock, dairy, fishery etc.

<sup>16</sup> It was reported that most rural banks have to be rehabilitated in 1986 due to weak financial status resulting from very high delinquency brought about by participation in the government subsidized directed credit programs.

<sup>17</sup> The National Credit Council was created under AO No. 86 in 1993. The NCC is a policy council comprised of representatives from both the government and the private sector.

<sup>18</sup> The National Credit Council (NCC) with technical assistance from the Credit Policy Improvement Project (CPIP), a technical assistance from USAID, conducted several studies that highlighted the inefficiencies and ineffectiveness of government-implemented directed credit programs in the country. Results of these studies became the basis for formulating and implementing the needed credit policy reforms that eventually led to increased interest of the private sector in providing financial services to the poor.

### 3.1.2 Policy reforms implemented

Heeding the results of the studies conducted and realizing the inefficiencies of government directed credit programs and its failure to provide the poor access to credit, the government started to implement credit policy reforms. In 1997, the government, through the NCC, formulated the National Strategy for Microfinance which became the policy framework for the formulation and implementation of succeeding policy reforms that paved the way for the development of the microfinance industry in the Philippines. The National Strategy for Microfinance is anchored on the following policy principles:

- Increased participation of the private sector in the delivery of financial services to the poor
- Adoption of market-based financial and credit policies in the delivery of financial services to the poor
- Government to provide the enabling policy and regulatory environment, and critical support services to facilitate the greater participation of the private sector in the delivery of microfinance
- Non-participation of government non-financial agencies and government-owned and controlled corporation in the implementation of government directed credit programs

Based on these policy principles, several laws and executive orders were issued to clarify and define specific policy guidelines for the microfinance industry in the Philippines. The following laws were enacted:

**Table 3. Key Policy Measures on Microfinance**

Policy Measures	Key Provisions
Issuance of the National Strategy for Microfinance (1997).	<ul style="list-style-type: none"> <li>▪ Market orientation of interest rates.</li> <li>▪ Rationalization of subsidized directed credit programs</li> <li>▪ Government to only provide the enabling policy and regulatory environment for the effective delivery of microfinance services by the private sector</li> <li>▪ Donors primarily as providers of technical assistance, e.g., capacity building</li> <li>▪ Recognition of savings mobilization as an integral part of successful microfinance programs</li> </ul>
Enactment of the Social Reform and Poverty Alleviation Act on December 11, 1997	<ul style="list-style-type: none"> <li>▪ Defining capacity-building to exclude any and all forms of seed funding, equity infusion, and partnership funds from government to microfinance institutions</li> <li>▪ Deletion of equity funding from the list of specific uses of the People's Development Trust Fund (PDTF), a trust fund created under the law which is aimed at funding capability building activities for MFIs</li> <li>▪ Rationalization of directed credit and guarantee programs</li> <li>▪ Emphasis on savings mobilization</li> </ul>
Enactment of the Agricultural Fisheries Modernization Act (AFMA) in December 22, 1997	<ul style="list-style-type: none"> <li>▪ Phase-out of directed credit programs in the agriculture sector over a four year period (i.e. ending February 2002)</li> <li>▪ Rationalization of loan guarantee programs</li> <li>▪ Adoption of market-based interest rates</li> <li>▪ Non-provision of credit subsidies</li> <li>▪ Review of mandates and performance of government agencies and government financial institutions in light of the rationalization of directed credit programs</li> </ul>
Issuance of EO 138 (August 10, 1999) that directs government agencies implementing credit programs to adopt the NCC Credit Policy Guidelines.	<ul style="list-style-type: none"> <li>▪ Non-participation of government non-financial agencies in the implementation of credit programs</li> <li>▪ Government financial institutions to be the main vehicle in the implementation of government credit programs</li> <li>▪ Adoption of market-based financial and credit policies</li> <li>▪ Increased participation of the private sector in the delivery of financial services</li> </ul>
Approval of the design of the Agricultural Modernization	<ul style="list-style-type: none"> <li>▪ No further implementation of directed credit programs by government non-financial agencies by end 2002</li> </ul>

Credit and Financing Program (AMCFP).	<ul style="list-style-type: none"> <li>▪ Limit lending decisions only to banks, viable cooperatives and microfinance NGOs</li> <li>▪ Adoption of market-determined lending rates to enable conduits to cover their costs and achieve sustainability in the long run</li> <li>▪ Focus of the Department of Agriculture on the monitoring and evaluation of the AMCFP, provision of infrastructure, institution building, research and extension and the provision of an appropriate policy environment conducive for increased private sector participation.</li> </ul>
Enactment of the General Banking Act (GBA) in May 23, 2000, which includes provisions mandating the Bangko Sentral ng Pilipinas (BSP) to recognize the unique nature of microfinance as it formulates banking policies and regulations.	<ul style="list-style-type: none"> <li>▪ Lifting of the moratorium on branching, specifically for those banks going into microfinance</li> <li>▪ Issuance of BSP Circular 272 in January 30, 2001 implementing the microfinance provisions of the GBA</li> <li>▪ Review of the supervision and examination process to consider the special nature of microfinance i.e. non-collateralized loans</li> </ul>
Enactment of the Barangay Microenterprise Business Act.	<ul style="list-style-type: none"> <li>▪ Adoption of market-based credit policies in the provision of financial services to barangay or village-based microenterprises.</li> <li>▪ Setting up of a special credit window, within a GFI, that will provide credit to barangay microenterprise business at market based interest rates.</li> </ul>

With the issuance of these laws and executive orders and the proclamation of the President in 2002 that microfinance is the cornerstone for poverty alleviation, several financial institutions got interested in the provision of microfinance services. In particular, the issuance of EO 138 and the AFMA, which specifically directed government non-financial agencies to phase-out the implementation of directed credit programs, provided sufficient incentive for the private sector to provide microfinance services. It is unfortunate though that on August 8, 2006, this landmark executive order was repealed by EO 558<sup>19</sup>. In view of this, there is now a growing apprehension among the private sector (the MFIs in particular), that government is again sliding back to the old credit policy regime which have serious repercussion on the viability and sustainability of the microfinance market in the Philippines. To date, however, no specific guidelines have yet been formulated regarding the implementation of EO 558. The private sector are continuously advocating for the reconsideration of EO 558 and the reinstatement of the provisions of EO 138<sup>20</sup>.

Also, the inclusion of a provision in the General Banking Act (GBA) that directed the Monetary Board to consider the peculiar characteristics of microfinance in BSP rules and regulations led to the issuance of microfinance-friendly regulations. These specific measures led to an increased number of private financial institutions providing microfinance services.

### 3.1.3 The regulatory framework and performance standards for microfinance

With the increased number of players, the NCC issued the Regulatory Framework for Microfinance in July, 2002. The regulatory framework clarifies and defines the role of the various agencies involved in regulating and supervising the three major institutions engaged in the provision of microfinance services, i.e. the banks, the credit cooperatives and the microfinance NGOs<sup>21</sup>. The regulatory framework is anchored on the basic premise that only deposit-taking institutions (i.e. the banks and the credit cooperatives) will be subjected to prudential regulation and supervision. In the Philippines, microfinance NGOs are considered non-deposit taking institutions. Hence, under the regulatory

<sup>19</sup> EO 558 is a one-liner executive order that repealed EO 138. There are no justifications or specific guidelines on what will be done given the repeal of EO 138.

<sup>20</sup> As of this writing, the NCC-DOF together with government non-financial agencies and government financial institutions are vigilantly discussing the guidelines to be implemented for the repeal to minimize the possible adverse impact of the policy reversal. Otherwise, this sweeping policy will have serious repercussion on the microfinance industry.

<sup>21</sup> The Regulatory Framework states that the banks engaged in microfinance operations will continue to be under the supervision of the BSP and the credit cooperatives will be under the supervision of the Cooperative Development Authority (CDA).

framework, microfinance NGOs is only allowed to get savings from their members up to the amount of the member's borrowings from the institution. If the total savings of the institution exceeds the total loan portfolio, the microfinance NGO will be required to transform either into a bank or a credit cooperative to be able to continue collecting savings from its members<sup>22</sup>. Since NGOs are registered by the Securities and Exchange Commission (SEC) and are not regulated by any government authority, the NCC has recently coordinated with the SEC to require all NGOs to disclose their microfinance activity in their annual submission of their General Information Sheet (GIS). A memorandum circular has been issued by the SEC on June 29, 2006 requiring all domestic non-stock corporations to use the revised GIS form which requires disclosure of MF operations.

Following the issuance of the regulatory framework, the NCC also formulated and issued the performance standards for microfinance operations in November 2005. These performance standards provide the industry benchmark and prescribe a set of indicators that could be used by both management and regulators in assessing and evaluating microfinance operations. The performance standards have specific indicators which focus on the following categories: Portfolio Quality, Efficiency of Operations, Sustainability and Outreach, or an acronym PESO. To date, the performance standards are being used by wholesale financial institutions (both government and private) to assess and evaluate the performance of any prospective MFI client. They use the standards and indicators in assessing the creditworthiness of a prospective MFI client. The Bangko Sentral ng Pilipinas (BSP) has, likewise, included the standards and indicators in their supervision and examination of any bank engaged in microfinance operations.

#### *3.1.4 Establishment of a credit bureau*

With the establishment of a policy environment that encourages greater private sector participation in the provision of microfinance services, there has been an increase in the number of institutions engaged in microfinance. While this development is deemed positive and is expected to promote competition among the service providers resulting in more efficient operations and eventually lower cost of services, recent developments show that this is also posing a potential threat to the industry. With increased number of players and without a comprehensive set of credit information on existing borrowers, the problem of credit pollution looms large. Some MFIs complain that a number of their clients borrow from multiple sources, hence affecting their ability to pay loans. This results in increasing delinquencies which affects the quality of an MFI's loan portfolio.

