

Country Profile



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A little over half a century ago, the Philippines appeared ideally positioned to develop rapidly as the world recovered from the devastation of World War II. The country had high levels of education and English literacy, decent savings rates, and an export-oriented agricultural sector that generated more than sufficient foreign exchange.

However, the Philippines followed a path of dependent development that failed to build domestic capital or pave the way for healthy and balanced development. Instead of growth and stability, the country faced decades of political crisis marked by massive corruption by government officials and the private sector, the insurmountable government debt, the accelerating polarization between the rich and the poor, the out-of-control population growth, and the continued increase in the number of poor Filipinos.

Needs for Microfinance

In a country with a population of 85.2 million in 2005, poverty remains to be one of the biggest problems in the Philippines. Poverty estimates by the National Statistical Coordination Board (NSCB) in the year 2000 reveal that the proportion of families with per capita incomes below the poverty threshold is 28.4 percent while the poverty incidence of the population as a whole for the same year is 34.0 percent. In absolute figures, about 4.3 million families or 26.5 million Filipinos are considered poor. Results of the latest Census 2000 indicate that 52.95% of the population live in rural areas.

The Philippine financial system is composed of formal and informal financial sector that are either regulated or non-regulated. The informal financial sector is composed of a variety of organized and singular sources of credit. On the other hand, the formal financial sector includes banking institutions that are authorized to provide credit and accept deposits from the general public. Non-bank institutions are also part of the formal financial sub-system. These non-bank institutions are authorized to provide credit but are not allowed to accept deposits from the public.

The banking system is composed of the commercial banks (universal and ordinary commercial banks), thrift banks, rural banks (rural banks and cooperative rural banks), and government banks. There are 42 universal and commercial banks, 87 thrift banks, and 764 rural/cooperative banks in the Philippines. It is estimated that 50 percent of banking offices of commercial banks are located in Metro Manila, while most banking offices of thrift and rural banks are outside Metro Manila. Offices and branches of rural banks are widely spread in rural areas. In general, commercial and thrift banks in the Philippines are not engaged in microfinance because they have no expertise in handling small loans without any collateral.

Studies show that microfinance services were delivered to only one third of the total poor households in the Philippines. This indicates that the potential market for microfinance institutions in the Philippines is 2.9 million families.

Microfinance Sector Development

Chronology

Rural banks and cooperatives started the concept and practice of servicing small loans as early as the 1950s. Agricultural workers and fisher folks benefited from this initial access to small credit. The said banks could not sustain the program, however, because of low repayment rate and some structural problems in the scheme.

During the 1970s until mid-1980s, the government mobilized rural banks, development banks and other government financial institutions to provide highly subsidized credit to the rural poor. The government, through its directed credit programs (DCPs), had hoped to bring down the cost of credit and help ease poverty. However, reflecting the broader political culture of the Marcos regime, and just like the first attempt of rural banks and cooperatives to provide small credit to the rural poor, the DCPs failed. This was due mainly to the following: a) DCPs did not reach the target clientele; instead, subsidies were cornered by big borrowers; b) DCPs bred corruption at different levels because these involved government funds; and c) massive repayment problems resulted in huge fiscal costs for the government.

The lessons learned in the implementation of various government credit programs in the 70s and 80s contributed greatly in developing the practice and operations of microfinance – a new approach in credit methodology. In the late 80s, non-government organizations (NGOs) became potent partners of a new, democratic, government in the fight against poverty. Through microfinance, they provided the much-needed small loans for small entrepreneurial activities. Microfinance NGOs devised alternative options for non-collateralized loans and savings instruments for the poor. These NGOs provided individual and group lending, but used group pressure or group accountability as collateral substitute. Although certain regulatory issues initially impeded microfinance NGOs, they ably met the needs of the entrepreneurial poor.

In 1989, the Grameen Bank Replication Project was implemented by the Agricultural Credit Policy Council, an attached agency of the Department of Agriculture. The project was implemented specifically through NGOs. This further underscored the role of the private sector in providing microcredit. The Philippines was among the first group of countries to replicate Grameen banking on a large scale with 27 replicators. Much of the success of Grameen banking in the Philippines can be attributed to its high repayment rate, although sustainability of the program posed a threat.

In 1996, a group of microfinance NGOs in the Philippines initiated the “Developing Standards for Microfinance Project”, to address the lack of capacity of Philippine MFIs to reach the poor on a sustainable basis. The project was funded by the United States Agency for International Development (USAID) and its goal was to develop performance standards to achieve increased outreach and sustainability.

Growing interest in microfinance within the formal financial sector led to the establishment of a new program supported by the Rural Bankers Association of the Philippines and funded by USAID. The Microenterprise Access to Banking Services (MABS) Program helped rural banks to develop sustainable microfinance strategies that focused on providing both loans and deposit services. Since its inception in 1998, over 80 participating rural banks have provided 8 billion pesos of loans to more than 245,000 borrowers and expanded the number of micro deposit accounts reaching more than 310,000 new micro-depositors.

