Report on Best Practices for Sustainable Models of Pro-Poor Rural Financial Services in PHILIPPINES

Investing in rural people

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Report on

Best Practices for Sustainable Models of Pro-Poor Rural Financial Services in PHILIPPINES

Gilberto M. Llanto and **Jocelyn Alma R. Badiola**

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Foreword

Promoting pro-poor growth is a pattern of growth that is inclusive and enhances the ability of impoverished people to participate, benefit in, and contribute to the growth process. This is a critical factor for developing countries to achieve a sustainable way out of poverty and to enable achievement of the Sustainable Development Goals.

The causes of poverty are complex and multi-dimensional. They involve, among other things, climate, gender, markets, access to finance and public policy. Likewise, the poor are quite diverse in both the problems they face and the possible solutions to these problems. Poverty remains a predominantly rural problem with a majority of the poor in developing countries living in rural areas. It is estimated that 76 percent of the developing world's poor live in rural areas whereas only about 58 percent of the overall global population lives in rural areas. Because of the complexity of rural poverty, each country needs to evolve its own strategy for addressing the concerns of rural poor that is in tune with its socioeconomic ethos.

APRACA has been in the forefront to lead access to finance in the rural areas through its member institutions in the Asia-Pacific region by providing technical assistance in capacity building, research and knowledge management. We are fortunate enough to receive generous funding from International Fund for Agricultural Development (IFAD), the global leader in development finance for documenting the pro-poor rural finance best practices (RuFBeP project). The knowledge gathered will help APRACA in disseminating the information that promotes innovations, productivity, inclusive growth, self-reliance, and welfare of the rural poor in the region and benefit the member institutions in 21 countries across the region. We are confident that documenting the best practices on sustainable practices of pro-poor financial services in the countries like China, India, Indonesia, Philippines, and Thailand will be extremely useful to the countries in the Asia-Pacific region to draw lessons in evolving suitable strategies for the benefit of their people and will add value to global knowledge resources.

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Chamnong Siriwongyotha

APRACA Secretary General

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We would like to acknowledge the contribution of Ms. Cristina G. Lopez [agricultural loan guarantee case study] and Mr. Joel Q. Matira [value chain case study] bothe from Agricultural Credit Policy Council (ACPC). The team also acknowledges the support and advice provided by Ms. Jovita M. Corpuz lead institution, Executive Director, ACPC. Her views, comments and feedback are greatly appreciated and acknowledged here.

Further, we would like to extend our thanks for the active participation of the members of the Study Country Working Group, particularly: Mr. Onesimo Cuyco of NLDC; Ms. Melaney Viajante of CARD-MRI; Mr. Allan Retamar of PCIC and Mr. Art Genavia of the Land Bank of the Philippines. The views, comments and feedback these individuals have provided from the conceptualization to the completion of the final draft have been very useful to the study team.

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Abbreviations

ACPC	Agricultural Credit Policy Council
ADB/N	Agricultural Development Bank of Nepal
AFMP	Agriculture-Fishery Microfinance Program
AGFP	Agricultural Guarantee Fund Pool
AMCFP	Agro-Industry Modernization Credit and Financing Program
AMP	Agriculture Microfinance Program
AOs	Account Officers
APRACA	Asia-Pacific Rural and Agriculture Credit Association
ASA	Association for Social Advancement
ASKI	Alalay sa Kaunlaran, Inc.
ATMs	Automated Teller Machines
BAAC	Bank for Agriculture and Agricultural Cooperatives
BACs	Bank-Assisted Cooperatives
BCDC	Bicol Cooperative Development Center, Inc.
BPRE	Bureau of Post-Harvest Research
BRI	Bank Rakyat Indonesia
BSP	Bangko Sentral ng Pilipinas
CALF	Comprehensive Agricultural Loan Fund
CARD MBA	Center for Agriculture and Rural Development Mutual Benefit Association
CDA	Cooperative Development Authority
CIC	Credit Information Corporation
CLIMBS	Cooperative Life Insurance and Mutual Benefit Services
CLPP	Coop Loan Protection Plan
CLSP	Coop Life Savings Plan
CRS	Catholic Relief Services
EE	Enabling Environment
FDL	Fondo de Desarrollo Local
FFFCI	Federation of Free Farmers Cooperatives, Inc.
FGD	Focused Group Discussion
FSCP	Food Supply Chain Program
GBA	Grameen Bank Approach
HF	Household Finance
HNB	Hatton National Bank
IFAD	International Fund for Agricultural Development
IFC	International Finance Corporation
JFC	Jollibee Foods Corporation
Kalasag	Kalasag Farmers Producers Cooperative
Land Bank	Land Bank of the Philippines
LCAP	Livelihood Credit Assistance Program
M&E	Monitoring and Evaluation
MABS	Microenterprise Access to Banking Services
MASSSPECC	Mindanao Alliance of Self-help Societies and the Southern Philippines Educational Cooperative Center
MBA	Mutual Benefit Association

MBO	Micro-Banking Office
MCPI	Microfinance Council of the Philippines
MFIs	Microfinance Institutions
MF-OBO	Microfinance Oriented Banking Office
MIS	Management Information System
M-PESA	“M” for ‘mobile’ and “Pesa” for ‘money’
MSME	micro, small and medium enterprises
MSO	Member Savings Operation
NAMVESCO	National Market Vendors Cooperatives Service Federation, Inc.
NATCCO	National Confederation of Cooperatives
NCAC	National Cooperative Advisory Council
NCC	National Credit Council
NFEF	Non-Farm Enterprise Finance
NGOs	Non-Government Organizations
NLDC	National Livelihood and Development Corporation
NORLU	Northern Luzon Cooperative Development Center, Inc.
OBO	Other Banking Office
OFs	Overseas Filipinos
PCFC	People’s Credit and Finance Corporation
PCIC	Philippine Crop Insurance Corporation
PEARLS	Protection, Effective financial structure, Asset quality, Rates of return and costs, Liquidity and Signs of growth
PEF	Peace and Equity Foundation
PFCCI	Philippine Federation of Credit Cooperatives, Inc.
PFCCO	Philippine Federation of Credit Cooperatives
PHP	Philippine Peso
PIC	Philippine Insurance Commission
PIDS	Philippine Institute for Development Studies
RBAP	Rural Bankers Association of the Philippines
RHBF	Rural Household Business Financing
RIMANSI	Risk Management Solutions, Inc.
SBC	Small Business Corporation
SEC	Securities and Exchange Commission
SEC	Securities and Exchange Commission
SFCL	Small Farmer Cooperatives, Ltd.
SFF	Small Farmers and Fishers
SHG	Self-Help Groups
SIFFS	South Indian Federation of Fishermen Societies
SKS	Swayam Krishi Sangam
SME	small and medium enterprises
TAGCODEC	Tagalog Cooperative Development and Education Center, Inc.
TAP	Text-A-Payment
TSPI	Tulay sa Pag-unlad, Inc.
TWGs	Technical Working Groups
VBARD	Vietnam Bank for Agriculture and Rural Development
VCF	Value-Chain Finance
VICTO	Visayas Cooperative Development Center, Inc.
WOCCU	World Council of Cooperatives and Credit Unions

US$ 1 = PHP 46.00

Executive Summary

Introduction/Background

Limited availability of credit and the lack of access to a range of critical financial services have hindered inclusive growth in many countries within the Asia-Pacific region. This has been proved to have serious repercussions on the development outcomes of national economies and also on efforts to lift the typical rural smallholder out of poverty. Providing smallholders with credit, and other financial services has always been a challenge to policy makers and financial institutions alike. For reasons, already known the problem of lack of accessibility to financial services by smallholders has been in strong prevalence.

However, it seems that this nagging problem is not insurmountable after all. A brief review of literature reveals the role of innovations in providing sustainable rural finance services and pointed to a number of successful and not-so-successful government interventions in the credit markets. A distinct lesson coming from the Philippine experience is the importance of giving private financial institutions a greater role in rural financial markets, and of the retreat of government into a role that it alone can effectively play, namely, that of providing a policy and regulatory environment conducive to private sector participation in the markets. Philippine experience also shows that private financial institutions can lend and provide a variety of other financial services to areas or clients wherein risks (e.g. loan default risk), can be assessed and mitigated.

In response to the specific requests from national governments of the Asia-Pacific region for support in expanding access to rural financial services for the poor, APRACA and the International Fund for Agricultural Development (IFAD) supported studies that documented global best practices on sustainable models of pro-poor rural financial services in developing countries. The Philippine study focuses on two to three best and sustainable models of pro-poor rural financial services for the practical purpose of replicating them in the source country (in this study, the Philippines) and sharing them with other APRACA member-countries or possibly replicating in other countries, which finds its suitability.

The objective of this report is "to enable rural finance providers and governments extend financial services on a sustainable basis, through the application of best practices suitable to their unique operating environments"[1]. A documentation of best practices of sustainable, pro-poor rural financial services provides the information and data for policy formulation on how those best practices could enhance the delivery of financial services to small clients, especially poor households.

Based on a set of criteria, the best practices documented in this report have the following characteristics: *First*, it is pro-poor, that is, accessible and favorable to the poor; *Second*, it is technically and financially feasible which are factors that can make replication feasible and; *Third*, it is cost-effective, profitable and sustainable. In other words it is viable and doable over a continuous period without the assistance of a subsidy in any forms. Sustainability of the rural financial service is a necessary but not sufficient condition for providing the poor with access to financial services such as credit, savings and other financial services. Those sustainable rural financial services should be pro-poor as well because a financial service could be sustainable but it does not serve the poor because it is not accessible and does not provide favorable terms to the poor. For instance, credit at relatively low and competitive rates. Governments in the region have realized the limited impact of efforts to mobilize substantial funds to support the rural population when those funds are not accessible nor provided at reasonable and favorable terms to the poor.

[1] The quoted phrases or sentences come from the Terms of Reference of the Study

Methodology

The methodology employed in the Philippine study combined desk review, field data gathering, key informant interview, focused group discussion (FGD), and a workshop with the Country Working Group. Both primary and secondary data and information were gathered through various means-interviews, FGDs, etc.

The best practices were chosen in consultation with the Agricultural Credit Policy Council (ACPC) according to the following criteria: *First*, it is pro-poor-accessible and favorable to the poor; *Second*, it is technically and financially feasible-factors that can make replication possible and *Third*, it is cost effective-profitable and sustainable without supports and subsidies. It is understood that there may be best practices, programs or projects that have several components like credit with education, credit with savings mobilization, loans released and repaid through ATMs, etc.

Case Studies

Within the above framework, a total of four best practices were selected for documentation. The first case which falls under the thematic area "Operational and Outreach Structures-Wholesale and Retail" is about micro-banking offices and how this recent innovation in microfinance has enabled CARD Bank to significantly expand its outreach even to hard-to-reach areas. The second case, which falls under thematic area I on "Collateral", is how GM Bank, a rural bank has used the government's loan guarantee scheme to lend to small farmers even without the benefit of collaterals. The third case, which falls under thematic area "New Innovations" discusses how small onion farmers, a microfinance NGO, a government development corporation, a large private food company, a donor and the local government successfully collaborated in using the value chain finance to provide small onion farmers with access to finance and a market for their produce. Finally, the last case, which is also under thematic area "New Innovations", is about how micro-insurance grew and developed under a conducive policy and regulatory environment created by the government with donor assistance.

Conclusion and Recommendations

As the case studies indicated, credit enhancements such as loan guarantee and risk protection schemes such as micro-insurance play a critical role in addressing perceived risks in smallholder lending. The best practices in sustainable rural finance that are encapsulated in the four case studies are really different types of innovations, which have been instrumental in providing the excluded segment of the population with access to financial services. Consumption smoothing, investments and risk-taking, and protection of families and individuals from catastrophic losses were made possible through the documented best practices. It is noted that collaborative effort by government, private sector, donors and the microfinance and micro-insurance communities was indispensable in developing and implementing those best practices.

The few[2] case studies discussed in this report provide insights into a rich menu of best practices on rural finance in the Philippines. One important observation is the increasing emphasis and recognition of the need for providing multiple financial services, and not on credit provision alone. Rural financial institutions currently are constrained by poor outreach, adequate fund base, cost of recoveries and lack of responsive financial products and services. The case studies indicate that attaining the stated objectives is feasible by using innovative product and service portfolios through an institutional linkage.

Best practice in product innovation is illustrated by the case studies on agricultural loan guarantee (case of GM Bank) and micro-insurance. Best practice in process innovation is showcased by the use of value financing to bridge financing and marketing gaps (case of Kalasag cooperative). Finally, best practice in

[2] Because of time, budget and space (in the report) constraints, only a few case studies are reported. However, there are many more similar experiences out there that could be investigated by a curious analyst or even by policy makers or financial institutions wanting to learn innovative practices and products.

institutional innovation is seen in the use of MBOs and OBOs to develop an extensive client outreach even in hard-to-reach areas (case of CARD Bank).

In this light, the report submits the following recommendations, which are basically a reiteration of specific recommendations arising from the four case studies:

On agricultural loan guarantee

- Intensify efforts for banks to enable participate in the agricultural loan guarantee program.
- Simplify and expedite processing and payment of guarantee claims.
- Streamline policies on accreditation of lending institutions and renewal of guarantee lines and consider linking lending institutions' performance in recovering paid claims.
- Develop and implement a more strategic information/communication plan on the loan guarantee scheme.
- Strengthen the Project Management Office, its management information system (MIS) and monitoring and evaluation (M&E) capacity including its "local presence".
- Establish a formal institution to implement the loan guarantee scheme.

On micro-insurance

- Enhance the technical and managerial capacity of the regulator-Philippine Insurance Commission
- Develop innovative micro-insurance products addressing multiple risks.
- Harness public-private partnerships (PPP) in micro-insurance.
- Develop micro-insurance (innovative) products dealing with effects of climate change.
- Educate clients on micro-insurance (insurance literacy).

On value chain financing

- Build capacity of small farmer-producers to participate in the value chain.
- Base interventions on a solid assessment of actual smallholder (small farmers) needs.
- Familiarize small farmers and other stakeholders with the structure and the dynamics of the value chain.
- In considering financial interventions, consider non-financial alternatives such as: 1) ensuring contact with financial institutions; 2) bringing together in workshops various stakeholders to see whether solutions can be found within ordinary business relationships; 3) providing technical assistance to producer organizations or lead actors in the chain, allowing them to meet the requirements of viable and sustainable chain operations; 4) facilitating linkages offering finance providers the comfort of well-established market outlets, and providing sufficient value added potential at the local level.
- Identify an effective lead partner in value chain finance.
- Provide necessary infrastructure in rural areas.

On MBOs and OBOs

- For regulators, to adopt proportionate ('light but firm touch') on regulation of microfinance;
- For MFIs/RFIs, adhere to highest performance standards required by the regulator to earn the trust and confidence of regulators to impose 'light' or proportionate regulation of microfinance operations.
- For MFIs/RFIs and regulator, maintain transparent and open policy dialogue to ensure the appropriateness of regulations imposed by the regulator.

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CHAPTER 1
Introduction

1.1 Background

The Asia-Pacific region has been an economic powerhouse for several decades and continues to be a source of dynamism and growth for the global economy. Overall growth has been traced to accumulation of capital including investments in human resources, which have both contributed to rising productivity in manufacturing and services, and to a limited extent in agriculture in some countries, notably the East Asian countries. However, the rural and agricultural sectors in many countries in the region have not kept with the pace of growth of manufacturing and services. An important factor that has "held back the rural and agricultural sectors in general amongst many countries within the Asia-Pacific region, thereby slowing the overall development of national economies" is "the limited availability of credit such that the "the lack of access to a range of financial services is a major hindrance to lifting the typical rural smallholder out of poverty"[3]. Thus, the national governments of many countries in the region are increasingly concerned with the limited impact of the substantial investments made to support the rural population[4].

Many of the reasons attributed for the lag in access to financial services are well known. Delivering small-scale financial services is particularly challenging in rural areas as on the one hand it is expensive to the financial institutions to operate and on the other, small holders (small scale clients) face high transaction cost. In addition, there are risks associated with natural disasters, low yields, unforeseen declines in prices and so on. This has led to the conclusion that agricultural and rural finance is a high risk activity for both the lender and the borrower. Hence, many banking institutions are often reluctant to extend credit to smallholder farmers and rural people.

However, despite these barriers, innovative ideas and approaches are constantly being developed and tested. IFAD's extensive experience in the sector demonstrates that both agriculture and rural finance can be profitable businesses. In this regard, the Asia-Pacific Rural and Agriculture Credit Association (APRACA; www.apraca.org) received a small grant from the International Fund for Agricultural Development (IFAD) to respond to the specific requests from national governments of the Asia-Pacific region for support in expanding access to rural financial services for the poor. The basic approach of this grant project is to document the best practices at the macro, meso and micro levels of the rural finance[5]. This study was commissioned by APRACA to document global best practices on sustainable models of pro-poor rural financial services in developing countries. The Philippine study focuses on two to three sustainable models, which are really financial innovations that are currently being used successfully in the country. It is important to document those best practices for practical purposes and replicating it in the source country (in this study, the Philippines) and sharing with other APRACA member-countries or possibly replicating them in wider contexts.

[3] Terms of Reference

[4] Terms of Reference

[5] The project will be implemented in 4 distinct phases, of which the Phase 1 will focus on documenting the activities in PR China, Indonesia, India, the Philippines and Thailand 2. The Phase 1 activities will be undertaken in the 5 focus countries, namely PR China, India, Indonesia, the Philippines and Thailand, and will run for five months (July-Nov, 2014). This phase will draw on the results of the global review to see how, and if, they are being applied in the selected operating environments.

1.2 Objective and scope of the study

The objective of the study is "to assist rural finance providers and governments extend financial services on a sustainable basis, through the application of best practices suitable to their unique operating environments"[6]. A documentation of best practices of sustainable, pro-poor rural financial services will provide information and data to policy formulation on how those best practices could enhance the delivery of financial services to small clients, especially poor households.

The desired development outcome of the study is poverty reduction and improvement of food security for rural communities through the provision of sustainable pro-poor rural financial services[7]. The provision of sustainable, pro-poor rural financial services is one key intervention that governments have used to address problems of poverty and food security[8]. As the terms of reference has stated, there are several well-known reasons for the lack of accessibility of rural financial services. There is an asymmetric situation faced by both financial institution and small holders or small clients (the poor). On the one hand, delivering small-scale financial services could be particularly challenging in rural and hard-to-reach areas such as uplands, remote coastal fishing communities. It could also be expensive as rural populations tend to be dispersed over large areas that may not be properly connected through all-weather roads. On the other hand, the small clients face high transaction costs. In addition various risks associated with natural and catastrophic disasters, low agricultural yields, unforeseen decline or volatility in prices and the unavailability of acceptable collaterals create problems for borrowers and potential lenders. One result is the perception of high risks in agriculture and rural finance, which discourage banking institutions from extending credit to smallholder farmers and rural population.

Despite these barriers, innovative ideas are constantly being developed and tested[9]. IFAD's extensive experience in the sector demonstrates that both agriculture and rural finance can be profitable businesses and that new and innovative approaches should be given both the opportunity and the appropriate resources (fiscal, institutional, political, etc.) to show their true potential to help lift the typical smallholder farmer out of poverty. The selected cases of best rural finance practices reported in this study partake of the nature of financial innovations, understood as 'product,' 'process,' and 'institutional' innovations that have been instrumental in efforts to provide sustainable rural finance services. Financial innovations provide a convenient frame to understand those best practices and to motivate pilot projects in another phase of the APRACA study on best practices in rural finance.

[6] The quoted phrases or sentences come from the Terms of Reference of the Study

[7] Terms of Reference of the Study

[8] The most effective interventions, e.g., agriculture and rural development policies, trade policies, etc. vary from country to country depending on socio-economic and political context, good institutions and other factors. The study focuses only on sustainable pro-poor rural financial services.

[9] This paragraph is from the Terms of Reference.

CHAPTER 2
Methodology and Data

2.1 Study design and inclusion criteria

The authors used a comprehensive methodology for collecting data and information for analysis: desk review of literature, field data gathering, key informant interviews, focused group discussions (FGDs) and a workshop with the Country Working Group. Both primary and secondary data and information were gathered through these instruments. In gathering information and documenting best practices the following steps were undertaken:

- Conducted a desk review of available local and international literature on financial innovations and best practices in sustainable, pro-poor rural financial services;
- Consulted the Agricultural Credit Policy Council, the lead institution identified by APRACA "to provide technical and logistic assistance and support to the team"[10] (composed of the international consultant and a local consultant) who will undertake the documentation in order to identify candidate best practices for the documentation on rural finance policies, financial innovations and best practices in sustainable, pro-poor financial services;
- With advice from ACPC, selected and evaluated best practices to document using the following criteria: (i) *outreach*, (ii) *technical and financial feasibility*, and (iii) *cost effectiveness/ profitability*. It is understood that there may be best practices programs or projects that combine two or three components to provide sustainable financial services. For example credit with education, credit with savings mobilization, loans released and repaid through ATMs, etc. It is noted that the determination of the minimum 2 to 3 best practices of sustainable pro-poor rural financial services was done in consultation with and advice of the Agricultural Credit Policy Council;
- Undertook field validation of secondary data and information, and collected relevant data/ information through FGDs and key informant interviews of officers of the financial institutions and a select group of clients;
- Documented the best practices and presented the findings in a workshop with the Country Working Group[11];
- Finalized the documentation after considering the comments and suggestions made by APRACA and the Country Working Group.

[10] From the Terms of Reference

[11] Conducted in December 2014. The Country Working Group is composed of ACPC, Land Bank of the Philippines, National Livelihood Development Corporation, Philippine Crop Insurance Corporation and the Center for Agriculture and Rural Development (NGO).

The Study Framework is shown in **Table 1** below.

Table 1. Study Framework

Level of analysis	Focus areas	Sources of data and information	Methodology
Enabling environment for sustainable and effective implementation of rural finance services	• Policies and regulations • Access to funds • Timely and relevant knowledge on rural finance development	• Government policy documents • Central bank	• Desk review of policies, secondary data • Key informant interview
Profile of rural financial services providers	• Government financial institutions • Microfinance institutions/rural financial institutions • Non-government organizations • People's organizations	• Providers of financial services	• Desk review of secondary data • Field data gathering (focused group discussion, interviews)
Finance service options for the rural poor	• Credit • Savings • Micro-insurance • Guarantee	• Government financial institutions • Microfinance institutions/rural financial institutions • NGOs, people's organizations	• Desk review of secondary data • Field data gathering (focused group discussion, interviews)
Best practices in providing rural financial services	Key success factors • Technical and financial feasibility • Cost effectiveness • Sustainability • Outreach • Innovations • Organizational characteristics such as legal structure, areas of operation, clientele, operating procedures, others	• Country working group • Providers of financial services • Clients	• Desk review of secondary data and literature • Field data gathering (focused group discussion, interviews) • Workshop with country working group

2.2 Inclusion criteria

The best practices documented in the study satisfy three basic criteria which were formulated in consultation with the Agricultural Credit Policy Council (ACPC). *First*, it is pro-poor-accessible and favorable to the poor; *Second*, it is technically and financially feasible which are factors that can make replication possible; and *Third*, it is cost effective, profitable and sustainable, that is, viable and doable over a continuous period without need or assistance of a subsidy in one form or another. Sustainability of the rural financial service is a necessary but not sufficient condition for providing the poor with access to financial services such as credit, savings and other financial services. Those sustainable rural financial services should be pro-poor as well because a financial service could be sustainable but it does not serve the poor because it is not accessible and does not provide favorable terms to the poor. For example, credit at relatively low and competitive rates. It is understood that there may be best practices, programs or projects that have several components, e.g., credit with education, credit with savings mobilization, loans released and repaid through ATMs, etc.

The Terms of Reference identifies these specific criteria in documenting pro-poor sustainable rural financial services. Governments in the region have realized the limited impact of efforts to mobilize substantial funds to support the rural population when those funds are not accessible nor provided at reasonable and favorable terms to the poor. Hence, the broad criteria of (a) sustainability and (b) pro-poor are used to select the best practices of sustainable financial services for the poor, and the use of the specific criteria for selecting the best practices discussed in this paper.

CHAPTER 3
Review of Literature

3.1 Inadequate and insufficient access to financial services

People living in the rural areas access financial services for purchasing agriculture inputs; hiring labor for planting/harvesting; transporting goods to markets; making and receiving payments; managing peak season to cover expenses during the low season; making investments in education, shelter and health; as well as in dealing with emergency situations, among others (ILO, 2009). Financial management for the poor, is a fundamental and well-understood part of everyday life (Cull, Ehrbeck and Holle, 2014). However, ILO (2010) reports that for the most part, rural communities remain underserved. Most rural households lack access to reliable and affordable finance for agriculture and other livelihood activities. Many small farmers live in remote areas with no access to basic market infrastructure where retail banking is limited and production risks are high. Todd and Sharma (2010) explain that when poor people have limited saving or borrowing options, their investment plans are stifled and it becomes harder for them to break out of poverty. If households have no access to insurance and are unable to accumulate small savings that enable them to pay for household and business expenses, especially during lean seasons, they are forced to limit their exposure to risk even if high returns are expected. This makes the pathway out of poverty more arduous. Inadequate access to financial services is, thus, part of what is often called the "poverty trap."

Todd and Sharma (2010) further explain that financial institutions have demonstrated a lack of interest in agricultural finance for four reasons: (i) Many agricultural households are located in remote parts of the country and are often so widely dispersed that financial institutions find it challenging to provide cost-effective and affordable services; (ii) Big chunk of the agricultural population is subject to the same weather and climate risks, making it hard for providers of financial services to circumvent risks or operate profitable insurance pools; (iii) Service providers, mainly urban-based, are simply not familiar with the business of agriculture making it difficult for them to design profitable financial products; and (iv) Most small agricultural producers in developing nations have little education and little knowledge of how modern banking institutions work. Other reasons for the reluctance of banks to lend to small holders (small scale clients, especially those in the rural and agricultural areas) documented in a recently concluded donor-funded microfinance project in the Philippines were the following: (i) lending to small farmers remains risky due to calamities; (ii) non-calamity risks in the form of pests, diseases and market risks adversely affect farm outputs; (iii) government guarantee programs tend to encourage rural banks to continue adhering to the traditional way of "supervised credit" that requires lump sum payments, and encourages underwriting practices that depend on payment from the guarantee fund on client's failure to repay (MABS Project Report).

3.2 Opportunities in agriculture and rural finance

The International Finance Corporation (IFC, 2012) cited four reasons indicating how agricultural enterprise financing could be a major opportunity for banks and other financial institutions: "First, global food demand is expected to grow 50 percent by 2030, led by increasing global population (expected to reach 7.5 billion by 2020), particularly in emerging markets where the middle class is growing as well. According to FAO figures, by 2018, world food consumption is expected to increase by approximately 30 percent compared to the 2005 reported figures.

Second, farmers in emerging markets can contribute to food security and improve their incomes by increasing their productivity and the quality of the crops they produce. For this they would need to invest in new technologies, access better inputs, improve farm and off-farm practices, and invest in sustainable production methods for their crops. In particular, the world's 450 million smallholder farmers, over 90 percent of whom are in Asia and Africa could play an important role in food security and also improve their incomes. Access to credit can play a key role. Without credit, smallholder farmers use sub-optimal inputs and farming practices that lead to low yields and often resort to unsustainable practices of production. Access to finance will, thus, contribute to moving farmers from subsistence/ semi-commercial into commercial farmers and improve the livelihoods of those farmers who are already commercially oriented. According to a recent report, the demand for credit by smallholder farmers globally was roughly estimated to be nearly as high as US$ 450 billion (Dalberg Development Advisors, 2012).

Third, for financial institutions, agricultural lending provides the opportunity to diversify into larger and broader portfolios. For example, during the economic crisis of 2008, agricultural commodities were enjoying high prices and commodity sectors were showing some very profitable opportunities. In fact, between 2004 and 2008 commodity prices almost doubled and, despite a dip in 2009, prices had again exceeded their 2008 levels by 2011. Another possible indication is that the NPLs in countries with a high agriculture sector share in GDP saw their NPLs decline during the recent economic crisis, compared to developed countries with low agriculture sector share in GDP, which saw their NPLs significantly increase.

Fourth, innovative financing, risk mitigation, and distribution models hold some promise that the risks and costs of agricultural lending can be managed. Given these, lenders are beginning to recognize the growing potential and profitability of lending to these generally feared but little understood agricultural enterprises.

There had been efforts to promote agricultural financing around the globe. In the study linking financial innovations to food security, Llanto and Badiola (2010) highlighted the importance of implementing sustainable rural financial innovations in order to encourage more investments in agriculture improve productivity and ultimately, achieve the goal of food security among developing nations. More discussions on these, including information on access to institutional credit and bank access in rural areas of the Philippines can be found in pages 31-38.

The importance of providing small scale economic agents, e.g., low income group, microenterprises with access to financial services has recently been strengthened by the recent discourse on financial inclusion through financial innovations as a development priority (Cull, Ehrbeck and Holle, 2014). By fall 2013, more than 50 national-level policy-making and regulatory bodies had publicly committed to financial inclusion strategies for their countries (World Bank 2013a, AFI 2013). Moreover, the World Bank Group in October 2013 postulated the global goal of universal access to basic transaction services as an important milestone towards full financial inclusion- a world where everyone has access and can use the financial services he or she needs to capture opportunities and reduce vulnerability (World Bank 2013b). To achieve financial inclusion a wide range of financial products and services is being made available to the excluded segments of the population in many developing countries.

Based on the earlier experiences of institutions like the Bank Rakyat Indonesia, savings deposit has become an important source of loanable funds. Financial institutions saw the need to innovate as conventional deposit mobilization practices in urban areas may not be applicable in the rural areas due to differing deposit market characteristics. Among these are: lower per capita savings propensities (correspondingly the bank will have to contend with small numerous deposit accounts), erratic and seasonal patterns of savings behavior, poor infrastructure and communication, lower education levels and lower population density (Charitonenko, 2005). Given the increasing demand for deposit services, rural financial institutions have thus, come up with deposit products and services tailor fitted to local conditions. Charitonenko (2005) noted that the innovations that have emerged from two countries, particularly Philippines and Madagascar, evolved from "going back to basics" type of customer service in order to appropriately address the needs and customs of rural clients. For instance, the Caisse d'Epargne de Madagascar (CEM) has partnered with one of the largest private insurance companies in Madagascar, Nyhayana, to develop new financial service packages. These packages bundle savings with other products, such as life and home insurance, which simultaneously encourages rural clients to open a savings account with CEM. As a pilot program, the CEM has reached approximately 1,500 clients and upon completion, will expand to other urban and rural areas. Moreover, the CEM signed a service agreement with Western Union to provide money transfer services from abroad to Malagasy citizens. By enhancing this service through the development of an MIS platform facilitating interbank electronic fund transfers, the bank was able to enhance its image and provide more efficient savings, transfer and remittance services. Over time, CEM found its remittance services rapidly expand, and could better meet the rural clients' demand for a reliable place to store savings and secure money transfer services. The CEM now handles about 60 percent of the country's total remittances.

In the Philippines, "piggy banks" are as common a practice as they are in American homes. In the past, rural banks commonly collected savings daily, based on the belief that poor and rural clients could not save on their own accord. In an effort to reduce staff time spent processing these multiple small transactions, the Rural Bank of Talisayan designed a savings product around the widely recognized piggy bank concept. The Bank issued clients a small locked box, called a *Ganansiya* Box, at or below cost after opening the savings account with a minimum deposit. Keys to the boxes are kept at the bank, but the clients keep the boxes at home and bring them to the bank as needed to deposit their savings. This allows clients to save small amounts on a daily basis while reducing staff time spent on collections. Use of the boxes has allowed the Rural Bank of Talisayan to achieve and sustain a deposit-to-loan ratio in excess of 100 percent. Other banks have also attracted significant savings deposits by adopting the concept.

It is interesting to note that savings mobilization can be effectively aided by well-designed voluntary savings products. These are observed mostly with MFIs. Karlan et al. (2003) conducted a survey of 113 microfinance institutions from developing countries, 31 of which are from Asia, to examine the different savings product designs. The savings products surveyed are those comprising the non-compulsory deposit liabilities of the financial institutions. The survey yielded 124 savings products from 25 countries. Karlan et al. examined the features of the deposit products that help individuals make regular deposits into savings account and withdrawal side features, that is, the features that deter individuals to withdraw. They found the following deposit features:

- Forty (40) percent of savings products have a 'bonus' deadline (bonus refers to lotteries and raffles open to deposit account holders) reported to be popular among rural clients. A 'deadline' can be linked to accumulating tickets for lottery- one can only increase chances of winning if she makes a regular minimum deposit.

  Twenty six (26) percent employed deposit collectors. Though this increases costs, this scheme makes it more convenient for depositors and encourages discipline among them in saving regularly. The deployment of staff to do "door to door" deposit collection was subsequently studied by Asharaf, et al. (2006) in a rural bank in the Philippines (that is, the Rural Bank of Caraga). The collection mimicked the door to door cash collection scheme of informal lenders quite popular in a number of Asian countries. The program proved the savings potential of rural women in meeting their own loan requirements (Ashe and Parrot, 2001).
- Cooperatives have played a significant role in mobilizing savings. Apart from the WOCCU credit union model, a Philippine initiative to enhance savings mobilization is the Land Bank of the Philippines-initiated savings mobilization campaign project called "Member Savings Operation" (MSO) among the bank's 559 assisted cooperatives in 1995. The methodology entailed: (i) adoption by a participating cooperative of an entire set of systems, forms and

procedures including office construction or renovation; (ii) establishment of accounting and recording system for members cash collection scheme of informal lenders quite popular in a number of Asian countries. The research confirmed that the use of deposit collectors substantially increased the savings of rural depositors.

- The research also found two factors as determinants of the deposit rate, namely, proximity to the bank and status of respondent. Most of the depositors were found to be married indicating the importance of household savings among those married.

Among the withdrawal features are the following:

- Withdrawal fee (30 percent of deposit products) which serves as a means of the finance institution to cover cost of opening and servicing the account. This is also intended to deter individuals from withdrawing money frequently.
- The other most common feature is restricted time which is a standard feature of term deposits and programmed savings accounts. The use of lock boxes (e.g. use of "piggy banks") is less common (used in only five products out of the 124 products surveyed).