Realizing this and its effect on the financial institutions engaged in microfinance, the Bangko Sentral ng Pilipinas worked with Congress in initiating the filing of a bill in 2005. The bill seeks to establish a comprehensive credit information system in the Philippines which will provide all types of participating financial institution specific information on the various credit transactions of a prospective borrower. Aside from the importance of this set of information in determining the creditworthiness of a prospective client, a fully functioning credit information system will result in lower cost of providing credit inasmuch as financial institutions need not spend as much in credit investigation. To date, the credit bureau bill has already been approved in the Senate. The House of Representatives, however, has yet to discuss the committee report during plenary sessions.

### **3.2 The demand and supply of microfinance services**

Given the current poverty situation in the country, the demand for microfinance services continue to be strong. The reported poverty incidence of 24.7 percent in 2003 translates to about 4 million families living below the poverty line. Not all of the poor, however, are able to access microfinance services inasmuch as most microfinance service suppliers prefer to provide services to those already engage in some form of entrepreneurial activity. Very few MFIs provide start up funds for clients. Anecdotal evidence show that not all the poor maybe considered entrepreneurial and potential clients of microfinance. The rest are positioned way below the poverty line and therefore welfare assistance is the most appropriate mode of support for them.<sup>23</sup>

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<sup>22</sup> Ideally, the total loan portfolio of the individual MF client should always be greater than its savings with the NGO. However, for administrative ease, this refers to the total savings and total loan portfolio of the NGO.

<sup>23</sup> The type of assistance needed by them include health and sanitation, basic education, water, and other form of welfare assistance. Providing them credit is not the solution inasmuch as they will use the fund to meet their basic need requirement instead of using the loan for entrepreneurial activities.

It is also estimated that majority of the potential clients for microfinance services are women. A survey conducted by ADB under the technical assistance project found out that women comprise more than three fourths of the clients of microfinance institutions.

Prior to the formulation of the national strategy for microfinance and the implementation of the credit policy reforms mentioned in the preceding section, there were only a handful of financial institutions engaged in the provision of microfinance services. Microfinance then is a turf dominated by the NGOs.

To date, microfinance services in the Philippines are provided by three major types of retail institutions. These are: the microfinance NGOs, the cooperatives and the banks (rural and thrift banks).

### *3.2.1 Microfinance Non-Government Organization (NGOs)*

In general, NGOs in the Philippines are non-stock, non-profit organizations registered with the Securities and Exchange Commission (SEC) with the main objective of providing developmental services to specific clientele in specific geographical locations. Microfinance NGOs are those that have chosen to provide development assistance through the provision of microfinance services to their members (or target clientele). Most of these NGOs started with the provision of general development assistance, however, they later found out that most the clients they are assisting are not able to improve their economic condition due to lack of access to financial resources which they badly need as capital for their entrepreneurial activities. Realizing this, a number of them started to pioneer the provision of financial services to the poor by initially using the Grameen technology<sup>24</sup>. They also used lessons from the failed directed credit programs in the past as springboard in coming up with the appropriate method of lending and in developing specific loan and savings products for the poor (e.g. adoption of market-based interest rates). To date, a number of NGOs have ventured into the adoption of other lending methodologies (e.g. modified Grameen, ASA methodology) to suit the needs and demands of their clientele. All of them, however, have made viability and sustainability of operations as key determinants of the appropriate lending technology they will adopt.

In a report compiled by the Microfinance Council of the Philippines (MCPI), it was reported that there are about 300, 000 NGOs in the country registered with the Securities and Exchange Commission. Around 300 NGOs are engaged in some form of financial service provision i.e. micro-credit. Only about 30 however, have a respectable size of microfinance operations<sup>25</sup>. As of December 31, 2005, the Microfinance Council of the Philippines reported that 31 reporting MFIs have a total microfinance loan portfolio of P4.3 billion to 911,180 clients.

One can say that the microfinance NGOs are key players in paving the way for the development of the microfinance industry in the Philippines. By demonstrating that microfinance is a viable and profitable business proposition, other types of financial institutions followed. To date, a few NGOs have reached a level of maturity in their operations such that they were able to easily convert their institutions into banks.<sup>26</sup> As banks, they are now able to generate savings from the general public as source of funds for their operations. These NGOs have professionalized their management and operations to almost the same level as that of formal financial institutions as evidenced by the relative ease in converting to banks. The level of maturity and professionalism among microfinance NGOs is also noted among the other big NGOs in the sector as shown by the extent and outreach of their operations as well as the systems and personnel policy they have adopted. A number of them are now able to access funds from commercial sources. The People's Credit and Finance Corporation (PCFC), a government wholesale financial institution for microfinance, reports that as of June 30, 2006, they have released about Php2.3 billion to 50 microfinance NGOs (10 are currently inactive). These NGOs has served about 1.2 million clients (of which only 929,517 are currently active).

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<sup>24</sup> Among the pioneer NGOs are the members of the APPEND Network and the PHILNET. These are the two biggest networks of NGOs prior to the establishment of the Microfinance Council of the Philippines.

<sup>25</sup> Source: Philippine Country Profile on Microfinance, submitted by the Microfinance Council of the Philippines to the Banking with the Poor (BWTP).

<sup>26</sup> The following microfinance banks started operations as microfinance NGOs: CARD Rural Bank (started as Center for Agriculture and Rural Development-CARD NGO), Dunganon Bank (started as Negrow Women for Tomorrow Foundation-NWTF), Vision Bank (started as Agricultural and Rural Development for Catanduanes Inc.-ARDCI), Kauswagan Bank (started as Taytay sa Kauswagan-TSKI) and Opportunity Microfinance Bank. (comprised of several NGO investors coming from the APPEND network),

At present, however, there are still some small NGOs that are heavily reliant on donor funds. The 80-20 principle still applies to the microfinance NGO sector, i.e. 80 percent of the NGO market is serviced by 20 percent of the total number of NGOs.

### 3.2.2 Cooperatives

The operations of the cooperative sector in the Philippines date back to the early years of the century. They have been providing savings and credit services to their members. A number of cooperatives claim that they have been providing financial services to the lower income segment of society since most of their members belong to the middle or low-income group. Unlike NGOs, cooperatives are registered with the Cooperative Development Authority (CDA). CDA is also the agency that has been legally mandated to supervise and regulate cooperatives.<sup>27</sup>

The exact number of cooperatives engaged in microfinance cannot be determined at this point inasmuch as CDA is yet in the process of requiring all cooperatives to submit financial reports for regulation and supervision purposes. PCFC, however reported that as of June 30, 2006, there are 93 (40 are inactive) cooperatives that were given loans amounting to a total of about Php 1.06 billion pesos. These cooperatives serve only about 386,432 clients. The Credit Union Enhancement and Strengthening Project in Mindanao (CUES) reported that partner coops served microfinance clients under their Savings and Credit with Education program (SCWE). Majority of the clients under the SCWE program are women in the rural areas.

Since the cooperative sector has not been regulated nor supervised for a long time, there is much to be desired in terms of their operations and reporting systems especially among small cooperatives. For instance, it is only in 2003 that CDA has started enforcing the adoption of the Standard Chart of Accounts (SCA) for all cooperatives with savings and credit services. As of December, 2005, only 32 percent of the 29,297 reportedly operating cooperatives with savings and credit services, have adopted and implemented the SCA in their operations. In view of the dearth of information regarding cooperatives in general and their microfinance operations in particular, one cannot categorically conclude that they are serving a sizable portion of the microfinance market. Their proximity to clients gives reason to conclude, however, that they are strategically and structurally poised to serve the microfinance market.

### 3.2.3 Banks

Prior to the issuance of the National Strategy for Microfinance, most of the banks are reluctant to lend to the poor due to the perceived risks associated with lending to the poor. Prior to 2000, there were only a few rural banks engaged in microfinance. With the enactment of the revised General Banking Act of 2002, the Monetary Board issued several circulars that encouraged banks to go into microfinance operations<sup>28</sup>. To date there are 204 banks engaged in microfinance operations serving almost 600 thousand clients with a microfinance portfolio amounting to about Php3.7 billion. Table 4 below shows that the traditional rural banks (microfinance portfolio is less than 50 percent of their total loan portfolio) comprise the majority of the banks providing microfinance services. A number of banks are interested in providing microfinance loans inasmuch as most of the banks realized the profitability potential of the product. As one banker attest, "... twenty percent of our portfolio, i.e. microfinance provides 60 percent of our profit." There are nine banks whose microfinance portfolio is at least half of their total loan portfolio (these are called microfinance-oriented banks).

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<sup>27</sup> It is only recently that CDA has refocused its efforts towards the regulation and supervision of cooperatives. Since its establishment in 1989, CDA has been mostly involved in the promotion and development of cooperatives which conflicts with its regulatory and supervisory mandate over cooperatives. To strengthen its regulatory mandate, CDA in coordination with the National Credit Council has recently drafted and formulated the Manual of Rules and Regulations for Savings and Credit Cooperatives. The MORR is expected to be finalized within the year.

<sup>28</sup> As a result of this provision in the law, the BSP has issued a number of circulars. These circulars among other things, provide for the following: recognition of the cash-flow based lending instead of requiring collateral from microfinance clients, use of portfolio at risk as a measure for assessing the quality of microfinance portfolio, lifting the branching moratorium and liberalizing the branching requirements for banks going into microfinance operations.