Government policies in the last decade brought about reforms to streamline microfinancing in the Philippines. The National Credit Council (NCC), an interagency body under the Department of Finance established in 1993, crafted in January 1997 the National Strategy for Microfinance (NSM) with the vision of having a viable and sustainable private microfinance market. The strategy’s main objective is to provide low-income households and microenterprises access to financial services. (*Source: Microfinance Handbook, Bangko Sentral ng Pilipinas*)

At present, there are three major providers of microfinance services in the Philippines: NGOs, rural banks, and cooperatives. It is estimated that 500 NGOs and 4,579 savings and credit cooperatives are engaged in microfinance. Many other types of registered cooperatives also provide some form of financial services. As of December 2005, there were 195 banks engaged in microfinance. Four of these banks are microfinance oriented thrift banks and another four are microfinance oriented rural banks. The remaining 187 banks are rural and cooperative rural banks engaged in some level of microfinance operations ranging from 3% to 40% of their gross loan portfolio.

Competition

In the Philippines, an indication of increasing competition in the microfinance industry is the rising incidence of credit ‘pollution’ among MFI clients. This term refers to a situation where borrowers take advantage of the availability of credit by borrowing from multiple MFIs. This is a result of the growing number of microfinance providers such as NGOs, rural banks, and cooperatives operating in similar geographical areas within the country. In addition, loan sharks and informal

moneylenders offer credit with faster loan releases but with higher interest rates. However, competition is intense only in areas where MFIs are highly concentrated such as Metro Manila, Central Luzon, and Southern Tagalog and it is in such areas that credit pollution is found.

As indicated above, there are a growing number of MFI players in the Philippines. Greater competition also has positive outcomes. MFIs deal with increased competition by broadening the range of their services to include savings, microinsurance, and micro-agricultural loan products. In addition, MFIs offer non-financial services to clients such as client trainings, livelihood skills development, product development, and marketing. By offering these additional services to clients, MFIs try to differentiate themselves from other MFIs. In a competitive market, it is expected that prices (interest rates) will decrease. However, an indication that competition in Philippine microfinance is not yet cutthroat is that interest rates have yet to decrease. MFIs have more levers of differentiation by offering more services to poor clients. The interest rate of their loan products is the last thing that MFIs will alter.

Challenges

One emerging challenge among microfinance providers is the spread of credit pollution, as mentioned above. Interviews with borrowers with loan collection problems indicate that they got a loan from one MFI in order to repay their loan with another MFI. Because of this practice, MFIs encounter loan collection problems.

In relation to this, the NCC and BSP have taken steps to establish a credit information bureau to service the requirements of MFIs. A bill for the proposed credit bureau is presently under deliberation in the House of Representatives. This is an attempt of the BSP to contain and eventually eradicate credit pollution. The credit information bureau is an important infrastructure to increase financial transparency and promote a more efficient microfinance sector.

In the JBIC Pilot Study on Sustainable Microfinance for Poverty Reduction in the Philippines¹, another challenge for the microfinance industry is the good governance of financial institutions. Board members of family-owned rural banks may be expected to practice good governance to protect their investments. However, rural banks also need to include independent Board members to provide expert advice on the bank's financial operations. On the other hand, cooperatives and NGOs need to improve the quality of their Boards whose members serve on a voluntary basis. In the absence of personal investments in the MFI, volunteer Boards may not be able to implement the appropriate management systems required in managing an MFI.

Another challenge indicated in the JBIC Study is the product development skills of MFIs. Many MFIs continue to consider their clients as recipients of credit programs instead of customers that need to be satisfied. However, client preferences change over time. MFIs need to respond to these changes by introducing and/or restructuring their loan products. Large MFIs like Negros Women for Tomorrow Foundation, Inc. (NWTF), TSPI Development Corporation (TSPI), and the Center for Agriculture and Rural Development (CARD) already responded to these changes by forming separate research units with the primary function of studying the changing preferences of clients. To keep MFIs in-tune with the changing needs of their poor clients, research and continuous product innovation will continue to play a vital role in the industry's continuous efforts to uplift the lives of the poor. Meeting client needs will result in high demand for microfinance services among the poor, in turn, facilitating strong cooperation of clients and faster outreach for the MFIs.

One challenge raised by Dr. Gilberto Llanto in a PIDS Policy Note² is building the capacity of microfinance institutions to lend to more clients, either by going down-market to poorer clients, going up-market to larger microenterprises, or including market segments that have been previously excluded by microfinance services. Thus, the government and donors may develop a systematic and sustained program of providing technical assistance to the MFIs in various areas such as strategic planning, financial management, audit and control system, basic banking skills, simple accounting and financial analysis and MIS, loan delinquency management, asset and liability management, product development and packaging, risk management, appropriate pricing of financial products, information tools and appraisal systems, internal control, human resource development and client development.

Another challenge is the need for MFIs to expand their operations in areas with a high magnitude of poor families and where access to microfinance is limited. In deepening outreach among the poor, MFIs are faced with the costs and risks involved in expanding to hard-to-reach areas. Some of the challenges involved in serving the bottom segment of the poor are the need for capital for expansion and the appropriate infrastructure to support operations in very poor communities.

Another issue is the regulation of NGOs engaged in microfinance. All NGOs, including those engaged in microfinance, are required to register with the Securities and Exchange Commission (SEC) as non-stock, non-profit organizations.

¹ JBIC Pilot Study on Sustainable Microfinance for Poverty Reduction in the Philippines - Final Report, Japan Bank for International Cooperation, November 2004

² Microfinance in the Philippines: Status, Issues, and Challenges, Policy Notes No. 2004-10, Gilberto M. Llanto, Philippine Institute for Development Studies, November 2004

Although microfinance NGOs are required to file annual audited financial statements and general information sheets to the SEC, they are not subject to prudential regulation and supervision by any government regulatory authority. However, in relation to the issue of regulation, enforcing standards may stifle innovation and lead to the stagnation of the microfinance industry. Therefore, there is a need to balance the use of prudential regulations particularly among NGOs engaged in microfinance.