Another approach to mobilize savings is to link it with loan services. Two common models in Asia are: (i) loans bundled with compulsory savings (e.g. Grameen, ASA models), which some termed as "credit-led approach" and (ii) savings first before loans model. Another approach to promote the savings-led microfinance is the 'village banking' model. "Village banking" is a term used by some international NGOs to describe their approach of forming informal savings and loan groups in villages, which regular banks do not serve. A village group is typically smaller than a cooperative with 20 members, operates on local savings and credit traditions with no infusion of funds from external sources. A Project that implemented this model is the PACT's Women Empowerment Program in Nepal. Launched in 1998 the Program trained 240 NGOs to organize 130,000 women into 6,265 self-help savings and credit groups. The Nepali self-help groups were organized into savings and credit groups. After four years, the program generated US$ 2 million in savings and self-financed US$ 1.5 million loans to more than 45,000 members (average of US$ 33 per loan) and 74,000 women were able to read and write. Village groups met weekly and custody of cash was handled with metallic lock boxes with three keys for control. Each village group was responsible for collecting, managing and lending its own savings; (iii) hiring and/or re-tooling (training) of staff for the MSO and (iv) training of core management on savings products design, pricing of products and liquidity management (Dingcong, 2005). The MSO is an offshoot of the APRACA's Linking Banks and Self-Help Groups Project funded by GTZ.

Apart from Bank Rakyat Indonesia that has successfully mobilized rural savings on a massive scale through its Unit Desas, the Bank of Agriculture and Agricultural Cooperatives of Thailand has implemented an effective rural savings program, called the "Save and Get a Chance" (Om Sap Thawi Choke). The program rewards savers who open and maintain savings accounts with prize drawings and parties to celebrate the savings culture. By 2002 (six years after the start of the program), there were 2.3 million rural savers with total deposits of about US$ 248 million and an average deposit of US$ 108.

Goodwin-Groen (2003) in a case study of the program cited the following as the key contributing factors for the success of the deposit campaign: (i) bank's stability and image that it can provide safe and secure savings services; (ii) product design matched customer requirements based on market research; and (iii) allowing sufficient time in scaling up the program. The product design features found to have matched client requirements were: security of deposits, convenience, low minimum balance, liquidity (that is, the deposit can be withdrawn anytime) and attractive yield[12].

[12] The program involved 24 months of market research, product design, pilot testing, re-testing on wider scale before the nationwide launch and implementation.

Policy makers have supported these credit and savings initiatives because of the conviction that financial inclusion through innovations can help poor households improve their lives and spur economic activity (IFAD, 2008; ILO, 2009). Thus, recently both the government and private sector in many developing countries have started to join forces in developing innovative financial services in the rural areas basically to reduce the risk and cost of lending to the poor and thus, encourage banks and other financial institutions to provide different financial services to poor communities, rural households and low income groups, including micro-entrepreneurs. Financial innovations seem to open the pathway for providing sustainable financial services to this target population.

3.3 Defining financial innovation

Innovation is the creation, diffusion and use of new ideas applied in the economy (Lundvall et al., 2003). The application may take the form of production processes, new products, new forms of organizations and new markets (Hotho and Champion 2011). Innovation can also refer to new organizational or managerial structures (Mazzarol and Rebould, 2008). It is the key to sustenance and growth at all levels of individual, organization, society and country if the community is to realize positive transformation (Temu et al., 2011).

Frame and White (2002) define innovation as "something new that reduces costs, reduces risks or provides a new product, instrument or service that better satisfies the participants' demands". Innovations can, thus, take various forms such as new products, new services, new 'production' processes, or new organizational forms, suggesting that in the case of financial innovation, this is driven by the desire of financial institutions to remain competitive. Therefore, these institutions try to find ways to reduce costs, satisfy their clients and yield better profits.

Tufano (2003) further defines financial innovation as the "act of creating and popularizing new financial instruments as well as new financial technologies, institutions and markets." The functions of innovations consist of: (a) completing inherently incomplete markets e.g. innovations address unmet preferences or needs of particular clientele; (b) addressing inherent agency concerns and information asymmetries (e.g. exploiting ways of generating information); (c) minimizing transaction, search or marketing costs; (d) responding to taxes and regulation; (e) responding to changes in economic conditions such as increased risk; and (d) capitalizing on technological developments like the use of information and communications technology (Tufano, 2003).

The following criteria are considered in identifying financial innovations (IFC, 2012): (i) new models and approaches not yet widely used (for instance, weather insurance, parametric credit scoring, mobile banking); (ii) adaptation of established models and approaches in use elsewhere but adapted to the context of emerging markets, particularly those relevant to lower income countries and smallholder farmers (for e.g., warehouse receipts, price hedging, agricultural equipment leasing); (iii) downscaling to smallholders those models and approaches that have worked in other sectors, commodity sub-sectors, and/or for the larger and medium-sized commercial farmers segment (e.g., value-chain financing).[13]

The literature shows that rural finance innovations follow certain thematic areas or priorities. Todd and Sharma (2011) point out that innovative practices can fall into four thematic areas: (1) addressing the business reality of small farmers in developing countries; (2) using modern communications technology to overcome distance and information bottlenecks; (3) managing risks at the farm and household level; and (4) bundling financial services with non-financial services to address the multiple constraints faced by most small farmers. Llanto and Badiola (2010) focused their review of innovations on approaches and practices that have the potential to reduce the risks and costs of lending to agriculture.

[13] Study on Innovative Agricultural and Finance Models, International Finance Corporation (IFC), 2012

To understand rural finance innovations in Southern Africa, Stone, et al. (2012) identified the following factors as important: (1) role of government; (2) addressing suppliers'/providers' constraints; (3) developing demand-driven financial products and instruments; (4) overcoming demand-side barriers to financial access; and (5) developing market infrastructure following a situational analysis of rural financial services. In Agar (2011) different innovations arise in an integrated framework based on an interrelation between the agricultural value chain, the non-farm enterprise and the rural household. A key element in the interaction is the enabling environment that defines how economic agents in the value chain can be impeded or motivated to do innovations (Box 1).

BOX 1
Innovations in an integrated framework based on rural value chains

1) Agricultural or Value-Chain Finance (VCF):
VCF 1: Reducing Third-Party Selling
VCF 2: Reducing Production, Price and Market Risks
VCF 3: Improving Fixed Asset Finance
VCF 4: Increasing Returns through Bulking and Storing
VCF 5: Integrating Poorer Farmers

2) Non-Farm Enterprise Finance (NFEF):
NFEF 1: More Appropriate Collateral Requirements
NFEF 2: Determining Capacity to Borrow
NFEF 3: Improved Design of NFE Services

3) Household Finance (HF):
HF 1: Reducing Households' Vulnerability
HF 2: Expanding FIs products to meet regular health, education, pension, and housing needs
HF 3: Improving FI Marketing and Outreach to Rural Audiences
HF 4: Improved Financial Education

4) Enabling Environment (EE):
EE 1: Overcoming infrastructural and cost barriers
EE 2: Creating a more enabling environment
EE 3: Improving MFI capacity and access to finance

Schrieder and Heidhues (1995) suggests the following classification of financial innovations: (a) *system or institutional innovations* which are innovations that can affect the financial sector as a whole, relate to changes in business structures, to the establishment of new types of financial intermediaries, or to changes in the legal and supervisory framework; (b) *process innovations* which cover the introduction of new business processes leading to increased efficiency and/or market expansion; and (c) *product innovations* which include the introduction of new credit, deposit, insurance, leasing, hire purchase, and other financial products. Product innovations are introduced to respond better to changes in market demand or to improve the efficiency of delivery of services.

In the following sub-section, we follow the classification proposed by Schrieder and Heidhues (1995) in the list of attempts to innovate in the Philippines, and Agar (2011) to provide a framework for the best practices discussed in Section 5 below.

3.4 Attempts at innovations and best practices

There remains questions on financial innovations viz, how can banks and other financial institutions in developing countries be encouraged to provide small scale economic agents such as farmers and microenterprises-especially those in rural areas with access to financial services in the face of risks, information asymmetries and other externalities that discourage formal financing? A common finding is that financial innovations could be a key instrument in reducing transaction cost, mitigating risks and ensuring profitability in lending to this target population. Those financial innovations can be classified into (1) product innovations; (2) process innovations; and (3) institutional innovations, byfollowing Schrieder and Heidhues (1995). Some Philippine examples of attempts/experiences with innovative financial products are reported below.

3.4.1 Product innovations

Innovative financial products create additional value and expand the frontier of finance if they allow groups previously without access, to have access to the formal financial system or if they reduce the transaction cost of either the financial services provider or the clients or both (Buchenau, 2003). Innovative financial products are either newly developed products or an offshoot of other products[14]. They cover rural finance, agricultural finance and microfinance products[15].

The Agro-Industry Modernization Credit and Financing Program (AMCFP). Republic Act 8435 or the Agriculture and Fisheries Modernization Act terminated subsidized credit programs of the government for agriculture and replaced it by the AMCFP as the umbrella credit program of the Department of Agriculture. The following features make the AMCFP different from the past credit programs of the government: (i) it is demand-driven and not supply-led; (ii) it is not commodity-specific but finances a whole range of income-generating projects of farm households; (iii) the government is not involved in any credit decision-making as the program is implemented as a two-step loan program with government financial institutions as wholesalers and qualified private banks as retailers; and (iv) it adopts market-determined interest rates as opposed to the subsidized rates of the past.

Rural Household Business Financing (RHBF) Program. One of the earliest attempts to replicate or adapt successful microfinance practices in agriculture was the RHBF, which was developed by the Agricultural Credit Policy Council (ACPC)) and piloted by Land Bank of the Philippines in 2004. The RHBF provides short-term loans to finance non-agricultural livelihood projects of agricultural households to diversify income and risk. The loan amount and repayment scheme are based on the cash flow of the entire household and not merely on that of the farmer borrower. Hence, the RHBF adopted a repayment schedule which requires either weekly or monthly amortizations on a portion of the loan plus balloon payment on the remaining portion, usually upon harvest. In addition to being cash flow-based, the RHBF does not require collateral from the farmer borrower. Under this scheme, credit funds were channeled through lending conduits (e.g. farmer cooperatives and associations) accredited by ACPC and the Land Bank of the Philippines.

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[14] Innovative products discussed in this section are based on a review of published case studies and report documents from APRACA member institutions.

[15] As defined by CGAP (2003), *Rural finance refers to* the provision of a broad range of financial services such as credit, savings, payments, and insurance to rural individuals, households, and enterprises both farm and non-farm. *Agricultural finance,* on the other hand, is a subset of rural finance dedicated to financing agricultural related activities such as input supply, production, distribution, wholesale and marketing of agricultural products. CGAP (2003) defines microfinance as the provision of financial services for the poor and low-income people who may either be in rural or urban areas. The common features of microfinance are:

- Small loans and frequent repayments. The loan size varies per country and model, but it is designed to be "small" enough such that it would suit the requirements of the targeted clientele and that the amount and mode of payment are within their capacity to pay. In most cases, the loan is required to be repaid in frequent installments, e.g. weekly, fortnightly or monthly.
- Allows borrowers to choose their own income generating activities. Loans can finance all types of income generating activities.
- Incentive for timely payment such eligibility for larger loans
- Interest rates are set to cover operating and financial costs plus return.

Consistent with these operational distinctions, agricultural microfinance can be defined as referring to the overlap of agricultural finance and microfinance dedicated to providing financial services to poor agricultural households or to financing agricultural activities of poor agricultural households.

The RHBF ended its pilot-run in July 2008 with a total of PHP 72 million in loans granted to 6,228 agricultural households. One successful feature of the program is the cash flow-based repayment scheme which gave the borrowers flexibility in settling their loan obligations. Another is the provision of loans for alternative livelihood projects of agricultural households which enabled them to augment income from farming. The lending program, which did not require collateral, enabled farmers to borrow from formal sources at much lower interest rates compared to those of informal lenders. Succeeding microfinance programs for agriculture have since been modeled after the RHBF, including regular programs such as the Agriculture-Fishery Microfinance Program (AFMP) with the Land Bank of the Philippines and the Agricultural Microfinance Program (AMP) with the People's Credit and Finance Corporation (PCFC).

Agricultural Microfinance Program (AMP). Launched in April 2009, the AMP provides short-term loans for income-generating livelihood activities – whether farm, off-farm, or non-farm – of small farming and fishing households. The AMP is implemented by ACPC in partnership with the PCFC, which was tasked to lend to small farming and fishing households through its network of microfinance institutions (MFIs) composed of cooperatives, cooperative banks, rural banks, non-government organizations and people's organizations. Eligible projects for financing include: (i) agricultural value chain activities (e.g., production, processing, marketing); and (ii) microfinance income-generating livelihood activities (e.g., farm, off-farm and non-farm) of agricultural households. Interest rates on loans are market-determined and repayment schedule is cash flow-based. To date, a total of PHP 200 million (USD 4.64 million) in AMCFP funds have been lent to PCFC. As of March 31, 2014, PHP 719.7 million (USD 16.69 million) in loans have been released by PCFC's accredited MFIs to 63,408 small farming and fishing households.

Sikat-Saka Credit Program for Rice and Food Staples. In the interest of attaining self-sufficiency in food staples, an integrated financing program named 'Sikat-Saka' was launched in January 2012. This is a joint program of the DA, ACPC, and the Land Bank of the Philippines. Sikat-Saka provides small farmers with direct access to credit for rice (palay) production through their respective irrigator's associations. Under this scheme, farmers are charged an interest rate of 15 percent per annum for the first two crop cycles. Then, in succeeding cycles, the interest rate goes down by 1 percent per cycle. Those who fully pay their production loan on time also enjoy a reduction in interest rates. To familiarize farmers with use of modern banking technology, loans are released though automated teller machines (ATMs).

To complement credit delivery, technical support is extended to farmer-beneficiaries in the form of: (i) extension and training from the Agricultural Training Institute; (ii) processing and market linkage from the National Agribusiness Corporation; and the National Food Authority; and (iii) organizational support to potential irrigator associations from the National Irrigation Administration. The program was pilot-tested for one year or two crop cycles in the four major rice-producing provinces of Isabela, Nueva Ecija, Iloilo and North Cotabato. The program has since been extended to include 25 other major rice-producing provinces nationwide. The target areas include municipalities that still remain unserved by Land Bank of the Philippines. The Sikat-Saka has an initial funding of PHP 400 million, provided by Department of Agriculture-ACPC and Land Bank of the Philippines with PHP 200 million each. As of March 31, 2014, Sikat Saka has provided 5,641 rice farmers with loans amounting to PHP 451.23 million (USD 10.46 million).

CARD Bank Agri-Microfinance Program. CARD Bank, a successful private microfinance-oriented rural bank also started to service smallholder agriculture through its Agri-Microfinance Program, a loan program designed to finance agriculture and agriculture-related businesses. The program's credit delivery mechanism was replicated in its own lending program that is focused solely on providing indigenous peoples with working capital loans at affordable interest rate and suitable repayment scheme.

The Livelihood Credit Assistance Program (LCAP). The Livelihood Credit Assistance Program of the National Livelihood Development Corporation (NLDC) provides credit support to livelihood and enterprise development projects of small farmers in agrarian reform communities and also of members of the marginalized sectors. NLDC channels the loans through a network of accredited microfinance institutions comprised of rural banks, cooperatives, non-government organizations, and people's organizations.

The Food Supply Chain Program (FSCP). The Food Supply Chain Program of the Land Bank of the Philippines (LBP) operates by linking all the economic units in the supply chain. LBP has allocated PHP 50.0 billion for production loans (crop, livestock, fisheries) and working capital loans for key food players (agriculture-producers, processors, consolidators, agriculture-exporters, service providers); technical assistance and capacity-building support to strengthen farmers cooperatives; market linkages between agricultural producers and processors. The program is basically a contract growing scheme which links small cooperative and SME producers to anchor firms or large institutional buyers[16]. The anchor firms will buy the outputs of cooperatives and SMEs and at the same time provide them with technical assistance to improve production efficiency. For the period January to September 2013, a total of PHP 5.7 billion was released for 95 projects participated by 214 farmer cooperatives, farmers' organizations and Non-Government Organization producers and 95 anchor firms. Cumulative total releases from October 2010 to September 2013 amounted to PHP 23.9 billion.

Insurance and Guarantee Products. In recent years, Philippine MFIs have become increasingly aware of the importance of micro-insurance as an instrument in reducing the risk of lending to small scale clients. Through various insurance products, poor households are able to smoothen their consumption in times of crisis or emergency. The two micro-insurance products, which most MFIs bundle with their microcredit services are:

- Health insurance to help the poor cope with debilitating illnesses, improve health in low-income households and, therefore, reduce mortality. However, it is one of the most notoriously difficult micro-insurance products to implement, because it requires significant managerial and actuarial expertise; and
- Life insurance to mitigate the financial shock of the death of the breadwinner through the proceeds of the life insurance policy and also by covering funeral expenses. Life insurance can be easily bundled with other types of insurance. For e.g. repayment of outstanding debts at the time of demise of the family's breadwinner. The death of a household's main breadwinner can severely impact household welfare.
- *Cooperative Life Insurance and Mutual Benefit Services (CLIMBS).* Operating since 1971, CLIMBS is a composite insurance cooperative owned by more than 2,000 cooperative primaries and federations all over the country. As an insurance provider for cooperatives and its members, it provides a number of services which include life insurance, property insurance, and health care products. Insurance products of CLIMBS are categorized into life and non-life. Life insurance products are generally available to individual members of cooperatives and other duly-registered organizations. However, some insurance products also cater to non-members. Among such products is the Coop Loan Protection Plan (CLPP) which provides indemnity for loss of life, limb, speech, hearing or sight, or total and permanent disability resulting from accidental bodily injury. The CLPP reduces delinquency in the cooperative and relieves beneficiaries of the financial obligation in case of natural death as CLIMBS takes care of paying for their loans. Another life insurance product is the Coop Life Savings Plan (CLSP), a group life insurance plan specially designed for members investing their resources in the cooperative in the form of share capital of fixed and savings deposits. The CLSP intends to protect the

[16] In Malaysia, many farmer organizations have contract growing arrangements with poultry companies (integrators) that supply them with all the necessary inputs and veterinary services on credit (Yedra, 2007). In Nicaragua, UCPCO, a union of six village-level cooperatives growing organic coffee has a partnership with the local rural microfinance institution Fondo de Desarrollo Local (FDL) to improve access to financing in the value chain. To avoid or minimize sale to third parties, UCPO and FDL supervise the harvest and offer competitive prices as well as provide additional client services, in effect, reinforcing the contract (Agar, 2011).

members' investment, and at the same time encourage them to put in more since they will be assured that their beneficiaries will receive not just their investment in the cooperative, but also indemnity of the same amount from CLIMBS in case of natural death.

- Non-life insurance products provides protection to properties including homes, household and personal belongings, and vehicles against fire, lightning, earthquake, typhoon, floods, explosions, housebreak, robbery, and other accidents. CLIMBS also has a weather index-based insurance which provides protection to cooperatives or members of cooperatives located in municipalities affected by frequent and extreme weather events based on trigger indexes for wind-speed and rainfall. This insurance product prevents such natural catastrophes from adversely affecting the cash flow, liquidity and earning capacities of poor households.
- Center for Agriculture and Rural Development Mutual Benefit Association (CARD MBA). CARD Bank was established as a separate entity to handle micro-insurance services for its micro-loan borrowers. The insurance entity, called "Mutual Benefit Association" (MBA) is owned by the policy holders, managed by professional staff and licensed by the Philippine Insurance Commission. The coverage is compulsory to all micro-loan borrowers of CARD Bank. The MBA provides life insurance coverage, loan redemption insurance and provident fund (retirement savings plan) to micro-loan borrowers. The MBA model is being replicated by other MFIs in the Philippines, Indonesia, and Cambodia in partnership with the RIMANSI (Risk Management Solutions, Inc.), a non-government organization micro-insurance technical assistance provider based in the Philippines[17]
- Insurance Programs of the Philippine Crop Insurance Corporation (PCIC). Philippine Crop Insurance Corporation (PCIC) provides crop insurance protection to the farming sector against loss of crops and/or non-crop agricultural assets on account of natural calamities such as typhoons, floods, droughts, earthquakes, volcanic eruptions, plant pests and diseases, and other perils. PCIC currently has regular insurance programs for rice and corn, high value commercial crops, livestock, fisheries, non-crop agricultural assets, and term-insurance programs (like life and non-life insurance). It is also implementing a special program, a fully subsidized agricultural insurance program for agrarian reform beneficiaries and their household members.
- PCIC is also piloting weather index insurance in Regions II, VI and in Butuan province with assistance from the World Bank and International Labor Organization. The index used in determining payment of claims is 'amount of rainfall'. Farmers will get financial compensation if there is little or excessive rainfall. Area-based yield index insurance is also currently piloted by PCIC in Southern Leyte in partnership with GIZ. The index used to determine payment of claims is the historic (20-30 years) average yield of an area. Depending on the results, PCIC plans to regularly implement both insurance products in late 2014 or early 2015.[18]
- The Agricultural Guarantee Fund Pool (AGFP). The AGFP Program was established to mitigate the risks involved in lending to the agricultural sector. It is expected to enhance food production by lowering the lenders' risks in non-collateralized agricultural lending. It guarantees up to 85 percent of the outstanding loan of a small farmer. Some of the new features or innovations of this loan guarantee program are, as follows:
- In addition to banks, other institutions like cooperatives, small and medium enterprises, non-government organizations or farmers' organizations can seek guarantee cover from AGFP;

[17] By professionalizing the insurance services, particularly product development e.g. through the conduct of actuarial studies, the financial viability of micro-insurance services markedly improved.

[18] Based on the article "Weather-based crop insurance products: Making farmers more climate-change resilient" published in the Business Mirror on 05 January 2013. http://businessmirror.com.ph

- Guarantee can cover all risks from losses due to non-payment of loans including those caused by natural calamities and pests and diseases as well as market aberrations except fraud on the part of the lending institution;
- Guarantee may cover all types of agricultural production projects, including production of grains (rice and corn) and high value crops; poultry and livestock; as well as fishpond operations;

The AGFP started operations in August 2008 with seed funding of PHP 4.48 billion (USD 103.87 million) coming from government revenues and surplus funds of government corporations and financing institutions. It targets to guarantee loans of eligible lending institutions up to three times the seed fund or up to PHP 13.45 billion (USD 311.85 million).[19]

The AGFP provides guarantee cover of up to 85 percent of unsecured loans extended by financial institutions and other eligible lenders to small farmer borrowers engaged in rice and/or other food production activities. The AGFP guarantee covers all types of risks of default including risks due to weather, pest and diseases and other fortuitous events, except those arising from willful default and/or fraud. In case of default or non-repayment of the guaranteed loan by the farmer-borrower for any of the said valid reasons, AGFP shall pay the lending institution the guaranteed portion or 85 percent of the unpaid loan.

3.4.2 Process Innovations

3.4.2a. Microfinance Méthodologies. Four of the most important microfinance methodologies used in Asia that has been successful in both outreach and financial viability during the past decade includes,

Grameen Bank Methodology. This is the most popular and widely replicated model in Asia because it has made possible wide outreach and high repayment rates. The early replicators were in the Philippines, India, Malaysia, China and Indonesia. David Gibbons (2006), one of the pioneering replicators in Southeast Asia, cited the following as essential elements of Grameen bank model, (i) exclusive focus on the poor with priority on the 'poorest' women, (ii) financial services delivery that facilitates participation and ensures timely repayment such as small loans payable in periodic mostly, weekly installments, formation of solidarity groups, self-choice of loan activities, loans for income generation only, and eligibility of succeeding loans based on repayment of previous loans; and (iii) attainment of financial self-sustainability. Gibbons recognized that replication is an art and most replicators adjusted the model to fit particular local conditions. However, he cited the following as among the important conditions for successful replication of the model: (i) poverty density – it is clear that cost is related to density of clients and thus, operational sustainability is reached in areas where there are high concentrations of the poor; and (ii) freedom to create self-employment (ease of entry of microenterprises), i.e., there are no serious impediments or constraints in putting up self-employment activities.

The features of the Grameen model are already well known and the innovation was how the Grameen technology can be effectively transferred. In the early 1990s the mode of technology diffusion was "exposure-then-training," i.e., early innovators in one country were sent for exposure and then by training in Bangladesh (Yedra, 2007). Those innovators then became the resource persons in extending the technology to other financial institutions in their respective countries. The new mode of technology transfer is "Build-Operate-Transfer" that has been piloted by Grameen Trust (Morshed, 2006). The approach contributed to the expansion of microcredit programs in countries where the Grameen model did not exist and where there were very few rural financial institutions. The Grameen Trust reported good results with their pilot "Build-Operate-Transfer" projects in Turkey, Myanmar, Kosovo and Zambia over the last nine years. The Myanmar project for instance has reached 95,000 clients as of 2006.

[19] This leveraging of up to 3x the amount of AGFP capital was authorized by the Bangko Sentral ng Pilipinas (BSP) in 201212. In previous years, BSP allowed the leveraging of AGFP funds up to 2x its capital fund or up to PHP 8.96 billion (USD 207.88 million).

ASA Model of Microfinance. The ASA (Association for Social Advancement) of Bangladesh started in 1990 and it was only in the late 1990s that its lending methodology was replicated in other Asian countries. ASA is among the largest microfinance institutions in the world in terms of outreach. As of end 2011, ASA Bangladesh has 3,154 branches in 72,204 villages manned by 21,422 staff. Each branch has about 60-120 groups comprised of about 20-30 members per group for a total of 1,200-3,000 clients. It has 4.36 million borrowers, US$ 47.4 billion outstanding loans, operational self-sufficiency of 188 percent, portfolio at risk of 2.28 percent and loan recovery of 99.84 percent[20].

Globally ASA's peers and industry experts recognize ASA as having the fastest growth with the most efficient, sustainable, and cost-effective day-to-day operations. Thus, since 1993 the international microfinance community has preferred ASA as technical assistance provider. Under the MicroStart Project UNDP selected ASA through an international bidding as the International Technical Service Provider for Philippines in 1998 and for Nigeria in 1999. As of 2005, the ASA microfinance model has been introduced in countries like the Philippines, Indonesia, India, Yemen, and Nigeria. The Philippines has the highest participation with 16 MFIs using the technology. Among the MFIs provided with technical assistance in replicating the ASA model and their corresponding outreach as of 2005 were: Bandhan – NGO in India – 121,525 clients, Bina Swadaya of Indonesia – 6,870 clients; CARD Rural Bank of the Philippines – 176,160 clients, Life Bank of Philippines – 46,062 clients. Fernando and Meyer (2002) called ASA as the "Ford model of microfinance" owing to its standardized operations approach. Each ASA branch follows standardized operations from composition of personnel, physical facilities, including type of furniture, accounting system, and lending operations. Yedra (2007) explains that each loan officer is responsible for about 18 groups per week or 3 groups per day. Loans and compulsory savings are collected weekly per group. There is no joint liability requirement among the groups, which distinguishes it from the Grameen approach. Branch offices are established near clients to keep transaction cost low for both lender and borrower. Their unique operating system is viewed as responsible for attaining the most cost-efficient operations of all microfinance models.

3.4.2b. Delivery Mechanisms. The literature also discusses the significance of value chains in enabling small holder participation in the market. A significant percentage of financial services to small farmers occur through the value chain (Fries and Akin, 2004). Agar (2011) defines the value chain as a range of activities and services required to bring a product or service from its conception to sale in its final markets. Value chains can be relatively simple, with a single agricultural commodity sold in a small number of end markets or more complex, with several commodities leading for sale in a variety of end markets (ACPC, 2009). Agriculture value chains have various sub-components such as sets of various services transport, fertilizer, equipment and finance. Llanto and Badiola (2011) pointed out that the value chain reduces commercial risk by providing an assured market for the produce, thus, making it easier for chain actors to obtain financing from banks and other formal sources. Llanto and Badiola (2010) cite the three most common value chain financing mechanisms as follows: *(a) trader finance; (b) contract farming arrangements; and (c) warehouse receipts.* Trader finance, typically provided in value chains of commodities, is a common practice among small crop farmers in developing countries. Traders either purchase farm inputs from input suppliers and provide them to small producers or provide cash to producers for the purchase of inputs. Traders, however, prefer the former arrangement to avoid loan diversion. For contract farming schemes, Llanto and Badiola (2010) explain that loans are tied to purchase agreements. A large agribusiness firm or 'buyer' enters into a contract with organized small producers for large-scale production of a certain commodity with specified standards of quality and quantity that the latter must meet. In turn, the buyer commits to provide additional service such as technology transfer, technical assistance, training, monitoring and supervision. Under this scheme different approaches are tried, which include attempts to police and prevent sales to third parties, offering incentives to sell to the original buyer, and greater integration of operations (Agar, 2011).

[20] Source: www.asabd.org

Other process type innovations to make financing available even in remote areas at reduced cost and risk include the following: (i) schemes that link formal financial intermediaries with informal financial intermediaries or tap grassroots-based associations as conduits to the poor; (ii) wholesale lending by big banks and retail lending by smaller banks; and (iii) use of information and communications technology to reach the excluded segment of the population (Llanto and Badiola, 2010).

Schemes linking informal grassroots institutions with formal financial intermediaries. These enable the latter (banks) to increase their outreach to small holder agriculture, microenterprises, and poor rural households at a lower cost. While the banks provide the funds for lending, the informal organizations are responsible for organizing the rural clients; monitoring their progress; disciplining members especially on the use of credit, on loan repayment and in promoting savings and other non-credit financial services; providing training and technical assistance on business or enterprise development; and linking clients to viable markets in the supply chain. Some of the successful models using this approach include the following:

- *India's Self-Help Groups (SHG) Linkage Banking.* SHG Banking (Kroft and Suran, 2002) promotes financial transactions between the formal banking institutions with informal self-help groups (SHGs) as clients. The SHGs usually start by making voluntary savings on a regular basis (monthly or fortnightly basis), which they use as quasi-equity together with bank loans to extend interest bearing loans to members. Such loans can be provided for production, investment or consumption activities. There are three models of the SHG-bank linkages, namely (i) SHGs formed and given loans by banks themselves (16 percent of all Indian SHGs); (ii) SHGs formed by NGOs or government agencies but given loans by the banks (75 percent of all SHGs); and (iii) SHGs financed by banks using NGOs as intermediaries (9 percent of all SHGs) where the NGOs act as both facilitators of group formation and credit conduits.
- *Vietnam's VBARD-Central Farmers' Union Linkage Banking.* In order to reach more farming and fishing households, the Vietnam Bank for Agriculture and Rural Development (VBARD) developed a model linking the Central Farmers' Union with VBARD. Under this model, a borrower-savings group composed of 5-7 members in the rural areas is formed in cooperation with the Farmers' Union according to a joint resolution between VBARD and the Farmers' Union signed in 1999. The group loan is disbursed by VBARD and the farmers' union takes charge of managing the preparation and over-all operation of the group including loan application assessment, debt repayment and interest collection from the group members. VBARD also covers the operating fees of the Farmers' Union, organizes regular training regarding borrowing procedures and invites agricultural organizations to give lectures on cultivation, aquaculture, animal husbandry, etc.
- *Cambodia's AMRET-Village Association Linkage Banking.* AMRET is a leading MFI in Cambodia. Like VBARD, AMRET employs the group lending model through village associations. A village association is composed of several groups of five members per group in a particular area or locality. The officers of a Village Association consist only of a Chairman and Vice-Chairman. The Village Association plays the role of an intermediary by borrowing funds from AMRET and lending them to its members.
- *South Indian Federation of Fishermen Societies (SIFFS) in Tamil Nadu, India.* In order to allow more fishermen to have access to credit, the SIFFS was tapped to manage a Debt Redemption Fund for fishermen. The objective of the fund is to provide fishermen with refinancing that will allow them to clear their debts from traders and middlemen. In order to benefit from the fund, however, these fishermen need to be a member of any fisherman society registered with the SIFFS.
- *Improving Market Access through Cooperative Strengthening in the Henan Province of the People's Republic of China.* This program is about strengthening the capacity of cooperatives in

the Henan province of China especially in terms of linking members to domestic and international markets as well as providing business development services that will help members improve the quality of their products and become significant players in the value chain.

- *BRI Unit Desa Village Banking Model.* The unit desas are the village bank units of the Bank Rakyat Indonesia (BRI) that enabled it to attain phenomenal outreach and turnaround in profitability. The strength of BRI unit desas is savings mobilization both in magnitude and in terms of deposit to loan ratio. It has the highest deposit to loan ratio among all major microfinance institutions in Asia (ADB, 2000).

Wholesale lending approach. Banks, as wholesalers, provide financing to retail banks and other institutions like cooperatives which, in turn, lend the funds to end-borrowers. Wholesaling, in this case, includes not only the provision of funds but other support services aimed at helping retail institutions like cooperatives to become viable financial intermediaries. Support services include capacity building on savings mobilization to enable retail financial institutions (rural banks and cooperatives) to tap the deposit market apart from managing and lending funds. The Land Bank of the Philippines has successfully employed this approach.

Use of information and communications technology. This is increasingly being used by banks and other financial institutions to improve internal business processes. For e.g. loan appraisal, loan monitoring and in reaching clients – use of SMS in payment services. The use of debit, credit and smart cards has also significantly reduced transaction costs of rural clients. However, some obstacles that prevent the widespread adoption of electronic cards in rural areas are the following: (i) unreliable electricity and telecommunications service; (ii) unreliable postal services that complicate billing and payment processes; (iii) nonexistent credit bureaus, or bureaus that report only negative information on mostly large firms and urban wage earners of limited duration; (iv) low levels of education in rural areas of developing countries; and (v) the use of competing and incompatible networks and proprietary standards that limit client access only to the machines of the issuing institution.

- Philippine rural banks have started to use mobile phones in providing microfinance services under its *"Text-A-Withdrawal"* program. The mobile phones use the G-cash, a mobile money platform of a Philippine telecommunications company. Launched in 2004, G-Cash turns mobile phones into "virtual mobile wallets". G-cash can be used to pay for goods, services, bills and as remittances. The mobile phone services use SMS messaging for these transactions.
- *ATM for the Poor.* The use of ATM cards in loan disbursement increase efficiency in microfinance delivery, which translates to greater expansion and outreach. The ATM cards allow clients to withdraw loan funds and savings at any machine nearest to the borrower doing away with the check encashment process at the MFI. The process reduces transactions cost of both borrowers and MFIs. In 2001, Tulay sa Pag-unlad, Inc. (TSPI), a Philippine non-government organization, in partnership with LandBank paved the way for the use of ATMs in delivering micro-loans to poor women entrepreneurs. In 2004, CARD Bank and TSPI formed a partnership with the Bank of the Philippine Islands (BPI) to provide ATM cards to their clients.
- *Mobile Phone Banking.* The Microenterprise Access to Banking Services (MABS) in Mindanao, Philippines, a project funded by USAID pioneered the use of mobile technology in microfinance through the "Text-A-Payment" (TAP) scheme in partnership with two domestic telecommunications companies. The TAP lowers the transactions costs of both lender and borrower. Borrowers can pay their loans through their mobile phones while loan officers could spend more time increasing the quality and size of their loan portfolios instead of making personal visits to clients. This in turn translates to lower interest rates and service charges to clients.