**Table 4. Direct Microfinance Exposure of the Banking Sector  
(As of March 31, 2006)**

Type of Bank	Amount of MF Loan Portfolio	No. of Borrowers
Microfinance-oriented Banks <sup>29</sup>		
Thrift Banks (5)	212.400	50,187
Rural Banks (4)	230.992	34,984
Traditional Banks		
Thrift Banks (9)	144.666	
Rural Banks (159)	2,373.291	410,110
Cooperative Banks (27)	696.803	97,899
Total Banks (204)	3,658.052	593.180

The interest of the banking sector especially the rural banks is expected to be further boosted by the recent issuance of a BSP circular No. 505 Series of 2005 that "...revised the existing branching guidelines to enhance competition in the banking system and maximize the delivery of financial services especially in underserved areas. These guidelines further provide a significant boost for the microfinance industry by creating the enabling environment for banks with microfinance operations to expand the reach and scope of their operations. Geographical restrictions were addressed which will allow sound and well managed banks to serve large demand for microfinance services in cities and urban centers. Another significant benefit for microfinance is the provision which allows for the servicing of deposits outside the bank premises. Under the new guidelines, as long as the capital requirements are met, the safety and soundness of the bank is ensured, and that the area of operation is within one hour normal travel time to the head office or branch, the bank may now be authorized to solicit and accept deposits outside their banking premises. This is once again a big advantage for microfinance institutions whose loan officers typically go out into the towns and cities to service their clients<sup>30</sup>.

### 3.2.4 Wholesale Financial Institutions

The credit policy reforms implemented by the government have limited the involvement of Government Financial Institutions (GFIs) to the provision of wholesale funds for retail microfinance institutions. In the case of the Philippines, these include the People's Credit and Finance Corporation (PCFC), the Land Bank of the Philippines (LBP), the Development Bank of the Philippines (DBP), and the Small Business Corporation (SBC).

Aside from government financial institutions, there has also been a growing interest among big commercial banks to provide wholesale funds to MFIs for microfinance operations. The BSP reported that in 2005, it has provided briefings to two commercial banks interested in microfinance. The Bank of the Philippine Islands, one of the biggest commercial bank in the country has recently set up a microfinance unit and is now gearing up to provide wholesale microfinance funds.

The foregoing shows that the provision of microfinance services has reached a certain level of maturity where a good number of MFIs providing retail microfinance services are no longer relying on grant funds nor cheap money for their operations. Most of the MFIs in the country, especially the banks and the big NGOs, are now accessing commercial sources of funds, thereby creating a market niche for big commercial banks that are interested in going into microfinance operations.

### 3.2.5 Insurance Providers

Together with the need for savings and credit services, a number of MFIs have realized that low income households are faced with various types of risks. These risks come in various forms such as illness or injury, death of a family member and, manmade or natural disasters. When faced with these events, the cash flow, liquidity and earning abilities of the poor are disturbed, hence affecting their

<sup>29</sup> The following are the names of the Microfinance-oriented rural banks: Banco ng Masa in Batangas, CARD Rural Bank in Laguna, Vision Bank in Catanduanes and Xavier Tibod Bank in Misamis Oriental. The Microfinance-oriented thrift banks are: Opportunity Microfinance Bank in Antipolo Rizal, Microfinance Maximum Savings Bank in Oriental Mindoro, Kauswagan Bank in Iloilo, Dunganon Bank in Negros Occidental and Micro-Enterprise Bank in Davao del Sur.

<sup>30</sup> Quoted from the 2005 BSP year-end report on microfinance.

ability to continue accessing savings and credit services from a microfinance institution. When clients are not able to manage the risks arising from these circumstances, the MFIs portfolio quality is also affected.

In view of this, several MFIs in the Philippines have initiated the implementation of programs that addresses the risks faced by their microfinance clients. These programs vary from formal to informal types. Informal types include the following: reciprocal lending or “damayan”<sup>31</sup>. Some MFIs provide micro insurance to their clients using the more formal route, e.g. linking up with commercial insurance companies or establishing mutual benefit association.

CARD-MBA pioneered the establishment of its own Mutual Benefit Association (MBA) for its MFI clients. Information from RIMANSI<sup>32</sup> shows that the four partners of RIMANSI (Rural Bank of Talisayon (RBT), Alalay sa Kaunlaran Incorporated (ASKI), Agricultural and Rural Development for Catanduanes (ARDCI) and Kasaganaka) have about 80,000 clients of microinsurance with life insurance coverage. Two of these partners (ASKI and RBT) have already been given MBA license by the Insurance Commission. There are also three RIMANSI partner MFIs (People’s Alternative Livelihood Foundation (PALFSI), USWAG Development Foundation and Kasanyangan Foundation) that are currently enrolled in the CARD MBA BOAT program<sup>33</sup>. A few MFIs, mostly rural banks have partnered or linked up with commercial insurers to provide insurance to their microfinance clients.

RIMANSI has noted that most MFIs that want to provide micro insurance to its members are not equipped to engage in micro insurance business. In almost all cases, they do not have the necessary actuarial and managerial skills to operate a viable and sustainable micro insurance business. Also, they need specific assistance in developing actuarially sound micro insurance products that meet the risk protection needs of the poor.

### **3.3 Donor support to the microfinance sector**

#### *3.3.1 Support from Official Development Assistance.*

The development of the microfinance industry in the Philippines is a result of the concerted effort of the government, donors and the private sector. Donor assistance has been put to good use because the government has endeavored to put in place the right policy environment and has spearheaded efforts in directing donor assistance to areas that has resulted in industry-wide gains and has propelled the industry to its current level of commercialization.

Realizing the need for an appropriate policy and regulatory environment for microfinance to thrive well, the United States Agency for International Development (USAID) provided a three-pronged assistance to the development of microfinance in the Philippines. The first is the support to the National Credit Council (NCC) through the Credit Policy Improvement Program (CPIP) which sought to establish a policy environment that will encourage the private sector to deliver microfinance services. CPIP was implemented from November 1996 to February, 2006. This assistance resulted in the adoption of key policy reforms that has helped the industry to move towards commercialization. Aside from the assistance at the policy level, USAID also provided direct assistance to rural banks that are interested in microfinance through the Microenterprise Access to Banking Services (MABS) project and to credit cooperatives through the Credit Union Enhancement and Strengthening Program (CUES). The MABS is an on-going capability building program (from 1997 to 2007) that provides training and on-site mentoring assistance to rural banks for the effective and efficient delivery of microfinance services. The MABS program also provides specific technologies for microfinance lending and for generating microsavings from microfinance clients. The CUES program on the other hand, provides technical

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<sup>31</sup> “Damayan” is an informal system wherein each MF client contribute a small amount on a regular basis. A fixed amount of money is given to a member if he or a member of his family dies.

<sup>32</sup> RIMANSI is a network of MFIs that are interested in providing micro insurance services to its MFI clients. RIMANSI provides the necessary technical assistance on micro insurance to its member-MFIs. RIMANSI as an organization is discussed further in section 4 of the report.

<sup>33</sup> The CARD MBA BOAT program is a build-operate transfer program wherein the members of the MFI under the boat program will become members of CARD MBA enjoying the same benefits except that the number of legal dependents covered will only be three legal children below 21 years of age. For a period of three years, CARD MBA will provide the necessary technical assistance in putting up the infrastructure for a new MBA for the MFIs clients. After three years, the MFI under the Boat program is expected to already have the expertise and capacity to run its own MBA, hence all the members entitled for the refund of contributions will be turned over to the new MBA with the refunds forming the seed capital.

assistance to partner cooperatives in building financial discipline within the cooperative. Realizing the significant role of credit cooperatives in alleviating poverty, CUES has a Savings and Credit with Education (SCWE) component that serves as the microfinance component of the Project. Through the SCWE, women in the rural areas are organized into village centers and are provided microfinance services through the partner cooperatives. The SCWE component provides assistance to the group in their lending and savings operations. SCWE members are initially considered as associate member of the partner cooperatives until they are able to save enough amount of savings to meet the required share capital contribution to the cooperative. The CUES program is now on its third phase (3-year program starting middle of this year) which will focus on the development of a network of CUES partners that will work together towards the establishment of a deposit insurance facility for its members.

Recognizing that the current policy and regulatory environment needs to be further strengthened to develop the Philippine microfinance industry and build an inclusive financial sector, the Asian Development Bank (ADB) has provided a \$150 million Microfinance Development Program loan to the Philippine government<sup>34</sup>. The assistance will focus on the following: strengthening the regulatory and supervisory capacities of concerned institutions for a sound microfinance sector; building the capacities of MFIs to provide cost-efficient microfinance services to the poor and improving financial literacy and increasing consumer protection for the poor. Accompanying the loan is a \$500,000 technical assistance and a \$900,000 grant which will assist the concerned government agencies in implementing the needed reforms.

The United Nations Development Program (UNDP) also provides technical assistance to MFIs in the Philippines through the Microfinance Sector Strengthening Project (MSSP). MSSP primed both vertical and horizontal outreach growth of breakthrough Microfinance Institutions (MFIs) to promising new and expansion areas. The project also mainstreamed gender concerns in the Microfinance Institutions (MFIs) that are being assisted, thereby helping bridge the income disparity between men and women.

The International Fund for Agricultural Development (IFAD) has also recently funded a program for microfinance. It has two components: micro-credit and support component and the microenterprise promotion and development component. The first component provides loan funds and capacity building assistance to MFIs. Loan funds are provided at market rates through the Small Business Corporation (SBC) while capacity building includes training, systems development and provision of institutional loans and matching grants to enable MFIs to open new microfinance windows in the program target areas. The second component provides efficient, cost-effective and demand-responsive business development services to rural micro-enterprises.

The European Union (EU) has also provided some form of assistance to the sector. EU provide assistance to specific area-based development programs wherein aside from the other development components, they also provide capacity building funds for partner-MFIs in the area where their projects are implemented. For some projects, microfinance loanable funds are deposited and administered by the PCFC. The funds are then provided to their partner MFIs at market rates using the eligibility and creditworthiness' criteria of the wholesale lending institution.