An emerging issue in the Philippine microfinance industry is the use of performance standards. The NCC has developed a set of performance standards to be applied to all types of microfinance institutions in the Philippines. The use of the performance standards by MFIs will help them observe financial discipline and governance and establish their credibility in the financial markets. Access to commercial sources of capital will be facilitated if MFIs can show adherence to certain performance standards that provide an objective basis for judging their financial performance. At present, however, the performance standards have not yet been widely adopted by MFIs. This may be due to the absence of incentives for the adoption of such standards and the issue of applicability of the standards to all types of microfinance institutions.

One more challenge for MFIs in the Philippines is lowering the cost of delivering microfinance services to clients. On average, the operating expense ratio of MFIs in the Philippines is 38.8 per cent, as reported by the Microfinance Council of the Philippines in its Performance Monitoring Report for December 2004. The standard for operating expense ratio in the 'Performance Standards for All Types of Microfinance Institutions' being promoted by the National Credit Council is 20% or less. Benchmarks from the MicroBanking Bulletin, issue no. 11, show that Asian MFIs can achieve an operating expense ratio of 18.2 percent. This suggests that MFIs in the Philippines have ample room to reduce costs through greater efficiency in the delivery of its services.

Related to the issue of lowering costs and in line with the latest innovations in communications and technology, the challenge for microfinance practitioners is to use these innovations for more cost-efficient operations. Although a number of MFIs have begun pilot testing Personal Digital Assistants (PDAs) and mobile commerce in microfinance, real benefits are yet to be demonstrated.

Regulations and Government Initiatives

Chronology

In 1990, the Cooperative Development Authority (CDA) was established through the enactment of CDA Act (R.A.6939) as a government agency to promote the viability and growth of cooperatives.

In 1990, the Cooperative Code of the Philippines was enacted. Individual cooperatives were allowed to buy land and were permitted to accept deposits and provide credit.

In 1993, the National Credit Council (NCC) was created through the Administrative Order No. 86. NCC was established by the government to create an enabling policy environment to encourage greater private sector participation in the delivery of financial services to the poor.

In 1995, the People's Credit and Finance Corporation (PCFC) was established as a government finance company for wholesale funds to retail MFIs for lending to the poor. It is incorporated under the Corporations Act (Presidential Administrative Order) and registered with Securities and Exchange Commission.

In 1995, PCFC received ADB-IFAD funds for on-lending to MFIs that provide MF credit and savings services to the poor through the Grameen Bank replication approach.

In 1997, the Credit Policy Improvement Project (CPIP), a USAID supported TA program, was implemented to strengthen the institutional capacity of NCC, rationalize government credit and loan guarantee programs, craft a strategy for microfinance, and create appropriate legal and regulatory framework for microfinance.

In 1997, NCC published the National Strategy for Microfinance, which provided the national framework for microfinance and emphasized the role of the private sector in microfinance.

In 2000, General Banking Law (GBL 2000) was revised to include provisions that mandate the formulation of appropriate rules and regulations for microfinance operations. As of December 2005, the BSP has issued Circulars 272,273,282, 340, 365, 369, and 409 in conjunction with the GBL 2000.

In 2005, NCC launched the Performance Standards for all types of microfinance institutions. The main objective of the Performance Standards is to facilitate the evaluation of any type of MFI and compare its financial performance with that of other MFIs, regardless of whether it is a bank, cooperative, or an NGO.

(Source: JBIC Pilot Study on Sustainable Microfinance for Poverty Reduction in the Philippines)

Legislation

According to the JBIC Study, the Philippines is one of a few countries with a well-defined policy and regulatory architecture for microfinance. The government, through the NCC and the CPIP, has worked for the creation of a favorable environment. Similarly, the Bangko Sentral ng Pilipinas (BSP) has issued various circulars supporting the creation and strengthening of MFIs. The favorable environment has contributed to the rapid growth of outreach of MFIs as well as the strengthening of the microfinance programs of rural banks/cooperative rural banks/ microfinance-oriented banks.

The basic policy statement on microfinance is the National Strategy for Microfinance, which was crafted by the NCC in 1997. The vision of this strategy is to have a viable and sustainable private micro-finance market. This will be achieved in a liberalized and market-oriented economy where the private sector plays the major role and the government provides the enabling environment for the efficient functioning of markets.

Specifically, the objective is to provide low-income households and microenterprises access to financial services. The target group consists of those who live below the poverty line and are engaged in some form of business or economic activity but who do not have access to or are inadequately served by the formal financial sector. The government's microfinance policy is built on the following principles:

- ❖ Greater role of the private microfinance institutions in the provision of financial services;
- ❖ Existence of an enabling policy environment that facilitates the increased participation of the private sector in microfinance;
- ❖ Adherence to market oriented financial and credit policies; and
- ❖ Non-participation of government line-agencies in the implementation of credit and guarantee programs.

The key elements of the national strategy are: the development of innovative financial products, capability building of MFIs, and the formulation of appropriate regulatory and supervisory framework for MFIs.

