

## Case Study on Philippines

### Electronic Banking: Delivering Microfinance Services to the Poor in the Philippines<sup>i</sup>

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#### Abstract

*Microfinance has proven to financial institutions (i.e. banks) that the services they provide to their "traditional" clients can also be offered to poor and low-income entrepreneurs and clients, in a sustainable and viable manner. These institutions have seen that reaching out to the majority of the country's population, which is the low-income market, does not necessarily mean a losing proposition for their institutions.*

*Similarly, it is only appropriate that the more efficient and cheaper methods of providing these financial services, such as electronic banking services, which are offered to valued traditional bank clients, should also be offered to microfinance clients. The increased convenience and lowered costs arising from innovations in electronic banking should also benefit the poor and low-income clients.*

*This paper will present a brief overview of the microfinance "industry" in the Philippines as well as the recent developments of increased commercialization. Commercialization of microfinance has spurred greater competition leading to increased innovations in microfinance products and service delivery.*

*Two case presentations will be made on existing models in which technological innovations of electronic banking are being used specifically to serve microfinance clients. First, is the use of mobile telephones through the short messaging services (SMS) to pay for microfinance loan amortizations using electronic cash platforms. The other case is a brief example of the distribution of Automated Teller Machine (ATM) cards to microfinance clients, which aims to lower costs for the microfinance institution while increasing convenience for the clients.*

*These two examples will include the discussions on enabling factors, barriers and obstacles. A closer look at the implication for regulation particularly by the Bangko Sentral ng Pilipinas will be undertaken. The direction of policy, existing relevant regulations and rules will likewise be presented.*

#### Overview of Microfinance in the Philippines

The practice and provision of microfinance has been increasing in the Philippines. Microfinance is continuously showing, through success stories and empirical evidence, that it is an effective tool for poverty alleviation and economic development. Microfinance provides the much-needed support for microenterprises to help them grow. This bears significance for the Philippines where micro, small and medium enterprises make up 99.6% of our total industries and employ 70% of our workforce.<sup>1</sup> It becomes even more significant when 4.1 million families belonging to the lowest income strata are engaged in

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microenterprise activities.<sup>2</sup> Without access to financial services, these microenterprises are forced to rely on more expensive sources of credit such as informal moneylenders, which limits their capacity to grow their businesses. By invigorating these microenterprises, microfinance empowers the many Filipinos living in poverty to increase their economic activity and income, build up assets, prepare against emergencies and better invest in education, health, and housing thereby improving the overall quality of their lives. Microfinance seems to address the various facets of poverty.

Past government initiatives for poverty alleviation in the 60s to 80s were focused on direct credit and guarantee programs, which provided massive credit subsidies to bring down the cost of borrowing for target sectors. These programs resulted in very limited effectivity and outreach, and at a great cost to the government's budget.<sup>3</sup> These programs were met with massive repayment problems, capture of funds by large-scale borrowers, neglect of deposit mobilization and huge fiscal costs for the government.

Learning from these experiences, the government policies of the last decade have shaped reforms to develop a market oriented financial and credit policy environment that promotes and supports private institutions to broaden and deepen their services; while government will instead focus not on the actual provision of credit but on creating the enabling policy environment. It is during this period that the National Strategy for Microfinance<sup>ii</sup> was created imbibing the following principles: 1) Greater role of the private microfinance institutions in the provision of financial services, 2) Existence of an enabling policy environment that facilitates the increased participation of the private sector in microfinance, 3) Adherence to market oriented financial and credit policies, 4) Non-participation of government line agencies in the implementation of credit and guarantee programs.<sup>4</sup> Several laws were enacted in support of this strategy namely; Social Reform and Poverty Alleviation Act, Agriculture and Fisheries Modernization Act, Barangay Micro-Business Enterprises Act, Executive Order 138 and the General Banking Act of 2000.

With the National Strategy for Microfinance and the subsequent policy issuances and laws that were passed, the microfinance market has been driven by the private sector with the government only providing the enabling policy and regulatory environment. The strategy also laid the groundwork for the establishment of a regulatory framework for microfinance as well as the uniform set of performance standards for all types of microfinance institutions.