- Kenya has a simple cell-phone-based payment service called M-PESA ("M" for 'mobile' and "Pesa" for 'money'). From a small-scale pilot program in 2006, M-PESA has become an outstanding success in Kenya. Customer response has been unprecedented. In July 2010, more than 9 million Kenyans use M-PESA to perform tens of millions of transactions every month throughout the country (Todd and Sharma, 2010)[21]. M-PESA allows customers without a bank account to send money home. People can begin using it simply by registering for free at certified M-PESA agents, which include retailers such as supermarkets, gas stations, and shops that sell prepaid airtime cards. Several banks have even become M-PESA agents. Customers can use cash to "buy" electronic money (e-money) from an agent, and then use their phones to perform financial transactions. The e-money can also be converted into cash by selling it back to an agent. Agents are paid a commission for providing cash-in and cash-out services and for registering customers. Other than 'sending money home', customers also have the option to pay via cell phone such bills as utilities, school fees and rent. Several microfinance institutions also use M-PESA's bill-paying feature for loan repayment collection. Insurance and micro-insurance premiums can also be paid using M-PESA. Another important feature is business payment which allows a business to pay a number of customers or employees through their M-PESA accounts.
- A similar scheme is the Refresh Mobile Wing of Cambodia which allows customers to transfer, deposit and withdraw money via any mobile phone in Cambodia at low cost. With a Wing account, customers can cash in and cash out their accounts at any of the 850 Win CashXpress outlets, and cash out from all ANZ-Royal ATMs using the accompanying WING ATM card. Transactions such as sending and receiving money to WING and non-WING users, phone top-up, and bill payments are done from any mobile phone, which are secured by a 4-digit pin code. All active mobile phone operators in the Cambodian market are now connected to WING, providing full geographical coverage. There is no monthly fee charged for holding an m-wallet with WING, and funds are stored in a bank. In line with the company's commitment to provide banking services to the rural poor, 64 percent of WING subscribers have household incomes below US$ 5,000 and 48 percent live outside the capital (IFC, 2012).

In sum, the rural financial markets in Asia have generated many product and process innovations, the most outstanding of which are summarized in Table 2 below. The next sub-section discusses institutional innovations, the third category of innovations.

3.4.3 Institutional Innovations

This section lists some Asian rural financial institutions that were organized to provide financial services to agriculture and rural areas. Agricultural development banks were established 20-30 years ago in many developing countries to extend financial services, mainly credit at subsidized interest rates, to customers not considered creditworthy by commercial banks (Steibel, 2000). They are largely state owned and funded by governments and international donor agencies. Those banks generally performed poorly although there were few exceptions (Nagarajan and Meyer, 2005; Steibel, 2000). Two outstanding exceptions were the Bank for Agriculture and Agricultural Cooperatives (BAAC) in Thailand and Bank Rakyat Indonesia (BRI), which introduced institutional innovations and became successful in delivering financial services to millions of small farmers and rural residents in a fairly sustainable manner. This section also reports the transformation of NGOs into regulated financial institutions, and also of cooperatives into commercially viable financial institutions as examples of institutional innovations that have gained currency in the microfinance community.

[21] This service was originally introduced at the request of a company called Safaricom for its temporary staff working in rural areas. These low-income workers previously had to travel to a Safaricom office in the nearest town to pick up their paychecks and deposit them into bank accounts; it was a time-consuming activity. Through M-PESA, they are able to get their wages directly.

Table 2. Comparative Features of Loan Products of Major Asian Microfinance Models

	Grameen Bank	ASA	BRI Unit Desas	SHG Banking
APRACA countries where model is practiced	Philippines Indonesia Malaysia China	Philippines India	Indonesia	India Nepal
Target clients	Poor	Poor	Low-income	Poor
Loan purpose	Any income generating activity	Any income generating activity	Any income generating activity	Any income generating activity
Loan size	Small (average of 9% to 15% of per capita GNI)	Small (15% of per capita GNI)	Wide range (average of 55% of per capita GNI)	Small (average of 15% of per capita GNI)
Mode of payment	Frequent amortization (weekly)	Frequent amortization (weekly)	Varied (mostly monthly)	Varied (mostly fortnightly, monthly)
Loan term	6 months to 1 year	6 months to 1 year	6-24 months for working capital; Up to 3 years for investment loan	1 to 3 years
Loan security	Group co-liability	No group co-liability	Pledge of household assets	SHG joint liability
Incentive for good payers	Larger succeeding loans	Larger succeeding loans	Larger succeeding loans; interest rebate	Incentive is based on savings 1:1 or 2:1 for first loan; Up to 4X succeeding loans
Savings	Requires collateral savings (mutual fund, personal savings)	Requires collateral savings (personal savings)	Voluntary personal savings	Group savings required, savings loans out to members

Source: Yedra (2007)

Bank for Agriculture and Agricultural Cooperatives (BAAC). BAAC's reforms were actually staggered over more than thirty years. In the beginning, the bank depended almost exclusively on capital from the government for operating funds. Allocations often arrived late, and the inflow of funds was difficult to synchronize with farmers' seasonal credit needs. The result was a chronic funding shortage. Loan-recovery rates dropped to as low as 51 percent in the early 1970s and, by 1974, administrative costs had risen to more than 8 percent, threatening BAAC's financial viability.

In 1975, the Bank of Thailand adopted an agricultural credit policy stipulating that commercial banks would initially have to lend 5 percent—and 20 percent subsequently—of their portfolios to the agricultural sector. Under this policy, the banks could either lend the amount directly to farmers or deposit with BAAC any portion of the loan quota that they could not lend directly to farmers. The policy marked a turning point in BAAC's operations and the increasing availability of commercial bank deposits made up for the BAAC's shortage of funds. Other measures were also taken, including shifting from wholesale lending through agricultural cooperatives to retail lending to individual farmers organized into joint-liability groups. By 1987, BAAC had formed about 100,000 joint-liability groups involving 1.5 million members, compared with providing wholesale loans to 821 agricultural cooperatives.

Between 1988 and 1996, the Bank of Thailand eliminated interest rate ceilings on the fixed deposits of commercial banks and eventually liberalized all interest rates. Restrictions were removed on the opening of branches, and commercial banks were allowed to offer a wide range of financial products in rural areas. By 1998, BAAC had increased the number of its branches to 535 from 82. On the one hand while commercial banks were expanding their lending portfolios and reducing their deposits with BAAC, on the other, BAAC was increasing its outreach and savings mobilization up to the point where rural deposits became its main source of funds. During the period after Thailand's financial and economic crisis in 1997 BAAC received significant inflows of deposits because it was seen as a safer haven than its commercial bank competitors.

The important elements of reform that enabled BAAC to improve and succeed in its operations as listed by Maurer and Seibel (2000) are the following:

- Government's respect, though not complete, for its operational autonomy;
- Corporate culture emphasizing cost-effectiveness, productivity and efficiency;
- Lending schemes attuned to Thai culture;
- Improvement in loan portfolio creating depositor confidence; and
- Shift in financial resource base to rural savings mobilization.

Bank Rakyat Indonesia. BRI's experience shows what can be achieved under deregulation. Since 1984, BRI has been a major provider of microfinance, mobilizing micro-savings and offering small and micro loans to individuals and groups at the village level. Seibel (2000) noted that by 1989, BRI was able to fully finance its village lending activities from locally mobilized savings. Since then, the growth of savings has outpaced that of loans, testifying to a strong demand by the rural poor for deposit services. By 1999, its 3,700 rural sub-branches had 2.5 million active borrowers and some 20 million savings accounts. Among the three leading rural financial institutions in Indonesia, BRI accounts for 78 percent of savings account deposits and 52.2 percent of all loan accounts (Yedra, 2007).

By implementing sound policies, including an emphasis on savings mobilization and massive staff retraining program, this formerly frail government-owned agricultural development bank made its microfinancing unit a tremendous success. Part of this success stems from the bank's recognition of the need to reach out to the rural poor as well as to wealthier clients. BRI benefited from interest rate deregulation and a management initiative to commercialize operations by transforming its sub-branches into self-sustaining profit centers. It offered its staff profit-sharing incentives. The bank covers its costs from the interest rate margin and finances expansion from profits; its long-term loss ratio is only 2.1 percent (Seibel, 2000).

Even during the recent Asian banking crisis, BRI's micro-banking unit remained profitable: it was the only profitable entity among the government-owned banks. At the peak of the crisis in June-August 1998, the demand for credit stagnated because of a general lack of confidence in the market. At that time, however, BRI attracted 1.29 million new savers, leading to increases in the volume of savings deposits in both nominal and real terms (APRACA, 2007).

Land Bank of the Philippines (LandBank): LandBank, a government-owned bank operates as a universal bank. It does not receive any government subsidy for its operations. Following government policy that government banks should provide wholesale loans to financial institutions that will take charge of retail lending, the LandBank extends credit facilities (loan and rediscounting facilities) to local rural financial institutions (mostly rural banks and cooperatives) which in turn lend to small farmers and micro-loan borrowers.

In the early 1990s, LandBank aggressively used cooperatives, sometimes hastily formed cooperatives, as conduits of loans to farmers. Haunted by increasing amounts of unpaid loans, LandBank adopted a new approach in mid-1990s. It slowed down the formation of cooperatives and shifted to a strategy of strengthening cooperatives. The strategy consisted of: (i) a cooperative rating system that emphasized the over-all institutional viability of the cooperative as basis in providing them with credit lines; (ii) performance-based lending and (iii) institutional development support to the cooperatives to improve their governance and management practices including improvement of savings mobilization through a program called "Member Savings Operation". The strategy paid off with positive results. There was a natural weeding out of cooperatives that did not make the grade and quality of cooperatives improved. While the number of cooperatives declined, the quality of cooperatives improved. Yedra (2007) reported that average loan repayment to LandBank improving from 60 percent to 90 percent, membership expanded, and internally generated funds (share capital and deposits) increased and significantly contributed to financial viability. The LandBank has maintained 13 percent to 14 percent of total loan portfolio for cooperative lending in recent years.

Agricultural Development Bank of Nepal (ADB/N): The Small Farmer Cooperatives, Ltd. (SFCL). SFCLs transformed from joint liability groups of small farmers in the 1980s. These were attached to the field offices of the Agricultural Development Bank of Nepal which graduated later into the SFCLs. The SFCL approach, according to Koch, et al. (2004) is based on three foundations: local SFCLs at the grassroots level, apex banks (Small Farmer Development Bank and Agricultural Development Bank) that provide the refinance facilities; and the federations of SFCLs that provide the non-financial technical support services. At the village level, small farmer groups are formed as joint liability groups consisting of 5 to 12 members. From each small group, a representative joins the so-called inter-group. This inter-group further validates specific group requests and gives recommendations to the "main committee" (composed of 9 members) of the SFCL that decides on the loans and projects of the SFCL. The SFCL delivers various financial and non-financial services to members. Non-financial services include irrigation system construction, nursery projects, or women empowerment projects. The key intervention is institution building which adopts a "farmer-to-farmer replication" approach that proved to be cost-efficient as well as effective. The replication of a SFCL took about three to four years. However while the organizational transformation from informal groups into SFCL was successful, the loan performance of the SFCLs in recent years deteriorated (Majorano, 2007 citing an ADB Report). To support the SFCLs, the Agricultural Development Bank, Ltd. of Nepal established a separate and independent bank – the Small Farmers Development Bank (SFDB) that provides wholesale lending to SFCLs. SFDB started operations as an independent bank in 2003 making loans for agriculture and livestock investments through SFCLs.

Vietnam Bank for Agriculture and Rural Development (VBARD). Using a novel approach, that is, 'mobile banking offices', VBARD was able to significantly expand outreach (Nguyen Hung, 2004). In 1998, the bank initiated a mobile banking program modeled after similar programs of other Asian countries. It started with 159 vehicles equipped to travel in hilly and dirt roads enabling its bank staff to reach remote areas where it can process loan applications, disburse money, collect repayments and savings. After five years, the program was able to provide services to 315,000 households representing around 6 percent of the bank's total clients (Yedra, 2007). According to Nguyen Hung (2004), VBARD's success can be attributed to its application of best practices in microfinance, including offering appropriate loan products, linking lending and savings, the use of joint-liability groups and solidarity groups and cost recovering interest rates. Nguyen Hung (2004) also noted good repayment rates and a US$ 1,000 monthly profit generated by each vehicle as well as mobilization of 1,983 small savings accounts each month.

Hatton National Bank: (Sri Lanka): Hatton National Bank (HNB) is a leading private commercial bank in Sri Lanka and a pioneer among private commercial banks in Asia in microfinance. As early as 1989, the bank introduced its own microfinance program called "Gami Pubuduwa" (Village Awakening). It provides a comprehensive package of banking services (savings and credit) and support services (e.g. technical assistance in input procurement and marketing arrangements). Loan appraisals are simplified and authorities decentralized at the branch level to expedite disbursements. A field officer takes care of both deposit taking and loan services. Most loans are arranged with individuals. The bank achieved a high deposit to loan ratio indicating the viability of micro savings mobilization. The bank has adopted the generally accepted good corporate governance practices in risk management, including creation of asset and liability committee, credit policy committee, and strong audit unit (Abeywickrema, 2005).

Transforming Cooperatives into Commercially Viable Financial Institutions. Cooperatives are among the significant financial service providers in rural areas especially among APRACA-member countries such as China, India, the Philippines, Nepal and Sri Lanka (Corpuz, 2007). Its potential, however, has been largely ignored due to a legacy of failed government credit programs that used cooperatives as channels of credit to small farmers. Many rural cooperatives were also not financially viable (Sasuman, 2001). In the late 1990s efforts by the World Council of Cooperatives and Credit Unions (WOCCU) around the globe to revitalize cooperatives and turn them into commercially viable microfinance institutions seemed to have paid off (Richardson and Lennon, 2001). Pilot projects were implemented in Latin America (Bolivia, Guatemala and Ecuador), Europe (Romania) and Asia (Philippines). Richardson and Lennon (2001) indicated that the approach was to make cooperatives "bank-like" in operation in terms of products and services offered (e.g., competitively priced loan and deposit products and professional services), physical image (as part of its marketing strategy) and financial structure (e.g., reliance on deposits as primary source of funds). The WOCCU credit union model emphasized the importance of meeting financial standards. Financial discipline is linked to expanded growth and outreach while keeping track of stability and soundness. The financial performance standards called PEARLS (Protection, Effective financial structure, Asset quality, Rates of return and costs, Liquidity and Signs of growth) guide management in assessing the results of their operations. In the Philippines, a USAID-funded project called Credit Union Empowerment and Strengthening (CUES) with savings and education components followed the WOCCU credit union model. Its microfinance scheme involved formation of women savings and credit groups and linking them with the cooperative. Microfinance served as the cooperative's strategy in penetrating the markets for both savings and loans. There were significant improvements in the performance of the first 11 cooperatives that participated in the CUES Project in terms of outreach (150 percent increase in membership), in volume of loans (270 percent increase), in delinquency rates (reduction of loan delinquency rate from 63 percent to 7 percent) and savings (450 percent increase) within a five year period (1998-2002) according to Sasuman (2001) and Yedra (2007). Similar exponential growth and performance results were achieved by other cooperatives that replicated the WOCCU CUES model even after the termination of technical assistance by USAID (Yedra, 2007).

Transforming NGOs into Regulated Financial Institutions. In Asian countries notably Bangladesh, Cambodia, Nepal, and India, non-government organizations (NGOs) play a significant role in the delivery of microfinance services. However, those NGOs are not within the purview of banking regulation nor are they granted the legal authority to mobilize deposits. Because they are dependent on outside funds, mostly donor funding, NGOs find attaining financial sustainability a big challenge. In some countries transforming NGOs into regulated formal banking institutions has become a sound option. As reported by ADB (2004), the transformation of NGO-microfinance institutions into regulated financial institutions started in the late 1980s in Latin America and in the 1990s in Asia. Between 1992 and 2003 at least 39 NGOs were transformed into regulated financial institutions, with Asia accounting for 15 of 39 cases worldwide (ADB, 2004). In most cases, the transformation brought significant improvements in governance and institutional sustainability. A comparison of the pre- and post-transformation outreach of 6 microfinance institutions in Asia (Cambodia, Mongolia, Nepal) showed an increase from US$ 20.4 million loan portfolio and 161,503 clients to US$ 78 million loan portfolio (390 percent increase) and 441,077 clients (173 percent increase) within three to four years (Fernando, 2004). Some NGOs that were transformed into regulated financial institutions are listed below (Fernando, 2004):

- *Cambodia:* (i) *HatthaKaksekar, Ltd*. – established as a non-bank regulated financial institution in 2001, owned by four shareholders and a staff association; (ii) *ACLEDA Bank* – established as a specialized bank in 2003 from the ACLEDA NGO; (iii) *AMRET Co., Ltd*. (formerly Ennatien Moulethan Tchonnebat or EMT) established as a regulated financial institution in 2001 from the EMT NGO; and (iv) *Thaneakea Phum Cambodia* – established as a regulated non-bank financial institution in 2003 from four NGO partners of Catholic Relief Services. Among these institutions, the Association of Cambodian Local Economic Development Agencies (ACLEDA) Bank has the widest outreach and fastest growth, from 82,976 borrowers in 2002 to 345,778 as of July 31, 2014 while loan portfolio increased from US$ 27 million in 2002 to US$ 1.7B as of July 31, 2014.[22]

- *Mongolia: XAC Bank of Mongolia* – from the Liberal Women's Brain Pool and XAC Golden fund for development. The two NGOs started under the UNDP MicroStart Project, transformed into a limited liability company in 1999 and obtained license to conduct lending activities in the same year and then transformed into a commercial bank in 2002.
- *Nepal:* (i) *NirdhanUlthan Bank* – from the Nirdhan NGO (Nepal), a Grameen replicator founded in 1991, transformed into a limited company bank in 1999; (ii) *DEPROSC Bikas Bank* – from the Development Project Service Center (Nepal), converted into a bank in 2001; (iii) *Chhimek Loghu Bitta Bikas Bank*, established in 2002 from the Chhimek Bikas Kendra NGO; and (iv) *Swalamaban Bikas Bank* from the Center for Self-Help Development NGO.
- *India:* (i) *SHARE Microfin, Ltd. of Andhra Pradesh* – transformed into a non-bank financial institution in 2000 from the SHARE NGO; (ii) Swayam Krishi Sangam (SKS) – transformed into a non-bank financial institution in 2005. Both were Grameen replicators that converted into regulated non-bank financial institutions. SHARE, established as non-bank in 2000, is the largest microfinance institution in India in terms of outreach and loans to the poor (Smith, 2006)

[22] Source: www. acledabank.com.kh.

CHAPTER 4
Findings on Rural Financial Services

4.1 Current Situation in Rural Finance

The country's rural financial system is composed of formal financial institutions and informal lenders. Formal institutions include banks that are regulated and supervised by Bangko Sentral ng Pilipinas (BSP). The formal sector is complemented by other formal institutions that offer financial services such as credit cooperatives, which operate under the cooperative law, and non-Government Organizations (NGOs), which are registered organizations but not regulated or supervised by any government entity.

The financial sector is dominated by banks comprised of 36 commercial and universal banks, 71 thrift banks, and 566 rural and cooperative banks as of end 2013. The combined number of bank branches and head offices total 9,935 during the same period. Rural banks comprise 27 percent of this total number, with almost two thirds of their branches being located in 3rd, 4th, 5th, and 6th class municipalities that are mostly rural (BSP, 2013).

BSP (2013) reports that the Philippine Financial System continued to deliver a remarkable performance in 2013 as key performance indicators showed stronger profitability, firm liquidity position, improved asset quality and higher capitalization. Banks' asset expansion is reinforced by domestically oriented deposit liabilities. Credit expansion continued on higher economic growth. With expanding assets and deposit base against the backdrop of improved macroeconomic environment, banks remained profitable and capitalized. Philippine banks, compared to its peers in Southeast Asia are the only ones rated "positive" by the international credit rating agency Moody's Investors Service. Standard and Poor's also has a positive outlook on the Philippine banking system. The positive performance of the industry hinged on increased profitability, development of innovative financial products and expansion of customer outreach, including the unbanked and under-banked areas in the countryside through alternative and technology-enabled service delivery channels.

Rural Banks. The main players in the rural areas are the rural and cooperative banks. As noted earlier, there are 566 rural and cooperative banks distributed in the rural municipalities, which is lower than the previous year's number because of mergers and closures of several rural banks. The rural banking system yielded a net profit of PHP 1.97 billion as of end June 2014. While net profits increased slightly in 2014 to PHP 1.97 billion from PHP 1.85 billion in 2013, the industry proved to be more efficient as the annualized cost-to-income ratio improved to 72.7 percent from 77.5 percent in the same period. The industry continued to grow as total assets reached PHP 206.9 billion as of end June 2014, 5.5 percent higher than the PHP 196.1 billion recorded a year ago.

Unlike more than two decades ago, rural banks have become self-reliant as they continue to rely on deposit generation to fund their operations. During the same period, deposit liabilities accounted for 68.7 percent (PHP 141 billion) share of total resources, slightly higher than 68.5 percent (PHP 135 billion) share a year ago.

With respect to loans, the industry continued to report gains from their lending activities. Total loan portfolio stood at PHP 110.7 billion, higher by 4.2 percent (PHP 4.5 billion) from the previous year's PHP 106.2 billion. The rural banking industry has also been actively involved in microfinance in the countryside. As of end June 2012, rural banks provided a total of PHP 5.6 billion worth of microfinance loans to 902,067 micro-borrowers. In sum, there were seven microfinance-oriented rural banks and 130 rural banks with some level of microfinance operations funding the credit requirements of the entrepreneurial poor.

The agriculture, hunting and fishery sector was still the main recipient of the industry's loans during the period ended March 2012. Compliance with the loan requirements for micro, small and medium enterprises (MSME) under Republic Act (RA) No. 6977, as amended by RA Nos. 8289 and 9501 showed that the total amount of funds set aside for MSME development amounted to PHP 11.7 billion. The industry far exceeded the statutory floors of 8 percent (for micro and small enterprises) and 2 percent (for medium enterprises) at 30.2 percent or PHP 8.2 billion and 13.0 percent or PHP 3.5 billion, respectively.

Finally, with respect to capitalization, total capital accounts of the rural banking industry went up by 5.6 percent (PHP 1.6 billion) to PHP 30.8 billion from the past year's PHP 29.2 billion on the back of the rise in paid-in-capital (11.1 percent). The industry remained well capitalized as the capital adequacy ratio stood at 18.4 percent (higher than the previous year's 18.2 percent).

Bank Lending to Agriculture. According to reports of the BSP and the ACPC, the combined loans granted to agriculture, fishery and forestry sectors in 2013 amounted to PHP 729 billion, a mere 2 percent of the total credit disbursements of PHP 37.7 trillion by the entire banking system (Table 3). Nonetheless, total agricultural loans granted increased by as much as 7.3 percent from PHP 679 billion in 2012 to P729 billion in 2013.

Table 3. Loans Granted by Banks to Agriculture, Fishery, and Forestry[a]

	2012	2013	% Increase/ Decrease
TOTAL LOANS GRANTED (Billion PHP)	**35,441.1**	**37,703.6**	**6.4**
Total Loans Granted to Agri, Fishery, Forestry	679.4	729.3	7.3
Agri-Production Loans Granted	209.6	236.4	12.8
Non-Agriculture	34,761.7	36,974.3	6.4
Ratio of Loans to AFF to Total Loans Granted, %	1.92	1.93	
Ratio of Agri-Production Loans to Total Loans Granted, %	0.59	0.63	
Ratio of Non-Agri Loans to Total Loans Granted, %	98.08	98.07	

[a] Estimated based on average growth rate from 2000-2011 except for LandBank and DBP which provided data.
Source: BSP, DBP, LandBank and ACPC

Among financial institutions, private commercial banks remained the major source of loans for the agriculture, fishery and forestry sector because of their sheer size and huge capitalization. For 2012, private commercial banks accounted for nearly 90 percent of all loans granted to the sector. Those loans are just 3 percent of the loans channeled by these institutions to all the sectors of the economy. Meanwhile, agricultural loans granted by rural banks posted a minimal growth of less than 1 percent at PHP 62.8 billion in 2013 from PHP 62.7 billion in 2012 (Table 4) largely because of the closure of eight rural banks and one cooperative bank during the first semester of 2013 (ACPC, 2013).

Among commercial banks, the Land Bank of the Philippines is particularly mandated by law to provide financial services to small farmers and fishers. It is by far the largest formal credit institution servicing more than 5,000 cooperatives and farmer groups and about 500,000 small farmers and fishers. The bank provides credit to small farmers and fishers through cooperatives and rural financial institutions (rural banks and cooperative rural banks) to finance various livelihood projects, which include the production of agricultural crops, livestock/cattle raising and the acquisition of pre- and post-harvest facilities, among others. In 2013, loans granted by the Land Bank of the Philippines (PHP 59.5 billion) increased by 16 percent from PHP 52.1 billion in 2012 (Table 4).

Table 4. Agricultural Loans Granted, by Type of Bank, 2012 and 2013[a]

Type of Bank	2012		2013[a]		% Change
	Amount (PM)	% Share	Amount (PM)	% Share	
Government Banks	66,708.5	9.8	75,583.5	10.4	13.3
DBP	14,574.6	2.2	16,032	2.2	10.0
LandBank	52,134	7.7	59,551.5	8.2	14.2
Private Banks	612,686	90.2	653,683.6	89.6	6.7
PKBSs	494,271	72.8	530,012.2	72.7	7.2
TBs	55,661	8.2	60,793.2	8.3	9.2
– PDBs	*18,413*	*2.7*	*20,217.4*	*2.8*	*9.8*
– SMBs	*23,382*	*3.4*	*24,479.7*	*3.4*	*4.7*
– SSLAs	*13,866*	*2.0*	*16,096.1*	*2.2*	*16.1*
RBs/CRBs	62,754.2	9.2	62,878.2	8.6	0.2
Total	**679,394.5**	**100.0**	**729,267.1**	**100.0**	**7.3**

[a] Estimated using the average annual growth rate of each type of commodity from 2000-2013.
Source: BSP, DBP, LandBank and ACPC

Agricultural Production Loans Granted. Agricultural production loans in all types of banks posted a positive growth for the period 2012 to 2013 averaging at around 12.8 percent. Government banks' farm production loans showed a robust increase of 19.0 percent amounting to ₽34.1 billion compared to ₽28.7 billion in 2012. Among private banks, rural banks' (RBs) production loans amounting to ₽62.9 billion exhibited the highest growth from the previous year at 23.8 percent (Table 5).

Table 5. Agricultural Production Loans Granted, by Type of Bank[a]

Type of Bank	2012		2013[a]		% Change
	Amount (PM)	% Share	Amount (PM)	% Share	
Government Banks	28,683.6	13.7	34,132.0	14.4	19.0
DBP	727.9	0.4	800.7	0.3	10.0
LandBank	27,955.6	13.3	33,331.2	14.1	19.2
Private Banks	180,927.6	86.3	202,257.0	85.6	11.8
PKBSs	74,480.7	35.5	78,585.6	33.2	5.5
TBs	55,661.0	26.6	60,793.2	25.7	9.2
– PDBs	*18,413.0*	*8.8*	*20,217.4*	*8.6*	*9.8*
– SMBs	*23,382.0*	*11.2*	*24,479.7*	*10.4*	*4.7*
– SSLAs	*13,866.0*	*6.6*	*16,096.1*	*6.8*	*16.1*
RBs/CRBs	50,785.9	24.2	62,878.2	26.6	23.8
Total	**209,611.1**	**100.0**	**236,388.9**	**100.0**	**12.8**

[a] Estimated using the average annual growth rate of each type of commodity from 2000-2013.
Source: BSP, DBP, LandBank and ACPC

Banks' Compliance with the Agri-Agra Law (RA 10,000). Overall compliance of banks to the mandatory lending quota under the Agri-Agra Law (RA 10,000)[23] hit P303.9 billion representing 16.9 percent of the banks' total loanable funds for the year amounting to more than P1.8 trillion. The overall compliance rate of 16.9 percent fell compared to the previous year's level of 23.8 percent. This is almost 8 percentage points short of the 25 percent requirement under the law. The banking industry in general complied (15.5%) with the 15 percent agricultural quota but under-complied (1.4%) with the 10 percent agrarian reform quota (Table 6).

By type of bank, rural and cooperative banks that are historically compliant with the law, again over-complied with a compliance rate of 69.1 percent. Thrift banks likewise over-complied with compliance rate of 33.5 percent despite falling short of the 10 percent quota for agrarian reform at 3.7 percent. On the other hand, universal and commercial banks' compliance fell short at 16.9, due largely to less than one percent (0.9%) compliance with the agrarian reform component (Table 6).

The downward trend of banks' compliance, particularly with the 10 percent agrarian portion, might indicate that some banks opt not to lend to the agri-agra sector due to perceived high cost and risk in lending to the said sector, lack of viable projects to finance, lack of repayment capacity of the sector, and the lack of business interest in this market by the banks.

Bank Lending to MSMEs. Banks continuously provide credit to micro, small and medium enterprises (MSMEs) under RA No. 6977 as funds allocated to MSMEs totaled PHP 403.5 billion, higher than the previous year's PHP 387.7 billion. This resulted in the banking system's over-all compliance ratio of 12.7 percent, which was above the required 10.0 percent (8 percent for micro and small enterprises and 2 percent for medium enterprises).

Cooperatives. Like the rural banking system, the cooperative sector has a big potential to be a significant player in rural finance and microfinance because of its extensive network. However, there are too few financially strong cooperatives; great efforts need to be exerted to build up the capacity of cooperatives to undertake sustainable rural finance and microfinance. As mentioned earlier, Cooperative Development Authority (CDA) reports a total of 23,672 registered cooperatives as of December 31, 2013, of which 2,959 are credit cooperatives and 14,722 are multi-purpose cooperatives. CDA estimates that 50 percent of registered cooperatives or 12,000 are functioning. While credit cooperatives used to account for the majority of the total number of cooperatives, multi-purpose coops now dominate with a share of about 60 percent.

There is a need to improve the regulation of cooperatives. The current state of the cooperative sector can be traced primarily to a poor regulatory environment and the lack of effectiveness of the CDA as a regulator. For almost two decades, CDA has focused mainly on its developmental functions rather than on its regulatory functions, in part because the CDA charter is ambiguous and does not grant the CDA the necessary authority to regulate and supervise cooperatives. Considering the potential of cooperatives as vehicles for promoting social and economic empowerment in the rural areas, the thrusts

[23] RA 10,000 of 2009 is the amended version of PD 717; It retains the mandatory credit allocation in PD 717 where 25% of banks' total loanable funds are to be set aside for agriculture and fisheries in general, of which at least 10% shall be made available for agrarian reform beneficiaries. The calculation of loanable funds is referenced against the start date of 20 April 2010 (the effectivity of RA 10,000) and is premised on the idea that only new funds channeled to the agriculture and agrarian reform sectors are considered.

The new law thus rationalizes the modes of compliance. Apart from direct compliance through loans to qualified borrowers, a streamlined list of alternative compliance mechanisms is also provided in the new law. Among the new alternatives are wholesale lending to and/or investments in accredited rural financial institutions (RFIs), investments in bonds that are declared eligible by the Department of Agriculture in consultation with the Department of Agrarian Reform, loans for construction and upgrading of infrastructure that will benefit the agri-agra sector as well as loans to NFA and NFA-registered warehousemen, millers and wholesalers. The Bangko Sentral ng Pilipinas will accredit the bank-RFIs while the Department of Agriculture will accredit the non-bank RFIs such as cooperatives, microfinance NGOs, among others.

Table 6. Compliance of Banks with the Agri-Agra Law (RA 10,000), in Billion PHP [a]

Item	Total	TBs	UKBs	RCBs
A. Total Loanable Funds Generated (₱ Billion)	**1,794.8 ($42.3)**	**193.6 ($4.6)**	**1,568.7 ($37)**	**32.5 ($0.8)**
B. Minimum Amount Required to be Allocated for:				
1. 10% AGRA i.e. Agrarian Reform Credit (10% x Item A)	179.5 ($4.2)	19.4 ($1.9)	156.9 ($15.7)	3.3 ($0.3)
2. 15% AGRI i.e. Other Agricultural Credit (15% x Item A)	269.2 ($6.3)	29.0 ($0.7)	235.3 ($5.5)	4.9 ($0.11)
C. Compliance with AGRA				
1. Direct Compliance	24.2 ($0.6)	2.6 ($0.06)	13.6 ($0.32)	7.9 ($0.19)
2. Alternative Compliance	1. 0 ($0.02)	0.3 ($.007)	0.5 ($0.012)	0.2 ($0.005)
3. Excess Compliance with AGRA Utilized for AGRI	(0.4) ($0.009)	(0.07) ($0.002)	(0.2) ($0.005)	(0.2) ($0.005)
4. Total Compliance with AGRA	**24.7 ($0.58)**	**2.8 ($0.07)**	**13.9 ($.33)**	**8.0 ($0.19)**
5. % of Compliance vs. Required 10% for AGRA	**1.4**	**1.5**	**0.9**	**24.5**
D. Compliance with AGRI				
1. Direct Compliance	102.1 ($2.4)	7.2 ($0.17)	80.8 ($1.9)	14.1 ($0.33)
2. Alternative Compliance	176.7 ($4.2)	2.7 ($0.06)	170.7 ($4.02)	0.2 ($0.005)
3. Excess Compliance with AGRA Utilized for AGRI	0.4 ($0.01)	0.04 ($0.001)	0.2 ($0.005)	0.2 ($0.005)
4. Total Compliance with AGRI	**279.2 ($6.6)**	**19.3 ($0.45)**	**251.6 ($5.9)**	**14.5 ($0.34)**
5. % of Compliance vs. Required 15% for AGRI	**15.5**	**29.8**	**16.0**	**44.6**
E. Total Compliance				
1. Direct Compliance	126.3 ($3.0)	18.6 ($0.44)	94.4 ($2.22)	22.1 ($0.52)
2. Alternative Compliance	177.7 ($4.2)	3.2 ($0.08)	171.1 ($4.03)	0.4 ($0.009)
3. Total	303.9 ($7.2)	21.8 ($0.5)	265.5 ($6.25)	22.4 ($0.53)
Overall Compliance, %	**16.9**	**33.5**	**16.9**	**69.1**

[a] Preliminary
Source: BSP – Systems & Reports Management Division

of the CDA need to be refocused and its policy and regulatory functions need to be clarified so that in turn it can help strengthen cooperatives in the areas of governance, management and operations, among others. An amendment to the CDA Charter (House Bill No. 291) which seeks the amendment of Republic Act No. 6939, otherwise known as the Charter of the Cooperative Development Authority, the restructuring of its organization, and the professionalization of its staff will strengthen the cooperative sector and help deliver rural finance and microfinance services in the rural areas.