Regulation of Microfinance NGOs

All NGOs, including those engaged in microfinance, are required to register with the Securities and Exchange Commission (SEC) as non-stock, non-profit organizations. Although microfinance NGOs are required to file annual audited financial statements and general information sheets to the SEC, they are not subject to prudential regulation and supervision by any government regulatory authority. Microfinance NGOs do not report to any regulatory agency and therefore, there is no single institution that has a complete set of relevant information on the financial performance of NGOs.

Almost all microfinance NGOs collect compulsory savings from member-borrowers as a form of compensating balance for members' outstanding loans. NGOs collect savings from member-borrowers only and not from the general public. The consensus among microfinance NGOs is that they should be allowed to collect savings from their clients without being subject to any prudential regulation provided that these collected savings do not exceed their total loan portfolios. Those that collect savings beyond the compensating balance will be subject to the appropriate regulatory agency.

Regulation of Banks Engaged in Microfinance

The BSP is the regulatory authority over all banking institutions including those engaged in the provision of microfinance (rural banks, cooperative rural banks, thrift banks). BSP issues the necessary rules and regulations for the safe and prudent operations of banks. BSP supervises and conducts regular examination of banks as part of its regulatory mandate over banks.

The basic law that paved the way for the creation of the favorable environment for banks engaged in microfinance is Republic Act 8791 more popularly known as the General Banking Law of 2000 (GBL 2000), which was enacted on April 12, 2000. The GBL 2000 gives recognition to the peculiar characteristics of microfinance and directed the BSP Monetary Board to establish rules and regulations for its practice within the banking sector.

Sections 40, 43 and 44 mandated the formulation of appropriate rules and regulations for microfinance operations. Section 40 acknowledged the “peculiar characteristics of microfinance, such as cash-flow based lending to the basic sectors that are not covered by traditional collateral.” Under Section 43, “The Monetary Board shall regulate the interest imposed on microfinance borrowers by lending investors and similar lenders, such as, but not limited to the unconscionable rates of interest collected on salary loans and similar credit accommodations.” Section 44 recognizes that “the schedule of loan amortization shall take into consideration the projected cash flow of the borrower and adopt this into the terms and conditions formulated by banks.”

The following BSP circulars implement the mandate of the General Banking Law of 2000 and the policy directives of the National Strategy for Microfinance:

- BSP Circular 272 (issued on 30 January 2001) recognizes cash-flow based lending as a peculiar feature of microfinance, defines microfinance loans and provides for the exemption of microfinance loans from rules and regulations issued with regard to unsecured loans;
- BSP Circular 273 (issued on 27 February 2001) lifts the moratorium on bank branching for those banks engaged in microfinance activities;
- BSP Circular 282 (issued on 19 April 2001) opens a rediscounting facility for rural banks/cooperative rural banks engaged in microfinance;
- BSP Circular 324 (issued on 2 March 2002) expands the coverage of the rediscounting facility to include thrift banks engaged in microfinance;
- BSP Circular 340 (issued on 30 July 2002) provides the rules and regulations concerning the establishment of branches or loan collection and disbursement points (LCDPs) of microfinance-oriented banks established under BSP Circular 273 and the establishment of microfinance-oriented branches/LCDPs of banks that are not wholly devoted to microfinance;
- Circular Letter (issued on 2 October 2002) provides revisions and additional reports on microfinance loans;
- BSP Circular 365 (issued on 16 January 2003) amends Section 3 (e) of BSP Circular 340, allowing newly established microfinance-oriented banks to set up LCDPs subject to certain conditions;
- BSP Circular 369 (issued on 17 February 2003) amends Section 3 (b) of BSP Circular 340, requiring thrift banks with head office outside the NCR that plan to establish a branch in the NCR to put up the minimum capital requirement for a new thrift bank in the NCR;
- BSP Circular 409 (issued on 14 October 2003) provides the rules and regulations for the portfolio-at-risk (PAR) of MFIs and the corresponding allowance for probable losses which depend on the number of days of missed payment;
- BSP Circular 505 (issued on 22 December 2005) revises branching guidelines by allowing qualified microfinance oriented banks and microfinance oriented branches of regular banks to establish branches anywhere in the Philippines.

Regulation of Cooperatives

Under Republic Act 6539, the Cooperative Development Authority (CDA) is tasked to regulate all type of cooperatives. However, a review of the regulatory environment for credit cooperatives conducted by the NCC through CPIP in 1997 revealed that CDA is not able to effectively implement its regulatory mandate due to conflicting mandates of regulation and development of cooperatives. CDA has been mostly occupied in the registration of cooperatives and the promotion and development of cooperatives.

To help build the architecture for the effective regulation and supervision of credit cooperatives, CPIP spearheaded work on the establishment of a standard chart of accounts and an accounting manual for credit cooperatives and other types of cooperatives with credit services. CDA has issued a circular directing all concerned primary credit cooperatives to adopt the standard chart of accounts. In addition, a set of performance standards for credit cooperatives called the COOP-PESOS is being promoted by CPIP. The CDA Administrator issued a circular asking all credit cooperatives to use the COOP-PESOS performance standards by January 2003.