### *3.3.2 Support from MicroNed Member DFOs.*

Aside from official development assistance coming from either bilateral or multilateral sources, the Philippine microfinance industry has also received assistance from Development Finance Organizations (DFOs) and Microfinance Investment Funds (MFIF) in the Netherlands. Table 5 shows the specific areas of assistance provided by various DFOs to the Philippine Microfinance Industry.<sup>35</sup>

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<sup>34</sup> The P150 million loan from ADB is a budget support policy loan. This is a loan directly provided to the GOP to finance the budget. As conditions to the release of the loan, the GOP will implement specific policy reforms for the development of the microfinance sector. Policy reforms include, among other things, the following: establishment of the credit information system, supervision and regulation of financial cooperatives, implementation of a financial literacy program etc.

<sup>35</sup> Dit is aangevuld op basis van NPM database. Dit komt niet overeen met lijstjes die extra aangeleverd zijn. De data op de lijstjes was niet volledig genoeg om in deze tabellen over te nemen

Grants for Financial Service Provider (1st Tier)

	2002	2003	2004	2005
Cordaid	€ 13.529	€ 76.330	€ 190.946	€ 54.018
ICCO	€ 315.441	€ 51.000	€ 56.580	€ 44.650
Novib	€ -	€ -	€ -	€ 87.977
Rabobank Foundation	€ -	€ -	€ 17.000	€ 17.30
DOEN Foundation	€ 373.832	€ 208.448	€ -	€ -
FMO	€ -	€ -	€ 9.584	€ -

Grants for Networks

	2002	2003	2004	2005
Cordaid	€ -	€ -	€ 49.147	€ 25.000
ICCO	€ 22.747	€ -	€ -	€ -
OxfamNovib	€ -	€ 20.000	€ 20.000	€ -

Outstanding loans Financial Service Provider (1<sup>st</sup> Tier)

	31-12-2004	31-12-2005
Cordaid	1.638.940	1.565.118
ICCO <sup>36</sup>	707.024	587.445
OxfamNovib	13.479	15.873
Rabobank Foundation	135.783	154.030
FMO	132.000	-
Oikocredit	2.624.819	5.250.292
TDOEN	327.869	393.701

Reinsurance for Insurance Service Provider (1<sup>st</sup> Tier)

	31-12-2004	31-12-2005
Interpolis	50.000	120.000

The foregoing table shows that the DFOs have provided some €1.5 million in grants and have an outstanding loan balance of €8.1 million to various types of institutions involved in microfinance in the Philippines. A large chunk of the assistance (almost 70 percent of the grant funds and almost all of the loan funds) were given to first-tier financial services provider (i.e. the retail MFIs). The funds were mostly used for capacity building and as loanable funds at the MFI level.

On sector level organizations both Cordaid and ICCO provided support to MCPI the Microfinance Council of the Philippines (MCPI), a network of retail microfinance NGOs<sup>37</sup>, in the period 2002-2005 in the amounts of €98.291 and €139.982<sup>38</sup> respectively. The assistance of Cordaid was focused on institutional support to MCPI whereas the assistance of ICCO was focused on building the capacity of member institution to do market research and develop products tailored to the clients of MFIs. Rabobank Foundation has had long ties NATCCO and the regional cooperative federations MASS-SPEC and VICTO. Rabobank Foundation provided assistance to NATCCO for the development of standard MIS software (Coop Banker) in the amount of €50.000.

### 3.4 Priority needs and support gap to the MFIs

Microfinance is defined as the provision of a broad range of financial services such as credit, savings, insurance, and remittances to the poor. Given the definition and the new vision for microfinance of "building inclusive financial sectors"<sup>39</sup>, there are still a number of areas concerning the development of the Philippine microfinance sector that needs further assistance.

Based on the cursory review of the various assistance provided to the sector, it seems that most of the assistance were focused on two general areas: establishing a responsive and appropriate policy and

<sup>36</sup> Part of this are guarantees outstanding for loans with Oikocredit in the Philippines.

<sup>37</sup> Recently, however, the MCPI has accepted banks and cooperatives as members of the Council. Majority of the members though are still microfinance NGOs.

<sup>38</sup> The money was transferred mainly in 2001. The project ran until December 2005.

<sup>39</sup> This new development paradigm envisions that these services are integrated in all levels of the financial sector

regulatory environment for microfinance and building the capacity of MFIs in delivering microfinance services. The latter, however, was mostly focused on building the capacities of MFIs in providing cost-efficient and effective microfinance (mostly focused on credit, only a few on savings) services to clients. A few (mostly from CordAid and IFAD) focused on the provision of technical assistance for business development services of MF clients.

The following gaps related to the provision of microfinance services by MFIs are identified. The gaps identified here are discussed in terms of the various type of services provided:

#### *3.4.1 Provision of credit services.*

Most microfinance institutions (especially the NGOs) started as credit-granting institutions to micro-entrepreneurs. Based on the current status of the sector, it seems that most of the MFIs have mastered the art of lending to micro-entrepreneurs, collecting from them, ensuring that delinquencies are contained at very low if not zero levels, and maintaining cost-effective and efficient delivery of credit to clients. As clients grow, their needs and demand for credit services also change. In this regard, the microfinance sector needs **assistance in developing new products** that meets the changing demands of current and prospective clients. This will enable MFIs to increase and extend their outreach. Development of the following products including the lending technology that must be used in offering these products is deemed important at this time. The products are:

1. Agri-based loan product especially those used for production purposes. This can be further categorized into loan products for lowland farmers and loan products for upland farmers;
2. Loan products for the frontier areas<sup>40</sup>;
3. Loan products with bigger amounts and longer term. As micro entrepreneurs grow, they would need higher amount of loans with longer term for their growing enterprises.

#### *3.4.2 Technology-based provision of services*

Aside from the development of new products, assistance may also be provided in using technology-based systems (e.g. use of cellphone based technology in payments and use of Personal Digital Assistant in recording loan payments) in lending operations.

As the number of client increases, MFIs need to adopt cost-effective systems to efficiently provide the needed microfinance services. Opportunities from recent innovations using information and communications technology should be exploited. For instance, the Rural Banks Association of the Philippines (RBAP) (about 12 banks) with assistance from the MABS Project, have been using mobile phone technology to facilitate loan payments of microfinance clients. Since MFIs may not be aware of the tremendous results arising from these innovations, assistance on how to take advantage and use these innovations to improve their services may be provided. Use of e-payment solutions for leapfrogging traditional systems (e.g., e-transfers, ATMs, mobile phones and use of Point of Sale devices (POS)) and offering payment services to more poor clients need to be exploited by MFIs.

#### *3.4.3 Provision of savings services*

Other than credit, microfinance clients also need savings services. The country level savings assessment study conducted by CGAP in 2005 reported that available evidence (secondary data, survey results and anecdotal evidences) suggest capacity to save among low-income Filipinos.<sup>41</sup> While some MFIs are able to collect savings from their clients, a number of them do not have a systematic savings program that meets the peculiar needs of the poor (i.e. easily accessible, can save in small amounts, no tedious documentary requirements etc). The CGAP study further notes that "...evidence shows that low income households in the Philippines save in financial institutions if they are given an opportunity that meets their needs. Confidence created through an image of a solid financial institution, as well as active savings promotion campaigns and attractive products, are sufficient to mobilize deposits even from low income clients in a short period of time."<sup>42</sup>

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<sup>40</sup> An ADB technical assistance project to the National Anti-Poverty Commission (NAPC) defined frontier areas as those areas with a poverty incidence of 40 percent with a very low saturation rate of MFIs (less than 20 percent). These are areas with poor infrastructure and in some case have peace and order problem.

<sup>41</sup> For instance, it was mentioned that based on a survey conducted by the Agricultural Credit Policy Council of 749 farming and fishing households, it was revealed that fishing households saved 40 percent of monthly income, while farming households saved 28 percent of monthly income.

<sup>42</sup> CGAP, Philippines, Country level Savings Assessment.

Based on the cursory review of assistance provided to microfinance, only the MABS program funded by USAID has a specific program component that assists its partner MFIs in mobilizing savings from its clients.

Other than the development of savings products appropriate to the needs of the poor, there is also a need to strengthen the institutions that cater to the financial service needs of the poor. As discussed in the previous sections, aside from the rural banks, the cooperatives and the microfinance NGOs, are the institutions that are most accessible to the poor. The CGAP study observed that these institutions tend to have weaker performance due in part to weaker management and governance, and in the case of cooperatives and NGOs, practically nonexistent regulation and supervision.

In this regard, and considering that this is an important financial service for the poor, assistance is needed in the following areas:

1. Specific techniques on generating savings from the poor
2. Development of savings products that meet the demand of small savers
3. Formulation and implementation of appropriate marketing strategies to mobilize small savings
4. Increasing public trust and confidence in the cooperative sector through an effective regulatory and supervisory environment
5. Ensuring prudential safeguards for savings collected by MFIs that are not supervised by any regulatory authority (e.g. microfinance NGOs)<sup>43</sup>

#### *3.4.4 Provision of insurance (microinsurance) services*

Some microfinance institutions (MFIs) have come up with microinsurance products either formally or informally. While establishment of Mutual Benefit Associations (MBAs) for microfinance clients is recognized as an effective way of providing microinsurance most of the MFIs interested in providing micro insurance to their existing clients are not equipped with the necessary managerial and actuarial skills to run a viable micro insurance business. Most of them are not even aware of how to provide micro insurance formally. Since provision of insurance service is very different from the provision of savings and credit services, the microfinance sector in the Philippines needs assistance in the following areas:

1. Developing appropriate and actuarially sound insurance products for the poor
2. Establishing and managing MBAs for MFI clients
3. Linking with commercial insurance companies to provide microinsurance for MFI clients

#### *3.4.5 Provision of services to OFWs*

Remittances from Overseas Filipino Workers (OFWs) contribute billions of pesos every year. "Remittances from overseas Filipino workers (OFWs) coursed through banks continued to post double-digit growth in August 2006 reaching US\$1.09 billion. The sustained rise in remittances brought the year-to-date level to US\$8.10 billion, or a 15.3 percent increase over the comparable period a year ago. Remittances for full year 2006 are expected to reach US\$11.87 billion.... Remittances also rose on the strength of the marketing activities of commercial banks and private remittance agents aimed at extending efficient remittance services to Filipinos abroad and their beneficiaries. These activities include, among others, enhanced modes of remittance transfer; competitive service charges and conversion rates; wider market visibility through product brochures and intensive promotions; increased remittance centers and tie-ups abroad; and enhanced electronic banking services."<sup>44</sup>

A number of these OFWs have families that reside within the operating areas of some MFIs. The volume of remittances provides a good source of resources for most MFIs. MFIs, therefore, need assistance on how they can harness this potential source of financial resources for microfinance operations. Assistance in the following areas are needed:

1. Development of savings instruments that are appropriate to the needs and cash flow of OFWs and their families;

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<sup>43</sup> The country's regulatory framework for microfinance provides that deposit taking institutions should be under prudential regulation. Microfinance NGOs in the Philippines are not under any regulatory authority, however, they are collecting savings from their clients. While the framework states that NGOs are allowed to collect savings up to the amount of the client's borrowings, in most cases, the amount of the client's savings exceed his/her borrowing after a given time.