Non-government organizations. There are more than 30,000 non-government organizations (NGOs) registered with the Securities and Exchange Commission as private, non-profit foundations, although only a small number of these, say two to four thousand are developmental in the strict sense of the term (SEC, 2012). It was originally estimated that around 500 NGOs are involved in some form of delivery of microcredit to the poor (JBIC, 2004). A few microfinance or credit-granting NGOs are performing well. Presumably, these are institutions which, through the years, have steadily expanded in terms of outreach and assets and have reached desirable levels of sufficiency and efficiency. Table 7 below indicates that for the years 2005, 2007, 2009 and 2011, NGOs accounted for the bulk of microfinance loans and savings deposits relative to banks and cooperatives.

The sector can be seen as having two extremes: the bigger, more established NGOs, and the smaller ones. The presence of two extremes in the sector seems to indicate a large room for growth of the smaller NGOs. However, they need to increase their financial base, employ professionals and improve their technical and managerial capacities for microfinance operations.

Table 7. Microfinance Outreach, Loans and Savings

Selected Indicators	2005	2007	2009	2011
Number of Active borrowers ('000)	1,508	2,143	2,887	3,600
Banks	597	779	883	1,032
NGOs	839	1,353	1,985	2,478
Coops	72	11	19	90
Loans Outstanding (million pesos)	7,478 ($136)	12,979 ($282)	16,547 ($367)	20,605 ($476)
Banks	3,478 ($63)	5,676 ($123)	6,677 ($140)	7,207 ($166)
NGOs	3,581 ($65)	7,226 ($157)	9,703 ($204)	12,701 ($293)
Coops	419 ($8)	77 ($1.7)	167 ($3.5)	697 ($16)
Savings Deposit (million pesos)	2,615 ($48)	4,858 ($105)	6,841 ($144)	9,225 ($204)
Banks	1,066 ($19)	1,900 ($41)	2,977 ($63)	3,891 ($86)
NGOs	1,417 ($26)	2,868 ($62)	3,792 ($80)	5,003 ($111)
Coops	132 ($2.4)	=	72 ($1.5)	331 ($7.3)
No. of MFIs	227	258	241	218

Source: ADB (2012)

4.2 Structure of the Rural Financial System

The Philippine rural financial system has three major players: (i) policymakers and regulators, (ii) wholesale financial institutions, mainly government financial institutions and (iii) retail lending institutions composed of commercial banks, rural banks, thrift banks and cooperatives.

4.2.1 Policy makers and regulators

Agricultural Credit Policy Council (ACPC). The ACPC is an agency attached to the Department of Agriculture tasked to oversee the country's rural financial system move toward an efficient, effective and sustainable delivery of financial services in the rural areas. Executive Order 113 (issued in 1986) mandated ACPC to provide policy directions on agricultural credit. It is also the agency tasked to administer the implementation of the Agro-Industry Modernization Credit and Financing Program (AMCFP), as provided for under the Agriculture and Fishery Modernization Act of 1997. Under another law, the Magna Carta for Small Farmers, the ACPC is also mandated to provide capacity building support to farmers and fishers to increase their creditworthiness, and to cooperatives and farmer organizations to improve their effectiveness and efficiency in credit delivery.

National Credit Council (NCC). Administrative Order No. 86 established the NCC, a unit of the Department of Finance on October 8, 1993 to rationalize government credit and guarantee programs. Under the leadership of the NCC, several policy dialogues and consultations resulted in the crafting of the National Strategy for Microfinance. Together with the ACPC, the NCC works with legislators and the government on the enactment or amendments of laws, issuance of policy statements and regulations to support rural finance/microfinance.

Bangko Sentral ng Pilipinas (BSP). The Bangko Sentral ng Pilipinas or the Central Bank of the Philippines is the regulator, supervisor and examiner of all banks as well as non-bank financial institutions in the Philippines. It oversees the country's monetary, banking and exchange rate policies.

Cooperative Development Authority (CDA). The CDA is the government agency tasked to register, monitor, develop and supervise all cooperatives in the Philippines. As provided for in Section 15, Article XII of the Constitution, the CDA is mandated to promote the viability and growth of cooperatives as instruments of equity, social justice and economic development.

Securities and Exchange Commission (SEC). The SEC registers and gives legal personality to for profit and non-profit companies, including non-government organizations (NGOs). While the SEC does not monitor nor supervise NGOs, it required all NGOs providing microfinance loans to categorically state in their respective charters and by-laws that microfinance is part of the services provided by these NGOs (Jimenez, 2010).

Insurance Commission. The Insurance Commission is a government agency under the Department of Finance. It supervises and regulates life and non-life companies, mutual benefit associations, and trusts for charitable uses including the provision of micro-insurance products. It issues licenses to insurance agents, general agents, resident agents, underwriters, brokers, adjusters and actuaries. It has also the authority to suspend or revoke such licenses.

4.2.2 Wholesalers of funds

The Philippines has two levels of rural finance delivery: wholesale and retail. The main players at the wholesale level are the following:

Land Bank of the Philippines (LandBank). The largest single source of credit to small farmers and fishers is the Land Bank, which was established in 1963 to purchase landholdings and finance their distribution to tenants under the Agricultural Land Reform Code. It is fully owned by the government. In 1973, it was given a license to operate as a universal bank and it has steadily stepped up its support of agrarian reform operations. The LandBank is organized into three sectors: (i) the Agrarian Sector which provides lending and extension services to agrarian reform beneficiaries, in particular and small farmers, in general; (ii) the Banking Sector which handles its commercial banking functions; and (iii) the Executive Operations Support Sector which provides administrative support. Regular commercial lending, including that to private and corporate agriculture, is handled by banking sector staff through a separate branch network.

The semi-formal financial sector (composed of cooperatives and NGOs) is handled by the Field Operations Group under the Agrarian Sector, through a network of field offices at the regional and provincial levels. Also part of the agrarian sector staff is the Countryside Financial Institutions Group, which is responsible for accrediting rural banks. To expand its outreach of ARBs/small farmers, it adopted the strategy of wholesaling funds through cooperatives or through private rural financial institutions such as rural banks through the LandBank's rediscounting program.

With the wholesale lending thrust, LandBank employed a Cooperative Accreditation Criteria in 1994 to rationalize and systematize the delivery of financial and technical assistance to bank-assisted cooperatives. To access appropriate financial and technical assistance a cooperative must first meet a set of performance standards and credit requirement. The accreditation criteria depend on whether the cooperative is a newly accessing cooperative or an existing bank-assisted cooperative.

LandBank is also tasked to implement the AMCFP as one of this program's wholesalers. As provided for in the Agriculture and Fisheries Modernization Act or RA 8435 of 1997, the AMCFP replaced the different subsidized credit programs under the Department of Agriculture in order to make credit delivery to small farmers and fishers efficient, responsive and sustainable.

People's Credit and Finance Corporation (PCFC). PCFC was established by Memorandum Order 261 and Administrative Order No. 148 to provide affordable credit to the marginalized sector. Republic Act 8425 of 1998 or the Social Reform and Poverty Alleviation Act strengthened the role of PCFC as the lead government entity specifically tasked to mobilize resources for microfinance services for the exclusive use of the poor.

PCFC provides wholesale loans to around 107 microfinance institutions (MFIs) including 78 rural banks, 26 cooperative rural banks, 2 thrift banks, 63 cooperatives and 30 non-government organizations as of September, 2014. It also provides loans for institution and capability building activities related to an institution's lending program. PCFC policy for reaching the poor is to deliver credit to the twenty poorest provinces considered as priorities by the government. Targeting the poorest provinces form part of the development agenda to fight poverty in rural and urban areas. PCFC reports a total outreach of 2,658,491 families as of September 2014 which is more than half of the total number of poor families in the country. Total loan portfolio for the same period is PHP 2.8 billion.

Small Business Corporation (SBC)[24] The SB Corporation provides loans to micro, small and medium enterprises (MSME) through its Credit Delivery Strategy. This strategy focuses on the MSME sector whose particular financing needs are addressed through credit interventions customized to their growth potential. SBC operates four financing programs. *First* is the microfinance wholesale lending program. Funds are provided to partner rural banks, microfinance institutions, and cooperatives, who in turn, re-lend the funds to eligible "pre-enterprises". The pre-enterprises include the graduating and start-up microenterprises. The *second* financing program involves direct lending to registered MSMEs. The program is intended to bridge the financing gap of what is referred to as the "pre-bankable but viable" MSMEs that are at the moment "unserved" by the banking system. Direct lending facilities are available for manufacturers, suppliers, traders, exporters, franchisers, and service providers. The *third* financing program is the credit guarantee program, which provides an entry point for small and medium enterprises (SME) to the banking system. The program targets what the "near bankable SMEs" who can access the banks but cannot provide sufficient collateral for their loan. The credit guarantee answers this need by serving as alternative or supplemental collateral for the SME loan. The credit guarantee facilities can be tapped by SMEs through their partner financial institutions. The *fourth* financing program is the wholesale lending for SMEs. Wholesale funds are coursed through partner banks for re-lending to "already bankable" SMEs.

As of end 2013, SBC operates through 4 area offices (South Luzon, North Luzon, Visayas and Mindanao) and 13 desk offices strategically located in major business hubs in the country (Isabela, Dagupan, Bicol, Mindoro, Palawan, Pampanga, Laguna, Iloilo, Tacloban, Bacolod, Cagayan de Oro, General Santos and Butuan). It has developed a network of 118 banks, cooperatives and microfinance institutions and other non-bank institutions for providing financing to MSMEs in 65 of 81 provinces in the country. Loan releases in 2013 were about PHP 3.3 billion, slightly lower by 14 percent compared to PHP 3.8 billion in 2012 mainly due to the contraction of the wholesale portfolio. As of end-2013, SBC's cumulative total loan releases to MSMEs have already reached PHP 40.0 billion since 2001.

[24] Drawn largely from www.sbgfc.gov.ph

Bangko Sentral ng Pilipinas (BSP). Bangko Sentral ng Pilipinas opened a rediscounting window for microfinance in support of the provisions of Republic Act (RA) 8791 or the General Banking Law of 2000 (RA 8791). Specific provisions in the law indicate the need for the Monetary Board to consider the "peculiar characteristics of micro-financing" (Sec. 40, RA 8791) and for the Monetary Board to "regulate the interest imposed on microfinance borrowers by lending investors and similar lenders" (Sec. 43, RA 8791). Bangko Sentral's major objective in opening said rediscounting facility is to support those banks that have achieved efficiency in their microfinance activities while adhering to BSP regulations and standards.

The BSP rediscounting facility for MFIs is for rural banks and cooperative rural banks that meet the following eligibility requirements: (i) a one-year track record in microfinance; (ii) at least 500 borrowers; and (iii) a repayment rate of not less than 95 percent during the preceding twelve month period. The BSP also requires the submission of a policy manual on the MFI operations of applicant-banks (BSP Circular 282).

Microfinance Council of the Philippines (MCPI). While the MCPI is not financial service provider but it is mentioned here because of its important role in the microfinance community. It is a NGO duly registered with the Securities and Exchange Commission. It is the national network of MFIs and support organizations working together to develop sustainable, innovative, and client-responsive microfinance. It is composed of 59 institutions including 48 MFIS and 11 support organizations (Bunker, 2014). In the approved microfinance regulatory framework in the Philippines, the MCPI is viewed as the repository of data of microfinance practitioners (Jimenez, 2010). It is envisioned that over time, the MCPI will act as a self-regulatory organization, especially for the NGOs doing microfinance programs in the Philippines.

4.2.3 Institutional Players at the Retail Level

Recent data on the state of rural finance/microfinance in the Philippines indicate that potential suppliers of loans at the retail level include 589 rural and cooperative banks; about 500 NGOs; and 2,959 credit cooperatives (RBAP, 2013; CDA, 2013).

Rural Banks.[25] In the 1950s, the government established a rural banking system, which envisioned one rural bank per municipality to address the financial requirements of local communities. Rural banks are private banks with a primary mandate to service the agricultural sector. They also lend to micro, small and medium enterprises in the countryside. They constitute a system of unit banks that is unique in the developing world, many of them growing out of the operations of moneylenders. As of 2013, there are 566 rural banks, a reduction from 589 banks a year earlier because of mergers and closure of a few failed rural banks. Likewise, the network of branches and other banking offices shrank to 1,987 from 2,015 branches nationwide. While most of the reduction came from the National Capital Region and Luzon banking presence increased in Visayas and Mindanao. Nevertheless, Luzon still had the most number of banking offices with 1,469 concentrated around Region IV-A and Region III. Meanwhile, there are seven (7) microfinance oriented rural banks with 295 branches as of end of June 2013.

Gross loans outstanding of the rural banks as of December 31, 2013 amounted to PHP 110.7 billion. Based on BSP data of the same date, there were 7 microfinance-oriented rural banks and 130 rural banks with a microfinance portfolio of PHP 5.6 billion pesos that have been provided to 902,607 microfinance borrowers.

Rural banks are supervised and regulated by the BSP. Most rural banks are members of the Rural Bankers Association of the Philippines (RBAP), a national tertiary level organization for rural banks. These banks are also members of their own provincial networks and regional federations. RBAP and the regional federations are lobby groups that advocate for policies favorable to the rural banking sector.

[25] Information gathered mostly from www.rbap.org and www.bsp.gov.ph

The Cooperative Sector[26]. The Cooperative Development Authority (CDA) regulates and supervises all types of cooperatives in the country. CDA reports a total of 23,672 registered cooperatives as of December 31, 2013 of which 2,959 are credit cooperatives and 14,722 are multi-purpose cooperatives. CDA estimates that 50 percent of registered cooperatives or around 12,000 are functioning. While credit cooperatives used to account for the majority of the total number of cooperatives, multi-purpose cooperatives now dominate the sector with a share of about 60 percent. By type of membership, cooperatives are also classified into "institutional" (i.e., those restricted to the employees of an institution, such as employees of a company), and "community" where membership is open to all residents, say, of a municipality. However, there are overlapping categories of membership, e.g., cooperatives whose members are vendors in a public market[27]. During the period 1973-1986, while the government development policy focused on assisting agricultural, electric and transport cooperatives, the other sectors in the cooperative movement were left on their own with little support from the government. This was a blessing in disguise because it forced non-agricultural, no-electrical and non-transport cooperatives to pursue self-reliant and progressive development that contributed to their viability and success.

A network of regional cooperatives training centers was established by the private sector initially to provide cooperative training and education services to cooperatives and self-help groups. Later on, these centers branched out to provide management consultancy services, inter-lending and inter-trading programs among its members and affiliates. These centers are located in five areas, namely: the Mindanao Alliance of Self-help Societies and the Southern Philippines Educational Cooperative Center (MASSSPECC) to serve the Mindanao cooperatives; the Visayas Cooperative Development Center, Inc. (VICTO) to serve the cooperatives in the Visayas; the Northern Luzon Cooperative Development Center, Inc. (NORLU) to serve the cooperatives in the Mountain Province and Northern Luzon; the Tagalog Cooperative Development and Education Center, Inc. (TAGCODEC) for the cooperatives of Metro Manila and the Tagalog provinces; and the Bicol Cooperative Development Center, Inc. (BCDC). These regional cooperative training centers formed a national federation in June 1977 now known as the National Confederation of Cooperatives (NATCCO).

Other tertiary federations/unions of cooperatives operating nationally include the Philippine Federation of Credit Cooperatives Inc. (PFCCI); Federation of Free Farmers Cooperatives, Inc. (FFFCI) and the NAMVESCO. Many primary cooperatives and provincial and regional federations are affiliated to more than one of the national federations and draw services from the latter on a selective basis. NATCCO, PFCCI, FFFCI and NAMVESCO representing the four privately initiated cooperative movements in the country, have banded together as the National Cooperative Advisory Council (NCAC), an informal, non-registered body which meets regularly on cooperative issues. NCAC officially represents the four federations in advocacy, lobbying and legislative activities[28].

Cooperatives are both rural lending conduits of LandBank and program partners of PCFC in microfinance services. Cooperatives engaged in microfinance are community-based open-type savings and credit cooperatives. Data from CDA indicate that there are around 100 credit cooperatives with assets exceeding PHP 100 million. Around 63 cooperatives are engaged in microfinance operations[29].

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[26] Data/information gathered mostly from www.cda.gov.ph

[27] These cooperatives are organized under a national federation like the National Market Vendors Cooperatives Service Federation, Inc. (NAMVESCO).

[28] The principal services provided by the national/regional federations to their affiliates comprise: (a) training in cooperative principles, leadership and management and in accountancy, bookkeeping and auditing; (b) audit services; (c) consultancy and advisory services to member cooperatives; (d) inter-lending through the establishment of a central fund system involving both lending of self-generated funds between member cooperatives and the channeling of additional externally sourced funds; (e) assistance with business development; and (f) inter-trading programs among affiliates.

[29] Reported as conduits of PCFC.

Non-Government Organizations. There are more than 30,000 Non-Government Organizations (NGOs) registered with the Securities and Exchange Commission as private, non-profit foundations, although only a small number of these, say 2,000 to 4,000 are developmental in the strict sense of the term (SEC, 2012). NGOs received a major impetus under the 1986 Constitution which requires the State "to encourage non-governmental and community-based organizations," and under Cabinet Decision 29 of the Aquino administration which called for nine line agencies and several government corporations implementing livelihood programs to directly channel all future assistance through financial institutions or NGOs as conduits.

Most NGOs are small and highly localized organizations with small full-time staff. They have a strong social orientation including value formation and community organizing. However, they are mostly small in size, operate on limited funds and thus, operational cost tends to be high. Those who choose to engage in microfinance see their role as organizing cooperatives or associations that will eventually become credit intermediaries. A few try to provide the poorest of the poor with credit.

4.3 Lending Methodologies and Practices

Rural Finance/Microfinance Methodologies.[30] Rural finance and microfinance institutions in the Philippines implement different lending methodologies as shown in Table 8. The Philippine government's policy is to be neutral regarding lending methodologies and it leaves the choice of lending methodology to the lending institutions.

Both GBA and ASA methodologies specifically target the poor, especially women with existing microenterprises. GBA and ASA utilize a housing index that they have developed and a means test to screen out the non-poor from their microfinance program.

Most of the Philippine NGO sector engaged in microfinance started with the group lending methodology popularized by Grameen Bank. The experience of NGOs in using the Grameen Bank Approach (GBA) spans a period of more than 15 years. GBA has been a principal methodology used because of the advantages of loans that are secured by group joint liability. Based on the experiences of those NGOs, it seems that the Grameen methodology works well in the first four years of implementation. Poor clients tend to be comfortable being members of a group and appear willing to answer for any unpaid loan of a defaulting member. However, it has been observed that as the groups mature and move into higher loan cycles with higher loan amounts, group cohesion seems to weaken when members who repay loans on time are asked to pay for the loan installment of a defaulting member. Under such circumstances, good borrowers decide to leave the group and eventually drop out of the program. They feel threatened that whatever income they derive from their microenterprise goes to the payment of delinquent loans of other group members. MFIs that implement the Grameen methodology have realized that the group liability feature is not fool-proof instrument to ensure loan repayment. Contrary to the common assumption that high collection rates indicate good repayment rate and low arrears it seems that high collection rates can mask a problematic situation. Good borrowers are simply asked to cover the unpaid weekly payments of delinquent borrowers. From the point of view of the lending institution, the loans get repaid and loan portfolio is whole. However, the situation is far from desirable when defaulting members escape from their obligation because of the joint liability scheme. In this situation, the true extent of loan delinquency can sometimes be hidden from the eyes of MFI management.

The introduction of the ASA methodology by a UNDP-funded project called Microfinance Support Program overhauled 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 ASA methodology emphasizes individual accountability for loans

[30] This section drew from Yedra (2009)

and individual borrowers alone are responsible for payment of their respective loans. This means that group members do not answer for loan defaults of other members. In the Grameen methodology, the center chief is made responsible for enforcing credit discipline and maintaining group cohesion. Center chiefs in the Grameen methodology carry a heavy load of responsibility. In the ASA methodology, loan officers are responsible for maintaining group cohesion and credit discipline. Because of this, they have to exert extra care in identifying and selecting potentially good borrowers.

Table 8. Dominant Philippine Microfinance Methodologies (1992-2010)

Key Features	ASA Methodology	GBA	MABS Approach for rural banks/ cooperative rural banks	CUES-SCWE
Target Clients	Poor women	Poor women with special focus to the poorest	Poor and non-poor women or men	Poor women with especial focus on economically disadvantaged
Credit Delivery	Center (20-30 members)	Center (30-60 members)	Small groups (5-10 members) or individual	Small groups (5-20 members)
Savings	Flexible (weekly minimum savings, no maximum limit); savings can be withdrawn provided 15% of loan disbursed remain in the account of the client	Compulsory (weekly minimum savings; 5% loan deduction); non-withdrawable savings	Compulsory weekly savings based on 10% weekly loan amortization; can be withdrawn after every cycle; client can also open their own individual savings account	Compulsory (weekly minimum savings, 5% loan deduction)
Repayment Responsibility	Individual liability	Group liability	Individual liability	Group responsibility
Loan Amortization	Weekly	Weekly	Daily, Weekly or monthly	Weekly, bi-weekly or monthly
Loan Terms	6 to 12 months but mostly 6 months	6 to 12 months depending on the clients	3, 6, 9, 12 months depending on the clients	6 to 12 months depending on the clients
Type of loan products	One type only (productive loan)	Multiple loans (productive, emergency, housing, seasonal loans)	One type of loan (productive loan)	Two types of loans (productive and emergency loans)
Branch Staffing	1 branch manager and 4-5 loan officers	1 branch manager; 1 assistant manager; 1 cashier; 1 bookkeeper; 6-10 loan officers	Integrated with normal branch operations of a rural bank (1 branch manager, 1 assistant manager, 1 cashier, 1 bookkeeper, 5-6 loan officers)	Integrated with cooperative structure (1 branch manager, 1 cashier, 1 bookkeeper, 5-6 loan officers)
Average clients per loan officer	300 members per loan officer	300 members per loan officer	100 members per loan officer	200 members per loan officer
No. of Replicators	16 MFIs	198 MFIs	81 rural banks/ cooperative rural banks	18 cooperatives

Sources: ADB Study on Philippine Microfinance 2002. "Delivering to the Poor: A search for Successful Practices in Philippine Microfinance"; JBIC, 2004; Assessment of MABS

The operating structure under the ASA methodology is highly decentralized. Majority of decisions related to operational issues are made at the branch and area levels. Field staff normally refers to operating manuals that spell out actions to take for many different situations. Bookkeeping is very simple and provides loan officers, branch and area managers sufficient information to manage operations in a cost-effective manner. The weakness of the ASA methodology lies in its inability to address the larger loan amounts required by growing entrepreneurs. Loan officers who are oriented toward lending fixed amounts with fixed weekly repayment schedules will need retraining to evaluate loan applications of growing enterprises, e.g., cash flow based lending.

NGOs generally 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 expressly 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 with a sizeable scale of lending operations are affiliated with the Microfinance Council of the Philippines. NGOs have no visible constraint to branch expansion. They can establish branches in any place they want to. Inadequate funding and their relatively small sizes (many are unit organizations) are generally the reasons why NGOs cannot expand their business operations and area coverage.

The ASA methodology is offering a way to low-cost fast growth and rapid expansion of the branching network. In a typical branch using ASA methodology, everything is manual. It neither has cashier, nor bookkeeper, nor computer. ASA has very simplified bookkeeping, forms, and filing systems. The simplified system allows the branch staff to track loan status anytime without waiting for inputs from the MFI head office. Therefore, staff at the branch level can take immediate and appropriate action in case there is deviation from targets. The simple structure of ASA branches is also more cost-effective because of lower overhead costs. This enables the ASA branch to realize bigger margins than fully-staffed regular branch operations.

Rural banks, in general, 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 rural banks by a USAID-funded project, called the Microenterprise Access to Banking Services (MABS). Under the MABS program, the individual lending approach has the following features: repayments are adjusted to a client's cash flow; customization of loan size; terms and repayment schedule based on client's needs; flexible loan sizes; and the use of movable assets and collateral substitutes such as co-makers. The MABS Program provides technical assistance and training to rural banks in microfinance best practices. The program is designed to develop the capability of rural banks to profitably provide financial services to microenterprises. Some 15 rural banks also used the Grameen group lending methodology. Those with an early start on GBA reported higher than average outreach compared to rural banks that stuck to individual lending. Rural banks using the GBA are among the top-ranked conduits of PCFC.

Rural bank clients generally belong to the non-poor. In this case, rural banks require collateral from borrowers. This regular practice of rural banks to demand collateral effectively shuts out the poor from availing themselves of banking services. However, for their microfinance operations, rural banks have learned how use cash-flow based lending to microenterprises, requiring no collateral from these borrowers. The targeted microenterprises are located mostly in and around urban centers and small cities. Lending rates to microentrepreneurs are in the range of 24 percent to 30 percent per annum, computed on a flat rate basis. The rates include payment of upfront service fees, commonly in the range of 2 percent to 5 percent. Collection for microfinance loans is done either daily or weekly. Majority of loans are collected on a weekly basis.

Managers of rural banks engaged in microfinance claim that microfinance best practices like zero tolerance for delinquency and enforcement of strict credit discipline have positively affected their rural bank lending operations. Significant improvements in financial performance of those rural banks come from learning good practices from the microfinance unit of the banks. Some rural banks also continue to innovate and come up with new financial products that address the requirements of their respective clients.

Cooperatives generally employ the individual lending methodology. 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 Project. The microfinance methodology, called Savings and Credit with Education targets poor women as clients. This approach is a variant of the Grameen methodology. It has all the salient features of the Grameen approach. However, it integrates education, health, nutrition, family planning, and functional literacy, among others during the weekly meetings. The major criticism to this approach is the added cost of the education component, both in training the staff to deliver the education sessions and the opportunity cost of the clients in remaining in the center meetings to receive some education.

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. Loans are repaid on a weekly, bi-weekly or monthly basis. Cooperatives are authorized by law to collect savings from their members[31]. They submit required reports annually to the CDA but regulation and supervision is generally weak. Cooperatives tend to operate within the municipality where they are registered. A cooperative registered in a particular municipality and operates there, which plans to open a branch in another municipality has to inform any registered cooperative operating in the municipality about the planned establishment of a branch in the said area

Innovative Practices[32]. Countryside financial institutions have adopted financial innovations to further increase their outreach. For instance, rural banks have made use of electronic banking to better service their clients. As of end-June 2012, there were 57 rural banks engaged in electronic wallet (G-cash), a few provide internet and mobile banking services. Growth in the number of automated teller machines (ATM) was highest among rural banks at 39 percent in 2013, compared to commercial and thrift banks. Electronic banking, particularly the application of mobile phone technology to financial transactions "has lowered the cost of transfers and payments and promoted savings mobilization for MFIs" (Micu, 2010, p. 21).

Rural banks have introduced innovative microfinance products such as micro-agriculture loans, microfinance plus and housing microfinance loans. The BSP reported that housing microfinance loans increased by 9 percent to PHP 263 million from PHP 242 million in 2012. Microfinance Plus loans, described as loans in the range of PHP 150,000 to PHP 300,000 designed for growing microenterprises, increased by 34 percent to PHP 111 million in 2013 from PHP 83 million in 2012. Thirty five banks provided micro-agriculture loans amounting to PHP 845.12 million in 2013.

More rural banks currently offer micro-insurance products. Data from the Rural Bankers Association of the Philippines showed that the total number of rural banks' clients provided with micro-insurance rose by 153 percent to PHP 1.4 million in 2013 from around PHP 543,500 in 2012.

[31] A number of cooperatives are affiliated with tertiary organizations like the National Confederation of Cooperatives (NATCCO) and the Philippine Federation of Credit Cooperatives (PFCCO).

[32] Drawn largely from Report on the State of Financial Inclusion in the Philippines, Bangko Sentral ng Pilipinas, 2013.

Finally, more banks are reporting significant increases in micro-deposits following the removal of the usual barriers to opening bank accounts such as high maintaining balance and dormancy charges. The BSP reported that micro-deposits rose 27 percent to PHP 2.96 billion in 2013 from PHP 2.33 billion in 2012. The total number of micro-deposit accounts surged by 36 percent to 1.5 million accounts in 2013 from 1.1 million accounts in 2012.

4.4 Regulatory Framework and Enabling Environment

4.4.1 Evolution of Rural Finance Policies

Before the Reforms[33]

In the 70s and 80s, the Philippine rural financial market followed the supply-led approach with a massive infusion of cheap credit funds from the government to rural banks. Various commodity-specific agricultural credit programs such as the *Masagana 99* for rice, *Masaganang Maisan* for corn, *Gulayang Pangkalusugan* for vegetables, and *Bakahang Barangay* for livestock, among others were implemented through rural banks acting as conduits of loans to target small farmers. Rural banks accessed highly subsidized loans at the Central Bank's rediscounting window as an incentive for them to lend to small farmers. It was assumed that without such an 'incentive', those banks would normally not lend to farmers because of perceived risks and high transaction costs.

Some government non-financial agencies directly provided loans to target beneficiaries, e.g., small farmers. It is during this period that the country attained self-sufficiency in rice production because of a well-managed production program and cheap credit, which enabled small farmers to buy farm inputs and other necessities. However, the positive results were short-lived as farmers started to default on their loan repayment, resulting in large arrears with the creditor rural banks. A great number of rural banks went bankrupt even as government was unable to sustain the infusion of highly subsidized credit into the rural banking system. A number of factors contributed to the failure of the supply-led approach to rural and agriculture finance: perception of subsidized credit as dole-out from the government, which did not have to be paid; faulty loan collection mechanisms both on the part of rural banks and government non-financial agencies; neglect of deposit mobilization by rural banks, which became overly dependent on cheap government funds, and leniency in screening loans and collecting payments, among others.

Some of the lessons learned from this experience can be summarized as follows:

- Lending by government non-financial agencies is costly and not sustainable; lending should be a function of financial institutions;
- Government should focus on creating a conducive policy environment, providing the needed infrastructure and support services, including building capacity among rural lending institutions;
- There is a case for increasing participation of the private sector in the delivery of credit to agriculture and rural financial intermediation;
- Banks should mobilize deposits and be less dependent on the government and other external sources of funds;
- To encourage banks to lend to agriculture, they should be allowed to cover lending costs through market-determined interest rates and to lend only to qualified borrowers and/or viable projects;
- There is a need for financial instruments that reduce the risk of lending to agriculture, e.g., effective crop insurance and loan guarantee programs; and

[33] Drawn largely from Llanto (2005)

- Credit access is both a supply and demand issue; thus, improving the creditworthiness of clients is critical. Technical assistance is needed to promote viability of their projects.

Deregulation of interest rates and other reforms

The failure of the supply-led approach, which also proved fiscally costly, led the government to deregulate the financial markets and terminate subsidized credit programs in agriculture in the eighties. Market-determined interest rates, which enable banks to cover lending costs, were deemed essential in encouraging more bank lending to agriculture. Interest rates were, therefore, deregulated and subsidies gradually removed. The Central Bank of the Philippines stopped its involvement in government credit programs and transferred the Agricultural Loan Fund to the Land Bank of the Philippines. Also part of the reform package was the promotion of universal banking or expanded commercial banking along with an increase in the required minimum bank capitalization. While restrictions were imposed on bank branching and entry especially after the financial crisis of 1983, this was liberalized in September 1989, which led to the increase in the number of banks and branches particularly of commercial banks and Land Bank of the Philippines (Lim and Esguerra, 1996).

One of the major efforts in 1987 was the termination of 42 subsidized agricultural credit programs and the consolidation of the remaining fund balances into a loan guarantee scheme for farmers called the Comprehensive Agricultural Loan Fund or CALF (Llanto, 2004). The CALF was meant to encourage private bank lending to small farmers and other small-scale borrowers by providing a loan guarantee of as much as 85 percent of the outstanding loan of small farmers.

The expected increase in credit flows to small farmers and other smallholder-borrowers following the paradigm shift to a market-oriented credit policy did not happen. The proportion of loans granted to agriculture by various types of banks declined steadily during the early 1990s (Castillo and Casuga, 1999). Only LandBank, the government bank mandated to serve agrarian reform beneficiaries, increased the share of agricultural loans in its total loan portfolio from 7 percent in 1987 to about 30 percent in the late nineties. In general, however, the share of agricultural loans dipped from 21-23 percent before the 1980s to proportions of less than 1 percent in the late nineties (Castillo and Casuga, 1999). At the borrower level, the incidence of borrowing among small farmers declined from 60 percent in the seventies to 49 percent in the nineties but recovered and increased in the mid-2000s to 68 percent (Table 9).

Table 9. Borrowing Incidence Among Farm Households in the Philippines, (Sub-Period Averages, Various Years)

Period	% Borrowers	% Non-Borrowers
1954-1960	76	24
1967-1970	55	45
1974-1978	60	40
1981-1988	49	51
1990-2000	59	41
2001-2002	64	36
2004-2005	68	32

Despite the initial reforms, small farmers and small scale clients in general continued to find difficulty accessing credit and other financial services. Banks find lending to agriculture risky and costly, which makes it unattractive notwithstanding the loan guarantee scheme (called the Comprehensive Agricultural Loan Fund or CALF) for small farmers. It seems also that banks lack the proper delivery structure for providing small loans to those millions of small farmers and other type of small scale clients, e.g. microenterprises. On the demand side, there was a slow growth in agricultural output (1.9 percent per annum on the average), and per capita output during the nineties. A significant number of farmers were disqualified from borrowing due to large scale default and arrears incurred under government credit programs in the late seventies till the early eighties. With reduced access to formal finance, many small farmers had to rely on limited off-farm and non-farm incomes, some savings, and disposal of fixed assets.

As the nineties wore on, it became evident that credit access to farmers and other smallholders was not gaining ground. While other government agencies continued to implement subsidized credit programs, the Department of Agriculture and ACPC in particular upheld market reforms in agricultural and rural finance policy. It did not take long for politicians and government bureaucrats to revive the defunct subsidized credit programs. By the end of President Corazon Aquino's administration, subsidized credit programs had once again mushroomed, undermining the government's own market-oriented credit and financial policy reform efforts. As many as 86 subsidized credit programs were implemented by 21 government non-financial and mostly line agencies (Llanto, Geron and Tang, 1999), more than three times the number of directed programs before the policy reforms in 1986. The estimated fiscal cost of those subsidized credit programs was as much as PHP 40 billion or 1.8 percent of GNP in 1996. The bulk of the funds used to support those programs came from foreign loans. In terms of beneficiaries, limited data made available by 24 agencies who cared to provide information on their directed (subsidized) credit programs indicated that in 1995-1996 only about 686,000 farmer-borrowers obtained loans from these programs. The outreach of those subsidized credit programs was small, the repayment rates were quite low and they proved to be a costly load on taxpayers.