Given this backdrop, there are now three types of institutions that provide microfinance services: the non-governmental organizations (NGOs), cooperatives and banks. The success factor in developing a range of microfinance institutions is that the policy environment encourages the development of these different types of institutions recognizing the strength of each type in delivering microfinance services. The current players include eight microfinance oriented banks<sup>iii</sup> and 187 thrift and rural banks with some level of microfinance operations,<sup>5</sup> approximately 300 NGOs where around 30 will have sizeable and significant microfinance portfolios, and 50 cooperatives engaged in pure microfinance activities.<sup>6</sup> Together, these institutions are providing microfinance services to approximately 1.3 to 1.5 million families.<sup>7</sup>

### *Commercialization of Microfinance*

The growth in the number of microfinance institutions continues to prove that microfinance, when delivered properly, can be a sustainable, viable and profitable undertaking. Progress toward commercialization of microfinance is usually hastened by a strategic decision of microfinance institutions to adopt a for-profit orientation, accompanied by a business plan to operationalize the strategy to reach full financial self-sufficiency and to increasingly leverage the institution's funds to achieve greater levels of outreach.<sup>8</sup> It is

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<sup>ii</sup> Created by the National Credit Council in 1997.

<sup>iii</sup> Banks licensed by the Bangko Sentral ng Pilipinas as microfinance oriented banks will have, at all times, at least 50% of their portfolio dedicated to microfinance.

with this onset of commercialization that banks are becoming more and more involved in microfinance. They are seeing that microfinance may take on a for-profit orientation which goes against past perceptions that microfinance is a service provided by non-profit organizations or charitable institutions. Around the world, formal financial institutions have become increasingly involved in microfinance and informal unregulated institutions are moving toward formalization or venturing into activities that they did not previously undertake such as deposit taking and savings mobilization. The Philippines is also showing similar developments. This can be seen by the large number of banks engaged in microfinance as well as the transformation of large microfinance NGOs to become formal regulated financial institutions. Seventy-eight percent (78%) of the microfinance-oriented banks in the country were previously microfinance NGOs. Aside from the increase in commercial players, the microfinance institutions are more seriously looking into best practices and performance standards leading to a more transparent and competitive industry.

These developments are encouraging for the microfinance sector. It has been proven in many cases that commercially viable institutions are more able to expand their reach to wider geographical areas and provide a more extensive range of financial services to their clients. With more commercially viable institutions in play, the ultimate benefit goes to the microenterprises because there will be more responsive products and services, innovative methodologies and lowered costs.

### *Some Key Challenges*

Despite the enabling policy and regulatory environment, the trends of commercialization and the positive developments in the microfinance industry, there are some key challenges that still need to be addressed.

The most obvious challenge is that although the microfinance institutions are reaching a significant number of 1.3 to 1.5 million families, there still remains a large unmet demand for microfinance services. In a recent country profile on microfinance by the Microfinance Council of the Philippines, there are still approximately 2.9 million families that are unserved by microfinance institutions in the Philippines.<sup>9</sup> This figure was confirmed by a recent Asian Development Bank study where they indicated that more than two-thirds of poor households, or 17 million people, still do not have access to microfinance services. Instead, the poor rely heavily on self-finance or informal sources that may be very costly, limiting their ability to participate in and benefit from development opportunities and income-generating activities.<sup>10</sup>

Related to the outreach, another challenge is the need to lower the cost of delivering microfinance services to clients. Although microfinance institutions have already proven to be a better alternative to informal moneylenders, better known in the Philippines as 5-6<sup>iv</sup> operators, there is still room to improve operations and lower costs. The latest Microfinance Council of the Philippines Performance Monitoring Report showed that 21 leading microfinance institutions posted an average operating expense ratio of 38.8%, which is a key indicator of efficiency. This figure may simply mean that it costs 38.8 cents per peso loan lent.<sup>11</sup> The recently approved Uniform Set of Performance Standards for All Types of Microfinance Institutions<sup>v</sup> indicates that the ideal standard for this indicator is 20% or less. This shows that efficiency of microfinance institutions could be further improved.