<sup>44</sup> Lifted from the BSP website, [www.bsp.org.ph](http://www.bsp.org.ph)

2. Marketing and promoting savings products to potential clients (OFWs and families of OFWs) in the MFIs' area of operations.

## 4 Meso level Support to Microfinance

### 4.1 The meso level supporters

Aside from the direct providers of microfinance services, the microfinance industry in the Philippines has a number of meso level supporters. These include the following: associations of banks engaged in microfinance, federations of cooperatives, national and regional association of MFIs, and training service providers. These organizations promote best practice among its member-MFIs and act as lobby groups to promote their interests. They also act as service providers and provide capability building assistance to their member-institutions. As lobby groups, they are instrumental in convincing policymakers and regulators to come up with the appropriate policy and regulatory environment for the microfinance industry<sup>45</sup>.

#### 4.1.1 Rural Bankers Association of the Philippines

The Rural Bankers Association of the Philippines (RBAP) is an organization comprised of rural bank owners and operating officers. The organization's main mission is to support the ability of its members to offer quality banking services to all their constituencies, comply with regulatory requirements, and to promote the welfare of the communities in which they operate. RBAP provides various trainings on corporate governance, risk management, financial management, credit and fund management and other relevant areas that will help rural banks improve their operations. In 1998, the RBAP received a technical assistance from the USAID to implement the Microenterprise Access to Banking Services in Mindanao (MABS-M). The technical assistance is currently still on-going and is providing technical assistance to rural banks going into microfinance. Several rural banks engaged in microfinance have availed of the services provided by the MABS project.

#### 4.1.2 Microfinance Council of the Philippines

The MCPI started as a tactical coalition of NGOs engaged in microfinance. With initial funding from a grant from the United States Agency for International Development (USAID), it started as a coalition with the objective of among other things, developing performance standards for microfinance NGOs. The coalition also provided advocacy work to concerned government agencies for the establishment of an appropriate policy environment for the development of the microfinance sector.

Upon termination of the grant, the coalition was officially registered with the Securities and Exchange Commission and was named as the Microfinance Council of the Philippines with its own Board of Directors. Today, the Microfinance Council of the Philippines, Inc. (MCPI) is a network of 40 institutions comprised of microfinance retailers and allied service institutions that aims to promote the development of the Microfinance industry in the Philippines. The 40 institutions include 33 practitioners and 7 service providers. While membership among the practitioners is currently dominated by non-government organizations (NGOs), the roster of practitioners also includes microfinance-oriented rural banks and one thrift bank. The Council is committed to the reduction of poverty in the Philippines by facilitating equitable access to financial and non-financial resources. The Council aims to do this by among other things, building the capacity of its members to serve poor households in a sustainable, innovative, and client-responsive manner.

In recent years, MCPI has been mostly involved in providing its members capacity building assistance. MCPI has been receiving support from various donors to implement its core activities. For instance, CordAid has provided EUR 98, 291 since 2004 to support MCPI activities. The Inter-Church Organization for Development Cooperation (ICCO), has recently also provided assistance to MCPI to support and strengthen the capacity of member-MFIs to design and develop new and improved financial products for their clients. In 2006 ICCO and Cordaid decided to co-finance the MCPI core-program where ICCO is the lead.

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<sup>45</sup> For instance, the MCPI, the RBAP and the NATCCO has been most active in coming up with position papers on the recent repeal of EO 138. These organizations fear that the repeal of the Executive Order will kill the growing microfinance industry inasmuch as there is a big threat that the government will again be engaged in lending especially to the poor.

As an interest group, MCPI has been very active in advocating for the establishment of a policy and regulatory environment that is supportive of the development of a viable and sustainable microfinance industry. It has participated in various fora and seminars where microfinance policies are discussed and formulated. It has also participated in the development of the Performance Standards for all types of MFIs in the Philippines.

It has also partnered and collaborated with the Microfinance Information Exchange (MIX) in coming up with Benchmarking Report for the Philippines. The 2004 Benchmarking report brings together data on financial performance and outreach measures for 25 leading MFIs and compares the results for 68 microfinance providers throughout Asia as well as with that of Philippine MFIs' local and regional peers in various areas of microfinance operations, e.g. outreach, sustainability and efficiency. At present, the 2005 benchmarking report is still being compiled and processed.

Recognizing the social value of providing microfinance services, the MCPI has also partnered with the Center for Agriculture and Rural Development and the Imp-Act programme in mainstreaming Social Performance Management in microfinance. MCPI has trained 12 MFIs on the SPM course. These 12 MFIs form the informal network of MFIs for SPM in the Philippines. By continuously providing the training on SPM, MCPI hopes to improve practice in SPM and enjoin a number of MFIs who are actively managing their social performance.

#### *4.1.3 Regional Microfinance Councils*

Aside from the Microfinance Council of the Philippines which is organized at the National level, there are also regional microfinance councils. Establishment of the regional councils were initially facilitated by the People's Credit and Finance Corporation (PCFC) for its borrower MFIs in the various areas. The regional councils serve as network of MFIs in the region where best practices in the provision of microfinance services are shared. The regional councils organize forum on microfinance to facilitate exchange of knowledge and networking among member-MFIs. Due to the reality of credit pollution among borrowers, some regional councils are discussing on how they will be able to exchange credit information of their borrowers. To date there are six regional councils have already been formed in the following areas: 1 in Mindanao, 2 in Northern Luzon, 1 in Bicol, 1 in Central Luzon and the most recent one is in Visayas.

#### *4.1.4 Federations of Cooperatives*

The Philippines has more than 70,000 registered cooperatives, about two-thirds of which are operating<sup>46</sup>. Of the operating cooperatives almost 80 percent are engaged in savings and credit services. Under the Cooperative Code and based on cooperative principles, primary cooperatives are enjoined to join cooperative federations. Cooperative federations are organized to provide assistance to its member cooperatives in the area education, business and advocacy. Since the Code does not prohibit multiple membership and does not establish minimum membership in a federation, there has been a proliferation of cooperative federations in the country. The following discussion focused only on the big federations that have primary members that are engaged in microfinance operations.

#### *NATCCO*

The National Federation of Credit Cooperatives (NATCCO) is a financial cooperative network that provides continuous capacity building services to its members in the following areas: good governance, financial management, accounting and bookkeeping, human resource management, management and information system. It also provides ancillary services such as the Federation's liquidity fund. Members are given the option to deposit their excess liquidity with NATCCO which then manages and invests these funds in safe and high yielding investments in behalf of the member. Aside from these business development services provided to its members, NATCCO is also engaged in advocacy work related to the establishment of an appropriate regulatory environment for cooperatives. It is actively involved in various legislative hearings on the proposed amendments to the Code and the CDA charter.

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<sup>46</sup> The actual number of operating cooperatives is still being validated by the Cooperative Development Authority (CDA).

Most recently, NATCCO has designed a microfinance program for its primary members. The microfinance program is called Microfinance Coop (MICOOP)<sup>47</sup>. The MICOOP program provides capacity building assistance in the following areas: i) financial intermediation (savings and credit) operations and ii) microfinance operations. NATCCO believes that only strong, stable and safe coops will be able to deliver microfinance services efficiently and effectively. Hence, the MICOOP program also provides assistance in improving the total savings and credit operations of the participating coop. The MICOOP has several modalities of assistance that a participating coop may choose from:

1. Coop manages the whole microfinance program. NATCCO provides technical assistance on microfinance operations.
2. Coop manages the whole microfinance program. NATCCO provides technical assistance on microfinance operations and lends out initial funds<sup>48</sup> to set up the microfinance branch.
3. Coop enters a joint venture with NATCCO in setting up a branch for microfinance operations.
4. Coop joins the Build-Operate and Transfer program wherein a more stable coop adopts a small, relatively weak coop that plans to engage in microfinance operations. The big coop is paid a franchise fee of P5,000 and is given ½ percent for every peso released by the small coop. The big coop supervises the operations of the small coop, provides the necessary technical assistance and eventually transfers the management to the small coop when it is already stable and operating at a sustainable level. NATCCO provides technical assistance in coordination with the big coop.

To date, NATCCO has already started the MICOOP in 2 coop branches and has 50 coops that have already signified interest to join the program. Cordaid is currently supporting the NATCCO MICOOP program for coops in various regions with EUR 760,000 as a loan and EUR 107,000 as a grant for TA and capacity building. ICCO is providing assistance to NATCCO in the amount of 81,593 EUR in implementing MICOOP in the following areas: Guimaras; Kabankalan, Negros Occidental; Samar and Midsalip, Zamboanga del Sur. Oikocredit will provide the loan complement of EUR 300,000.