After the Reforms

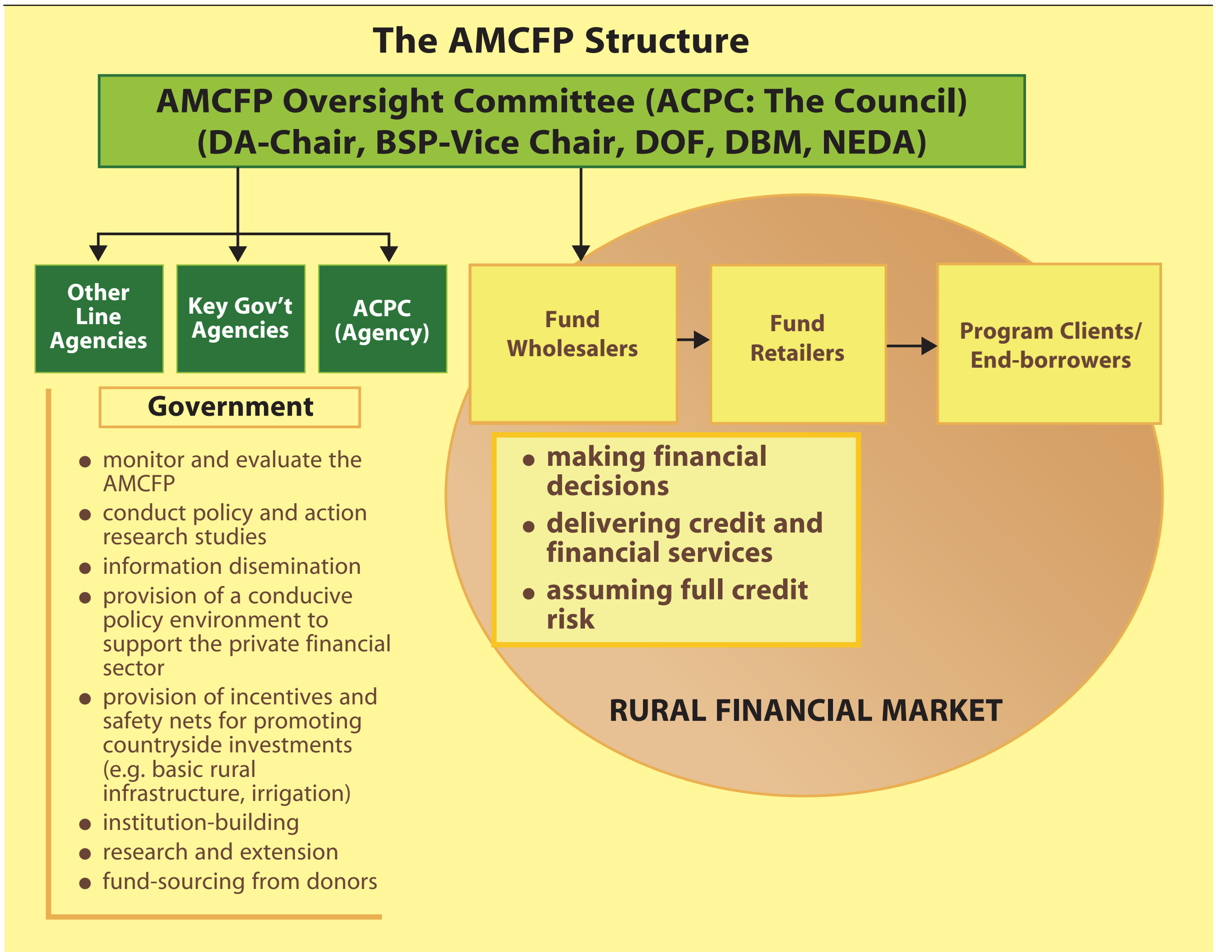
The Agriculture and Fisheries Modernization Act (AFMA) of 1997 and Executive Order 138

A more serious round of reforms in agricultural and rural finance policy started in the late nineties. Executive Order No. 138 and the AFMA phased out all directed (subsidized) credit programs in the agriculture sector, consolidated the remaining funds from these programs into a comprehensive agricultural credit program called the Agro-Industry Modernization Credit and Financing Program or the AMCFP; rationalized the government's loan guarantee programs; adopted market-oriented interest rates; and mandated government non-financial agencies to stop their lending activities and designated government financial institutions (e.g., LandBank) to be the main vehicle for implementing credit programs. An important component of the reforms is the increased participation of private financial institutions in the delivery of financial services.

The following features make the AMCFP different from the past directed credit programs of the government: (i) it is demand-driven and not supply-led; (ii) it is not commodity-specific but covers a whole gamut of income-generating projects which farm households may choose to undertake; (iii) the government is not involved in any credit decision-making as the program is implemented as a two-step loan program with government financial institutions as wholesalers and qualified private banks as retailers; and (iv) it adopts market-determined rates as opposed to the subsidized rates of the past. Figure 1 illustrates the AMCFP structure. On-going AMCFP lending facilities are shown in Box 2.

Other reforms included the enactment of the General Banking Act on May 2000, which had specific provision mandating the Bangko Sentral ng Pilipinas to recognize the unique nature of microfinance in formulating banking policies and supervising financial institutions. BSP Circular 272 (issued on January 2001) was the instrument for implementing the microfinance provisions of the General Banking Act. Risk-based supervision of microfinance-oriented banks was adopted by the BSP. Another policy reform was the enactment of the Barangay Microenterprise Business Act, which directs the adoption of market-based credit policies in the provision of financial services to barangay or village-based microenterprises. Under this Act, government wholesale financial institutions are directed to create special credit windows adopting market based interest rates for private financial institutions intending to provide credit to barangay microenterprise business.

Figure 1. Agro-Industry Modernization Credit and Financing Program (AMCFP) Structure



BOX 2
AMCFP Lending Facilities[34]

- **Sikat Saka Program.** Credit support program of the Department of Agriculture's Food Staples Sufficiency Program; loans at a lower interest rate (maximum of 15% per annum) to small palay farmers through irrigators' associations.
- **Cooperative Bank Agri-Lending Program.** Stable, low-cost funding support to eligible cooperative banks that lend to small farmers and fishers at full credit risk
- **Agri-Microfinance Program.** Microfinance facility for agriculture that extends short-term loans for income generating livelihood activities (farm, off-farm or non-farm) of small farming and fishing households.
- **Agri-Fishery Financing Program.** Credit facility implemented through PCFC and LandBank to finance priority agricultural commodities and fisheries.

[34] Another program is the **Typhoon Yolanda Rehabilitation Support Program.** One year moratorium on the payment of outstanding loans of farmer/fisher borrowers directly affected by typhoon Yolanda under any of the ACPC-AMCFP programs; and (ii) extension of interest-free loans to existing farmer/fisher loan clients of financing institutions currently accredited partners under the ACPC-AMCFP programs to finance their agricultural production activities or other income-generating projects to help them recover from the calamity. This is not listed in Box 2 because it is a temporary lending facility directed to particular areas devastated by Typhoon Yolanda (Haiyan, international name).

Principles for Increasing Access to Rural Finance

Lessons learned from the past twenty years led to the following principles for increased access to rural finance that now inform the policy and regulatory environment in the rural and microfinancial markets:

1. Provision of a conducive policy environment, critical support and capability-building services that would facilitate increased participation of the private sector in the delivery of financial services
2. Greater role of the private sector including rural banks, cooperative rural banks, cooperatives and NGOs in the provision of financial services
3. Adoption of market-oriented interest rates
4. Participation of government financial institutions in the delivery of credit services through wholesaling of loans to private financial institutions that take care of the retail side of the market
5. Non-involvement of government non-financial agencies in the provision of credit
6. Utilization of credit enhancement instruments such as crop insurance, loan guarantee to reduce credit risks,
7. Need for a credit information bureau and a comprehensive credit registry to address information asymmetry in credit markets

The Rise of Microfinance

Bangko Sentral ng Pilipinas defines microfinance loans as small loans granted to the basic sectors, as defined in the Social Reform and Poverty Alleviation Act of 1997 (Republic Act 8425), and other loans granted to the poor and low-income households for their microenterprises and small businesses so as to enable them to raise their income levels and improve their living standards. These loans are granted on the basis of the borrowers' cash flow and are typically unsecured.

Microfinance services have become more accessible to farm households as a result of policy and regulatory reforms that encouraged financial institutions to engage in microfinance. It complements the provision of agricultural credit in the countryside. Access to microfinance services has allowed farm households to diversify and increase incomes, thereby improving rural households' quality of life. The recent ACPC Small Farmer Credit Survey reported a higher incidence of borrowing from formal sources among small farmers mainly because of the accessibility of microfinance services in the rural areas.

The Philippines is one of a few countries with a well-defined policy and regulatory architecture for microfinance. From 2009-2013, the regulatory environment for microfinance has been consistently ranked as "one of the best in the world" by the Economist Intelligence Unit Global Microscope on the Microfinance Business Environment. The national microfinance policy framework includes the following specific strategies:

- In providing for a conducive policy environment: (a) implementing a market-oriented interest rate policy; (b) pursuing financial policy reforms with the end in view of removing existing distortions in the financial market; (c) rationalizing all existing government credit and guarantee programs.
- In establishing a market-oriented financial and credit policy environment which is conducive for the broadening and deepening of microfinancial services: (a) provision of appropriate supervisory and regulatory framework for MFIs which will enable them to engage in the development of new and innovative product lines and services appropriate to the demand for financial services/products by poor households and microenterprises; (b) establishment of standards of performance and business practices to guide the operations of MFIs; (c) promotion of broad-based savings mobilization, linkage banking technology and other microfinance technologies; (d) information and training on best practices in microfinance to MFIs.

- In implementing a capacity-building program for MFIs: (a) provision of technical assistance to MFIs with particular emphasis on local deposit mobilization; financial and project management; use of information technology; and development and establishment of microfinance technology, innovative product/service lines; (b) documentation, packaging and dissemination to MFIs of practitioner-based training and technical services; (c) encouraging research and academic institutions to conduct studies, convene policy level discussions that will promote awareness of microfinance as a sound commercial investment.

The ADB also provided support to the microfinance sector through the Microfinance Development Program (MDP) (Table 10), which helped to address systemic weaknesses in the microfinance sector. The MDP resulted in strategic reforms in the areas enumerated below (ADB, 2012). It is noted that these reforms are not new. They merely validated the earlier reforms spearheaded by the USAID-funded Credit Policy Improvement Project (CPIP) under the DOF National Credit Council. The reforms under CPIP were the foundation of the conducive regulatory environment for microfinance in the Philippines.

- Enhance the enabling policy and regulatory environment of microfinance and remove regulatory impediments and policy distortions, thereby promoting market efficiencies and outreach of services to the poor at competitive prices;
- Build viable microfinance institutions that could provide efficient and cost-effective retail delivery of services to the poor;
- Strengthen regulatory and supervisory capacity and oversight for a sound microfinance sector; and
- Increase financial literacy and consumer protection for the poor and users of microfinance services

Table 10. Outputs of the ADB Microfinance Development Program

Areas	Developments
Enhancing policy and regulatory environment	• BSP liberalized the branching of microfinance-oriented banks and promoted electronic banking with consumer protection • SEC required microfinance NGOs to disclose their microfinance operations, which promoted transparency
Building viable MFIs	• Performance standards for MFIs were developed and adopted. • CDA undertook training and capacity development to strengthen the oversight of compliance by savings and credit cooperatives with the performance standards required. • In 2008, Congress passed the Credit Information Systems Act, which provided for the establishment of a central credit registry. • The National Anti-Poverty Commission (NAPC) issued an industry advisory containing guidelines and model-development services manuals, and issued advisories on best microfinance practices, including micro-savings and micro-insurance
Strengthening regulatory and supervisory capacity	• BSP adopted risk-based supervision for microfinance operations • BSP issued various Circulars on safe and sound banking practices, including regulations on risk management, internal control systems, and bank controls for probable losses. • CDA formulated and issued the Manual of Rules and Regulations, and developed a risk-based supervision and examination manual for cooperatives engaged in savings and credit.
Increasing financial literacy and consumer protection	• Training-of-trainers were conducted in seven regions of the country and were replicated in priority provinces. • Consumer protection guidebook was drafted and widely distributed to stakeholders and posted on the NAPC web site. • NAPC's web site was developed to receive public complaints concerning microfinance products and services

Source: DLSU, 2013

The favorable environment has contributed to the rapid growth of outreach of MFIs (which include rural banks, NGOs and credit cooperatives as well as some thrift banks) as well as the strengthening of the microfinance programs of rural banks/cooperative rural banks/microfinance-oriented banks (ADB, 2012). This result was envisioned in 1998-2000 by CPIP.

There is no single regulatory authority for entities providing microfinance services. Hence, the regulatory authority varies by type of institution, as follows:

Regulation of Banks Engaged in Microfinance

The basic law that paved the way for the creation of the favorable environment for banks engaged in microfinance is the General Banking Law of 2000. It recognized the special features and peculiarities of microfinance and mandated the BSP to issue appropriate regulations. Sections 40, 41 and 44 mandated the formulation of appropriate rules and regulations for microfinance operations[35]. Section 40 recognizes the "peculiar characteristics of microfinancing, such as cash-flow based lending to the basic sectors that are not covered by traditional collateral." Section 41 provides for the issuance of regulations covering unsecured loans and 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."

Regulation of Cooperatives[36]

The Cooperative Development Authority (CDA) regulates cooperatives under Republic Act 6539. However, the CDA has not been an effective regulator because of institutional weaknesses and pre-occupation with its other major objective to develop and promote the cooperative sector. The CDA does not supervise nor examine the books of credit cooperatives (NCC, 2004). To help build the architecture for effective regulation and supervision of credit cooperatives, the National Credit Council prepared a standard chart of accounts, an accounting manual and set of performance standards for credit cooperatives called the COOP-PESOS. The CDA Administrator issued a circular asking all credit cooperatives to use the COOP-PESOS performance standards starting January 2003 (Almario, 2002). To date, CDA's field personnel apply the standard chart of accounts and the COOP-PESOS performance standards to credit cooperatives.

Registration of NGOs[37]

The NGOs are required to register with the Securities and Exchange Commission (SEC) as non-stock, non-profit organizations. They are not subject to prudential regulations. At present, there is no government agency that has supervision over the NGOs. The NGOs do not report to any oversight agency and hence, there is no single institution that has a complete set of relevant information on the financial performance of NGOs (NCC, 2004).

NGOs collect "forced" savings or the so-called "capital build-up" as compensating balance or the proportion of the loans of their microfinance clients (NCC, 2003). The consensus among the 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 shall be required by the government to transform into either a bank or credit cooperative, both regulated entities.

[35] For the record, the reform provisions were crafted with the assistance of DOF-NCC-CPIP.

[36] The government through the NCC has recognized the potential of cooperatives in microfinance. In this report, "cooperative" means both cooperatives and credit unions. Credit unions are solely engaged in providing savings and credit services to members and are usually located in the urban areas. Cooperatives may be engaged not only in providing savings and credit services but also other services, e.g., marketing, input supply, to members. Cooperatives may be found chiefly in rural areas.

[37] This is from Llanto (2003).

The present view of the government is that only regulated financial institutions shall be allowed to take deposits from the public. Banks which are regulated by BSP are considered 'deposit-taking institutions'. Cooperatives which are regulated by CDA mobilize deposits among their members. On the other hand, NGOs are not regulated entities and thus, no external body monitors their performance and imposes sanctions for poor performance, implying that depositors would not be adequately protected from misbehavior by NGOs. Thus, government has ruled that NGOs shall not be allowed to mobilize deposits from the public.

Performance Standards

The National Credit Council 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 (see Annex A for specific indicators). The standards proved to be useful in motivating MFIs to improve their financial performance and also in assessing the capacity of a MFI.

Financial Inclusion Policies

The Bangko Sentral ng Pilipinas (BSP) is guided by the following principles of financial inclusion:

- The availability of financial products that are appropriately designed, priced, and tailor-fitted to market needs and capacities of the financially excluded segments of the population;
- The participation of a wide variety of strong, sound, and duly authorized financial institutions utilizing innovative delivery channels to provide financial services to more Filipinos; and
- The effective interface of bank and non-bank products/delivery channels, technology and innovation to reach the financially excluded.

Some of the significant circulars issued by the BSP to promote financial inclusion are listed in Annex B.

Regulation of micro-insurance

Given the huge market for risk protection among the poor, the proliferation of informal insurance activities among those directly involved in providing financial services to the low-income sector and the inherent limitations of mutual benefit associations, the Department of Finance-National Credit Council in coordination with the Insurance Commission and with technical assistance from the Asian Development Bank and the German Agency for International Cooperation formulated and developed the Regulatory Framework and the National Strategy for Micro-insurance in 2009. The National Strategy for Micro-insurance defines the objectives, roles of various stakeholders, and key strategies to be pursued in enhancing access to insurance by the poor. The National Strategy for Micro-insurance mimics the market-based approach taken by the National Strategy for Microfinance that was formulated with the assistance of DOF-NCC-CPIP in 1997.

The following are the key policy strategies (ADB, 2013):

(i) Increased participation of the private sector in the provision of micro-insurance services;
(ii) Establishment of an appropriate policy and regulatory environment for the safe and sound provision of micro-insurance by the private sector;
(iii) Mainstreaming of informal insurance, insurance-like and other similar activities or schemes; and
(iv) Institutionalization of financial literacy (learning or education) that will highlight the importance of micro-insurance, the applicable rules and regulations, the duties and responsibilities of the providers and the rights of the insured.

The regulatory framework for micro-insurance defines and outlines the necessary regulatory and policy measures that should be adopted and implemented by concerned regulatory authorities to facilitate the participation of the private sector in providing risk protection for the poor. It also ensures that the rights and privileges of the insured poor are protected and promptly acted upon. Given a huge informal market for micro-insurance, the framework also provides for a formalization path for informal providers.

The regulatory framework amended the definition of micro-insurance to mean an activity of providing specific insurance, insurance-like, and other similar products and services that meet the needs of the low-income sector for risk protection and relief against distress, misfortune and other contingencies. According to the Insurance Commission, micro-insurance coverage among Filipinos rose to 19.95 million (20.4 percent of the population) in 2013 from 3.1 million (3.4 percent of the population) in 2008 (BSP, 2013). This makes the Philippines one of the top micro-insurance markets in Asia. The strong support by the insurance providers and warm reception by policyholders were cited as significant factors contributing to the phenomenal growth of micro-insurance in the country (BSP, 2013). Adding to this, the proportionate regulatory stance adopted by the Insurance Commission that has allowed the development of micro-insurance schemes that respond to the risk protection needs of the low income groups.

4.5 Current Issues and Challenges[38]

A big challenge among rural finance/microfinance institutions is good governance. Board members of family-owned rural banks are expected to protect their investments, and thus practice good governance. However, the Philippine experience with rural banks also indicates that failures and eventual closure of many of those banks may be explained by bad or faulty management. The BSP requires now the appointment of independent board directors to provide expert advice on the bank's operations and to perform oversight function on behalf of depositors and minority shareholders as well. The same may be said of cooperatives and NGOs. They do need to improve the quality of their respective board of directors/trustees, professionalize management and adhere to performance standards set by the regulators and the government.

Another challenge is the development of products and processes and improvement of skills of rural financial institutions. They have to take a more positive and pro-active outlook on clients as customers waiting to be satisfied with quality and timely financial services. The rural financial markets will be very competitive as more rural banks, including the bigger banks improve internal systems and use modern technology to deliver services to customers. To keep themselves abreast of the changing needs of customers, including of course poor rural households, and keep up with the competition, they need to undertake continuing research and innovations to deliver competitively priced financial services. Meeting customer needs for affordable and responsive products will require investments in human resources and technology.

There is also the challenge of building the capacity of RFIs to lend to more clients, especially in so called hard-to-reach areas. Thus, the government and donors may develop a systematic and sustained program of providing technical assistance to the RFIs 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.

[38] Some of the ideas and opinions in this section drew from the findings of the 2014 Asia Pacific Forum on Financial Inclusion held on 19-20 March 2014 at the Asian Development Bank, which apply to the Philippine situation.

Those rural financial institutions in search of customers/clients would have to expand their operations to areas with a high magnitude of poor households and where access to microfinance is limited. In deepening outreach among the poor households and microenterprises, RFIs are faced with the costs and risks peculiar to those areas. They will need to discover the proper mixture of capital, human resources, professional expertise, and technology and grit in serving the excluded segment of the population.

A big challenge among microfinance providers is the spread of credit pollution, that is, over-saturation of microfinance services and multiple borrowing that have led to loan delinquencies. Past studies show that borrowers with repayment problems tend to get a loan from more than one microfinance institution (MFI) in order to repay loans with another MFI. In relation to this, the NCC and BSP have taken steps to establish a credit information bureau to service the requirements of microfinance institutions. A law was passed in 2009 creating the Credit Information Corporation (CIC), a government-owned and controlled corporation, which is an important infrastructure to increase financial transparency and promote a more efficient microfinance sector. The CIC is a centralized national credit bureau that is expected to start operations under the auspices of the Securities and Exchange Commission by early 2015. The CIC is a partnership between the government, which owns a 60-percent stake, and the private sector, which controls the remaining 40 percent. The credit bureau's stockholders include the Credit Card Association of the Philippines, the Bankers Association of the Philippines and the Cooperative Development Authority. While the law creating the CIC was passed in 2009, it took another two years to approve the implementing rules and regulations and more time to fill up the board and for the government to make its equity contribution.

Another big challenge for the microfinance industry is the decline in quality and adherence to performance standards of microfinance due to the pressure of competition, especially in urban areas where the MFIs have congregated. Still another is the continuing self-examination especially by MFI NGOs about mission drift that has alienated some of their customers and perhaps donors.

Finally, there is the outstanding issue of 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. 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. Those microfinance NGOs are imbued with a non-profit oriented mission and they perform a vital function for society in making scaled down financial services (small and medium size loans and capital build up opportunities) to the excluded segment of the population. Government and regulators have to tread carefully on the issue of regulation of NGOs. The challenge is to find an appropriate balance between the goal of ensuring financial viability of those NGOs and at the same time, providing some degree of flexibility in NGO efforts to innovate and reach the poorer, even the poorest, strata of society.

CHAPTER 5
Cases of Best Practices in rural Finance[39]

This section provides four case studies of best practices in rural finance. These best practices were chosen in consultation with the Agricultural Credit Policy Council (ACPC) according to the following criteria: *First*, it should be pro-poor, that is, accessible and favorable to the poor; *Second*, it should be technically and financially feasible which are factors that can make replication possible; and *Third*, it should be cost effective, profitable and sustainable, that is, viable and feasible over a continuous period without assistance of a subsidy in one form or another. So far, the best practices selected fall under the following thematic areas as provided for in the TOR of the study: one on *Operational and Outreach Structures,* two on *New Innovations*; and three on *Collateral*.

The first case, which falls under Thematic Area F, that is, Operational and Outreach Structures-Wholesale and Retail, is about establishing micro-banking offices (MBOs) and other banking offices (OBOs) and how this recent innovation in microfinance has enabled CARD Bank to significantly expand its outreach even in hard-to-reach areas. It is a best practice because putting up MBOs has enabled CARD Bank to bring microfinance products and services in the doorsteps of the excluded in a sustainable and profitable manner.

The second case is how GM Bank, a rural bank has used the government's loan guarantee scheme to lend to small farmers even without the benefit of collaterals. This falls under Thematic Area I which is on Collateral. Since the guarantee scheme is able to bring down the risk and cost of lending to small farmers who are perceived as high-risk borrowers, the GM Bank has succeeded in expanding its small farmer loan portfolio significantly and in effect, increasing access of small farmers to rural financial services even without collateral. Given GM Bank's success, other banks can replicate the same which would further expand lending to small farmers in more areas of the country.

The third case, which falls under Thematic Area G on New Innovations, discusses how small onion farmers, a microfinance NGO, a government development corporation, a large private food company a donor (Catholic Relief Services), and the local government have successfully collaborated in using the value chain finance to provide small onion farmers with access to finance and a market for their produce. It is a successful case of bundling financial services with other support services. It is a best practice because the collaboration of several institutions that successfully linked financial services with other support services enabled small onion farmers to have access to credit; have a market for their produce; and improve their incomes. It can be replicated to help other poor producers including farmers and fisher-folk.

The last case is about how micro-insurance grew and developed under a conducive policy and regulatory environment created by the government with donor assistance. This falls also under Thematic Area G on New Innovations. It is a best practice because the government has successfully created a policy and regulatory environment that strongly encouraged the active participation of the private sector in allowing the poor to have access to micro-insurance products and services which service providers would not have done under different circumstances.

[39] Only two to three cases are required by the TOR.

A. Case Study of Micro-banking Offices and Other Banking Offices: CARD Rural Bank[40]

1. Introduction

This case study chronicles the significant contribution of other banking offices (OBOs) and micro-banking offices (MBOs) in providing accessibility of financial services to an expanding client base. In short, it is an effective service delivery structure for a microfinance bank that has been established to provide microfinance services to those excluded from mainstream banking. The case study explains how OBOs and MBOs has helped CARD Bank to reach those excluded in a sustainable and profitable manner

CARD Bank, the largest microfinance bank in the country is a member of the CARD Mutually Reinforcing Institutions group of companies. Established as a rural bank in September 1997, it has since provided microfinance services to hundreds of thousands of microenterprises and poor rural households who would otherwise not have been able to access formal financial services. It started with 3,689 clients who were transitioned to the bank from the San Pablo Branch of CARD, Inc., the non-government organization (NGO) established earlier by the same founders of CARD Bank. On December 31, 2013, CARD Bank was awarded by the Bangko Sentral ng Pilipinas (BSP) with a Hall of Fame award on financial inclusion, a fitting recognition for CARD Bank's dedication to financial inclusion of the poor people especially women who have been excluded from mainstream banking in the country.

2. Microfinance Operations Prior to the Establishment of OBOs and MBOs

From 1997 to 2005, CARD Bank conducted all banking transactions in a regular branch, which is staffed by one branch manager, an assistant branch manager, a cashier, bookkeeper, and two to three tellers. The assistant branch manager supervises the account officers in their day to day work, while the branch manager is responsible for banking and over all branch operations and supervision. The number of account officers (AOs) depends on the size of areas covered and the number of existing and prospective microfinance clients that can be generated from these areas. Based on the bank's experience, the following have constrained the growth of the branches:

- Regular branches are usually located in the city or town proper but these are not accessible to many microfinance clients who live in far flung rural, coastal, and mountainous areas.
- Prospective clients in those areas have demonstrated very high interest to become clients of CARD Bank but they face various transportation problems. Some areas are not accessible by land transport and residents have to rely only on horses to go to the town. In other areas, public utility jeep service provide very limited transport service, that is, one early morning trip to the town proper and a late afternoon or evening trip back to the (rural) area. Residents would have to rely on motorbikes but these are not really safe modes of transport and are prone to accident. In coastal areas, residents rely on small motorized boats ("bancas"), which unfortunately are not suitable for travel on rough seas brought by typhoons or even strong winds.

CARD Bank tried hard to reach those microfinance clients but at the cost of productivity and efficiency. Transaction costs were simply too high. Table 7 shows the efficiency of some branches according to number of clients, loan portfolio and total saving balances per branch from December 1997 to December 2005 prior issuance of BSP Circular 505.

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[40] The author gratefully acknowledges the support of Ms. Dorie Torres, President of CARD Bank, Inc. In the preparation of this case study.

Table 11. Efficiency of some CARD Bank branches prior to BSP Circular 505

No.	Branch	Date Established	Average Production per Year		
			Clients	Loan Portfolio	Savings
1	San Pablo	Sep 1997	533	5,090,883	11,107,905
2	Masbate	Jul 1999	717	2,722,105	1,753,464
3	Mogpog	Dec 1999	503	2,317,750	1,985,276
4	Gasan	Mar 2001	251	1,642,893	1,017,366
5	Bay	Jan 2002	743	6,872,966	4,844,584
6	Dolores	Jan 2002	580	5,508,718	2,891,266
7	Dimasalang	Oct 2002	664	5,578,692	1,412,384
8	Cataingan	Oct 2002	799	8,570,909	2,318,782
9	Torrijos	Mar 2005	658	2,671,885	1,858,159
10	Las Pinas	Jun 2006	na	na	na
	Average		**605**	**4,097,680**	**2,918,919**

CARD Bank's analysis of the production in number of clients, loan portfolio and savings generated in those years revealed that the outputs were way below the potential of those branches and indicated that branch banking may not be cost effective for microfinance operations. Table 11 implies the following:

- Average production of 605 clients per year meant that only 50 clients were being generated per month.
- Only an average of PHP 341,473 loans outstanding is added into the loan portfolio per month per branch.
- Savings mobilized per month is at a low level of PHP 243,243 per branch.

3. Establishing OBOs and MBOs

BSP Circular 505 (issued on December 22, 2005) states that "banking offices other than "branch" as defined (by BSP) may be allowed anywhere, without prior BSP approval, subject to the submission of a certification by the head of the branches department with the rank of Vice President or its equivalent or by a higher ranking officer that said banking office shall neither accept deposits nor service withdrawals. The certification shall be submitted to the appropriate supervising and examining department of the BSP not later than five (5) banking days from date of opening".

Under the BSP implementing guidelines in the management of OBOs the following must be implemented and complied:

- An OBO must be established to service microfinance clients only and must be located within two hours travelling time from the branch.
- An OBO must not maintain a complete set of books of accounts.

To ensure that the OBO has no cash and records, all transactions and excess cash must be remitted daily and must be taken up directly in the head office or branch to which it is attached.

Immediately after issuing the circular, CARD Bank established OBOs in different locations, within and outside the town where the branches are located. This really brought micro-loans to the door-steps of microfinance clients. Thus, in June to December 2006, twenty six OBOs were established. The immediate impact was a boost in the productivity and efficiency of CARD Bank. The bank complemented the OBOs by establishing micro-banking units (MBUs) inside the branch office. An OBO typically is staffed by one unit manager and four account officers. The MBU has the same number of staff inside the branch office. This improved the monitoring and supervision of the bank's microfinance operations.

By the end of December 2006, twenty five MBUs have been established. In subsequent years, the simultaneous establishment of OBOs and MBUs in branches was done. By the end of December 2010, CARD Bank had a total of 245 operating units composed of 163 OBOs and 82 MBUs. Table 12 provides a summary of the OBOs and MBUs established per year from 2006 to 2010.

Table 12. Other banking offices and micro-banking units, CARD Bank, 2006-2010

Year	OBOs	MBUs	Total
2006	26	25	51
2007	64	36	100
2008	110	56	166
2009	145	67	212
2010	163	82	245

On October 14, 2010, the BSP issued Circular 694, an Amendment of Regulations on the Establishment of Other Banking Offices and Notes to Microfinance. It expanded the functions of the OBOs. According to the Circular, Other Banking Office (OBO) shall refer to any permanent office or place of business in the Philippines other than the head office, branch or extension office which engages in any or all of the following non-transactional banking-related activities:

- Market loans, deposits and other bank products and services;
- Accept loan applications and conduct preliminary credit evaluation as well as perform credit administration support services;
- Host on-site automated teller machines (ATMs);
- Perform customer care services;
- Perform customer identification process, receive account opening documents and facilitate account activation activities, provided, that account opening approval and actual opening of deposit accounts shall be done only at the head office/branches/extension offices; and
- Such other non-transactional banking related activities as may be authorized by the BSP.

An OBO may also be recognized as "microfinance-oriented". A "microfinance-oriented BO" (MF-OBO)/ "micro-banking office" (MBO) shall refer to an OBO that primarily caters to the banking needs and services of microfinance clients and overseas Filipinos (OFs) and their beneficiaries. As contemplated under Appendix 45, "microfinance clients" refer to microcredit borrowers and/or micro-depositors. OBOs/MBOs may be established only in areas where the bank is allowed to establish branches as provided in BSP's branching guidelines.

In addition to the non-transactional banking-related activities and services allowable for regular OBOs, MF-OBOs/MBOs may also engage in any or all of the following limited transactional banking related activities and services that enable and facilitate financial inclusion and broader access to financial services:

- Accept micro-deposits including initial deposit and service withdrawals thereof;
- Accept check deposits of microfinance clients for collection and credit to own deposit accounts;
- Disburse/release proceeds of micro-loans and collect loan amortization payments and related charges;
- Present, market, sell and service micro-insurance products in accordance with existing regulations;
- Receive/pay-out funds in connection with authorized remittance transactions; and other functions[41].

[41] The full text of BSP Circular 694 is available at the BSP web site.

Both circulars resulted in the significant growth in CARD Bank's OBOs/MBOs and in the number of clients reached (Table 13).

Table 13. Summary of CARD Bank's MBOs and MBUs established from 2006 to September 2014

Year	OBOs/MBOs	MBUs	Total
2006	26	25	51
2007	64	36	100
2008	110	56	166
2009	145	67	212
2010	163	82	245
2011	229	95	324
2012	242	95	337
2013	233	102	335
2014	249	110	359

CARD Bank experienced a significant improvement in productivity and efficiency in terms of total clients, total loan portfolio, total savings balances and managing portfolios-at-risk. Tables 14, 15 and 16 show the efficiency brought about by the establishment of OBOs/MBOs/MBUs. There are other factors that have contributed to the expansion of the client base such as the transition of clients and purchase of their loan portfolio from CARD, Inc. (NGO) and others. However, according to the management of CARD Bank the MBOs have really played a highly significant role in expanding its client base and loan portfolio.