A recent Economist Survey stated that although competition will help to reduce costs, the biggest hope comes from new technology.<sup>12</sup> This also seems to be a possible solution to further increasing the reach of microfinance services.

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<sup>iv</sup> 5-6 operators are those who typically provide PhP 5 credit in the morning and collect PhP 6 in the evening, or similar variations.

<sup>v</sup> Approved by the National Credit Council 2004

## Electronic Banking in the Philippines

Electronic banking is sometimes defined as the provision of retail and small value banking products and services through electronic channels. It is also often used to describe processes in which customers can perform banking transactions without visiting a brick and mortar institution.

In the Philippines, e-banking made an auspicious debut when automated teller machines (ATMs) were introduced in the 1980s revolutionizing how we viewed the conventional, brick-and-mortar bank structure.<sup>13</sup> Today, ATMs have become a common customer delivery channel that is predominant in urban centers and sometimes even in the countryside.

Aside from ATMs, other innovations have taken place such as phone and internet banking which again provide customers the ability to access banking services from various locations and at a 24-hour by 7-days basis. At end-June 2004, 57 banks (41 domestic banks and 16 foreign banks) provided electronic banking services. Out of the 57 banks, 36 were universal and commercial banks (85.7 percent of the 42 operating universal and commercial banks) and 21 were thrift banks (23.6 percent of the 89 operating thrift banks).<sup>14</sup>

With these developments, customers are able to enjoy the many conveniences and lower costs that are offered by the said innovations. However, it can be seen that the poor and low-income segment is still underserved or do not fully enjoy the benefits of such innovations.

For example, ATMs have a nationwide presence but there is a concentration in urban areas, which are not easily accessible to those residing in the countryside. In addition, ATMs would require that you have a bank-issued ATM card. The banks that typically issue ATM cards are the larger banks with which poor and low income individuals do not transact. The smaller banks like rural banks do not yet have the vast ATM networks as the bigger banks. As of September 2005, there are a total of 5,996 ATM units in the country where only 38 are rural banks ATMs<sup>15</sup>.

Another example is internet banking services, which has significantly increased convenience for clients, as they are able to perform certain transactions without leaving their home or workplace. However, this service is available only to those who have internet connection or are, at the very least, computer literate. In the same manner as ATM services, the poor and low-income clients will not be able to fully enjoy the benefits of this service.

### Examples of Electronic Banking Targeted to Microfinance Clients: Enabling Factors, Prospects, Barriers and Other Issues

These barriers to inclusion of the poor and low-income segment are currently being addressed by particular innovations in microfinance delivery. Microfinance institutions are pioneering efforts to make sure that the benefits of electronic banking are also enjoyed by the low-income market in terms of increased convenience and lower cost.

#### *Mobile Phone Banking*

The use of mobile phones is one such innovation that is gaining focus in the Philippines and is proving as an ideal channel for service delivery to microfinance clients, the poor and low-income sector. Banks are seeing that mobile phones could be used in purchases, payments, remittances and other related services.

The main enabling factor for the success of this approach is the existing wide network of mobile phone users in the Philippines. Unlike the ATMs and the internet, it is estimated that 43% of Filipinos, or 36 million people, use cellular phones; and the penetration rate is expected to increase by year-end 2005.<sup>16</sup> Several estimates show that market penetration will soon reach 50% of the total population of the country. The volume of mobile phone usage specifically the short message service, more commonly called in the Philippines as "texting", has reached a volume of nearly 300 million texts a day dubbing the Philippines as the texting capital of the world.