### *PFTEC*

The Philippine Federation of Teachers Cooperatives (PFTEC) is a federation of school-based cooperatives that assists in the organization and promotion of cooperatives in the various public schools in the country. Most school-based cooperatives are engaged in the consumer/canteen operations and in savings and credit operations. It also provides technical assistance services to its members in the following areas: savings and credit operations, audit promotion, development of credit products to support additional livelihood of teachers and school employees. To date, PFTEC provides loan funds to member cooperatives whose members want to engage in livelihood activities as additional source of income. PFTEC provides P1 million per cooperative for this type of lending. Other than this, PFTEC does not have a systematic program to assist its member cooperatives in microfinance operations.

### *PFCCO*

The Philippine Federation of Credit Cooperatives (PFCCO) takes pride in the fact that they are the first cooperative federation in the Philippines and in Asia. The federation is still registered as a secondary cooperative with primary credit cooperatives as members. In the recent past, however, PFCCO decided to strengthen their regional leagues and make them secondary federations by itself thereby making the national PFCCO a tertiary federation. As a federation, PFCCO has been mainly involved in providing capacity building and ancillary services to its member primary cooperatives (e.g. conduct of training on governance, financial management and accounting). It is also active in various fora advocating for a more cooperative friendly policy environment. Most recently, PFCCO has been vigilantly involved in the various committee hearings being conducted on the amendments to the Cooperative Code and the CDA charter.

One of the banner programs of PFCCO is their Credit Union Microfinance Innovations Program (CUMI). CUMI is a specially designed product that provides sustainable and affordable access to both savings and credit to entrepreneurial poor that do not have access to formal financial institutions. Under the CUMI, partner cooperatives joining the program provide microfinance loans to the poor in

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<sup>47</sup> Claiming that the coop has always been providing microfinance without the microfinance label, NATCCO conducted a study looking at the best practices of 4 coops doing microfinance. Using the best practices of the 4 coops, NATCCO designed a microfinance program for its members known as the Microfinance Coop (MICOOP).

<sup>48</sup> The initial fund borrowed from NATCCO may include both loan fund and initial outlay to start the microfinance operations.

the community where the cooperative operates. The client is initially considered an associate member until he/she is able to build up his/her enough savings for her share capital contribution. Microfinance loan funds come from the coop's resources. To date, there are 42 participating cooperatives in the CUMI program with a total outreach of about 15,300 member-clients. Total microfinance loans granted under the program is about Php 210 million.

Technical assistance on the specific microfinance lending technology to be adopted by the coop is provided by the PFCCO with funding support from the Association of Asian Confederation of Credit Unions (ACCU). Together with ACCU, Cordaid started a pilot program for CUMI in 1998, which during the past 8 years has been replicated in several countries. The ACCU funding support, however, is already terminating this month.

Realizing the importance of good clients in maintaining a sound microfinance program, PFCCO is now starting to come up with assistance in providing market linkage services to its members. Having several primary cooperatives whose membership varies in terms of products and entrepreneurial activities, PFCCO has started to pilot test the establishment of business development centers which facilitate the exchange of information regarding markets for the various products of the cooperative member. This is an area that is still in the pilot test and would need funding assistance if to be rolled out to its member cooperatives.

#### *Association of CUES partner cooperatives*

This is an association of cooperatives engaged in the provision of savings and credit services in Mindanao that received technical assistance from the Credit Union Enhancement and Strengthening Project (CUES). CUES provided technical assistance to participating cooperatives using the Model Credit Union Building technology of the World Council of Credit Unions (WOCCU). Partner cooperatives that have been given brands and seals of excellence have formed an association with the primary objective of maintaining and ensuring the quality of performance among member cooperatives.

The foregoing discussion on the major federations of cooperatives show that most of them have been involved in capacity building activities related to the management and operations of primary cooperatives. Aside from this, the cooperative federations have also been involved in the on-going discussions related to formulation and development of the Manual of Rules and Regulations for savings and credit cooperatives. With the current thrust of the government to develop the cooperative sector through the effective implementation of appropriate regulation and supervision of cooperatives, most of the federations have started to make their members aware of the current policy directions. A number of them (e.g. PFCCO, NATCCO and PFTEC) have started to provide assistance to enable their members to comply to the rules and regulations and performance standards.

While a number of the federations have started to brief their members on the current thrust on supervision and regulation, most of them do not yet have a full understanding of what their specific roles would be should they be deputized as supervisors. The federations themselves still lack the capacity to perform supervision and examination of cooperatives.

#### *4.1.5 RIMANSI Organization of the Philippines*

The RIMANSI Organization of the Philippines is a network of professionally managed mutual benefit associations. RIMANSI is a microinsurance resource center that provides business development support services to microfinance institutions and other interested organizations that want to provide micro insurance to its clients. It also assists MFIs that are providing informal micro insurance schemes to formalize their micro insurance business. RIMANSI also operates in other Southeast Asian countries such as Cambodia. .

#### *4.1.6 Service Providers*

The increasing number of institutions going into microfinance highlights the need for capacity building. As MFIs expand their operations and as new institutions enter the microfinance market, demand for training and capacity building on microfinance increased. This resulted in the establishment of new institutions engaged in the provision of this type of service. Some of the current service providers in the Philippines are the following: Asian Institute of Management (AIM), Punla sa Tao Foundation, and the CARD Mutually Reinforcing Institutions Development Institute. All of these institutions have various training modules on the different aspects of microfinance operations. CARD MRI development

institute<sup>49</sup>, for instance provides training in the following areas: microfinance management, social performance management, micro-insurance, basic financial management training, internal auditing and financial controls, training of trainers on micro-enterprise management, various lending methodologies, leadership and governance. At present, there are also various universities that are offering management courses, e.g. Ateneo de Manila University and De la Salle university. In Ateneo for instance, they are offering some courses that are focused on management of microfinance operations.

## **4.2 Needs and support gaps at the sector level**

### *4.2.1 Providing business development support services<sup>50</sup> to MFI clients*

Provision of financial services is a necessary but not a sufficient form of assistance to the enterprising poor in improving their income levels. It is observed that most of the clients of microfinance services are often engaged in the same livelihood or income generating activities posing stiff competition in the market for their products.

Also, it is observed that some MFIs prefer to lend out to those clients who are already engaged in a microenterprise hence, leaving out the poor that may have the potential but do not yet have the capacity to start a business. Most MFIs have opted to cater to clients that are already engaged in enterprise activities, to ensure repayment of loans. A number of the poor, however, are not engaged in any entrepreneurial activity, hence they are not able to access MF services. Some MFIs, however, have tried to link up with the Technology Resource and Livelihood Center (TLRC), a government corporation engaged in providing training and mentoring activities related to the provision of skills and technical know-how on the various aspects of livelihood industries. Others are providing BDS services to their clients on their own, e.g. Taytay Sa Kauswagan Inc (TSKI) and Alalay sa Kaunlaran Inc (ASKI), both are microfinance NGOs.

In this regard, another area of assistance for the microfinance sector is on combining Business Development Services (BDS) with credit operations. Business development services may be provided to existing and prospective clients of microfinance. Since provision of BDS would entail costs on the part of MFIs, they need assistance in developing ways by which they can provide BDS efficiently and on how they should incorporate the associated costs in the price of the loan without unduly taxing the client (through increased cost of the loan). Aside from providing assistance on how to engage in a specific enterprise, BDS should also include facilitation of market linkages for the products of microfinance clients. Realizing the need for this type of services, PFCCO is currently working on a program that would facilitate market linkages for its member primary cooperatives.

As a support service to clients of microfinance, assistance may be given to various federations and associations of MFIs in coming up with programs that will support the marketing of the clients' products. As observed, MF clients in a specific geographic location are often involved in the same kind of enterprise making product marketing difficult and competition stiff. Assistance may be provided in developing higher value entrepreneurial activities for the clients of microfinance and in facilitating market linkages for the products of microentrepreneurs.

### *4.2.2 Improving the credit information system for MF clients*

Another problem faced by MFIs is the risk of credit pollution. As the number of institutions engaged in microfinance increase, some clients have learned the art of borrowing from multiple sources resulting in credit pollution. In view of this, the establishment of a comprehensive credit information system that is accessible to MFIs would be very helpful to the microfinance industry. While there is already a bill in Congress that seeks to establish the credit information system in the country and make submission of credit information to the system mandatory for all regulated financial institution, it is likely that the bill

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<sup>49</sup> CARD MRI Development Institute was primarily established to serve its CARD MRI staff members. Over time and based on demand from other MFIs, the institute offered training courses and sponsored study tours and exchange visits for the staff members of other MFIs. The experiences of CARD as one of the leading microfinance institution in the country has been one of the reason why most MFIs avail of the training courses under the institute.

<sup>50</sup> The Department of Trade and Industry (DTI) has established provincial business development centers (called as small and medium enterprise centers, SME centers) whose main function is to provide information and facilitate linkages on where prospective SME and micro investors can get specific business development services assistance.

may not yet be passed in the immediate future in view of the current discussions on the charter change. Considering the importance of knowing the credit standing of MF clients and the increasing likelihood of multiple borrowings among clients, MFIs must be able to participate and make effective use of a credit information system. This could be done by participating in any of the existing credit bureaus in the country. Since most MFIs are not familiar with credit bureau operations, assistance may be provided on how they can reasonably participate and provide information to a credit bureau<sup>51</sup>. The NATCCO has some experience on this inasmuch as it has enjoined its members to join the Credit Investigation Bureau Inc. (CIBI) credit bureau. Or alternatively, MFIs located in contiguous areas may cooperate and exchange credit information about their clients.