Practices

NGOs

The NGO sector engaged in microfinance is the chief proponent of the group lending methodology, essentially patterned after the Grameen Banking Approach (GBA) to microlending. The experience of NGOs in GBA spans a period of more than 15 years. GBA is the preferred methodology by NGOs due to its feature of group accountability for loans. The introduction of the ASA methodology by a project funded by the United Nations Development Programme (UNDP) called Microfinance Support Project (MSP) is overhauling the group lending methodology by doing away with the group accountability feature. Groups are still formed in the ASA method but group members are solely accountable for the payment of their respective loans. The APPEND Scale-up Branch Model is a group lending methodology being practiced by majority of NGO-members of the Alliance of Philippine Partners for Enterprise Development (APPEND) network. This is an upgraded version of the Trust Bank methodology, which is being used in more than 20 countries by member-MFIs of Opportunity International.

Both the GBA and ASA methodologies specifically target the poor, especially women with existing microenterprises. GBA and ASA utilize the Housing Index and the means test to screen out the non-poor from entering the microfinance program. The APPEND Scale-up model targets the poor with existing enterprises, however there are some centers where 30% of group members (between 30 to 40 borrowers) are start-ups.

Generally, microfinance NGOs charge interest on loans at rates ranging from 24 percent to 40 percent per annum flat rate, inclusive of upfront service fees of 2 percent to 5 percent. Collection of loan payments is done weekly. NGOs are not authorized by law to collect deposits from the public but nevertheless collect compulsory savings from member-borrowers as a form of compensating balance for members' outstanding loans. NGOs are not supervised nor regulated by any government agency. They are, however, required by law to submit audited financial statements to the SEC. NGOs have no visible constraint to branch expansion. They can establish branches in any place they want to. Inadequate funding is one of the reasons why NGOs cannot expand their number of branches as fast as their plans warrant. Another reason is the lack of capacity of NGOs to meet the organizational manpower and middle management requirements of expansion.

Many sustainable MFIs offer microinsurance as part of their service to their clients. For a fixed amount of weekly payments, clients of MFIs such as TSPI Development Corporation (TSPI), Taytay sa Kauswagan, Inc. (TSKI), and Negros Women for Tomorrow Foundation (NWTF) are entitled to receive a certain amount in case of death due to sickness or accident. The microinsurance program of the Center for Agriculture and Rural Development and CARD Rural Bank is being provided by its member-owned CARD Mutual Benefit Association.

(Source: JBIC Pilot Study on Sustainable Microfinance for Poverty Reduction in the Philippines)

Rural Banks

About 15 rural banks (RBs)/cooperative rural banks (CRBs) have earlier learned the group lending methodology generally patterned after the Grameen Bank Approach (GBA) to microlending. RBs/CRBs that had an early start on GBA are reporting higher than average outreach compared to the others that are into individual lending.

RBs/CRBs are familiar with individual lending as this is the methodology employed in their regular banking operations. The individual lending approach targeted to poor clients was formally promoted among the RBs/CRBs by a USAID-funded project, called the Microenterprise Access to Banking Services (MABS). The MABS Program provides technical assistance and training to rural banks/cooperative rural banks in microfinance best practices. The program is designed to develop the capability of RBs/CRBs to profitably provide financial services to microenterprises. The MABS approach involves training and technical assistance geared toward understanding microfinance best practices.

The clients of RBs/CRBs in their regular banking operations generally belong to the non-poor. In regular banking, RBs/CRBs often require collateral-based lending which prevents access by the poor to banking services. However, many RBs/CRBs offer collateral-free salary loans to teachers and other low income employees in rural areas. For their microfinance operations, RBs/CRBs target microenterprises based on cash-flow lending, requiring no collateral from the borrowers. RBs/CRBs target the entrepreneurial poor located in small towns and rural communities. Lending rates to microentrepreneurs are in the range of 24 percent to 36 percent per annum, computed on a flat rate basis. The rates include payment of upfront service fees, commonly in the range of 1.75 to 4 percent. Frequency of loan collection for microfinance loans is either daily, weekly, or monthly. Majority of loans are collected on a weekly basis.

RBs/CRBs are authorized by law to collect savings from the public. The MABS approach trains RBs/CRBs to mobilize savings from micro depositors. One significant achievement of the MABS program is that the number of micro deposit accounts is four times the number of micro loans. The amount of the aggregate micro deposits is approaching the

aggregate value of micro loans outstanding. This fact suggests that RBs/CRBs are able to finance their micro loans with micro deposits mobilized from the public.

RBs/CRBs are supervised and regulated by the BSP. Most RBs/CRBs are members of the Rural Bankers Association of the Philippines (RBAP), a national tertiary organization for RBs/CRBs. RBs/CRBs are also members of their own provincial networks and regional federations. RBAP and the regional federations are effective lobby groups that advocate for policy change.

(Source: JBIC Pilot Study on Sustainable Microfinance for Poverty Reduction in the Philippines)

Cooperatives

Cooperatives generally employ the individual lending methodology in their lending operations. The current practice is to lend amounts that are a multiple of the value of share capital and savings deposit of the member-borrower. However, cash flow-based lending is slowly being accepted as a better lending method by cooperatives. A microfinance methodology, essentially based on solidarity group lending was introduced by a USAID-funded project namely the Credit Union Empowerment and Strengthening (CUES) Project. The microfinance methodology, called Savings and Credit with Education (SCWE) targets poor women as clients.

Membership rules in open-type, community-based savings and credit cooperatives do not distinguish between poor and non-poor members. While the SCWE methodology specifically targets poor women, the self-selection process in solidarity group lending tends to screen out the very poor in entering the program.