Aside from the significant volume of mobile phone users, this technology has been one that has served all income groups. The mobile phone industry in the Philippines particularly supports the needs of the low income market because of some key industry characteristics and attributes particularly; (1) the 'calling party pays' system; (2) pre-paid service; and (3) text messages.<sup>17</sup> The 'calling party pays' system ensures that the user will not get charged if no calls are made. Unlike in other countries where users get charged even when calls are received, this system controls the fees incurred by either limiting outgoing calls or not making any calls at all. The pre-paid service, on the other hand, awards the user the chance to avoid the fixed charges associated with postpaid accounts as well as the high credit standards and penalty charges for late payments. More importantly, this model which is sometimes dubbed as the "telecommunications-in-sachet"<sup>18</sup> is sensitive to the cash flow and purchasing power of the low-income market. Lastly, the text messaging system has proven to be a very economical way to communicate as it is priced between PhP 0.50 to PhP 1.00. Another enabling factor is the burgeoning used-cellular phone market that has thrived in the country. Handsets can go as low as PhP 500.00 or approximately US\$ 10.00.<sup>19</sup>

In addition to the above discussion, the industry leaders are also deliberately focusing their attention to the needs of the low-income market. Smart Communications, Inc., for example, has created innovative products specifically designed for the "bottom-of-the-pyramid" (BOP) consumer and thereby growing their pre-paid subscriber base<sup>20</sup>, which is the main source of their income.

Given this backdrop, the Rural Bankers Association of the Philippines has estimated that 90% of the rural bank clients have access to mobile phones.<sup>21</sup> In the same manner, it may also be safe to assume that a significant number of microfinance clients also have access to mobile phones.

The low-income market has therefore shown high receptiveness to innovations in services using the mobile phones. In the book *Fortune at the Bottom of the Pyramid*, this phenomenon is explained that "BOP consumers are more willing to adopt new technologies because they have nothing to forget. Moving to wireless from nothing is easier than moving to wireless from a strong tradition of efficient and ubiquitous landlines".<sup>22</sup> In addition, the widely accepted and used SMS technology has proven to be an ideal channel and instrument to facilitate the adoption of financial/ banking products.

In 2003 Smart Communications and in 2004 Globe Telecom launched the electronic money concept in the Philippines called *Smart Money* and *G-Cash*, respectively. The *Smart Money* technology allows users to make purchases, pay and receive domestic payments and to receive remittances by loading or transferring money from a bank account into a mobile phone account or reloading a prepaid card electronically through the mobile phone. The cash can be withdrawn from the phone account at either an ATM or one of the many SMART encashment centers, which include retail stores and even Mc Donald's outlets. The *G-cash* is a similar technology, which provides the same services but does not use a debit card and instead just uses Cash In and Cash Out Center/ Outlets<sup>vi</sup> via the mobile phone.

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<sup>vi</sup> Cash In and Cash Out Outlets are those accredited to convert actual money to electronic money and electronic money to actual money, respectively.

### *Mobile Phone Banking: "Text A Payment"*

With the availability of the electronic money technology, the Rural Bankers Association of the Philippines-Microenterprise Access to Business Services (RBAP-MABS<sup>vii</sup>) entered into a joint project with Globe Telecom through the Text A Payment Project (TAP). RBAP MABS is exploring various services using the *G-Cash* platform but the following discussion will focus only on the TAP project specifically on the actual customer interface.

TAP allows micro loan clients to pay their loan amortizations using the *G-Cash* platform through short messaging services (SMS). Shifting from the traditional client field collection to TAP will lower banks' transaction costs and increase the productivity of their account officers. It has been a revolutionary solution for low value payments. On the other hand, paying through TAP is more convenient and less costly for clients as *G-Cash* outlets, establishments where clients can make cash-in transactions, are now widely distributed, ensuring increased accessibility.<sup>23</sup>

The process is very straightforward. The client will register in the system through SMS inputting some key information such as name, address and phone number. The user will then receive a reference number and TAP identification number through Globe Telecom's SMS facility. Once registered, the client can go to any Globe Cash In Center/ Outlet to convert actual money to electronic money. The process adequately addresses security concerns, as the client will provide a valid ID card and fills in the necessary forms in the Globe Cash In Center/ Outlet. A minimal service fee is also paid during this phase. Once the verification and processing is completed, the electronic money amount is sent to the mobile phone with a reference number. Both the outlet's service unit and the client will receive the confirmation.<sup>24</sup>

The client can then use the loaded electronic money to pay the rural bank by simply sending a text message with the amount and the personal identification number (PIN) to satisfy security concerns. Again, both the sender and receiver will get a confirmation of the transaction.<sup>25</sup>