#### *4.2.3 Improving financial literacy*

As the number of financial institutions engaged in microfinance services increase, there is always the fear that the plight of the poor maybe taken advantage of. For instance, some camps view the adoption of market-based interest rates as a license to take advantage of the poor because these allows MFIs to impose prohibitively high cost of credit. While this may not be obvious in the nominal rates charged to the clients, there are some suspicions that cost of credit is increased through hidden charges. In view of this, there is a need to make sure that the clients themselves are aware and are informed of their rights and responsibilities (e.g. truth in lending). Since this is a relatively new area, there is a need for assistance in developing relevant training and advocacy modules on financial literacy. The modules may include, among other things, consumer protection, managing financial resources, basic concepts of microfinance, and rights and responsibilities as clients of microfinance services.

#### *4.2.4 Development of a microfinance database and indicator system for monitoring purposes*

As discussed earlier, the Philippine microfinance industry is comprised of various types of service providers, i.e. the banks, the microfinance NGOs and the cooperatives. Being under different supervisory authorities (i.e. the banks are supervised by the BSP, the cooperatives are supervised by the Cooperative Development Authority (CDA), and the microfinance NGOs are not supervised at all), reporting systems vary. While systematic information on the financial status of banks engaged in microfinance is readily available from the BSP, similar data from the cooperatives engaged in microfinance and the microfinance NGOs is scant. There is no single consolidated information that could be used to determine status and performance of the industry. This information is deemed essential in coming up with effective advocacy materials for politicians, legislators and bureaucrats who wants government to directly intervene in the microfinance market. Politicians always believe that the poor needs credit from government. Hence, it is always useful to show to them that the private sector through the MFIs are already doing a great job in providing the poor access to financial services. In view of this, there is a need to come up with a comprehensive and systematic database and information system. Since there is already a set of performance standards that cuts across all types of MFIs, the data from the system can be used to rate the performance of the industry, by various dimensions (e.g. type of provider, size of institutions etc) using the PESO standards and indicator system. Establishment of an effective database and information system would be useful to wholesalers of microfinance funds and prospective investors in the sector.

#### *4.2.5 Improving the supervisory capacity of cooperative federations*

As mentioned in the earlier part of the paper, cooperatives in the Philippines have a strong potential for the delivery of microfinance services since they are most accessible to the poor. It was also mentioned earlier that at present majority of the cooperatives, especially those engaged in the provision of savings and credit services have weak performance due to poor management and governance and the lack of regulation and supervision. The lack of regulation and supervision for cooperatives is due to the lack of capacity on the part of the government mandated authority to effectively regulate. Realizing this, the CDA<sup>52</sup> has recently refocused its thrust towards effective regulation and supervision. Given the number of cooperatives in the country, CDA plans to deputize cooperative federations to supervise and examine primary cooperatives. To date, the Manual of Rules

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<sup>51</sup> At present there are three private credit bureaus (the Bankers Association of the Philippines Credit bureau, the Credit investigation Bureau Inc. and the PhilBizInfo, a Dan and Bradstreet subsidiary) operating in the country. Participation in these credit bureaus, are however, still very limited resulting in a wait and see who participates attitude among most financial institutions.

<sup>52</sup> The Cooperative Development Authority is the legally mandated entity to regulate and supervise the cooperative sector.

and Regulations (MORR) is already being finalized by the CDA and the NCC and is expected to be completed within the year. The supervision and examination manual which will be used by the deputized cooperative federations is yet to be drafted and formulated under the on-going ADB grant for the development of financial cooperatives<sup>53</sup>. The supervision manual is expected to be finalized by year 2007. At present, all cooperative federations (even the big ones) lack the necessary expertise and capacity to supervise and examine cooperatives. In this regard, all the cooperative federations need assistance in the supervision and examination of cooperatives. This is deemed important for the microfinance sector since only strong, stable, safe and sound cooperatives will be able to deliver microfinance services efficiently and effectively.

#### *4.2.6 Provision of capacity building for the provision of micro insurance*

Recognizing the importance of micro insurance in enabling the poor to cope with risks and the current lack of capacity among most MFIs on how to effectively and sustainably provide actuarially sound micro insurance services to their clients, there is a need to provide the necessary assistance for micro insurance at the sector level. Capacity of networks and associations engaged in providing business development services to institutions engaged or contemplating to engage in micro insurance should be strengthened. Realizing the role of an appropriate regulatory environment for the promotion and effective delivery of micro insurance, these networks should be strengthened to be able to articulate and advocate for sound and appropriate regulatory policies that would encourage the provision of micro insurance by the private sector, including commercial insurance companies. For instance, the Insurance Commission has recently increased the amount of guaranty fund required from MBAs from P10,000 to P12.5 million for existing MBAs. By 2007, the amount of guaranty fund will be increased to P125 million for new MBAs. Since this may be too prohibitive for MFIs creating their own MBAs, advocacy on appropriate regulation for micro insurance should be given due importance.

#### *4.2.7 Strengthening capacity of networks and association for advocacy*

The growth and commercialization of the microfinance industry in the Philippines has largely been due to the government's adoption of a market-based policy and regulatory environment. Since 1997, the government implemented the National Strategy for Microfinance which paved the way for greater private sector participation and less government intervention in the microfinance market. While these policies are now in place and laws supportive of the National Strategy have already been enacted, the threat of policy reversal remains real as evidenced by the most recent repeal of EO 138. This created a great apprehension in the sector since this will have a negative impact on the microfinance industry. While considerable efforts were exerted to give opinion and create advocacy against the repeal, there seems to be no systematic and strategic plan of action on the part of the networks and associations on how to advocate against the repeal.

Considering the political attractiveness of microfinance, there is always a tendency for politicians to come up with programs and policies that may be inimical to the growth and development of a privately-led microfinance industry. In this regard, the private sector participants in the microfinance market through the various networks and federations should remain vigilant in making sure that the government continues to pursue the appropriate policy and regulatory environment for microfinance. Networks and associations supporting the microfinance market should be appropriately equipped to lobby and advocate against any move to bring back the old subsidized credit regime that is a poison pill to the growth of the microfinance market. Aside from this, the networks should also be given assistance in terms of developing and implementing advocacy strategies for both the executive and legislative branch of government.<sup>54</sup>

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<sup>53</sup> The ADB grant for developing financial cooperatives is mainly focused on developing the capacity of CDA as the regulatory authority. There is no specific component on building the capacities of deputized supervisors in examination and supervision processes.

<sup>54</sup> For instance, there is now a call to support one Congressman who plans to draft a bill that essentially contains the provisions of EO 138. The private sector through the Microfinance Council has been gathering support from all concerned individuals and institutions.

## 5 Conclusion and Recommendation

Microfinance plays a crucial role in the poverty alleviation thrust of the Philippine government. Realizing that the government is a poor creditor, the Philippines took the right step by providing the appropriate policy and regulatory environment to enjoin the private microfinance institutions to provide the needed financial services to the poor<sup>55</sup>. From only about 55 banks in 2000, there are now about 204 banks engaged in microfinance operations serving about 600,000 clients. These banks are able to mobilize deposits from the public and access commercial sources of funds from both government and private wholesale institutions. The cooperatives on the other hand, are able to mobilize deposits from their members. While only a few are implementing a systematic approach to microfinance, most cooperatives claim that they have long been providing finance to the poor since most members of the cooperatives belong to the low income segment of the population. A number of these cooperatives were also able to borrow from commercial sources although most of them used their own funds (from savings and share capital of members) to finance their microfinance operations. The microfinance NGOs mostly started from grants provided by donor institutions. To date, however, a few big NGOs have transformed into banks and the remaining big ones are already able to access commercial funds from government financial institutions or from the private sector. Based on the classification of microfinance institutions in the MicroNed inception report, the Philippine microfinance sector may be described as an industry with a mix of emerging and commercial MFIs. There are, however, still a number of starting MFIs, that has not yet reached a level of sustainability and would need grants for assistance<sup>56</sup>. Comprised mostly by emerging and commercializing MFIs, assistance to the Philippine microfinance sector should be aimed at further developing the microfinance market by improving and strengthening the capacities of all the players (clients and MFIs) and by providing the needed infrastructure support for the sector.

Given the foregoing, strategic assistance to the Philippine Microfinance sector should be focused in the following areas: i.) support to the clients of microfinance; ii.) support to the MFIs as a sector and iii.) support to networks, associations and federations providing assistance to MFIs. Since the foregoing sections already discussed each of these areas of assistance, this section suggests some specific activities that might be considered in the formulation of the Country Development Strategy.

### 5.1 Support to clients of microfinance services

#### 5.1.1 Provision of business development service.

While there has been a growing interest in the provision of microfinance services among private financial institutions, there has not been much activity regarding improving the capacity of the clients in maximizing the gains from having access to financial services. This other side of the market should also be given attention if microfinance is expected to contribute in the poverty alleviation thrust of the government. Assistance in the following areas may be provided:

1. Establishment of business development centers that will facilitate market linkages for the products of the different MF clients in a specific area. The business development centers may also be tapped to identify specific resources for microentrepreneur;
2. Conduct of training and mentoring activities on specific livelihood and income generating projects and in developing and enhancing skills in any of the following: marketing, management, quality control, product development, financial management.

#### 5.1.2 Improving financial literacy

This is a relatively new area of assistance but has been given emphasis lately as the global movement for microfinance move towards building an inclusive financial sector. The National Anti-Poverty Commission (NAPC) under the technical assistance for the ADB-funded Microfinance Development Program is expected to develop a national financial literacy program for the poor. Taking off from what will be developed and implemented by the NAPC, the networks and associations of MFIs may

<sup>55</sup> As mentioned in an earlier section of this paper, there is growing apprehension among the players in microfinance that this policy is being reversed with the issuance of EO 558, repealing EO 138. The issuance of a clarificatory EO is now being discussed.