Table 14. Comparison of client base before and after establishment of MBOs

	Total Clients		
	Without MBO (2005)	With MBO (2013)	% Growth
San Pablo	4,264	76,446	1,693
Masbate	4,658	30,880	563
Mogpog	3,016	20,670	585
Gasan	1,229	12,523	919
Bay	2,970	38,877	1,209
Dolores	2,319	14,690	533
Dimasalang	2,191	16,340	646
Cataingan	2,636	13,950	429
Torrijos	3,288	9,810	198
Las Pinas	140	43,083	30,674
TOTAL	**26,711**	**277,269**	**938**

Table 15. Loan portfolios before and after establishment of MBOs

	Loan Portfolio		
	Without MBO, PHP (2005)	With MBO, PHP (2-13)	% Growth
San Pablo	40,727,061	204,264,766	402
Masbate	17,693,683	102,128,312	477
Mogpog	13,906,497	49,998,885	260
Gasan	8,050,178	19,335,260	140
Bay	27,491,863	115,866,700	321
Dolores	22,034,873	27,532,560	25
Dimasalang	18,409,685	69,825,669	279
Cataingan	28,284,000	45,431,997	61
Torrijos	13,359,427	27,623,274	107
Las Pinas	2,211,864	117,983,654	5,234
TOTAL	**192,169,131**	**779,991,077**	**306**

Table 16. Savings mobilization before and after the establishment of MBOs

	Total Savings Balance		
	Without MBO, PHP (2005)	With MBO, PHP (2013)	% Growth
San Pablo	88,863,237 ($1,615,695)	899,075,726	912
Masbate	11,397,518	74,457,650	553
Mogpog	11,911,656	63,258,228	431
Gasan	4,985,094	32,081,293	544
Bay	19,378,336	120,615,961	522
Dolores	11,565,063	30,679,021	165
Dimasalang	4,660,867	44,204,493	848
Cataingan	7,651,982	39,070,090	411
Torrijos	9,290,794	36,307,718	291
Las Pinas	5,020,472	85,310,794	1,599
TOTAL	**174,725,019**	**1,425,060,974**	**716**

4. Conclusions and Recommendations

There is really a need for an extensive service delivery structure to reach those who have been excluded from mainstream banking. Proportionate regulation of the microfinance industry, which has been the hallmark of BSP's approach to regulate microfinance, has allowed the formation of MBOs/OBOs, essentially scaled down branches. This novel approach has equipped microfinance-oriented banks such as CARD Bank to expand outreach and also to contribute to achieving the financial inclusion objectives of the BSP and the banking community in general.

In particular, the establishment of OBOs/MBOs with supporting implementing guidelines has been a major factor in successfully expanding the capacity of CARD Bank to provide microfinance products and services to microenterprises and poor rural households in far flung rural areas. Through OBOs/MBOs, CARD Bank was able to continuously motivate and create more awareness among the general public, especially micro-enterprises and rural households to save in the bank. Moreover, those OBOs/MBOs have also become the channel for members/clients, including their dependents to avail themselves of the benefits of micro-insurance. An approximate total of 6,250,000 members and dependents are now insured with a micro-insurance company that has been established as a mutually-owned company.

An important lesson is the importance of maintaining an open policy dialogue between regulator and regulated entity. CARD Bank would have been able to develop an extensive service delivery structure without the BSP's regulatory framework that was balanced in providing support to microfinance with maintaining financial stability.

In light of the findings of this case study, the following are recommended:

- Regulators are urged to adopt proportionate ('light but firm touch') on regulation of microfinance;
- Microfinance institutions should adhere to highest performance standards required by the regulator to earn the trust and confidence of regulators to impose 'light' or proportionate regulation of microfinance operations.
- Regulator and regulated entities should maintain transparent and open policy dialogue to ensure the appropriateness of regulations imposed by the regulator.

B. Case Study on Using the Agricultural Loan Guarantee: GM Bank

1. Introduction

This case study describes the Philippine experience in implementing a credit guarantee program for small farmers and fishers through an assessment of the performance of one of the program's outstanding accredited financial institutions, the GM Bank – a rural bank. The case study shows how Agricultural Guarantee Fund Pool (AGFP) credit guarantee has helped this rural bank to succeed in expanding its loans to small farmers. The credit guarantee seems to function as an effective instrument to mitigate credit risks, which has encouraged this rural financial institution to expand its small farmer loan portfolio. However, there are areas for improvement of the AGFP guarantee to make it a truly effective credit enhancement instrument. This case study indicates how the guarantee scheme may be improved based on the findings of a recent evaluation study.

2. The AGFP

Features. The AGFP was established in May 2008 through an Executive Order to increase access of small farmers and fishers (SFF) to credit. It provides an 85 percent guarantee cover on agricultural food production loans granted by accredited lending institutions against all types of risks of non-repayment by farmer-borrowers except fraud. Both financial institutions (banks and cooperatives) and non-financial institutions (small and medium enterprises, large corporations, traders and input suppliers, NGOs, and farmer organizations) that lend to SFF are allowed to use this credit enhancement instrument. The innovation introduced by the Department of Agriculture (chair of the Program Committee) is to allow the enumerated non-financial institutions to avail themselves of a guarantee cover for their loans to SFF borrowers. In the past, only regulated financial institutions (banks and cooperatives) were eligible to use the credit guarantee scheme provided by the government.

The lending institution applies for accreditation and a guarantee line. To be eligible for the guarantee, lending institutions must satisfy the following criteria: (i) sufficient experience (three years) in lending to small farmers and fishers (SFF), particularly for agricultural production; (ii) satisfactory standing with creditors; (iii) stable financial standing; and (iv) good moral character and satisfactory credentials of management, officers and owners. The approved guarantee line is based on the amount applied for, the institution's net worth, area covered, number of SFF to be financed and to those with previously AGFP-approved line, and the extent of utilization. The approved guarantee line is the maximum amount of guarantee cover that may be utilized by the qualified lending institution at any given time to secure 85 percent of the loans given to SFF borrowers. The line is valid for one year and may be renewed based on the institution's utilization of the guarantee line.

While many banks that have yet to fully understand appreciate and use the AGFP guarantee, some banks such as the GM Bank of Luzon have used it to intensify their agricultural lending operations. As the experience of GM Bank shows, positive results in terms of an increase in the number of new SFF borrowers as well as the volume of agricultural loans. Applied well, the AGFP guarantee has the potential to improve the micro-agriculture loan portfolios of rural banks (countryside banks that serve the Philippines rural areas).

3. The GM Bank of Luzon[42]

Company overview. The GM Bank, Inc. is a consolidation of two (2) of Nueva Ecija's[43] most established rural banks namely the Community Rural Bank Inc. (CRBI) and the Muñoz Rural Bank Inc. (MRBI). GM Bank, Inc. was founded in 2004 and is based in Cabanatuan City, the Philippines. Muñoz Rural Bank Inc., established in 1956, is one of the oldest and most reputable rural banks in the country. Its operations began in 1956 in a very humble community now known as Nueva Ecija's Science City of Muñoz. The Community Rural Bank (CRBI) was established in 1987 and was located at the Municipality of Guimba, Nueva Ecija.

GM Bank, Inc. provides rural banking services in the Philippines. It offers a range of financial services, such as saving accounts, checking accounts, automatic transfer accounts, time deposits, and money transfers. The bank provides various types of loans: micro-agriculture loans; commercial loans; industrial loans; special financing such as countryside loans, vehicle loans, motorcycle loans, salary loan, and loan against peso deposits. In addition, it offers ATM services.

Experience with AGFP. Before merging with the AGFP, the bank only had a micro-agriculture loan portfolio of PHP 12 million with around 1,000 farmer-borrowers. In 2011, the bank was accredited under AGFP and was initially provided a guarantee line of PHP 100 million. This was raised to PHP 200 million in 2012 and PHP 300 million in 2013. At present, PHP 192 million in loans are covered by AGFP credit guarantee. The guarantee cover enabled the bank's micro-agriculture loan portfolio to increase from PHP 23 million in 2012 and PHP 250 million in 2013 and the number of farmers from 1,000 to 3,600. Areas covered include several municipalities of the provinces of Nueva Ecija, Pangasinan, Tarlac, Aurora, La Union, Bulacan and Zambales. Those are new areas for GM Bank lending operations. Both potential borrowers and local officials were oriented on the bank's loan programs to benefit the borrowers through the credit guarantee. This contributed to the increase in number of borrowers and the volume of loans. Maximum loan granted per borrower is PHP 260,000 which is payable after harvest, i.e., after 6 months. Once a loan is approved, 60 percent of the loan amount is released prior to land preparation while the 40 percent is released after transplanting.

The credit guarantee has motivated GM Bank to expand its micro-agriculture loans, which have been beneficial to the SFF borrowers and the bank's bottom line. The expansion in its micro-agriculture portfolio was accompanied by the implementation of a loan collection strategy developed by the bank after a diligent study of the clientele and the rural economy. To ensure loan collection, the bank adopted the following measures:

- Hiring of an appropriate number of account officers (1 account officer = 80 borrowers)
- Monthly monitoring of all borrowers
- Flexible loan repayment, e.g., loan repayment may be extended if production is affected by calamities
- Extension of credit for another cycle to borrowers who did not pay on time a chance to recover and repay the previous loan

[42] From interviews with the microfinance officer and micro, small and medium enterprise (MSME) officer of GM Bank of Luzon on November 7, 2014.
[43] Nueva Ecija is one of __ Philippine provinces and is a top producer of rice.

- Reduction of interest rate from 3 percent to 2 percent per month for borrowers who pay on time or before due date in two consecutive cycles

Failure of the borrower to pay the loan on time triggers the declaration of the loan as past due on the following day and sets in motion the preparation and filing of a guarantee claim with the AGFP. From PHP 192 million loans covered by the AGFP, the bank was able to claim PHP 11 million in March 2014, and another PHP 14 million in Sept. 2014. The bank indicated that it will continue to use the AGFP guarantee because it has helped in expanding the client base. It is noted that new borrowers have been given loans because of the guarantee scheme. At the same time, an effective loan collection strategy has resulted in a relatively high collection performance with past due loans pegged at around 7 percent. Considering the risks surrounding this type of lending, it seems that GM Bank has found a good instrument to achieve its outreach (number of clients) target and profit objectives (relatively high loan collection rate).

At the demand side, key informant interviews with a few small onion producers who borrowed from GM Bank corroborate the claim that the guarantee cover has resulted in an increase in the number of new borrowers. The informants indicated that submission of (traditional) collateral was not a key requirement for a loan and that the bank used the AGFP guarantee to secure the loans. Farmer borrowers also cited the following reasons for borrowing from the bank: low interest rates, easy access through account officers who approached and helped them with the documentation requirements such as farm plan and budget, etc., quick and timely release of the loans.

AGFP performance and areas for improvement[44]. The AGFP has guaranteed a total of PHP 14.1 billion agricultural production loans of 607 lending institutions to 229,623 SFF borrowers as of 2012. A total of 854 lending institutions have been accredited and provided with guarantee lines under AGFP, of which about two-thirds (71 percent) or 607 lending institutions have used their guarantee lines at least once. These lending institutions which have used the AGFP are comprised of banks (13 percent) and non-banks (87 percent).

Since the start of AGFP operations, the total amount of agricultural production loans guaranteed has increased substantially from PHP 1.4 billion in 2009 to PHP 5.2 billion in 2012. Roughly 23 percent of the SFF borrowers of AGFP-covered loans were new borrowers, and another 24 percent were granted bigger loan amounts for the expansion of their agricultural production projects. The study found, however, that the remaining half (53 percent) of SFF borrowers were not the intended end-beneficiaries of the Program. Nevertheless most borrowers were SFF with farms averaging 1.9 hectares in size with loans averaging roughly PHP 40,000.00 per borrower. The bulk (78 percent) of guaranteed loans were for palay (rice) production.

As of end 2012, overall utilization by lending institutions of guarantee lines/fund allocation was at 60 percent based on accumulated loans granted, and 29 percent based on outstanding loans which averaged at PHP 1.3 billion per month. Although the utilization of guarantee lines have generally been increasing since 2009, which in 2012 was at 83 percent based on loans granted and 34 percent based on loans outstanding, the AGFP was found to be still underutilized and, therefore, underleveraged.

As of yearend 2012, 154 lending institutions have filed claims totaling PHP 886 million, of which about half (PHP 406 million) has been approved for payment. These claims represent 20,504 defaulted loans for reasons of crop failure or damages due to typhoons, pest infestations, and plant diseases. It is also noted that the number of lending institutions with guarantee claims and the aggregate amount of paid claims have increased significantly since 2009.

[44] This section draws liberally from Casuga, Magdalena, etc. (cite other authors and study title, etc.)

The few banks accredited under AGFP were provided with bigger guarantee lines comprising more than half (57 percent) of the total or an average of PHP 45 million per bank. Non-banks on the other hand were given much smaller guarantee lines averaging PHP 8 million per annum. Banks generated more than PHP 5.3 billion loans (average of PHP 68 million per bank) comprising only 43 percent of their combined guarantee lines. In contrast, non-bank lending institutions generated a total of PHP 8.3 billion loans (average of PHP 6 million per non-bank), or 80 percent usage rate of their combined guarantee allocation/lines. These findings indicate that if banks could improve utilization of their guarantee lines, the overall utilization rate of the Program would significantly increase. Also, since banks were able to lend to more new borrowers, it is a good indication of 'additionality' that is gained from the increased utilization of their lines for the benefit of new SFF borrowers.

It is noted that the utilization of the AGFP by lending institutions is currently still relatively low. This may be because lending institutions perceive SFFs as risky borrowers, especially those not familiar or known to them (case of asymmetric information). This is where an instrument such as the AGFP credit guarantee can play a critical role but it has to be properly marketed to potential lenders.

Banks, in particular, have been very careful and selective in lending to new clients mainly to protect their portfolio from bad loans especially since many SFF borrowers are already indebted with other sources particularly moneylenders. Thus, conservative lending institutions prefer to lend to long-time regular clients and are hesitant to try new clients. Moreover, a significant number of lending institutions still require collateral (real estate or chattel mortgage) from SFF borrowers even after availing themselves of the AGFP credit guarantee. It seems that lending institutions perceive the credit guarantee as insufficient cover for the risks involved in agricultural lending. They continue to demand traditional collateral to fully secure the loans to SFF borrowers.

4. Conclusions and Recommendations

The AGFP credit guarantee is a relatively 'young' intervention and it shows signs that it could be an effective instrument to increase the accessibility of credit for SFF borrowers. It has enabled a good number of lending institutions, especially banks, to increase lending to SFF borrowers. To expand its use, several issues have to be addressed. Processing and approval of guarantee claims should be improved[45].

- Intensify efforts to persuade banks to participate in the Program

Banks have stronger financial capability than other types of lending institutions. They have performed better under the Program in terms of generating loans and recovering paid guarantee claims. Banks are potentially the best type of lending institution in providing SFFs with greater access to credit. These are some initiatives that could be done to get more participation from banks: (i) conduct of regular, frequent consultations with accredited banks to discuss issues and constraints to guarantee line utilization; (ii) Awarding/recognition of best lending institutions; (iii) creation of an incentive system (e.g. guarantee fee rebates) for better-performing lending institutions in terms of guarantee line utilization, coverage, and recovery of claims paid; (iv) expanding the coverage and scope of the guarantee to cover financing for the agriculture and fisheries activities in the whole value chain beyond agricultural production; (v) dissemination of information/data on potential borrowers and projects to finance.

- Simplify and expedite processing and payment of guarantee claims.

The credibility of AGFP, or any guarantee program, largely depends on timely payment of claims of lending institutions. The AGFP has to streamline implementation procedure and requirements in processing claims and in cases of invalid claims or delayed processing of the payment of claims, it is important to immediately inform lending institutions of the status of claims submitted for payment.

[45] Majority of lending institutions that have filed guarantee claims experienced lengthy processing of claims, citing periods ranging from 3 to 13 months from date of filing up to payment.

- Streamline policies on accreditation of lending institutions and renewal of guarantee lines and consider linking lending institutions' performance in recovering paid claims.

The institution of a policy linking claims recovery to the renewal of guarantee line could increase the recovery of claims and weed out less capable lending institutions.

- Develop and implement a more strategic information/communication plan on AGFP.

There is a need to develop a comprehensive information and communication plan to raise awareness and acceptance of the AGFP program, address inaccurate perceptions (like confusing the guarantee with the crop insurance, and misconception that paid claims need not be collected), increase knowledge of lending institutions on program guidelines and procedure, and facilitate participation of lending institutions. The following are some of the activities that may be included in the communication plan: (i) conduct of regular consultations for accredited lending institutions as a venue for explaining/ clarifying the implementing guidelines and procedures, discussing operational issues and concerns, and updating on new program policies; (ii) more accessible means of communication through consultations, phone, written or online communication; (iii) more active participation of AGFP Project Management Office in information dissemination campaigns of the Department of Agriculture; and (iv) recognition of best lending institutions through awards and similar schemes.

- Strengthen the AGFP Project Management Office, its management information system (MIS) and monitoring and evaluation (M&E) capacity including its "local presence".

Inefficiencies in the processing of guarantee lines, coverage and claims seem to have been caused by lack of manpower, poor coordination with LandBank Lending Centers, and/or weak monitoring. These could be addressed by establishing a system that will make stronger "AGFP presence" in the LandBank Lending Center at the local level or among banks and other lending institutions (e.g., a focal person for rural banks). A more localized implementation of the AGFP is expected to result in quicker processing of applications (lines, coverage, claims), tracking or retrieval of documents in updating status of applications, and availability of personnel to quickly address inquiries of lenders. Also it would help to have an MIS that would provide the AGFP management and governing board up-to-date information for timely decision and policy-making. To keep track of the progress of the program particularly in terms of achievement of its objectives, it is important to develop and implement an effective M&E system.

- Establish a formal institution to implement the guarantee scheme.

This is necessary because right now, AGFP is a program of the Department of Agriculture (DA) that is managed by a steering committee and supported by a small technical staff. Access to the guarantee scheme is hampered by the inefficient delivery structure being a mere program in that department. Meanwhile before the establishment of such formal institution it will be important for the government to have more solid empirical evidence about the efficacy of the guarantee scheme in providing SFF borrowers with access to formal credit.

C. Case Study of Agricultural Value Chain Finance: Kalasag Cooperative

1. Introduction

In agriculture, a value chain is often defined as a series of activities that add value to the final product, beginning with the production, continuing with the processing, and ending with the marketing and sale to the consumer or end user (FAO). The chain involves different players, including a wide range of technical, business and service providers starting with the farmers in the rural areas leading to the bigger global market. With growing demand for higher value, more processed products, and consistent quality and safety standards, it has been a challenge for agriculture to keep up. Thus, development programs are now geared towards enhancing small farmers' and fishers' productivity, competitiveness and their participation in these global value chains.

In the Philippines, limited access to financing hampers the competitiveness of smallholders. Typically, small farmers and fishers depend on traders or middlemen for inputs and marketing of their produce. Because of the risks agriculture financing, formal financial institutions tend to shy away from those smallholders. This case study discusses how the value chain can help such smallholders to break barriers to financing and markets. Lessons learned through the failures of interventions focusing on one link in the value chain alone directed efforts on addressing constraints in the entire chain from production, to post-harvest, to marketing to distribution. Value chain financing offers tremendous potential for providing small holders and other small scale clients in the countryside with access to financial services and markets for their outputs.

In recent years, value chain financing has been recognized as an effective credit delivery mechanism not only for small producers but for all the actors in the value chain. The value chain reduces commercial risk by providing an assured market for the produce, making it easier for chain actors to obtain financing from banks and other formal sources. Efficient value chain financing is critical in smallholder agriculture and this case study shows how its impact on small onion producers whose experience can help other small scale producers in accessing financing and markets for their outputs.

In the case of the Kalasag Farmers Producers Cooperative (Kalasag), the viability of the value chain financing project is strengthened because of the presence of a "custom-fit" financing package and the availability of institutional markets that adapted to the farmers' situation. Organized by ordinary farmers, the Kalasag Multi-purpose Purpose Cooperative (MPC) of San Agustin, San Jose City, Nueva Ecija is now an accredited supplier of onions to the country's leading food chain company, the Jollibee Foods Corporation (JFC), a milestone for Kalasag in its six years of existence.

2. The Onion Farmers of San Agustin, San Jose City, Nueva Ecija and Birth of a Cooperative

For the longest time, the farmers of two adjacent barangays in San Jose City, Nueva Ecija have to face a perennial problem with onion farming. Farmers face uncertain market conditions. Fluctuations in the retail price of onions or even low onion prices can bankrupt them in any cropping season if sales proceeds are below the amount invested. Investments would typically be financed by informal loans at high rates of interest. If the investment fails, there is always the trader or middlemen to provide financing so they may try their luck in the next planting cycle and the hope to recover and pay present and previous loans. In this situation, marketing of produce is often seen as one of the major challenges they constantly face. With abundant harvests, the problem is getting a fair price for their produce but they have little bargaining power with local traders who control access to credit and markets. Agricultural imports also offer tough competition and this adversely affects prices at the farm gates. Another problem is lack of modern storage and transportation facilities. To avoid spoilage, farmers are forced to dispose of their produce as quickly as they can but unfortunately at very low prices resulting in low income, and even possibly huge financial losses.

An opportunity came with the possibility of supplying the onion needs of Jollibee Foods Corporation (JFC), which owns the fastest growing restaurant chain in the Philippines. With more than 1,200 stores nationwide, JFC buys produce from domestic farmers to reduce its dependence on imports. However, JFC, which buys in bulk will find it difficult to transact with a large number of individual small onion farmers.

With the assistance of the Catholic Relief Services (CRS), an international humanitarian agency of the Catholic community in the Philippines and an advocate of the clustering of small farmers in order to have a leverage in bargaining with institutional markets, the farmers of Barangays Kaliwanagan and San

Agustin in San Jose City, Nueva Ecija organized themselves into clusters and later on transformed into a cooperative in 2008-2009.

The newly formed cooperative was named Kalasag Farmers Producers Cooperative (Kalasag). Kalasag got its name from barangays Kaliwanagan and San Agustin, which are adjoining barangays of San Jose City in Nueva Ecija. Both are classified as 2nd class barangays with a total population of 11,840 or 1,230 households whose ethnic origin is either Ilocano or Tagalog. Majority (90 percent) of the population are engaged in farming while the remaining 10 percent are employed as laborers and market vendors.

3. The Kalasag Farmers Producers Cooperative

Kalasag is the first and only farmers' cooperative that supplies onion to Jollibee Foods Corporation. It entered into a marketing agreement with Jollibee Foods Corporation with the assistance of the local government of San Jose City, CRS, NLDC and ASKI under the project called, "Bridging Farmers to the Jollibee Supply Chain."

To finance the farmers' onion production, the National Livelihood and Development Corporation (NLDC) enlisted the services of the Alalay sa Kaunlaran, Inc. (ASKI), a microfinance NGO to finance those farmers. NLDC provided a wholesale loan to ASKI. Kalasag applied for a PHP 1.8 million production loan from ASKI. The loans to individual members of the cooperative ranging from PHP 30,000 to PHP 120,000 are given to them in cash and in-kind (in the form of a can of onion seeds). Cash loans given on a staggered basis are allotted for fertilizers, transplanting, weeding, and harvesting.

Technical supervision was handled by the City Agriculturist Office. Yield of onions improved through the introduction of biological control initiated by the local government. Synchronous planting of onions planned per cluster and the usage of single high quality variety improved yield and quality. Exposure trips to sustainable farms and market studies were conducted by the farmers themselves through the facilitation of CRS staff following basic steps of agro-enterprise development. Support from the different agencies of the government and NGOs for CY 2010 included the following: multi-tilling machine and motorized sprayer from DA-Region 3, cold storage bin of the Bureau of Post-Harvest Research (BPRE), PHP 0.48 million Cold Storage Loan from Peace and Equity Foundation (PEF), and PHP 1.5 million Buying Fund from the Agricultural Credit Policy Council (ACPC), granted during a simple turn over ceremony in March 10, 2010.

JFC bought 60 metric tons of white onions amounting to PHP 1.7 million from Kalasag in 2009. In 2010, JFC gave it a target to supply 200 metric tons of fresh and peeled white onions within a 5 month delivery period starting February. This would generate an estimated gross proceeds of at least PHP 6 million. Kalasag delivered and met its target. Aside from the JFC target of 200 metric tons, the Kalasag farmers planted 35 percent buffer volumes of white onions in cases of "force majeure". The buffer volumes are raised simultaneously with the committed volumes. In cases where no calamities occurred during the harvest season, the buffer volumes shall be marketed collectively to local traders by Kalasag.

The project was extended until 2012 with the Project Management Plan for 2010-2012 formulated by the Site Working Group composed of CRS, Kalasag, ASKI, DA and the City Cooperative Office. The target volume of onion for delivery was increased from 60 to 200 metric tons for 2010 as mentioned above. Aside from fresh onion, the cooperative also committed to deliver salad tomato, green/red bell pepper and peeled onion. Onion peeling has generated additional jobs and income for the cooperative and for the women in the community.

Kalasag was able to deliver white onions to JFC with a very low percentage of rejection of 0.17 percent. This record is considered excellent compared to the Jollibee standard of five to ten percent rejection and is the lowest percentage of rejection in the history of JFC. They were also able to sell their produce at PHP 30 per kilo when the prevailing market price of white onion during the period March to April

2009 was only PHP 20 per kilo. The quality difference justified the premium price paid for Kalasag onions.

A buying fund for the buffer volume valued at PHP 1.5 million is necessary to satisfy the household needs of the farmer beneficiaries during the three months after harvest. They receive the net proceeds from sales only three months after the harvest period. This is where the funding from ACPC will be used.

Projections show that Kalasag could generate a net income of PHP 196,750.00 per crop cycle if they could sell the buffer onions at PHP 27.00 per kilogram to local traders. Profit from this transaction will be used as capital build up for each beneficiary; alternatively such profits can be plowed back as buying funds in succeeding planting seasons.

Today, the cooperative has the capability to ask for the best possible price for their produce even during peak season when there are supply gluts. This is due to the established marketing linkages of cooperative to JFC and other companies.

The leaders and member's efforts, support of the government and private sector, the right technology and financial assistance made the cooperative successful in its venture. In 2012, Kalasag started supplying onions to another company, the CDO Foodsphere, Inc., a leading Filipino food corporation in the meat processing industry, with 3 tons of onions requirement per week. Likewise, Kalasag has ventured into corn production to supply a feeds company.

Kalasag has shared the results of its success to other sectors of the community. The cooperative has been providing livelihood opportunities to the out-of school youth and farmers' wives. In almost six years of existence, Kalasag is now made a name for itself in agriculture and industry. From farmers with simple dreams to provide for the needs of their families, they are now gearing up to be the leading producer of onions in the country.

4. Value Chain Finance Innovation

The pilot collaboration project of the NLDC, CRS and the JFC was successful in linking the small farmers to JFC and other markets. This approach has become a local model in supporting farmers through sustainable agro-enterprise development.

With a policy framework and advocacies for small farmers or the rural poor in general, the government has mandated specialized financing institutions for the agricultural sector such as the NLDC which has helped the rural poor in the past three decades. The NLDC offers a variety of programs and services that directly benefit the marginalized sectors, which have been excluded from mainstream banking and finance.

With the community-based agro-enterprise development approach, NLDC continuously partners with conduit institutions such as cooperatives, rural banks and non-government organizations at the local level. Under the current set up, the main recipients are the agrarian reform beneficiaries and their households, who, aside from being tillers of the land, have small enterprises that augment the household income from farming. This means that financing in the rural areas need not necessarily be concentrated on farming activities.

The overall goal is to enable small farmers to increase their incomes through agro-enterprise development and market linkages. Specifically, the program aims to organize small farmers into agro-enterprise clusters for the purpose of consolidating supply, pooling transport logistics and linking to formal business entities. This role has been traditionally played by traders or middlemen. The program assists farmers in value-adding activities, which will enhance their compliance to quality requirements and increase competitiveness.

The NLDC program involves a developmental capacity-building process where the farmers acquire knowledge in basic marketing, awareness of alternative market chains for their crops, grasp of buyers' preferences as to quality, volume and price. At the same time, the farmers get a better understanding of their crop supply condition, production costs and practices, and ways to improve product quality, post-harvest handling, and marketing. Farmers appreciate the benefit of forming themselves voluntarily into clusters (of 8-15 farmers), and consequently several clusters pooling their supply capacities to achieve the volume requirements of commercial buyers. Armed with the knowledge about buyer preferences as to quality, volume, delivery and price, the farmers in the clusters make decisions as to what crop and corresponding seed variety to plant, the timing or scheduling of planting and harvesting that will coincide with the purchasing schedules of the buyer, and the committed volume of the product that will be sold through the cluster.

The project rested on the assumption that a business relationship between modern agri-food companies like JFC and small farmers is mutually beneficial. A well-organized small farmers' group with the number and geographical spread could provide JFC with a stable, diversified source of supply while meeting the required quality standards. JFC, with 1,200 stores nationwide, can provide a stable and long-term market for the farmers' produce. While the project followed this business model, NLDC, JGF, and CRS were aware of the unique challenges. JFC is a highly integrated company that procures from suppliers that are able to organize their activities from farm production to post-harvest, processing and marketing following the concept of supply chain management. On the other hand, small farmers were typically unorganized, tilling fragmented farm areas and are used to produce small amounts of low value crops with uneven quality. Their market has traditionally been limited to the wet market – or the trader or the trader's agent from whom they would ask for cash advances or input supplies for farm production or household needs. In effect, they would have sold their crops before these are even harvested. Then, their market horizon would not usually include institutional buyers such as JFC.

Farmers are often disadvantaged if they remain producers of raw materials, are disorganized and lacking of capacity to market their produce directly. They can become victims of price-cost squeeze situations where the costs of inputs increase and the prices of produce slump with bigger harvests. This happens because farmers do not have direct access to markets and do not process raw produce for higher value-added earnings. Ironically, the inefficient multi-tiered system prevalent in the trading of rice, corn, and other high value crops including onion results in consumers paying up to as much as 10 times the farm gate prices (The ACPC Challenge, 2010). Interestingly, the analysis of this price contrast also shows that the interests of both farmer-producers and the consumers are inherently the same. If farmers produce more volume, theoretically, it would mean lower prices for consumers. Further, a farmer producing more volume would mean more jobs in the farms, the purchase of more agricultural inputs, and the increased milling and processing of raw farm produce, which add to other economic multiplier effects.

The ACPC's Direct Market Linkage program specifically addresses this problem. It serves as a complementing strategy to the Department of Agriculture's "Bagsakan Centers" or food terminals, which are outlets or drop-off centers for farmers' produce. These trading centers can offer lower prices to consumers by at least 10 percent. With a direct link to market, farmers earn more and can bring more volumes to the markets at a lower price, ultimately benefiting the consumers.

One item being funded under the Direct Market Linkage program is the provision of marketing funds for buying buffer volume of the farmers' produce. Under this program, the ACPC in 2010, has granted the Kalasag a PHP 2.5 million loan complementing NLDC's assistance to Kalasag being one of its beneficiaries under its agro-enterprise development program. Kalasag with its experience in the production and marketing of onion is presently one of the major suppliers of onions to Jollibee Food Corporation.

After the initial years of pilot implementation, the following were achieved:

- Organize some 350 farmers into agro-enterprise clusters, thus consolidating product supply and pooling logistics such as warehousing and transportation;
- Assist farmers to engage in value-adding activities, thus enhancing their compliance to quality requirements. The wives of the farmers, for example, had found jobs peeling the white onions, adding value to the produce;
- Increase the knowledge of farmers about modern farming practices and technology, thus improving their productivity, reducing their cost and increasing their competitiveness. All these have contributed to higher incomes; and
- The MFI (ASKI) under the project was able to pilot test and develop a financing product that is suitable to the requirement of onion farmers in the value chain.
- Each collaborating organization (public and private) used their relative competencies and contributed their own resources (technical, financial, etc.) to support the market linkage between Kalasag and JFC.

The following matrix summarizes the innovations and practical schemes employed by the collaborators (Table 17).

Table 17. Innovations and schemes of different organizations

Component	Implementing Organization	Innovation	Schemes	Outcome
Community organizing	CRS	Clustering Approach	• 8-step-Plan for Agro-enterprise Development • Forming farmers into small clusters of 10-15 farmers • Capacity building	• Farmers are guided in finding the right product to supply, how to bring the products to the market, and how to meet buyers' expectations • Farmers able to set up a joint marketing enterprise, selling their crops as a business entity • Farmers can consolidate crops meeting volume requirement of target market
Access to Financing	NLDC, ASKI, ACPC	Provision of flexible financing support based on requirement of farmers	• Production loan made on a staggered basis based on the farmers' needs for funds using the farming timetable	• Risk of fund diversion mitigated
			• Support to market linkages, e.g. buying fund for the consolidate produce, loans for storage fees, truck loan	• Risks brought about by calamities mitigated

Table 17. *(continued)*

Component	Implementing Organization	Innovation	Schemes	Outcome
			• Other services: savings, life insurance, farmers' forum, participation to trainings	
Marketing	JFC	Linkage to institutional buyers	• Contract growing • Capacity building	• Sustainable markets for farmers produce
Other support services	DA, LGU, Academe		• Provision of post-harvest facilities	

5. Conclusions and Recommendations

The experience of Kalasag provides the main lesson that agricultural value chain financing can be viable provided that the market for agricultural produce is assured. This assurance is a risk-mitigation measure that counters the voluminous risks specifically those brought about by natural disasters and infestations. Financing structure still needs to be aligned with the specific requirements of the small farmers at a particular time and thus, it is best described under a value chain financing approach. It can also be noted that corporate markets are accessible if the farmers would know how to be competitive in terms of prices and be consistent on quality and quantity of produce.

Specifically, linking the onion farmers to the supply chain of Jollibee Foods Corporation and local markets has improved their income in a more sustainable manner. Among the learnings are:

- The finance provider must have both goals of social responsibility and business interest to make the project more sustainable.
- Although the project's end-goal is to link farmers to the market, this market opportunity requires quality and consistency of supply.
- While it takes time for the farmers' group to be in the forefront of market negotiation, the finance provider (in this case, ASKI) could take this role in the initial stage while the farmers' group observes the entire process.
- Public-private sector collaboration is crucial in assisting and getting farmers involved in a complex mechanism such as value chain financing.

Value chain finance can improve access of smallholders to agricultural loans. It also offers an opportunity to expand the financing for agriculture, improve efficiency and repayments, and strengthen linkages among participants in the chain. The following should be done to improve the quality and efficiency of agriculture value chain finance: (a) identifying financing needs of different actors in the chain, especially smallholders; (b) tailoring financial products to fit the needs of the actors in the chain; (c) reducing financial transaction costs through direct discount repayments and delivery of financial services; and (d) using value chain linkages and knowledge of the chain to mitigate risks of the chain and its partners.

The agricultural value chain is a comprehensive and holistic approach that covers a whole range of value-adding activities. In using the value chain to enhance smallholder access to and use of financing, the following are recommended:

- Build capacity of small farmer-producers to participate in the value chain.

This involves increasing their understanding and capacity to participate. In the evolution of a value chain involving small farmers, two important steps can be distinguished: first, the effective linkage of farmers to more attractive markets which requires their ability to produce to exact product specifications required; second, is the transition towards sustainable local finance delivery.