Savings and credit cooperatives charge interest rates on loans to members ranging from 18 percent to 24 percent per annum. Some cooperatives additionally charge an upfront service fee ranging from 2 percent to 5 percent on loans. Collection frequency on loans is weekly, bi-weekly or monthly. Cooperatives are authorized by law to collect savings from their members. They submit required reports annually to the CDA but remain largely unsupervised and unregulated. A number of cooperatives are affiliated with tertiary organizations like the National Confederation of Cooperatives (NATCCO) and the Philippine Federation of Credit Cooperatives (PFCCO). Cooperatives tend to operate within the municipality where they are registered. Opening a branch in other municipalities outside the original place of registration generally includes informing any registered cooperative operating in the locality about the planned establishment of a branch in the area and securing the permission of the local government unit, usually the municipal mayor.

(Source: JBIC Pilot Study on Sustainable Microfinance for Poverty Reduction in the Philippines)

Innovations

One of the main challenges of MFIs in the Philippines is lowering the cost of delivering microfinance services to clients. In line with the latest technology in mobile commerce, a number of MABS participating banks have begun pilot testing the use of Personal Digital Assistants (PDAs) in managing loan collections. In addition, loan collection through short-messaging service (SMS) technology has been pilot tested by several MABS banks and is now being rolled out nationwide. Cost savings for both clients and institutions are now being documented. Loan disbursements and payments through mobile phones are also being explored by large NGO MFIs and credit cooperatives. In general, the use of mobile commerce is an attempt by MFIs to improve their efficiency and productivity by introducing technology that will reduce costs and accelerate processing of loan payments. This allows MFIs to allocate more time in generating new loan accounts.

Many sustainable MFIs offer microinsurance as part of their service to their clients. However, MFIs such as CARD have started to realize that an insurance business must be managed by insurance professionals. It was also realized that the insurance business of an MFI should not be tied to the capital of a microfinance institution. MFIs are now starting to formalize their microinsurance services by setting-up Mutual Benefit Associations (MBAs).

In an effort to broaden their service and include non-financial assistance to poor clients, MFIs such as TSKI, TSPI, KMBI, and Rangtay sa Pagrang-ay, Inc. (RSPI) are offering Business Development Services (BDS) to their clients. BDS is an integrated approach in developing business or enterprises. Its immediate aim is to assist clients in establishing productive and sustainable businesses or enterprises. Business Development Services may vary from one MFI to another but may include livelihood skills development, product development, and marketing.

Although microfinance targets low-income households in the Philippines, market segments have been excluded by microfinance services. This includes farmers whose earnings are irregular and volatile. In an effort to include farmers in microfinance services, several MFIs such as NWTF, TSPI, and ASKI are now offering micro-agricultural loan products. This loan program aims to provide small Filipino rice and sugarcane farmers with access to farm credit. The RBAP-MABS program has also helped rural banks to adapt to their market and develop expanded microfinance services including a new Micro-Agri Loan product that was successfully pilot tested in 2004-2005 and rolled out to additional banks in 2005.

The table below shows challenges in Philippine microfinance and how MFIs have responded to these challenges through innovations.

Challenges	Innovations
Lowering the cost of delivering microfinance services	Use of PDAs in managing loan collections Use of mobile phones in loan collections
Building the capacity of MFIs to deliver value-added services to its clients	Formalizing microinsurance by setting-up MBAs
Broadening MFI service to include non-financial services	Business development services to clients
Building the capacity of MFIs to include market segments that have been previously excluded by microfinance services	Micro-agricultural loan products

Providers

In the Philippines, there are three major providers of microfinance services: NGOs, rural banks, and cooperatives.

There are more than 30,000 NGOs registered with the SEC. It is estimated that around 300 NGOs are involved in some form of delivery of micro-credit to the poor. NGOs are not regulated; therefore, there is no single entity that has complete information on NGOs. However, approximately 30 NGOs have a respectable size of operation in microfinance. Leading microfinance NGOs are members of the Microfinance Council of the Philippines, Inc. NGOs with sizeable microfinance operations in terms of number of active borrowers and amount of gross loan portfolio include TSPI Development Corporation, Taytay sa Kauswagan, Inc, Center for Agricultural and Rural Development, Inc., Negros Women for Tomorrow Foundation, Inc., and Kabalikat para sa Maunlad na Buhay, Inc.

Data from the Bangko Sentral shows that the rural banking system is composed of 720 rural banks (RBs) and 44 cooperative rural banks (CRBs) for a total of 764 RBs/CRBs. As of December 2005, there were 195 banks engaged in microfinance. Four of these banks are microfinance oriented thrift banks (Microenterprise Bank, Opportunity Microfinance Bank, Kauswagan Bank, and Dunganon Bank) and another four are microfinance oriented rural banks (CARD Bank, Vision Bank, Banco ng Masa, and Xavier Tibod). The remaining 187 banks are rural and cooperative rural banks engaged in some level of microfinance operations ranging from 3% to 40% of their gross loan portfolio. In total, these banks are reaching approximately 600,000 microfinance clients with a total outstanding loan portfolio of PhP 3.3 billion.

According to CDA, there are 66,000 registered cooperatives in the Philippines. Approximately 50 percent of registered cooperatives or 33,000 are functioning and of this number 85 percent have some form of savings and credit activity. Cooperatives engaged in microfinance are community-based open-type savings and credit cooperatives. Around 4,579 cooperatives are deemed to be engaged in microfinance operations. Cooperatives engaged in microfinance usually have microfinance clients ranging from 500 to 5,000. The cooperative with the largest microfinance operations in the Philippines is CCT Credit Cooperative.