Aside from the benefits briefly mentioned above, this service and product is very much attuned to the needs of the microfinance market. First, the loan amortizations for microfinance loans are usually very small and frequent therefore can be easily made through the *G-Cash* platform. Second, the large network of conveniently located *G-Cash* merchants/ outlets also makes it easier for microfinance clients to access. It is also more economical as it saves time and money for microfinance clients who can then use the time for their businesses. Some studies have shown that payment by mobile phone can result in savings of 6-8 hours that could be used for productive work.<sup>26</sup> As mentioned earlier, the technology is very user friendly and the receptiveness of the market to the SMS platform also contributes to the success of the product. On the part of the institution, there are significant savings since the bank will not have to field as much loan officers to make actual collections of payments. There is also less cash-on-hand risk for their loan officers. A research project conducted by a student of the Asian Institute of Management saw this cash-on-hand risk issue as a very significant one for microfinance operations.<sup>27</sup>

TAP is currently being used by some RBAP-MABS participating banks. The success of such pilot offerings will prove beneficial for the industry in general as well as the microfinance clients themselves. The possibility of greater outreach and well as expansion to the use of the same technology for other products and services seem forthcoming.

For example, the National Confederation of Cooperatives, Inc. (NATCCO), the largest confederation of cooperatives in the country, has already aligned with a service provider to enhance loan services and

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<sup>vii</sup> RBAP MABS is a USAID funded technical assistance to increase the capacity of rural banks engaged in the provision of microfinance services.

implement livelihood programs for member cooperatives. As for other products, savings and remittances seem to be taking center stage. A recent Consultative Group to Assist the Poorest study on Savings in the Philippines saw the potential of the mobile banking technology for facilitating small savings from microfinance clients.<sup>28</sup> The Asian Development Bank, on the other hand, sees the outreach opportunities for transfer and payment services are great, and the developments underway for an alliance among major mobile operators in the Asia-Pacific that will support regional mobile infrastructure for a common service platform that will allow seamless cross-border services. Remittances via cell phones are expected to gain significant market share especially in rural areas with weak financial infrastructure.<sup>29</sup>

### *Automated Teller Machine Cards for the Poor*

The earlier discussion on the non-inclusion of the low-income market in the country's ATM network is slowly being addressed by particular initiatives stemming from the microfinance players.

In 2004, CARD Bank, the first rural bank that focused on microfinance, and Tulay sa Pagunlad, Inc (TSPI) one of the largest microfinance NGOs, partnered with the Bank of the Philippine Islands (BPI), one of the country's largest commercial banks, to provide ATM cards to their clients. Since a significant portion of CARD and TSPI clients are in the National Capital Region and Region IV, which are highly urbanized, ATMs are very accessible. Through this partnership, CARD and TSPI clients can use any of the ATMs in the express link (elink) system of BPI. The elink is one of the largest ATM networks in the country with several commercial banks as members.

In this partnership, BPI issue ATM cards to the CARD and TSPI clients as a way to access their respective accounts. Riding on the ATM network of the elink system, the clients can access their account from the large network of ATMs in various areas of the country. The cards can be used as either loan disbursement cards or even withdrawal cards from the clients' savings account, when applicable.

These two products discussed above show great potential in a reaching wider range of clients, increasing convenience and lowering costs. Some of the barriers are seen on the application of the technology. Although, the receptiveness of the market is generally positive, there will still be some resistance to the use of technology for financial services. A survey conducted among 60 microfinance clients, revealed that a significant number still did not fully understand the *G-Cash* despite the advertisements on television and billboards.<sup>30</sup> Despite the discussions above of the wide network of mobile phone users across income levels, there may still be limited awareness of using the electronic money platforms.

In addition, the infrastructure of Cash In and Cash Out Centers/ Outlets may still be limited especially in the rural areas. Although there are numerous retail outlets that are accredited, reach in the very rural areas still leaves some room for improvement. The involvement of rural banks may additionally be a step in the right direction.

Another area that should be focused on is that of the appropriate and adequate regulation of these activities which will be discussed below.