- Base interventions on a solid assessment of actual smallholder (small farmers) needs;

For each of the financing opportunities in a value chain, corresponding capacity building needs may be identified. While financial service providers will not take prime responsibility for these interventions, their involvement is crucial to arrive at a joint strategy. Moreover they also need to build up their own capacity to deal with these issues, to develop appropriate products and to appraise clients from a value chain finance point of view.

- Familiarize small farmers and other stakeholders with the structure and the dynamics of the value chain.

This will involve, among other things, an analysis of the value addition potential in the chain. This will reveal whether benefits can accrue to primary producers by organizing the chain more efficiently and whether the cost of chain organization and financial services can be covered from product margins.

- In considering financial interventions, consider non-financial alternatives such as: (1) ensuring contact with financial institutions; (2) bringing together in workshops various stakeholders to see whether solutions can be found within ordinary business relationships; (3) providing technical assistance to producer organizations or lead actors in the chain, allowing them to meet the requirements of viable and sustainable chain operations; (4) facilitating linkages offering finance providers the comfort of well-established market outlets, and providing sufficient value added potential at the local level.

- Identify an effective lead partner in value chain finance.

An active player in the chain, like a farmer marketing organization or a processing company, can take the lead in streamlining the value chain, thus providing a degree of 'chain governance'. Such a party can also play a role by providing embedded finance to suppliers, and/or to establish a working relationship with a finance provider for financing of producers and input suppliers.

Weakness at any link in the chain can increase financing risk at all levels. Value chain finance decisions derive from the health of the chain or sector, including its cash and commodity flows, rather than on traditional collateral of an individual business or category of actor. The viability of value chain finance also depends on 'insider knowledge' of the industry.

The drivers of a value chain, which are often the businesses involved in the processing and marketing of agricultural outputs, know the business and the other actors in the chain in a way the financial institutions by themselves do not.

- Provide the necessary infrastructure in rural areas.

Infrastructure is a critical requirement for area development. Serious gaps in basic infrastructure such as inadequate electricity for operating machinery and processing equipment, lack of storage facilities to ensure product quality, undeveloped road systems to promote fast delivery and reduced spoilage, and insufficient water and technologies for irrigation and other farm activities constrain growth of outputs and productivity. Policy makers must make agriculture a priority to overcome these obstacles.

D. Case Study on the Development of the Micro-insurance Industry

1. Introduction

One of the most important services that can be given to small farmers and fishers, microentrepreneurs and rural households is micro-insurance. Micro-insurance is defined as insurance that (i) operates by risk-pooling, (ii) is financed through regular premiums, and is (iii) tailored to the poor who would otherwise not be able to take out insurance (Churchill (2006). Micro-insurance is generally for low income people, poor rural households, microentrepreneurs, who are excluded by traditional commercial insurance schemes because they come from the informal sector, have irregular cash flows and have seasonal fluctuations in earning capacity (Churchill 2006; Llanto 2007). The Regulatory Framework for Micro-insurance developed by government defines micro-insurance as "activity of providing specific insurance, insurance-like and other similar products and services that meet the needs of the low-income sector for risk protection and relief against distress, misfortune or other contingent events"[46].

Very recently, the Philippine Insurance Commission reported that the Philippines was one of the top micro-insurance markets in Asia. The micro-insurance coverage among Filipinos rose to 19.95 million (20.4 percent of the population) in 2013 from 3.1 million (3.4 percent of the population) in 2008 (BSP, 2013). This case study looks at how the government regulator (Insurance Commission) and private insurance providers have collaborated to make micro-insurance accessible to a large segment of the population formerly excluded from the formal insurance system in a short period of four years.

2. Path taken

From the author's perspective, the development of micro-insurance in the Philippines was supported by the following pillars: (i) establishment of an appropriate policy and regulatory environment; (ii) strong coordination and collaboration by key government agencies to adopt reform measures in the insurance industry; (iii) active public-private sector participation in developing appropriate and affordable micro-insurance products; (iv) emphasis on education, awareness campaign and advocacy; and (v) efficient use of scarce donor resources (technical assistance) in improving the regulatory framework for micro-insurance. These pillars are not silos in themselves but are integrated activities spearheaded and coordinated by the National Credit Council of the Department of Finance and the Insurance Commission with support from key government agencies.

Establishment of an appropriate policy and regulatory environment. Micro-insurance had a good start with private insurance providers, basically the mutual benefit associations (MBAs) and commercial insurance providers entering into a policy dialogue with the government (National Credit Council of the Department of Finance, Insurance Commission). There was a realization among private insurance providers, especially the mutual benefit associations and the government that informal insurance schemes give the insured poor households and low income clients a disservice. Those informal insurance schemes are neither regulated nor provided by regular insurance companies. They were formulated to respond to the need of those excluded from the formal insurance system for some form of protection from various risks that could lead to catastrophic losses when they unfortunately occur.

The policy dialogue eventually led to the National Strategy for Micro-insurance, which defined the respective roles of government, especially the regulator, and the private sector in the development of the micro-insurance industry and provided the framework for public-private sector collaboration. Overall, the National Strategy for Micro-insurance recognizes the ability of the market to introduce innovations in insurance products and services to make them responsive to the demand of small scale

[46] This paragraph is from Llanto, Gilberto M. (2014) "Financial Inclusion, Education and Regulation in the Philippines," Paper read at the ADBI Conference on Country Experiences of Financial Inclusion, Regulation and Education Bangkok, ADB Thailand Mission, 31 October 2014.

clients (microentrepreneurs, rural households, small farmers and fishers) and for government to provide a supportive role to enhance the working of the market. The immediate objective was to develop affordable and appropriate micro-insurance products while at the same time ensuring consumer protection. Table 18 lists some of the key policy reforms adopted in the Philippine micro-insurance industry. These policy reforms resulted in proportionate regulation of micro-insurance that balances accessibility (ease of access, affordable, appropriate) with consumer protection (sufficient capitalization of private insurance providers, monitoring and adherence to performance standards).

In addition to the provision of an appropriate policy and regulatory environment, the Insurance Commission provided incentives to persuade licensed private insurance providers to consider the specific insurance needs of the low income market. For instance, the Insurance Commission allowed lower capitalization requirements for providers that are wholly engaged in micro-insurance. It also created a new category of micro-insurance agents and brokers with lighter licensing requirements. Moreover, the government, with funding assistance from donors, conducted the following activities to develop the capacity of the private sector in providing insurance for the poor:

- Conducted a market survey to determine the needs of the low-income sector, which provided the basis for designing the products, formulating policies, marketing and distribution.
- Developed a prototype micro-insurance non-life product that corresponded to the characteristics and needs of the poor using a one-page simplified policy contract. The product is a basic cash assistance policy that provides benefits to the insured and his/her livelihood against perils of personal accident, fire, flood and earthquake.
- Simplified the wordings of life policy contracts for easier comprehension by the low-income sector.
- Conducted trainings for Micro-insurance Advocates. Training modules that matched the different types of stakeholders were developed. Close to 700 individuals from the macro (policy makers, national government agencies, regulators and local government units) and meso (insurers, intermediaries, support institutions, donors) sectors were trained as Micro-insurance Advocates.
- Carried out a nationwide micro-insurance awareness campaign which run for a year. This consisted of trainings on micro-insurance advocacy as well as public seminars, micro-insurance information exhibits and media briefings. A learning center on micro-insurance was also established in Southern Philippines.
- Conducted trainings on the Performance Standards for Micro-insurance.

*Strong coordination among key government institutions***.** The development of the micro-insurance industry cannot rely on the efforts of one or two government agencies. A crucial step in the development of the micro-insurance industry was the strong coordination and collaboration among key government agencies which led to full support and commitment to develop the micro-insurance industry. The key government agencies are the National Credit Council of the Department of Finance (NCC) and the Insurance Commission which collaborated on the National Strategy for Micro-insurance and the Regulatory Framework for Micro-insurance, with support by other government agencies, namely the Bangko Sentral ng Pilipinas (BSP), Securities and Exchange Commission (SEC), Cooperative Development Authority (CDA), Department of Health, National Anti-Poverty Commission and the Philippine Health Insurance Corporation.

Table 18. Policy reforms in micro-insurance, Philippines

Policy Reforms	Features
National Strategy for Micro-insurance (issued on January 2010)	Defines the objective, the roles of the various stakeholders and the key strategies to be pursued in enhancing access to insurance of the poor. It encourages complementation of the products of social health insurance by the private sector. It provides directions towards mainstreaming informal insurance and insurance-like activities and the promotion of public awareness and financial literacy.
Regulatory Framework for Micro-insurance (issued on January 2010)	Outlines the government's policy thrusts and direction for the establishment of a policy and regulatory environment that will encourage, enhance and facilitate the safe and sound provision of micro-insurance products and services by the private sector. It identifies and promotes a system that will protect the rights and privileges of those who are insured.
Roadmap to Financial Literacy on Micro-insurance (issued on January 2011)	Spells out the key strategies and measures to be adopted for institutionalizing financial literacy on micro-insurance. Key principles, guidelines and specific directions on how to promote and change behavior favorably for the adoption of micro-insurance among the low-income sector are provided for.
Alternative Dispute Resolution Framework for Micro-insurance (issued on October 2012)	Requires all insurance entities, agents and brokers who are engaged in micro-insurance business to follow mediation-conciliation processes of claims dispute based on the following parameters: **Least cost, Accessible, Practical, Effective and Timely**.

Source: ADB (2013)

Together, they worked as a team to develop an enabling environment and ensured the consistency of reform measures, policy actions and regulatory guidelines and their implementation. One important lesson learned from the Philippine experience is that it is important to ensure that concerned government agencies are convinced of and own the policy and regulatory reform agenda and that there are key officials within the concerned government agencies who support and champion the reform agenda (ADB, 2013).[47]

The commitment of the four key regulatory authorities, BSP, SEC, CDA and the Insurance Commission is indicated by the issuance of the following circulars to guide product development and approval, product distribution and marketing, consumer protection, and industry performance monitoring, all in accordance with the Regulatory Framework for Micro-insurance and the National Strategy for Micro-insurance (**Table 19**).

Strong public and private sector collaboration. The private sector was deliberately engaged in the development of appropriate products to achieve the goal of inclusive insurance. The private sector has the competence and comparative advantage in developing viable and sustainable insurance products and services to rural households and low income clients. The private sector made use of the incentives provided by the Insurance Commission (described above) to develop appropriate micro-insurance products.

The collaboration between the public and private sectors may be considered the most challenging if not the most important in the entire process. It was done through technical working groups (TWGs) which included representatives from microfinance institutions and other concerned stakeholders (ADB, 2013). The idea was to set up venues for discussions, debates and negotiations on policy proposals. The TWGs met regularly until agreements were reached which eventually led to the issuance of policy and

[47] This was confirmed during the interview with Mr. Reynaldo Vergara of the Insurance Commission.

Table 19. Various circulars and memorandums affecting micro-insurance, Philippines

Circulars/Memorandums	Description
Insurance Memorandum Circular (IMC) 9-2006: Micro-insurance Regulation and Declaration of Policy Objectives	• Defines micro-insurance products according to limits of premium and benefits for Mutual Benefit Associations (MBAs) engaged in micro-insurance. • Qualifications and capital requirements of MBAs that can engage in micro-insurance.
IMC 01-2010: Regulation for the Provision of Micro-insurance Products and Services	Defines Micro-insurance products according to: • Limit of premium cost (5% of daily wage) and amount of benefits (500 times of daily wage). • Features of insurance policies – affordable, simple and easy to understand. • Sets the qualification of entities that can underwrite and sell Micro-insurance. • Requires micro-insurance policies to clearly identify the face amount, benefits, and terms of the insurance coverage and ensure that contract provisions can be easily understood by the insured; documentation requirements are simple; and the manner and frequency of premium collections coincides with the cash-flow and not onerous for the insured • Defines rules on product bundling. • Evaluates performance of providers through a set of Performance Standards • Use of Micro-insurance logo in the policy contracts.
Joint IC-CDA-SEC Memorandum Circular (MC) 01-2010 – Defining Government's Policies on Informal Insurance Activities.	• Defines activities on insurance that need to be formalized. • Requires all entities practicing informal insurance activities to formalize their schemes by seeking authority from the PIC. • Provides various options to formalize informal schemes.
Joint IC-CDA-SEC Memorandum Circular (MC) 02-2010 – Guidelines on Treatment of Funds Collected from Informal Insurance Activities	• Requires that funds accumulated from contributions from informal insurance activities be used exclusively for the benefits of the contributors. • Emphasized that excess moneys, after the formalization of the informal insurance schemes, shall be returned to or be used for the benefits of the contributors.
BSP Circular 683 on Marketing, Sale and Servicing of Micro-insurance Products	Sets out clear guidelines for banks that want to sell Micro-insurance as Agents. Clearly differentiates banking functions from insurance activities.
Circular Letter 29-2010 – Sale, Issuance or Distribution of Insurance Products	Emphasized that it is the responsibility of insurance companies and cooperative insurance societies to ensure that only authorized or licensed intermediaries, i.e., agents and brokers, are engaged to sell insurance/micro-insurance policies. In the case of mutual benefit associations, MBA insurance products must be issued only to members.
Circular Letter 5-2011 – Performance Standards for Micro-insurance	Sets guidelines for reporting micro-insurance activities and prescribes the calculations of prudential and performance ratios according to set of Performance Standards called SEGURO (Solvency, Efficiency, Governance, Understanding of Micro-insurance, Risk Management and Outreach of clients).
Circular Letter 6-2011 – Guidelines for the Approval of Training Programs and Licensing of Micro-insurance Agents	Outlines the procedures of training and licensing MI agents. Requires the minimum disclosures such as "A Licensed Micro-insurance Agent" signage visible in the premises of the institution.

Table 19. *(continued)*

Circulars/Memorandums	Description
Circular Letter 39-2011 Re-approval of Micro-insurance Products	Requires all MI products approved under the IMC No. 9-2006 (the very first MI circular issued by PIC) to be submitted for re-approval to conform to the definition of Micro-insurance under IMC 1-2010.
Circular Letter 16 to 18-2013 – Guidelines for the Implementation of Alternative Dispute Resolution for Micro-insurance by Commercial Companies, Cooperatives and MBAs	Describes the principles and procedures of claims-related dispute resolution mechanisms at least cost, accessible, practical, effective and timely. It emphasizes consumer protection and also protection of the insurance industry against illegitimate claims.
Circular Letter 15-2013 – Procedures for Accreditation of Mediators-Conciliators in Alternative Dispute Resolution for Micro-insurance	Sets out the qualifications of mediators-conciliators, training, responsibilities and code of conduct.

Source: ADB (2013)

regulatory reform measures. The dynamic interaction within the TWGs, which was made possible through the able leadership of the DOF-NCC and the Insurance Commission, proved to be critical in ensuring the private sector's acceptance and ownership of the reform measures and consequently, in their adoption and smooth implementation. Aside from TWGs, consultations and dialogues among national and regional stakeholders were also undertaken, consistent with the principle of making the private sector involved in the process of policy formulation in order to facilitate institutionalization and sustainability of the reforms.

Emphasis on education, awareness campaign and advocacy. Another important element in the development of micro-insurance in the Philippines was the emphasis on education, awareness campaigns, and advocacy to generate and sustain the interest and buy-in of clients and insurance providers. The information and education cum advocacy campaign was necessary due to the following reasons: (1) the low income sector lacks understanding and appreciation of insurance, the benefits and obligations arising thereto; (2) most of the insurance providers are not familiar with the low-income sector and therefore do not consider them as a potential market, which is reason why insurance products are mostly designed for the middle class and the higher-income groups; (3) various stakeholders such as policymakers, legislators, regulators, banks, and donor institutions have to be educated about the peculiar characteristics of the micro-insurance market so that they can formulate the proper policies, rules and regulations (see ADB, 2013).

Efficient use of grant funds from development partners. Technical and funding assistance for the formulation and development of the Regulatory Framework and the National Strategy for Micro-insurance and capacity building activities came from two development partners, namely, the Asian Development Bank-Japan Fund for Poverty Reduction and the German Agency for International Cooperation. The government agencies concerned and these partners were seriously involved in project formulation, preparation and implementation. There was effective donor coordination to avoid overlaps or conflicting activities. This was made possible by having only one steering committee for the two donor-funded projects making coordination simple and easy (ADB, 2013). In effect, project activities were effectively coordinated and the end result was efficient use of those grant funds.

3. Gains achieved

The market had an overwhelming response to the implementation of policy reforms[48]. Before 2009, only the MBAs provided insurance to the low-income sector for understandable reasons. The MBAs serve mostly this type of clientele and not the middle and high income group. However, as of end 2012, thirty five commercial insurance companies have entered the market and started to sell micro-insurance products, of which 7 are life insurance products and 18, non-life. By that time, the Philippine Insurance Commission had approved 54 life micro-insurance products and 26 non-life for a total of 80 micro-insurance products. The MBAs also started to secure a license to operate from the regulator and today there are 17 licensed micro-insurance MBAs.

Before the reforms initiated in 2009, the micro-insurance products sold to borrowers of microfinance institutions (MFIs) were mostly credit life insurance products, which in reality were designed to protect the loan portfolios of MFIs. Today, micro-insurance products provide health insurance and protection against flood, crop loss, fire and earthquake. Another change brought about by the reforms was the increase in number of micro-insurance agents. Before 2009, MBAs covered about 3.1 million individuals. As of end-2012, around 7.8 million individuals are covered by 124 licensed micro-insurance agents, of which 34 are rural banks. Greater awareness and information about micro-insurance has also helped in extending the coverage[49].

The simplified policy contracts provided the poor with a better understanding of the insurance concept, its benefits as well as their rights and obligations as insured individuals. Consequently, risk protection of the low income sector has increased. Table 16 below summarizes the changes in the performance of the industry.

Table 20. Changes in the industry before and after the reforms

Before 2009	After the reforms, as of end of 2012
Micro-insurance products mostly credit life, offered by MBAs	80 micro-insurance products approved (54 life and 26 non-life)
6 licensed MBAs offering micro-insurance	17 licensed MBAs offering micro-insurance
Very few commercial insurance companies with micro-insurance products	35 insurance companies (17 life and 18 non-life) voluntarily selling micro-insurance products
No micro-insurance agent category	124 licensed as micro-insurance agents (34 rural banks and 90 individuals)
3.1 million individuals covered under micro-insurance	7.8 million including dependents provided with micro-insurance
Insurance penetration was 1.02% of GDP	Insurance penetration is now 1.42% of GDP
Insurance density PHP 878: life insurance PHP 654; Non-life PHP 224	Insurance density PHP 1,541; life insurance PHP 1,265; Non-life PHP 276
Estimated life insurance coverage was 13.90% of 91 million population	Estimated life insurance coverage was 23% of 97.6 million population

[48] From interviews with the Insurance Commission

[49] This was also indicated by Piedad Geron in the paper Assessment of Micro-insurance as Emerging Microfinance Service for the Poor written for the Asian Development Bank.

4. Conclusion and Recommendations[50]

Amid the phenomenal growth, there is still room for expansion. Considering the 7.8 million people insured (including dependents) after the micro-insurance policy, this falls short of the potential demand from the low-income sector based on the latest poverty statistics which shows that as of 2012, 27.3 million people live below poverty line. To further the growth and sustain micro-insurance, the following steps are recommended:

- Enhance the technical and managerial capacity of the Philippine Insurance Commission (PIC).

For micro-insurance to be sustainable, regulation should provide adequate protection to consumers while ensuring the growth and stability of the industry. The capacity of the PIC should therefore be strengthened in the following areas:

(i) Development of appropriate rules and guidelines to ensure the effectiveness and soundness of innovative delivery channels that will keep the cost of administration and distribution to a minimum without sacrificing the timely settlement of claims and that will minimize the transaction costs on the part of the clients;

(ii) Consumer protection through appropriate market guidelines

(iii) Formulation of an appropriate policy framework and rules and regulations for technology-based platforms in micro-insurance that will facilitate expansion and at the same time, protect consumers;

(iv) Adoption of risk-based supervision approach to enable insurance supervisors to review the manner in which insurers identify, manage and control risks;

(v) Formalization of informal insurance schemes in the light of the proliferation of informal insurance schemes provided by some entities dealing with the low-income market;

(vi) Approval and evaluation of index-based micro-insurance products given the increased frequency of natural calamities due to climate change through the formulation of guidelines for evaluation and approval; developing standards; and implementing evaluation and approval procedures for parametric and index-based insurance products.

(vii) Formulation of regulations for mutual benefit associations, which are the institutions that have a greater proximity to the low income market, to ensure standardization of operations and practices for prudential purposes.

- Develop innovative micro-insurance products addressing multiple risks.

This is in response to the numerous risks faced by the low-income sector, which they want entirely covered in one insurance product under one insurance entity. While Insurance Memorandum Circular 1-2010 recognizes and allows the bundling of life and non-life insurance products, there has yet to be a product of this type that would cover the multiple risks faced by the poor.

- Harness public-private partnerships (PPP) in micro-insurance.

Given the gaps in the services provided by the government in providing social insurance for low income groups and the increasing interest and willingness of private insurance providers to cater to the low-income market there is great potential in harnessing partnerships with the private sector to address these gaps.

[50] The main source is ADB (2013)

- Develop micro-insurance innovative products dealing with effects of climate change.

There is a need to expand the options of the poor to reduce vulnerability to current and future risks brought by the climate change phenomenon. The poor are more severely impacted by the negative effects of climate change. Government agencies and organizations implementing climate change adaptation programs may be encouraged to partner with micro-insurance providers in order to give additional risk protection to low income groups. Such innovative micro-insurance products can be initially pilot-tested in selected areas based on a set of criteria given the occurrence of natural disasters and catastrophic risks.

- Educate clients on micro-insurance.

Teaching the poor about the benefits of insurance remains a tough challenge. It is not easy to explain and make them appreciate the importance of paying premiums with the promise of big benefits when a contingent event occurs. Education will build a strong insurance culture among the poor in the future through a consistent and comprehensive financial education program.

CHAPTER 6
Conclusions and Recommendations

6.1 Conclusions

At the beginning of this study it was noted that limited availability of credit and the lack of access to a range of financial services have hindered inclusive growth in many countries within the Asia-Pacific region. This has serious repercussions on the development of national economies and also on efforts to lift the typical rural smallholder out of poverty. Providing smallholders (small scale clients) with credit, and other financial services has always challenged policy makers and financial institutions alike. For, reasons already known, the problem of poor accessibility of financial services by smallholders has been persisted.

However, it seems that this nagging problem is not insurmountable after all. The brief review of literature discussed the role of financial innovations in providing sustainable rural finance (services) and pointed out to a number of successful and not-so-successful government interventions in the credit markets. A distinct lesson coming from the Philippine experience is the importance of giving private financial institutions (private sector) a greater role in rural financial markets, and of the retreat of government into a role that it alone can effectively play, namely, that of providing a policy and regulatory environment conducive to private sector participation in the markets. Philippine experience also shows that private financial institutions can lend and provide a variety of other financial services to areas or clients wherein risks, e.g. loan default risk, can be properly assessed and managed. As the case studies indicated credit enhancements such as loan guarantee and risk protection schemes such as micro-insurance play a critical role in addressing perceived risks in smallholder lending. The best practices in sustainable rural finance that are encapsulated in the four case studies are really different types of financial innovations, which have been instrumental in providing the excluded segment of the population with access to financial services. Consumption smoothing, investments and risk-taking, and protection of families and individuals from catastrophic losses were made possible by the accessibility of those financial services that have been designed by government or co-designed by government and the private sector.

The few[51] case studies discussed in this report provide insights into a rich menu of best practices on rural finance in the Philippines and other countries. One important observation is the increasing emphasis on providing various types of financial services and not on credit provision alone. Rural financial institutions are concerned with outreach, an adequate fund base, cost recovery and responsive financial products and services. The case studies indicate that attaining these objectives is highly feasible with the use of financial innovations, described as product, process and institutional innovations.

Best practice in product innovation is illustrated by the case studies on agricultural loan guarantee (case of GM Bank) and micro-insurance. Best practice in process innovation is showcased by the use of value financing to bridge financing and marketing gaps (case of Kalasag cooperative). Finally, best practice in institutional innovation is seen in the use of MBOs and OBOs to develop an extensive client outreach even in hard-to-reach areas (case of CARD Bank).

[51] Because of time, budget and space (in the report) constraints, only a few case studies are reported. However, there are many more similar experiences out there that could be investigated by a curious analyst or even by policy makers or financial institutions wanting to learn innovative practices and products.

6.2 Policy Recommendations

In the light of the above, the following recommendations are made, which essentially meant to reiterate specific inferences from the four case studies:

6.2.1 On agricultural loan guarantee

- Intensify efforts to persuade banks to participate in the agricultural loan guarantee program.
- Simplify and expedite processing and payment of guarantee claims.
- Streamline policies on accreditation of lending institutions and renewal of guarantee lines and consider linking lending institutions' performance in recovering paid claims.
- Develop and implement a more strategic information/communication plan on the loan guarantee scheme.
- Strengthen the Project Management Office, its management information system (MIS) and monitoring and evaluation (M&E) capacity including its "local presence".
- Establish a formal institution to implement the loan guarantee scheme.

6.2.2 On micro-insurance

- Enhance the technical and managerial capacity of the regulator, i.e., Philippine Insurance Commission
- Develop innovative micro-insurance products addressing multiple risks.
- Harness public-private sector partnerships in micro-insurance.
- Develop micro-insurance innovative products dealing with effects of climate change.
- Educate clients on micro-insurance.

6.2.3 On value chain financing

- Build capacity of small farmer-producers to participate in the value chain.
- Base interventions on a solid assessment of actual smallholder (small farmers) needs
- Familiarize small farmers and other stakeholders with the structure and the dynamics of the value chain.
- In considering financial interventions, consider non-financial alternatives such as: (1) ensuring contact with financial institutions; (2) bringing together in workshops various stakeholders to see whether solutions can be found within ordinary business relationships; (3) providing technical assistance to producer organizations or lead actors in the chain, allowing them to meet the requirements of viable and sustainable chain operations; (4) facilitating linkages offering finance providers the comfort of well-established market outlets, and providing sufficient value added potential at the local level.
- Identify an effective lead partner in value chain finance.
- Provide the necessary infrastructure in rural areas.

6.2.4 On MBOs and OBOs

- For regulators, to adopt proportionate ('light but firm touch') on regulation of microfinance;
- For MFIs/RFIs, adhere to highest performance standards required by the regulator to earn the trust and confidence of regulators to impose 'light' or proportionate regulation of microfinance operations.
- For MFIs/RFIs and regulator, maintain transparent and open policy dialogue to ensure the appropriateness of regulations imposed by the regulator.

6.3 Way Forward: Pilot Testing of Good Practices

Based on the best practices cited in Chapter 5 they were further evaluated according to the set of criteria recommended by the ACPC. The following best practices are, therefore, recommended for replication or pilot-testing[52]:

6.3.1 Micro-Banking Offices and Other Banking Offices (MBOs and OBOs). Given that CARD Bank has successfully tested and achieved significant gains from establishing MBOs in terms of expanding outreach in far-flung areas. The successful experience indicates that the MBO strategy offers other MFIs the potential of reaching target clients in frontier or hard-to-reach areas. Other banks in the Philippines and other countries can learn from the CARD Bank's experience since the technical and financial requirements as well as the guidelines provided by Bangko Sentral ng Pilipinas are all in place. MBOs and OBOs can serve as an extensive service delivery structure to reach those who have been excluded from mainstream banking. Through OBOs/MBOs, CARD Bank was able to continuously motivate and create more awareness among the general public, especially microenterprises and rural households to save in the bank. Moreover, those OBOs/MBOs have also become the channel for members/clients, including their dependents to avail themselves of the benefits of microinsurance. This strategy calls for collaboration between regulator and the MFI. The regulator should be open to innovative measures such as MBOs while MFIs should be ready to invest in human capital who will man those MBOs.

6.3.2 Agricultural Value Chain Finance. This has great potential because the experience of Kalasag showed that agricultural chain financing can be viable provided that the market for agricultural produce is assured. It involves linking small producers to lead actors in the value chain to enable them to secure technical, financial and marketing assistance. More importantly, it highlights the crucial role of coordination and adherence to quality standards to sustain market access. The Kalasag experience showed that farmers can be linked to corporate markets for as long as farmers would stay competitive in terms of prices and ensure consistent volume and quality of produce. Linking the onion farmers to the supply chain of Jollibee Foods Corporation and local markets has provided vast opportunities for sustaining farm incomes. The identified success factors as well as lessons learned show the way to replicate this highly successful scheme.

6.3.3 Micro-Insurance for Small Scale Clients. It was shown that the development of micro-insurance in the Philippines was supported by the following pillars: (i) establishment of an appropriate policy and regulatory environment; (ii) strong coordination and collaboration by key government agencies to adopt reform measures in the insurance industry; (iii) active public-private sector participation in developing appropriate and affordable micro-insurance products; (iv) emphasis on education, awareness campaign and advocacy; and (v) efficient use of scarce donor resources (technical assistance) in improving the regulatory framework for micro-insurance. These pillars are not silos but are integrated activities spearheaded and coordinated by the National Credit Council of the Department of Finance and the Insurance Commission with support from key government agencies. Given that the Philippine experience has carefully outlined the activities undertaken as well as the factors that have contributed towards the development of microfinance in the Philippines, there is potential in replicating the same in other countries. The proposals to pilot-test these best practices are shown attached as Annex C.

[52] This excludes the guarantee scheme used by GM Bank because the AGFP still needs to tighten its operating guidelines especially with respect to processing and payment of guarantee claims. More importantly, the AGFP is currently a government program. For sustainability, it needs to be organized as a formal institution that will focus on providing the guarantee service to rural lending institutions.

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Annex A. Performance Standards for all Types of Microfinance Institutions in the Philippines

I. Introduction

The National Credit Council (NCC), an inter-agency body chaired by the Department of Finance (DOF), formulated and approved the Regulatory Framework for Microfinance Institutions (MFIs) in July 2002. The framework specifically directed the NCC, in coordination with concerned stakeholders, to formulate and develop a uniform set of performance standards that will cut across all types of institutions involved in microfinance. These standards will serve as the microfinance industry benchmarks to allow the comparison of performance among all institutions engaged in the delivery of microfinancial services. These benchmarks will also guide regulators in the assessment of financial institutions under their supervision. It should be noted, however, that these standards are only applicable to financial institutions that are engaged in retail microfinance operations.

The Performance Standards for all Types of Microfinance Institutions are based on international best practices, industry benchmarks and ratios that are being used by different players in the microfinance industry.

II. Purpose of Establishing a Common Set of Standards for Microfinance

As required under the Regulatory Framework for Microfinance Institutions, a common set of performance standards for all institutions engaged in microfinance was formulated and developed by the Technical Working Group (TWG) to allow greater transparency in the operations of MFIs. More particularly, the standards will provide the user the basic tools that will 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. The following are expected to use these standards in evaluating the performance of MFIs:

a. MFI management;
b. Appropriate regulatory authorities;
c. Wholesale financial institutions (government and private);
d. Donor agencies;
e. Domestic and international private sector investors;
f. Rating agencies; and
g. Social policy institutions.

The indicators and standards can be used in various ways. Management can use these indicators and standards in identifying weak areas in their microfinance operations and in determining the appropriate measures to improve operations. Domestic and international private investors can use these standards as guideposts in deciding whether they will invest in an MFI or not. Wholesale financial institutions-public or private can use these standards in assessing the creditworthiness of MFIs. Donor agencies, on the other hand, can use these standards in identifying the type of assistance for a specific MFI.

III. General Features of Microfinance

- Clients come from the low-income sector, lack assets for collateral, usually self-employed in the informal sector, and are engaged in economic livelihood activities;
- Loan sanctioning is based on the borrower household's net cash flow;
- Non-traditional forms of security are acceptable;
- Documentation requirements are simple, loan processing is fast, and loan release is timely;
- Lending methodology may be on a group or individual basis;

- Loan sizes are typically small, not exceeding P150,000; and
- Loans are typically short-term and amortizations are either on a daily, weekly, semi-monthly or monthly basis.

IV. Minimum Criteria in Evaluating Retail Microfinance Institutions

The minimum criteria below will provide a bird's-eye view of the nature and status of the MFI. These institutional criteria indicate whether the financial institution employs sound financial practices and has satisfactory performance and stable financial condition. Moreover, these criteria will indicate the financial institution's capability and seriousness in microfinance operations.

Institutional viability criteria 1

- CAMELS rating for banks of at least 3, with management score of not less than 3; and
- COOP-PESOS rating for cooperatives with savings and credit services of at least 70 with net institutional capital to total assets ratio of not lower than 5 percent.

1. Governance

a. The institution is regularly audited by an independent external auditor. For banks, the auditor should be recognized by the BSP; for cooperatives, the external auditor should be accredited by the Cooperative Development Authority (CDA); and for Non-Government organizations (NGOs), the external auditor should be certified by the Philippine Institute of Certified Public Accountant (PICPA) as a member in good standing; and
b. Audited financial statements are readily available.

2. For microfinance operations:

a. Presence of program objective to reach the poor;
b. Number of active microfinance clients, classified by gender – at least 500 for group lending or 200 for individual lending;
c. At least one year in microfinance operations;
d. Presence of a functioning and effective management information system (MIS) for regular monitoring of microfinance operations as evidenced by timely generation of basic financial, loans tracking, and aging reports using Portfolio at Risk (PAR);
e. Manual of operations or product manual; and
f. At least 2 full time account officers for microfinance operations.

V. Performance Standards for Microfinance

1. Portfolio Quality – Two indicators below provide specific information on the state of financial health of the microfinance portfolio of the institution. Maintaining good portfolio quality is very important for continued delivery of microfinance services to the MFI's clients. Poor quality of loan portfolio will lead to losses to the institutions, making it difficult to sustain microfinance operations.

a. Portfolio at Risk (PAR) Ratio – reflects the proportion of the microfinance loan portfolio with one day missed payment to the total microfinance loans outstanding at a given time, and shows the degree of riskiness of the total microfinance portfolio.

Since microfinance loans are usually small and are payable within a short period of time, the likelihood of default of the entire loan balance is high when one amortization payment is missed. The formula for this indicator is:

$$\frac{\textbf{Principal Balance of Loans with at Least One Day Missed Payment}}{\textbf{Total Principal Loan Balance}}$$

Restructured or refinanced loans shall be considered non-performing and no interest income shall be accrued thereon. These loans shall be included in computing PAR.

Restructured loans are loans that have been renegotiated or modified to either lengthen or postpone the original scheduled installment payments or substantially alter the original terms of the loan.