<sup>56</sup> It is the author's view that starting MFIs may be provided start-up grants that is time-bound and with specific conditions to meet specific performance standards (the PESO standard may be used). Prolonged assistance to an MFI on the same area of operations is deemed not healthy as this is considered perpetuating donor dependence. Assistance to an MFI may be extended provided that the assistance is meant to expand operations in currently unserved areas.

collaborate with NAPC in making sure that current and prospective clients of microfinance are able to participate in the financial literacy program. Assistance may be provided in the following:

1. Review of the current policy and regulatory environment for consumer protection with special reference to the provision of financial services to the poor;
2. Conduct of advocacy and collaborating with concerned government agency in the development of a financial literacy program that meets the needs of the clients of microfinance. The program should be focused, among other things, on raising the level of awareness of the poor with regards to their rights and privileges as borrowers/clients of financial services (e.g. truth in lending act seminars)
3. Conduct of seminars on any of the following: basic concepts of microfinance; various savings instruments available (e.g. short and long term savings products, insurance); managing financial resources (including debt and savings).

## **5.2 Support to the MFI sector**

### *5.2.1 Development of MF products (savings and credit products) for the rural, agriculture and upland clients*

The needs of microfinance clients are varied, dynamic and changes over time. As clients grow, their demand for services also changes. In the same manner, as MFIs expand their outreach in the rural, upland and other frontier areas, the financial needs of clients in these areas are also different. Hence the need to provide assistance to MFIs in developing new products. Development of new products should, however, not be limited to credit products only. Evidence shows that the poor can save. Hence it is also important that assistance be given in the development and marketing of savings products for the poor. Assistance in the following may be considered:

1. Establishment of a product innovation fund which could be used to develop new MF products (agri and rural microfinance, loans for microentrepreneurs needing bigger amount of capital, loans for clients in upland areas, loans for prospective clients in the frontier areas) suited to the current needs of the clients. This fund should be made available to MFIs as they innovate and develop new loan and savings products (e.g. development of savings products that meet the demand of small savers).
2. Specific techniques on generating savings from the poor;
3. Formulation and implementation of appropriate marketing strategies to mobilize small savings.

### *5.2.2 Implementing social performance management within the MFI*

As MFIs grow and commercialize, the threat of mission drift is always something that must be guarded against. Implementing and adopting social performance management for MFIs is a way by which this threat can be averted. In this regard, assistance to MFIs in adopting and implementing this tool would help the industry maintain its focus on the poor. The assistance may take off from what the MCPI in coordination with the ImpAct program has already developed.

### *5.2.3 Establishment of a credit information system for MFIs*

As clients become more aware of the increasing number of microfinance providers, the tendency for multiple borrowings resulting in credit pollution increases. While there is already a pending bill in Congress that will make the submission of credit information to a credit bureau mandatory, it is important at this point that MFIs be made aware of the importance of a credit bureau. The following assistance may be considered in this regard.

1. Facilitating linkages with existing credit bureaus including assistance to MFIs in generating the necessary report and information for submission to credit bureau;
2. Pending approval of a bill, establishment of a credit information exchange system among MFIs in contiguous areas of operation. Using this system, MFIs in a certain area can exchange credit information about their clients, hence preventing clients to borrow beyond their credit capacity from multiple sources.

## **5.3 Support to networks, associations and federations**

### *5.3.1 Building and strengthening capacities of cooperative federations in the supervision and examination of primary cooperatives*

It seems that both the government and the cooperative sector are in agreement that to increase public trust and confidence in the cooperative sector, an effective regulatory and supervisory environment

should be present. Given this thrust and the plan of government to accredit cooperative federations and deputize them to supervise and examine cooperatives, there is a strong and urgent need to build the capacities of cooperative federations to effectively supervise and examine primary cooperatives. Assistance in the following areas may be provided:

1. Building the supervisory and examination capacities of cooperative federations with special focus on governance;
2. Establishing appropriate systems for off-site and on-site supervision of primary cooperatives

### *5.3.2 Building and strengthening capacities of networks supporting microinsurance.*

Anecdotal evidence show that providing the poor access to savings and credit services is not sufficient to enable the poor to cope with the risks they face. In most cases, poor households are not able to cope with the risks brought about by large and uncertain losses, highlighting the importance of providing micro insurance. Recognizing this need, some MFIs have started to provide micro insurance on an informal basis. Since provision of microinsurance require a specific set of skills and capacity, there is a need to provide appropriate business development services to institutions that want to provide micro insurance. In this regard, it would be useful to provide assistance to networks already engage in this business. Assistance in the following areas would be useful:

1. Provision of technical assistance services to enable micro insurance entities to provide and manage safe and actuarially sound micro insurance business;
2. Implementation of an advocacy program that is focused on the establishment of a regulatory environment that will encourage and promote the provision of safe and sound micro insurance business;.
3. Establishment of appropriate performance standards for micro insurance that could be used by both regulators and management of micro insurance business for safe and sound operations.

### *5.3.3 Establishing a standard chart of accounts for microfinance NGOs and a microfinance database and indicator system*

At present, there is no systematic set of information regarding status and performance of the microfinance industry in the Philippines. Only the banks have organized and readily available set of information regarding their microfinance operations. Information on the performance and operations of NGOs and cooperatives are scant. Available information regarding the operations of these institutions are mostly from wholesale financial institutions which may not be complete inasmuch as some MFIs are not getting wholesale loan funds for their microfinance operations. Assistance in developing a microfinance database and indicator system is therefore deemed useful and important as the microfinance industry in the country matures. This information will be useful to rating agencies and future investors in microfinance. This information would also come in handy and useful in coming up with advocacy materials that Assistance may be focused in the following areas:

1. Establishment of a microfinance database and indicator system using the PESO performance standards;
2. Establishment of a standard chart of accounts for microfinance NGOs. While CGAP has already circulated a standard for the use of microfinance NGOs, this is still not being used by NGOs making comparison difficult. SEC has recently issued a memorandum circular requiring all NGOs engaged in microfinance services to disclose such in their general information sheet which is required to be submitted annually along with their financial statements. SEC may be convinced to require the adoption of a standard chart of accounts for microfinance NGOs. This will enable the concerned regulatory authorities to determine who among the NGOs are collecting savings beyond the borrowings of their members.

## Annex 1: Directory of Contact Persons

Contact Person	Focus of Interview
<p>Dir. Joselito S. Almario National Credit Council 4th Floor, Department of Finance Building Bangko Sentral ng Pilipinas Roxas Blvd. Manila <a href="http://www.dof.gov.ph">www.dof.gov.ph</a></p>	<p>Interview was focused on the various policy initiatives of government relating to Microfinance. Discussions on the following were also done: on the regulatory framework, performance standards for microfinance, regulatory environment for savings and credit cooperatives and manual of rules and regulations.</p>
<p>Ms. Pia Roman Microfinance Unit Bangko Sentral ng Pilipinas Roxas Blvd. Manila <a href="http://www.bsp.gov.ph">www.bsp.gov.ph</a></p>	<p>Interview was focused on the regulatory environment for banks engaged in microfinance and the credit bureau bill. Data on banks engaged in microfinance was also gathered.</p>
<p>Mr. Eduardo Garcia Jollibee Plaza, Ortigas Pasig City Microfinance Council of the Philippines Tel. No. +63-9167282939</p>	<p>Interview was focused on the current activities and initiatives of the microfinance council. Specific discussion was also focused on the social performance monitoring project that MCPI collaborated with CARD.</p>
<p>Mr. Cresente Paez/Mr. Alex Almendral National Federation of Credit Cooperatives (NATCCO) 227 J.P. Rizal St. Project 4, Quezon City Tel. No. +632-9136005/7016 <a href="mailto:ccpaez@natcco.coop">ccpaez@natcco.coop</a> <a href="http://www.natcco.coop">www.natcco.coop</a></p>	<p>Interview was focused on the following:</p> <ul style="list-style-type: none"> <li>▪ Current activities on microfinance</li> <li>▪ Assistance related to microfinance activities</li> <li>▪ Needs and perceived gaps for the federation to function effectively</li> </ul>
<p>Mr. Mario Arenas/Mr. Ed Bato Philippine Federation of Credit Cooperatives (PFCCO) Gen. T. De Leon Valenzuela City Tel. No. +632-2774738/4487605 <a href="mailto:Mar7arenas@yahoo.com">Mar7arenas@yahoo.com</a> <a href="http://www.pfcco.coop">www.pfcco.coop</a></p>	<p>Interview was focused on the following:</p> <ul style="list-style-type: none"> <li>▪ Current activities on microfinance</li> <li>▪ Assistance related to microfinance activities</li> <li>▪ Needs and perceived gaps for the federation to function effectively</li> </ul>
<p>Ms. Lucy Furo Philippine Federation of Teachers Cooperatives Rm 307 and 308 Educators' Community Center DepED Complex Meralco Avenue, Pasig City Tel. No. +63-9189138018</p>	<p>Interview was focused on the following:</p> <ul style="list-style-type: none"> <li>▪ Current activities on microfinance</li> <li>▪ Assistance related to microfinance activities</li> <li>▪ Needs and perceived gaps for the federation to function effectively</li> </ul>
<p>Mr. Luis Sasuman Credit Union Enhancement and Strengthening Program Davao City +63-9177012116</p>	<p>Interview was focused on the following:</p> <ul style="list-style-type: none"> <li>▪ Current activities on microfinance</li> <li>▪ Assistance related to microfinance activities</li> <li>▪ Needs and perceived gaps for the federation to function effectively</li> </ul>
<p>Mr. Epifanio Maniebo/Ms. Luville Marin RIMANSI Organization of the Philippines Medical Plaza Building Ortigas Center, Mandaluyong City</p>	<p>Interview was focused on the activities of RIMANSI on micro insurance. Specific information on the operations of their partner MFIs already engaged in the provision of micro insurance was also gathered.</p>

## **ANNEX 2: References**

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