### *Implications for Regulation*

The Basle Committee on Banking Supervision has recognized the important role of bank supervisors and regulators in ensuring that the risks associated with the use of technological developments in electronic banking are well managed. It was emphasized however that the supervisory authorities avoid policies that hamper useful innovation and experimentation.<sup>31</sup>

The enactment of the Electronic Commerce Act has laid down the basic legal and regulatory framework governing e-banking while the General Banking Law gave Bangko Sentral the authority to regulate electronic banking services. The Bangko Sentral has since issued various implementing circulars.

The twin objectives of managing the risks associated with electronic banking and ensuring that ample room is provided for innovations are carefully balanced by the BSP. The regulatory approach is primarily aimed at mitigating and ensuring proper control of operational risks that are inherent to the technology. In allowing banks to do e-banking, the two basic things that are evaluated are: 1) the underlying soundness of the banking institution itself, and 2) the soundness of risk management control surrounding the e-banking activity.<sup>32</sup>

The BSP has issued two general Circulars for electronic banking specifically Circular 240 and 269, Series of 2000. These Circulars set the basic and general rules and regulations for electronic banking services in the banking sector. Below are some of the key components of the said Circulars:

1. Banks wishing to provide and/or enhance existing electronic banking services shall submit to the BSP an application describing the services to be offered/enhanced and how it fits the bank's overall strategy. This shall be accompanied by a certification signed by its President or any officer of equivalent rank and function to the effect that the bank has complied with the following minimum pre-conditions:

a. An adequate risk management process is in place to assess, control, monitor and respond to potential risks arising from the proposed electronic banking activities;

b. A manual on corporate security policy and procedures exists that shall address all security issues affecting its electronic banking system, particularly the following:

i. Authentication - establishes the identity of both the sender and the receiver; uses trusted third parties that verify identities in cyberspace;

ii. Non-repudiation – ensures that transactions can not be repudiated or presents undeniable proof of participation by both the sender and the receiver in a transaction;

iii. Authorization – establishes and enforces the access rights of entities (both persons and/or devices) to specified computing resources and application functions; also locks out unauthorized entities from physical and logical access to the secured systems;

iv. Integrity – assures that the data has not been altered;

v. Confidentiality – ensures that no one except the sender and the receiver of the data can actually understand the data.

c. The system had been tested prior to its implementation and that the test results are satisfactory. As a minimum standard, appropriate systems testing and user acceptance testing should have been conducted; and

d. A business continuity planning process and manual have been adopted which should include a section on electronic banking channels and systems.

2. The BSP, thru the Technical Working Group on Electronic Banking, shall pre-screen the overall financial condition as well as the applicant-bank's compliance with the BSP rules and regulations based on the latest available Bank Performance Rating (BPR) and Report of Examination (ROE) including CAMELS<sup>viii</sup>.

The Working Group shall ensure that the applicant bank's overall financial condition can adequately support its electronic banking activities and that it shall have complied with certain comprehensive prudential requirements such as, but not limited to, the following:

- a. Minimum capital requirement and net worth to risk assets ratio;
  - b. Satisfactory solvency, liquidity and profitability positions;
  - c. CAMELS composite rating of at least 3 (this number, however can be flexible depending on other circumstances prevailing), and with at least a moderate risk assessment system (RAS) based on the latest regular examination;
  - d. There are no uncorrected major findings/exceptions noted in the latest BSP examination.
3. Based on the recommendation of the Technical Working Group on Electronic Banking, the Deputy Governor, SES, shall approve in principle the application so that banks may immediately launch and/or enhance their existing electronic banking services.
4. Banks shall be informed of the conditional approval of the DG, SES and they shall in turn notify the BSP on the actual date of its launching/ enhancement.
5. Within thirty (30) calendar days from such launching/enhancement, banks shall submit to the BSP thru the Supervisory Reports and Studies Office (SRSO) for evaluation, the following documentary requirements:

- a. A discussion on the banking services to be offered/enhanced, the business objectives for such services and the corresponding procedures, both automated and manual, offered through the electronic banking channels;
- b. A description or diagram of the configuration of the bank's electronic banking system and its capabilities showing (i) how the electronic banking system is linked to other host systems or the network infrastructure in the bank; (ii) how transaction and data flow through the network; (iii) what types of telecommunications channels and remote access capabilities (e.g. direct modem dial-in, internet access, or both) exist; and (iv) what security controls/measures are installed;
- c. A list of software and hardware components indicating the purpose of the software and hardware in the electronic banking infrastructure;
- d. A description of the security policies and procedures manual containing (i) a description of the bank's security organization; (ii) definition of responsibilities for designing,

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<sup>viii</sup> CAMELS Rating System used by Bangko Sentral ng Pilipinas in evaluating banks, acronym for Capital Adequacy, Asset Quality, Management, Earnings, Liquidity and Sensitivity to Market Risk.

implementing, and monitoring information security measures; and (iii) established procedures for evaluating policy compliance, enforcing disciplinary measures and reporting security violations;

e. A brief description of the contingency and disaster recovery plans for electronic banking facilities and event scenario/problem management plan/program to resolve or address problems, such as complaints, errors and intrusions and the availability of back-up facilities;

f. Copy of contract with the communications carrier; arrangements for any liability arising from breaches in the security of the system or from unauthorized/fraudulent transactions;

g. Copy of the maintenance agreements with the software/hardware provider/s;  
and

h. Latest report on the periodic review of the system, if applicable.

6. If after the evaluation of the submitted documents, the Working Group has still some unresolved issues and grey areas, the bank may be required to make a presentation of its electronic banking transactions to BSP.

7. Upon completion of evaluation, the appropriate recommendation shall be made to the Monetary Board. The following shall be the standard conditions for approval:

a. Existence at all times of appropriate top-level risk management oversight;

b. Operation of electronic banking system outsourced to a third party service provider taking into consideration the existence of adequate security controls and the observance of confidentiality [as required in Republic Act. No. 1405 (Bank Secrecy Law)] of customer information;

c. Adoption of measures to properly educate customers on safeguarding of user ID, PIN and/or password, use of bank's products/services, actual fees/bank charges thereon and problem/error resolution procedures;

d. Clear communication with its customers in connection with the terms and condition which would highlight how any losses from security breaches, systems failure or human error will be settled between the bank and its customers;

e. Customer's acknowledgement in writing that they have understood the terms and conditions and the corresponding risks that entail in availing electronic banking services;

f. The bank's oversight process shall ensure that business expansion shall not put undue strains on its systems and risk management capability;

g. The establishment of procedures for the regular review of the bank's security arrangements to ensure that such arrangements remains appropriate having regard to the continuing developments in security technology;

h. Strict adherence to Bangko Sentral regulations on fund transfers in cases where clients use the electronic banking services to transfer funds;

i. The electronic banking service shall not be used for money laundering or other illegal activities that will undermine the confidence of the public; and

j. The BSP shall be notified in writing thirty (30) days in advance of any enhancements that may be made to the online electronic banking service.

To further institutionalize the process within the BSP, a Core Information Technology Supervision Unit (CITSU) was later established in June 2005 tasked to issue information technology risk policies as spelled out in Basel II, provide baseline information technology risk standards and align information technology policies with international best practices.<sup>33</sup> In line with these core functions, the CITSU is also tasked with the evaluation of emerging electronic banking products as well as the provision of the necessary procedures and guidelines for the adoption of the same. The CITSU is headed by a senior staff (Deputy Director) with a core of specialized personnel in the field of information technology and supervision and examination. The Unit is housed under the Office of Supervisory Policy Development of the BSP. The creation of the Unit exemplifies the importance that the BSP places in having responsive and relevant policies, rules and regulations for electronic banking and related services for the banking sector. Its creation has also paved the way for a more expedited process in evaluating and approving electronic banking and technology related products and services.