As of December 31, 2005, the main microfinance providers with their amount of gross loan portfolio and number of active borrowers were:

Microfinance Institution	Charter Type	Gross Loan Portfolio (PhP)	Gross Loan Portfolio (US\$)	Number of active borrowers
TSPI Development Corporation	NGO	613,728,146	11,565,156	151,714
Taytay sa Kauswagan, Inc.	NGO	603,269,563	11,368,074	162,867
Center for Agricultural and Rural Development, Inc.	NGO	473,828,363	8,928,870	109,477
Negros Women for Tomorrow Foundation, Inc.	NGO	356,368,241	6,715,440	67,982
CARD Bank, Inc.	Rural Bank	281,213,999	5,299,225	31,479
CCT Credit Cooperative	Cooperative	247,342,519	4,660,948	63,084
Kabalikat para sa Maunlad na Buhay, Inc.	NGO	231,989,325	4,371,631	80,078
New Rural Bank of San Leonardo, Inc. (June 2005) *	Rural Bank	160,071,772	3,016,409	15,699
Opportunity Microfinance Bank, Inc.	Thrift Bank	137,984,972	2,600,203	23,044
ABS-CBN Bayan Foundation,	NGO	137,382,059	2,588,842	38,422

Inc. (December 2004)				
Producers Rural Banking Corporation (December 2004) *	Rural Bank	122,529,316	2,308,955	24,336
Alalay sa Kaunlaran sa Gitnang Luzon, Incorporated	NGO	103,059,979	1,942,073	31,099

* Data for Producers and NRB San Leonardo cover their microfinance operations only.
ER December 2005: US\$1 = PhP 53.067

Funding and Supporting Organizations

Funding

Government Financial Institutions

People's Credit and Finance Corporation. The People's Credit and Finance Corporation (PCFC) provides wholesale funds to retail MFIs for on-lending to poor clients. PCFC is a government-owned finance company that was established in compliance with the Social Reform Agenda of the government. It is the only government agency mandated by law to provide financial services to the poor through wholesale funds to retail MFIs. It also manages Overseas Development Assistance (ODA) funds from ADB-IFAD and World Bank coursed through the Land Bank of the Philippines. PCFC borrowers are rural banks/cooperative rural banks, cooperatives and NGOs and are called conduits. PCFC has more than 200 conduits nationwide.

PCFC is the only government financial institution (GFI) with sole focus on microfinance. PCFC reported total resources of PhP 3.01 billion, gross loan portfolio of PhP 2.89 billion, and net income of PhP 66.1 million.

Land Bank of the Philippines. The Land Bank of the Philippines (LBP) is a government financial institution (GFI) that was created under the Agrarian Reform Law enacted by Congress in 1963. The mandate of LBP to undertake microfinance operations is spelled out in two laws: RA 8425 known as the Social Reform and Poverty Alleviation Act, and RA 9178 known as the Barangay Microenterprise and Business Enterprises (BMBE) Act passed by Congress in the year 2002. Both laws mandate LBP and other government financial institutions (GFIs), to set up a special credit window for microenterprises and to promote microfinance programs for the poor.

LBP's current involvement in microfinance is the guarantee that it has provided to the loans obtained from ADB-IFAD Rural Microenterprise Finance Project (RMFP) and the World Bank for the funding needs of PCFC. As of December 31, 2004, the loans of LBP to PCFC amounted to PhP 1.52 billion. LBP had total resources of PhP 287.7 billion, gross loan portfolio of PhP 151.3 billion, and net income of PhP 2.25 billion.

LBP has not directly lent to retail MFIs for microfinance purposes. However, some LBP branches are known to have lent to MFIs, mostly rural banks/cooperative rural banks and cooperatives under the Countryside Loan Fund (Rural Finance III) provided by the World Bank. LBP started its microfinance operations in 2004 on a "limited engagement" basis. There are twelve MFIs initially identified by the 5 LBP regional area heads as potential LBP conduits for microfinance. These MFIs are rural banks, cooperative rural banks, cooperatives and NGOs. As of December 2005, wholesale loans to these MFIs amounted to PhP 104.46 million.

Development Bank of the Philippines. The Development Bank of the Philippines (DBP) was established by an act of Congress in 1949. The main purpose of DBP is to provide banking services principally to small and medium enterprises (SMEs). Its mandate to undertake microfinance operations is spelled out under the BMBE Act of 2002. In July 2001, DBP launched its Financing Program for Micro Enterprises (FPME). It allocated PhP 500 million pesos from its Window III facility for wholesale lending to retail MFIs.

DBP is relatively new to microfinance. At the end of 2003, its microfinance portfolio reached only PhP 36 million. As of December 31, 2004, DBP reported total resources of PhP 157.12 billion, a loan portfolio of PhP 77.19 billion, and a net income of PhP 2.27 billion.

Small Business Corporation. The SB Corporation is the result of a merger between the Small Business Guarantee and Finance Corporation (SBGFC) and the Guarantee Fund for SMEs (GFSME). SBGFC was created under a law passed by Congress in 1991 and amended in 1998, known as the Magna Carta for SMEs. The mandate of SB Corporation to undertake microfinance operations is included in the BMBE Act of 2002.