For the Text A Payment, CITSU evaluated the product through a series of product presentations. Since telecommunication services are not under the regulatory ambit of the BSP, it is only when there are linkages with the banking system that will allow BSP to carefully evaluate the key product characteristics. Since banks need to be accredited as *G Cash* Cash In/ Cash Out Outlets before offering the service, BSP undertook an extensive evaluation process of the product and system. Apart from the product linkage of *G Cash* with banks, Globe Telecom's subsidiary, G Exchange that operates as its payments system for its *G Cash*, also awards the BSP some de facto regulatory authority. During the evaluation period, the BSP was and is allowed by Globe Telecom to look at the telecommunication company's database and for the Anti Money Laundering Council of the Philippines to look at the same for suspicious accounts and covered transactions as defined by the Anti Money Laundering Act (AMLA). The AMLA covered transactions are those that are PhP 500,000 and above and the suspicious transactions are those that are identified using relevant and appropriate transaction profiling procedures. All these procedures are aimed at verifying the following critical areas:

1. Fulfillment of the Know Your Client Procedure
2. Anti Money Laundering Requirements
3. Adequate Risk Management
4. Integrity
5. Security and Confidentiality

The additional security feature for the TAP is the transaction cap that has been determined. For the TAP, there is a cap of PhP 10,000/ transaction, PhP 40,000/ day and PhP 100,000/ month. This condition as well as the fact that the product is a pre-paid, poses relatively less risk to the system. It is evident that the security and risk management requirements and measures are commensurate with the possible risk<sup>34</sup>.

Taking these product factors into considerations and following the evaluation and the careful study of the pilot proposal by the RBAP-MABS for the TAP, CITSU has devised a process flow that will allow the more expeditious approval for similar products in the future. The process builds on the strength of the industry

networks as well as fulfills the basic requirements set by the telecommunications provider to properly implement the system. The following steps characterize the process flow:

1. Banks that are interested in participating as G-Cash outlets will apply directly to the Bank Industry Associations (i.e. Chamber of Thrift Banks or Rural Bankers Association of the Philippines)
2. The respective associations will accredit the bank after complying certain training on the use and implementation of the product.
3. The training focuses on the product functionalities, problem resolutions, mechanism to address losses from human error, etc. The other focus of the training is on the implementation of the Anti Money Laundering guidelines particularly the Know Your Client Principle and the record keeping and reporting of suspicious transactions.
4. Also prior to accreditation, the bank shall submit satisfactory results of the User Acceptance Testing.
5. The industry association will then submit the accredited banks to the CITSU and copy the relevant department handling the supervision and examination of the accredited banks.

It can be seen that the Bangko Sentral carefully evaluated the characteristics, risk and security concerns as well as the other relevant features of the TAP. While keeping the safety and soundness of the financial system in mind as well as the protection of the clients and users of the product, the Bangko Sentral was open to the innovation and the use of information technology to increase efficiency of the delivery of financial services. With the appropriate safeguards, the Bangko Sentral has now laid down a process that will allow other players to offer similar services.

### **Final Comments**

Microfinance has proven to financial institutions (i.e. banks) that the services they provide to their "traditional" clients can also be offered to poor and low-income entrepreneurs and clients, in a sustainable and viable manner. These institutions have seen that reaching out to the majority of the country's population, which is the low-income market, does not necessarily mean a losing proposition for their institutions.

Similarly, it is only appropriate that the more efficient and cheaper methods of providing these financial services, such as electronic banking services, which are offered to valued traditional bank clients, should also be offered to microfinance clients. The increased convenience and lowered costs arising from innovations in electronic banking should also benefit the poor and low-income clients.

Recent developments in the Philippines are showing that innovations undertaken by microfinance institutions deliberately consider the unique characteristics of the poor and low-income clients. It is therefore encouraging that the said innovations in the field of electronic banking will more effectively and appropriately reach the needs of this market thereby allowing them to enjoy the benefits of electronic banking.

In addition, the regulatory approach of the Bangko Sentral ng Pilipinas, the receptiveness of the existing market as well as the potential users of the e-banking products, the advancements in information technology and the increased interest in the use of technological advances by the institutions serving poor and low income clients provides a promising picture for the coming years insofar as reaching the poor through electronic banking. By carefully managing all these factors, the future will open wide opportunities for expanded outreach and usage as well as increased diversification of services.

Endnotes:

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