SB Corporation's microfinance loan portfolio as of end 2003 is in the amount of PhP 40 million. There were 12 cooperatives that had outstanding microfinance loans from SB Corporation in 2003. At the end of 2004, SB Corporation had total resources of PhP 2.92 billion, a loan portfolio of PhP 1.74 billion, and a net income for the year of PhP 62.44 million.

The table below shows December 2004 data on government financial institutions engaged in wholesale lending to microfinance institutions

	People's Credit and Finance Corp.	Land Bank of the Philippines	Development Bank of the Philippines	SB Corporation
Total resources (US\$)	53.5 million	5.11 billion	2.79 billion	51.9 million
Loan portfolio (US\$)	51.4 million	2.38 billion	1.37 billion	30.9 million
Microfinance loan portfolio (US\$)	51.4 million	1.9 million (plus 27 million to PCFC)	0.64 million	0.71 million
Net income (US\$)	1.2 million	40 million	40.3 million	1.1 million

* Sources: PCFC, LBP, DBP, and SB Corporation financial reports from www.coa.gov.ph; Report and Recommendation of the President to the Board of Directors on a Proposed Loan and Technical Assistance Grant to the Republic of the Philippines for the Microfinance Development Program, Asian Development Bank, October 2005

* ER December 2004: US\$1 = PhP 56.267

Other Sources of Funds

The Philippines has several sources of ODA and technical assistance including those from USAID, Australian Agency for International Development (AUSAID), UNDP, ADB-IFAD, European Union (EU), Canada Fund, and World Bank. In addition, international organizations with local offices in the Philippines also provide wholesale fund and technical support to MFIs. These are Plan International, Oikocredit, CARE Philippines, World Vision, and Catholic Relief Services. Local organizations such as the Peace and Equity Foundation, Foundation for Sustainable Societies, Inc. and the Federation of People's Sustainable Development Cooperatives cater to the capital needs of relatively smaller MFIs.

Client savings is also becoming a major source of funding for regulated MFIs. Historically, the dependence of MFIs on subsidized credits from the Government, donors, and lending agencies led to weak savings mobilization. As such MFI's savings deposits increase, so does the amount of resources for MFIs to improve services and expand outreach. The cost of funds raised through savings mobilization is considerably lower than the cost of funds provided to MFIs by GFIs for on lending. Rural banks have moved from low deposit-to-loan ratios from the 1980s to deposit-to-loan ratios of over 110%. A large percentage of the client savings comes from micro deposits of low income and micro-enterprise clients.

Some MFIs have access to loans with local commercial banks such as the United Coconut Planters Bank, Philippine National Bank and Bank of the Philippine Islands (BPI). The Hongkong and Shanghai Banking Corporation (HSBC), one of the largest international banks, has also opened its loan facility to retail MFIs.

Support

Policy and Advocacy

The Bangko Sentral ng Pilipinas (BSP) was mandated by the General Banking Law of 2000, to establish rules and regulations for the practice of microfinance within the banking sector. Subsequent to this law, the BSP has declared microfinance as its flagship program for poverty alleviation. It has focused its microfinance initiatives on policy and regulatory environment, training and capacity building, and promotion and advocacy.

The National Credit Council (NCC) was established by the government to create an enabling policy environment to encourage greater private sector participation in the delivery of financial services to the poor. The NCC published the National Strategy for Microfinance, the Regulatory Framework for Microfinance, and the Performance Standards for All Types of Microfinance Institutions in the Philippines. The National Anti-Poverty Commission (NAPC), on the other hand, is the government agency responsible for coordinating all government-supported poverty reduction programs.

Networks

The Microfinance Council of the Philippines, Inc. (MCPI), a network of 34 retail MFIs and 7 service providers, provides support services to MFIs through the promotion of microfinance best practices, policy advocacy, and performance benchmarking. Another network, the Alliance of Philippine Partners for Enterprise Development (APPEND) groups together Christian development organizations engaged in microfinance. The Rural Bankers Association (RBAP), a network of rural banks, promotes and safeguards the welfare of its member rural banks, including those that are engaged in microfinance. A number of cooperatives are affiliated with tertiary organizations like the National Confederation of Cooperatives (NATCCO). Regional associations of microfinance institutions such as the Mindanao Microfinance Council,

Bicol Microfinance Alliance, and Central Luzon Microfinance Alliance cater exclusively to MFIs operating within a certain region.

Technical Assistance

The United States Agency for International Development (USAID) funds projects on technical assistance services such as: Microenterprise Access to Banking Services (MABS) Program; Credit Union Empowerment and Strengthening (CUES) Project; and Credit Policy Improvement Program (CPIP). The MABS program provides microfinance technical assistance and training to rural banks. The CUES Project is a technical assistance project that promotes the sustainable growth and expansion of credit cooperatives worldwide. CPIP is a technical assistance program that was implemented to strengthen the institutional capacity of the National Credit Council (NCC). CPIP helped the NCC draw up the National Strategy for Microfinance, which became the blueprint for the microfinance policy and regulatory architecture in the Philippines.

Training institutions

Training institutions such as the Asian Institute of Management – Center for Entrepreneurship and Punla sa Tao Foundation help build the capacity of microfinance institutions to provide financial services to the poor by offering training programs in market research, delinquency management, business planning, information systems, operational risk management, and product development.

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