Refinanced loans are loans that have been disbursed to enable repayment of prior loans that would not have been paid in accordance with the original installment schedule. Refinanced loans shall be classified and treated as restructured loans.

STANDARD: 5 percent

Loan Loss Reserve Ratio – indicates the degree of protection of the institution against expected losses due to delinquency.

An allowance should be provided once the microfinance loan is considered at risk, since the likelihood of default increases as amortization payments are missed. Hence, allowance for probable losses is based on PAR. Restructured and refinanced loans are considered as risky and should be provided the appropriate allowance.

As a general provision, all current microfinance loans shall be subject to a 1 percent loan loss provisioning. The following shall be the basis in computing for loan loss reserves:

	Required Reserves
Current	1%
PAR 1 to 30	2%
PAR 31 to 60 and/or loans restructured once	20%
PAR 61 to 90	50%
PAR 91 & above and/or loans restructured twice	100%

Loan Loss Reserve Ratio

$$\frac{\textbf{Total Reserves Provided}}{\textbf{Total Reserves Required}}$$

STANDARD: 100% of the required reserve

2. Efficiency – The indicators under this category show whether the MFI is able to deliver microfinance services at the least cost to the institution. They also indicate the ability of the institution to generate sufficient income to cover the expenses related to the microfinance operations.

a. Administrative Efficiency – measures the cost of managing the organization's assets.

$$\frac{\textbf{Administrative Costs* (direct and indirect costs)}}{\textbf{Average Gross Loan Portfolio**}}$$

*Administrative cost should include loan loss provision expense.
**(Beginning Gross Loan Portfolio + Ending Gross Loan Portfolio) ÷ 2

Indirect Costs is allocated in proportion to the number of personnel directly dedicated to each cost center. Indirect cost allocated to the microfinance operations is computed as:

Indirect Costs = (Number of Full-time MF Staff ÷ Total Number of Full-time Staff) × Total Indirect Costs

Full-time MF Staff refers to employees working full-time in the microfinance operations regardless of employment status, i.e., whether contractual or regular.

Total Indirect Costs refers to costs shared by both the microfinance and non-microfinance operations. It includes, among others, salaries and benefits, rent, office materials and supplies, publications and publicity, transportation, travel and training for overhead staff, telephone and postage, insurance, utilities, repairs and maintenance, legal, audit and consultant fees, bank charges, taxes, and depreciation.

STANDARD: 10 percent and below

b. Operational Self-Sufficiency – indicates whether or not enough revenues are earned to fully cover the costs of the microfinance operations.

Interest Income from Loans + Service Fees + Filing Fees + Fines, Penalties, Surcharges

Financing Costs + Administrative Costs (direct and indirect costs)2

STANDARD: greater than 120 percent

c. Loan Officer Productivity – measures the ability of loan officers to service microfinance borrowers.

$$\frac{\textbf{Number of Active Borrowers}}{\textbf{Number of Account Officers}}$$

STANDARD: Group: greater than or equal to 300

Individual: greater than or equal to 150

3. Sustainability – Two indicators below measure the ability of the institution to continuously finance its microfinance operations from internally generated funds in the long run without any subsidy.

a. Financial Self-Sufficiency – indicates whether the organization is earning enough revenue to sufficiently cover in the long-run all operating costs and at the same time maintain the value of its capital and assets, without the need for subsidy.

$$\frac{\textbf{Operating Revenue}}{\textbf{Financial Expense + Loan Loss Provision Expense + Adjusted Expenses*}}$$

Adjusted Expenses = Total Operating Expense + [(Average Equity – Average Fixed Assets) × Inflation Rate] + [(Market Interest Rate × Average Total Liabilities) – Actual Interest Expense] + Other Implicit Costs. Other Implicit Costs include those costs relevant to the conduct of its business such as grants, rent free building, donor paid technical advisor, or other subsidized expenses.

STANDARD: greater than 100 percent

b. Loan Portfolio Profitability – measures the proportion of net revenues generated from the MF lending operations to the MF loan portfolio. This ratio indicates whether earnings can sufficiently cover the annual depreciation of the peso.

$$\frac{\textbf{Net Operating Income}}{\textbf{Average Net MF Loan Portfolio}}$$

STANDARD: greater than the inflation rate during the period

4. Outreach – These indicators show the extent of reach of the MFI. They take into account the growth in the number of the active clients, the expansion of the microfinance portfolio, and the depth of outreach.

a. Growth in Number of Active MF Clients 3 – measures the ability of the MFI to expand its operations through increases in its active clients (referring to those with outstanding MF loans with the institution).

$$\frac{\textbf{Ending No. of Active MF Clients – Beginning No. of Active MF Clients}}{\textbf{Beginning No. of Active MF Clients}}$$

STANDARD: ≥ 5 percent

b. Growth in Microfinance Loan Portfolio – determines the rate of expansion of the MF loan portfolio, which may be a result of an increase in the number of active clients or in the loan amounts, or a combination of both.

$$\frac{\textbf{Ending MF Loans Outstanding – Beginning MF Loans Outstanding}}{\textbf{Beginning MF Loans Outstanding}}$$

STANDARD: ≥ 5 percent

c. Depth of Outreach – indicates whether the MFI provides microfinancial services to clients belonging to the lower segment of the economy

$$\frac{\textbf{Total Loans Outstanding} \div \textbf{Total Number of Active Borrowers}}{\textbf{GNP per Capita}}$$

STANDARD: Not exceeding 20 percent

Rating System

1. Portfolio Quality (40 percent)

a. Portfolio At Risk (PAR)

Score in percent	Equivalent Points
5 or less	20
>5 to 10	15
>10 to 15	10
>15 to 20	5
Above 20	0

b. Loan Loss Reserve Ratio

Score in percent	Equivalent Points
100	20
70 to <100	15
50 to <70	10
30 to <50	5
Below 30	0

2. Efficiency (30 percent)

c. Administrative Efficiency

Score in percent	Equivalent Points
0 to 10	10
>10 to 15	6
>15 to 20	4
Above 20	0

d. Operational Self-Sufficiency

Score in percent	Equivalent Points
120 & above	10
115 to <120	8
110 to <115	6
105 to <110	4
100 to <105	2
Below 100	0

e. Loan Officer Productivity

Score in percent	Equivalent Points
For group loans:	
300 and above	5
250 to 299	3
200 to 249	1
Below 200	0
For individual loans:	
150 and above	5
100 to 149	3
50 to 99	1
Below 50	0

Note: If MFI is using only one methodology, MFI gets an additional 5 points

3. Sustainability (15 percent)

f. Financial Self-Sufficiency

Score in percent	Equivalent Points
100 & above	10
95 to <100	8
90 to <95	6
85 to <90	4
80 to <85	2
Below 80	0

g. Loan Portfolio Profitability

Score	Equivalent Points
Greater than inflation rate	5
Equal to inflation rate	3
Less than inflation rate	0

4. Outreach (15 percent)

h. Growth in Number of Active Microfinance Clients

Score in percent	Equivalent Points
5 or higher	5
0 to 5	3
Below 0	0

i. Growth in Microfinance Loan Portfolio

Score in percent	Equivalent Points
5 or higher	5
0 to 5	3
Below 0	0

j. Depth of Outreach

Score in percent	Equivalent Points
≤20	5
>20-100	4
>100-150	3
>150-200	2
>200-300	1
>300	0

VI. Overall Adjectival Rating

- **Rating 1 (90 to 100) – Excellent.** The MFI has strong performance that provides safe and sound operation. The microfinance operations of institutions in this category are resistant to external shocks and financial disturbances and are able to withstand adverse changes in the business environment.

- **Rating 2 (80 to 89) – Very Satisfactory**. The MFI has satisfactory performance. They have safe and sound operations and are able to withstand business fluctuations. However, there are some areas in its operations that need special attention which, if left unchecked may negatively affect its microfinance operations.

- **Rating 3 (70 to 79) – Satisfactory**. There are areas in the microfinance operations that need special attention. Key performance measures indicate that the operations may be adversely affected and may deteriorate further when left unchecked.

- **Rating 4 (Below 70) – Needs Improvement**. The microfinance operation has serious problems and needs close supervision.

Annex B. BSP Circulars on financial inclusion

Bangko Sentral ng Pilipinas (BSP) Circular 694 dated October 2010. This circular sets the provisions for the establishment of other banking offices (OBOs) and micro-banking offices (MBOs). The Circular stipulates that an OBO refers to any permanent office or place of business in the Philippines other than the head office, branch or extension office, which engages in any of the following non-transactional banking-related activities:

a. Market loans, deposits and other bank products and services;
b. Accept loan applications and conduct preliminary credit evaluation as well as perform credit administration support services;
c. Host on-site automated teller machines (ATMs);
d. Perform customer care services
e. Perform customer identification process, receive account opening documents and facilitate account activation; provided that account opening approval and actual opening of deposit accounts shall be done only at the head office/branches/extension offices; and
f. Such other non-transactional banking-related activities as may be authorized by the BSP.

An OBO that is microfinance-oriented is called a micro-banking office or MBO. This primarily caters to the banking needs of services of microfinance clients and overseas Filipinos and their beneficiaries.

This circular also expands the products and services that can be offered such as: micro-loans; micro-deposits; check deposits of existing microfinance clients; micro-insurance; e-money conversion; collection/pay-outs of benefits from government; utility payments; and purchase of foreign currency.

According to the BSP Report on the State of Financial Inclusion in the Philippines, the number of MBOs went up by 26 percent to 465 in 2013 from 370 in 2012. Acording to the same report, MBOs are effectively serving the banking needs of the poor and low income clients, especially those who are living in the countryside. The number of LGUs that do not have a regular bank branch but are being served by MBOs increased to 56 LGUs in 2013 from 50 LGUs in 2012.

BSP Circular 649 dated March 2009. This circular provided the regulations on the issuance of electronic money. E-money is defined as monetary value that is: (1) electronically stored in an instrument or device; (2) issued against receipt of funds of an amount not lesser in value than the monetary value issued; (3) accepted as a means of payment by persons or entities other than the issuer; (4) withdrawable in cash or cash equivalent; and issued in accordance with the Circular. Electronic money issuer is classified, as follows: (1) Banks (called EMI-Bank); (2) Non-Bank Financial Institutions (NBFIs) supervised by the BSP, referred to as EMI-NBFI; and (3) Non-Bank institutions registered with the BSP as a money transfer agent, referred to as EMI-Others.

BSP reports that the number of e-money issuers (EMIs) continues to increase. A year after the issuance of e-money rules and regulations in 2009, there were 21 registered EMIs. Three years later, the number of EMIs increased to 32 (by 52%) EMIs in 2013. The number of e-money agents has experienced remarkable growth as well, with 10,620 active agents in the span of 4 years. Furthermore, the number of registered e-money accounts increased by 34 percent to 26.7 million accounts in 2013 from 19.9 million accounts in 2010. The e-money accounts in 2013 was composed of 8 million mobile wallets and 18.7 million cash cards. The number of e-money transactions has also significantly grown over the years. From 138 million transactions in 2010, the number of transactions that passed through e-money jumped by 57 percent to 217 million transactions in 2013. In terms of amount, the total value of e-money transaction rose by 58 percent to P348 billion in 2013 from P220.5 billion in 2010.

The use of electronic money also enabled meaningful retail payments. For instance, e-money is now being used to deliver Conditional Cash Transfers (CCTs) from Government to People (G2P). This has resulted in huge government savings while reaching 400 municipalities and 500,000 beneficiaries (BSP, 2013).

BSP Circular 706. The salient features of the Circular that are relevant to financial inclusion include: (a) the provision of scope for banks to have a risk-based and tiered system of classifying customers (i.e., low, average, high risk); (b) the establishment of a framework for applying reduced, average and enhanced due diligence, customer acceptance, retention and identification process based on the level or risk of the customer; and (c) the possibility of outsourcing or relying on a third party on the face-to-face requirement for KYC (know your client), gathering of information and documents.

This issuance can be potentially groundbreaking as it addresses a main obstacle (i.e. compliance with AML regulations such as face to face KYC, ID requirements, etc.) in serving the unbanked yet bankable. With this issuance, banks can outsource or rely on customer identification by agents that are located in unbanked and under-banked communities. It therefore addresses the limitations of the existing physical reach of banks and lowers the cost in acquiring new customers.The decision to open accounts and provide credit still rests on the bank (BSP, 2013).

***BSP Circular 725*.** This Circular aims to promote transparency and good governance through the issuance of rules regarding the relationship between banks and their related microfinance non-governmental organizations. This issuance recognizes the possible synergy between a bank with microfinance operations and a related microfinance NGO Foundation. While this has become a successful model for some, the issuance aims to ensure that the banks with related microfinance NGOs are able to safely and viably coexist by mitigating possible operational, governance and reputational risks. The salient features of the issuance includes (a) requiring clear contractual agreements between the two entities, (b) prohibiting bank personnel from holding any concurrent full time positions that may cause them to be involved in the daily operations of related NGOs/foundations and (c) issuing general principles and standards that will govern the business relationships between banks and their related NGOs/foundations.

***Amendment to BSP Circular 694* (June, 2011)**. This recognizes Microfinance Plus as microfinance loans from PHP 50,001 to PHP 300,000 to address the increasing credit requirements of growing microenterprises or those who have “graduated” from the traditional microfinance loans of up to PHP 150,000. The borrowers shall have a savings account, a track record of at least two loan cycles in the PHP 50,000-150,000 range demonstrating success of the business, its increasing credit demand and subsequent increased capacity to pay.

ANNEX C. Proposed Projects for Replication

1. Proposal to Replicate Micro-banking Offices and Other Banking Offices

A. Introduction

Micro-banking offices (MBOs) and other banking offices (OBOs) have become an effective service delivery structure for a microfinance bank, which provides microfinance services to those excluded from mainstream banking. In particular, the establishment of OBOs and MBOs has helped CARD Bank, the largest microfinance bank in the Philippines, reach those excluded in a sustainable and profitable manner. CARD Bank is a member of the CARD Mutually Reinforcing Institutions group of companies. Established as a rural bank in September 1997, it started with only 3,689 clients who were transitioned to the bank from the San Pablo Branch of CARD, Inc., the Non-Government Organization (NGO) established earlier by the same founders of CARD Bank. CARD Bank established OBOs in different locations, within and outside the town or city proper where the branches are located. This really brought micro-loans to the door-steps of microfinance clients. Thus, in June to December 2006, twenty six OBOs were established. The immediate impact was to boost the productivity and efficiency of CARD Bank. It has since provided microfinance services to hundreds of thousands of microenterprises and poor rural households who would otherwise not have been able to access formal financial services.

On December 31, 2013, CARD Bank was awarded by the Bangko Sentral ng Pilipinas (BSP) with a Hall of Fame award on financial inclusion, a fitting recognition for CARD Bank's dedication to financial inclusion of the poor people especially women who have been excluded from mainstream banking in the country.

Given the success of CARD Bank, replication of the same approach by other microfinance institutions in the Philippines and even in other countries can help achieve deeper financial inclusion.

B. Objectives

The general objective is to help achieve financial inclusion through the establishment of OBOs and MBOs in the Philippines and other countries.

The specific objectives are: (i) to enable microfinance institutions in the Philippines and other countries to increase their outreach among the poor at a reduced cost through MBOs and OBOs; and (ii) to provide guidelines that will allow microfinance institutions in the Philippines and other countries to replicate the successful experience of CARD Bank in the establishment of OBOs and MBOs.

According to Bangko Sentral ng Pilipinas, other banking offices or OBOs in general refer to a permanent office or place of business of a bank with less requirements to set up as compared to a head office, branch or extension office. There are two classifications of OBOs: (i) regular OBO is one that undertakes purely non transactional banking related activities such as marketing, customer care services, acceptance of loan applications, among others; (ii) Microfinance Oriented Banking Office (MF-OBO) or Micro-Banking Office (MBO) which provides a wide range of transactional activities which reflect the particular needs of the unserved and underserved market particularly microfinance clients, overseas Filipinos and their beneficiaries. This MBO is authorized to provide services that are appropriately designed for the target market such as to accept micro-deposits, disburse micro-loans and collect payments, sell, market and service micro-insurance products, receive and pay out authorized remittance transactions, act as cash in/out points for electronic money, receive utility payments, collect premiums and pay out benefits from social security institutions and other benefit systems including government conditional cash transfer programs, and purchase a limited level of foreign currency. The MBO shall only perform the activities for which it has specifically applied for and had been authorized to perform.

C. Key Players

The key players are: (i) microfinance institutions, which will implement and manage OBOs and MBOs; and (ii) Central Bank (Bangko Sentral ng Pilipinas), as regulator of banks and microfinance institutions, which would provide the policies and implementing guidelines in the establishment of MBOs and OBOs.

D. Mechanics

The very first step that should be done is to develop a good relationship with the regulatory institution, the Central Bank, in order for the latter to better understand the needs and requirements of the microfinance industry. Doing so will enable the Central Bank of a country to develop clear policies and guidelines with respect to the establishment of OBOs and MBOS. In the Philippines, the establishment of MBOs and OBOs is anchored on several Circulars issued by Bangko Sentral ng Pilipinas (BSP), which specify the implementing guidelines for establishing MBOs and OBOs. For instance, an initial circular (Circular 505 issued on December 22, 2005) states that "banking offices other than "branch" as defined (by BSP) may be allowed anywhere, without prior BSP approval, subject to the submission of a certification by the head of the branches department in the rank of Vice President or its equivalent or by a higher ranking officer that said banking office shall neither accept deposits nor service withdrawals. The certification shall be submitted to the appropriate supervising and examining department of the BSP not later than five (5) banking days from date of opening". In the beginning the OBOs/MBOs were allowed only to be loan servicing units and were not allowed to take deposits. The latter restriction was subsequently relaxed by other Circulars.

Under the BSP implementing guidelines in the management of OBOs, the following must be implemented and complied:

- An OBO must be established to service microfinance clients only and must be located within two hours travelling time from the branch.
- An OBO must not maintain a complete set of books of accounts.

On October 14, 2010, the BSP issued Circular 694, an Amendment of Regulations on the Establishment of Other Banking Offices and Notes to Microfinance. It expanded the functions of the OBOs. According to the Circular, Other Banking Office (OBO) shall refer to any permanent office or place of business in the Philippines other than the head office, branch or extension office which engages in any or all of the following non-transactional banking-related activities:

- Market loans, deposits and other bank products and services;
- Accept loan applications and conduct preliminary credit evaluation as well as perform credit administration support services;
- Host on-site automated teller machines (ATMs);
- Perform customer care services;
- Perform customer identification process, receive account opening documents and facilitate account activation activities, provided, that account opening approval and actual opening of deposit accounts shall be done only at the head office/branches/extension offices; and
- Such other non-transactional banking related activities as may be authorized by the BSP.

To ensure that the OBO does not maintain cash in the premises and records, all transactions and excess cash must be remitted daily and must be taken up directly in the head office or branch to which it is attached.

An OBO may also be recognized as "microfinance-oriented". A "Microfinance Oriented Banking Offices" (MF-OBO)/ "micro-banking office" (MBO) shall refer to an OBO that primarily caters to the banking needs and services of microfinance clients and overseas Filipinos (OFs) and their beneficiaries.

OBOs/MBOs may be established only in areas where the bank is allowed to establish branches as provided BSP's branching guidelines.

In addition to the non-transactional banking-related activities and services allowable for regular OBOs, MF-OBOs/MBOs may also engage in any or all of the following limited transactional banking related activities and services that enable and facilitate financial inclusion and broader access to financial services:

- Accept micro-deposits including initial deposit and service withdrawals thereof;
- Accept check deposits of microfinance clients for collection and credit to own deposit accounts;
- Disburse/release proceeds of micro-loans and collect loan amortization payments and related charges;
- Present, market, sell and service micro-insurance products in accordance with existing regulations;
- Receive/pay-out funds in connection with authorized remittance transactions; and other functions[53].

An OBO typically is staffed by one unit manager and four account officers. The MBU has the same number of staff inside the branch office.

E. Success Factors

Regulatory Framework

An important factor is a regulatory framework provided by the Central Bank (Bangko Sentral ng Pilipinas) which balances providing support to microfinance and maintaining financial stability. An open policy dialogue between regulator and regulated entity should therefore be maintained.

Based on Philippine experience, the following should also be considered:

- Regulators are urged to adopt proportionate ('light but firm touch') on regulation of microfinance;
- Microfinance institutions should adhere to highest performance standards required by the regulator to earn the trust and confidence of regulators to impose 'light' or proportionate regulation of microfinance operations.
- Regulator and regulated entities should maintain transparent and open policy dialogue to ensure the appropriateness of regulations imposed by the regulator.

Commitment and Motivation of Senior Management

Like other rural banks that successfully offer microfinance services in the Philippines, there is a motivating force behind the innovations undertaken to make microfinance services cost-effective and efficient. That force is usually the president along with one or more high-level operational managers that are equally committed to ensuring that their microfinance services are successful.

Human Resources and Organizational Structure

Properly trained and motivated staff is also a key factor in the success of innovative products and services. Performance based staff incentives are essential in getting the best performance out of loan account officers and field staff. Successful banks offer microfinance services and also properly integrate

[53] The full text of BSP Circular 694 is available at the BSP web site.

the microfinance unit or department that handles these services within the overall organizational structure of the bank.

Understanding the Market

For microfinance banks to successfully introduce and implement innovative products and approaches that meet the needs of their clients, it is important for these banks to carefully study their markets. Careful market analysis should also include an understanding of their competitors (informal, semiformal, and formal institutions offering microfinance services).

Business Planning and Product Development

Successful banks like CARD Bank develop business plans and then carefully design and introduce innovative methods to reduce the operating costs associated with managing small deposit and loan accounts. These banks also carefully prepare well-documented procedural and operational manuals.

Technical Assistance

Support should be continuously provided to focus on training and technical assistance in areas such as market research, product development, improving organizational structures, and new technologies, products and services.

Monitoring and Evaluation

While MBOs and OBOs enable the financially excluded to have greater access to microfinance services, it is important for microfinance operations to have computerized management information systems that monitor loan officer productivity, portfolio quality, and institutional efficiency. This is particularly essential for microfinance banks that process and manage hundreds of loans each month. Committed bank managers also regularly monitor the performance of microfinance services on a regular basis. Through MBOs and OBOs, banks should be able to process first-time loan applicants within a week and repeat borrowers' applications within a day.

Clients not Beneficiaries

Microfinance banks that successfully manage microfinance services treat all clients as business customers of the banks rather than as "beneficiaries." Given this, these banks tend to focus on improving customer service to retain their microfinance clients which explain successful implementation of innovations like MBOs and OBOs.

F. Cost Estimate

Other Banking Office/Micro Banking Office

Cost Item	MFI	Government
Start-up Cost (furniture and fixtures, leasehold improvements)	PHP 150,000	Loan at concessionary rate so bank would not have to use own funds for start-up
Monthly Office Rental	PHP 20,000	
Monthly Salaries of one Unit Manager and 4 account officers	PHP 15,000 (Unit Manager) 12,000 (Account Officer) × 4 = PHP 48,000	

2. Proposal to Pilot-Test the Development of Micro-insurance Products for the Poor[54]

A. Introduction

One of the most important services that can be given to small farmers and fishers, microentrepreneurs and rural households is micro-insurance. Micro-insurance is defined as insurance that (i) operates by risk-pooling, (ii) is financed through regular premiums, and is (iii) tailored to the poor who would otherwise not be able to take out insurance (Churchill 2006). Micro-insurance is generally for low income people, poor rural households, microentrepreneurs, who are excluded by traditional commercial insurance schemes because they come from the informal sector, have irregular cash flows and have seasonal fluctuations in earning capacity (Churchill 2006; Llanto 2007). The Regulatory Framework for Micro-insurance developed by government defines micro-insurance as "activity of providing specific insurance, insurance-like and other similar products and services that meet the needs of the low-income sector for risk protection and relief against distress, misfortune or other contingent events"[55].

Very recently, the Philippine Insurance Commission reported that the Philippines is one of the top micro-insurance markets in Asia. The micro-insurance coverage among Filipinos rose to 19.95 million (20.4 percent of the population) in 2013 from 3.1 million (3.4 percent of the population) in 2008 (BSP, 2013). The Philippines has succeeded in making micro-insurance accessible to a large segment of the population which was formerly excluded from the formal insurance system in a short period of four years. The key to success was the active collaboration between the government regulator (Insurance Commission) and private insurance providers in developing micro-insurance products that are suitable to the poor. How this can be done is outlined in the proposal.

B. Objectives

The general objective is to encourage the development of micro-insurance products that are suitable to the poor. The specific objectives are: (i) to enable governments in other countries to develop and promote a micro-insurance sector that is responsive to the needs of the poor by replicating the experience of the Philippines and (ii) to provide guidelines to key players or stakeholders from the government, private insurance providers, and target clientele (poor households) in replicating the successful experience of the Philippines in developing micro-insurance products for the poor.

C. Key Players

The key players are: (i) the government particularly the regulator of the insurance industry, e.g. the Insurance Commission and other relevant government agencies such as the Central Bank; Securities and Exchange Commission (or the agency that regulates and supervises corporations, partnerships and other associations), the agency that regulates cooperatives in case the insurance provider is a cooperative; the agency that is concerned with the micro-insurance product to be developed (e.g., the Department or Ministry of Health for health insurance products) and other relevant institutions, depending on country context; (ii) the private sector represented by key private insurance providers as well as microfinance institutions, and (iii) a representative group of the target clientele (poor households).

D. Mechanics

The development of micro-insurance products is anchored on the following pillars: (i) an appropriate policy and regulatory environment for micro-insurance; (ii) strong coordination and collaboration among key government agencies to adopt reform measures in the insurance industry; (iii) active public-

[54] Prepared by a team composed of Gilberto Llanto, Jocelyn Badiola, Cristina Lopez and Joel Matira.

[55] This paragraph is from Llanto, Gilberto M. (2014) "Financial Inclusion, Education and Regulation in the Philippines," Paper read at the ADBI Conference on Country Experiences of Financial Inclusion, Regulation and Education Bangkok, ADB Thailand Mission, 31 October 2014.

private sector participation in developing appropriate and affordable micro-insurance products; (iv) sustained education, awareness campaign and advocacy; and (v) efficient use of scarce donor and government resources for technical assistance to stakeholders. These pillars integrate the activities that are coordinated by a micro-insurance champion or champions (government ministry, e.g., Ministry of Finance) and the insurance regulator (Insurance Commission or Insurance Regulatory Agency).

Formulate the National Strategy for Micro-insurance

It is critical to have from the very start to have an appropriate regulatory framework for micro-insurance, which recognizes the different character and uniqueness of providing micro-insurance to the target population (poor, semi-literate or illiterate households). But first, the stakeholders should agree on an overall strategy (a National Strategy) that provides a broad template defining policy goal or goals, specific objectives, roles of stakeholders, method and approach, resources to be committed and a timetable to accomplish the policy goal or goals. The National Strategy also provides the framework for public-private sector collaboration in developing the micro-insurance industry.

Overall, the National Strategy for Micro-insurance recognizes the ability of the market to introduce innovative insurance products and services for small scale clients (microentrepreneurs, poor households, small farmers and fishers) for social protection in the form of insurance. The government's and the regulator's stance is to pursue policies (in the case of government) and regulations (in the case of the regulator) that enhance the ability of the insurance market to develop such innovative micro-insurance products.

The immediate objective is to develop affordable and appropriate micro-insurance products while at the same time ensuring consumer protection. In addition to the provision of an appropriate policy and regulatory environment, the National Strategy for Micro-insurance should espouse policies that recognize the need to incentivize or motivate licensed insurance providers to develop innovative micro-insurance products for the low income market.

For instance, the Insurance Commission of the Philippines allowed lower capitalization requirements for private insurance providers that are wholly engaged in micro-insurance. It also created a new category of micro-insurance agents and brokers with lighter licensing requirements.

Specific activities

Conduct policy dialogues and meetings. The first step is for the Department or Ministry of Finance along with the Regulator of the insurance industry to initiate policy dialogues and meetings with private insurance providers in order to determine the key issues and constraints affecting the micro-insurance sector. It can be done through small roundtable discussions (RTDs) in various parts of the country, culminating to a big national seminar-workshop where the outputs from the different RTDs can be presented and measures addressing outstanding issues and constraints can be proposed and discussed.

Creation of a technical working group (TWG). The next step is the creation of a TWG composed of selected stakeholders from government, academe, and the private sector that will have the task of drafting the National Strategy for Micro-insurance in accordance with the results and recommendations generated from policy dialogues, meetings and workshop discussions, and broad-based consultations. The TWG will ensure a constant feedback and information sharing mechanism with the government ministry leading the effort (e.g. Ministry of Finance) and the Regulator.

Conduct consultations with stakeholders nationwide. In order to validate that the National Strategy for Micro-insurance reflects the requirements of the stakeholders, the draft National Strategy for Micro-insurance should be presented to stakeholders nationwide for consultation and comment. The TWG is the secretariat for the nationwide consultations.

Formulate Reform Measures, Policy Actions and Regulatory Guidelines. What follows after the formulation of the National Strategy for Micro-insurance is the formulation of specific reform measures, policy actions and regulatory guidelines. This can be done through the following activities:

Technical review of proposed reform measures, policy actions, and regulatory guidelines by the TWGs. The TWG will subject the proposed reform measures, policy actions, and regulatory guidelines generated from the nationwide consultations and workshops into a technical review to determine the socio-economic desirability and feasibility of the different specific proposals. The TWGs should meet regularly. It is in charge of fleshing out the different recommendations into practical and workable measures that will be inputs for deliberation and consideration by the Regulator.

Consultations and Dialogues. Aside from the technical review by the TWG, consultations and dialogues among national and regional stakeholders should also be undertaken, consistent with the principle of involving private insurance providers, a representative group of target clientele, and other stakeholders in the process of the formulation of necessary reform measures, policy actions and regulatory guidelines. This will facilitate acceptance and implementation of the official Circulars or Memorandums containing the reform measures, policy actions and regulatory guidelines affecting the micro-insurance sector.

The commitment of the government champion agency or agencies/institutions to uphold those reform measures, policy actions and regulatory guidelines is critical to ensure the development of innovative micro-insurance products for the poor. The expected result is the issuance of Circulars or Memorandums by the Regulator that will guide product development and approval, product distribution and marketing, and foster consumer protection, and industry performance monitoring, all in accordance with the Regulatory Framework for Micro-insurance and the National Strategy for Micro-insurance.

Identify and implement specific activities which the government should undertake (hopefully, with funding assistance from donors) to develop the capacity of the private sector in providing insurance for the poor, such as the following:

- Market survey to determine the needs of the low-income sector, acceptance of the concept of micro-insurance among the target clientele, affordability levels, and others, which will provide information for designing the products, formulating policies, marketing and distribution of such products.
- Development of a prototype micro-insurance product, e.g., non-life product that should respond to the characteristics and needs of the poor using a simplified policy contract. An example is a simplified micro-insurance product consisting of a basic cash assistance policy that provides benefits to the insured and his/her livelihood against perils of fire, flood and earthquake.
- Simplification of the wordings of insurance policy contracts for easier comprehension by the low-income sector.
- Trainings for Micro-insurance Advocates to spread information and generate support to key stakeholders' initiative to develop responsive micro-insurance products and introduce reforms in the insurance industry. In this regard, the development of training modules for Micro-insurance Advocates is an important activity. For instance, in the Philippines close to 700 individuals from the macro (policy makers, national government agencies, regulators and local government units) and meso (insurers, intermediaries, support institutions, donors) sectors were trained as Micro-insurance Advocates.
- Carry out a nationwide micro-insurance awareness campaign which could run for at least a year. This will consist of trainings on micro-insurance advocacy as well as public seminars, micro-insurance information exhibits, media briefings, among others. It is worth noting that a learning center on micro-insurance was even established in Southern Philippines.
- Conduct trainings on the Performance Standards for Micro-insurance.

E. Critical Elements/Success and Sustainability Factors/Recommendations

1. Strong coordination among key government institutions

A critical factor in developing innovative micro-insurance products is the strong coordination and collaboration among key stakeholders, especially government agencies, which are involved in crafting regulations affecting the micro-insurance sector. The development of the micro-insurance sector cannot rely on the efforts of one or two government agencies alone; on the contrary it needs concerted collaborative work by key stakeholders. The key government agencies are the Department or Ministry of Finance (or concerned government oversight agency) and the Insurance Commission or the Regulator of the insurance industry with support from other government agencies, such as the Central Bank, Securities and Exchange Commission (SEC); the agency that regulates cooperatives or NGOs; the Department or Ministry in charge of health; and other relevant institutions.

These agencies should work as a team to develop an enabling policy and regulatory environment in order to guarantee the consistency of reform measures, policy actions and regulatory guidelines and their implementation. One important lesson learned from the Philippine experience is that it is important to ensure ownership of the policy and regulatory reform agenda by concerned government agencies. It will help to have a champion government agency or institution collaborating with the private sector who will lead the formulation and implementation of the reform measures, policy actions and regulatory guidelines.

2. Strong public and private sector collaboration

The private sector should be deliberately engaged in the development of appropriate micro-insurance products to achieve the goal of inclusive insurance. The private sector has the competence and comparative advantage in developing viable and sustainable insurance products and services to rural households and low income clients. The private sector can make use of incentives that may be provided by the government to develop appropriate micro-insurance products.

The collaboration between the public and private sectors may be considered the most challenging if not the most important activity in the entire process of developing appropriate micro-insurance products. The teamwork between the government oversight agency or agencies (e.g. Ministry of Finance and Insurance Regulator) and the TWG will be critical in ensuring acceptance and ownership by key stakeholders of the reform measures, policy actions and regulatory guidelines and consequently, in their adoption and smooth implementation.

3. Emphasis on education, awareness campaign and advocacy

Another important element in the development of micro-insurance based on the Philippine experience is the emphasis on education, awareness campaigns, and advocacy to generate and sustain the interest and buy-in of clients and insurance providers. The information and education cum advocacy campaign is necessary due to the following reasons: (1) the low income sector lacks understanding and appreciation of insurance, the benefits and obligations arising thereto; (2) most of the insurance providers are not familiar with the low-income sector and therefore do not consider them as a potential market, which is why insurance products are mostly designed for the middle class and the higher-income groups; (3) various stakeholders such as policy makers, legislators, regulators, banks, and donor institutions have to be educated about the peculiar characteristics of the micro-insurance market so that they can formulate the proper policies, rules and regulations (see ADB, 2013).

4. Availability of grant funds from development partners to augment government funds

In addition to available resources of governments of developing countries, which may not be sufficient in achieving the required outputs necessary for the development of micro-insurance, funding assistance for capacity building activities from donors/development partners is essential. In the case of the Philippines, the Asian Development Bank-Japan Fund for Poverty Reduction and the German Agency for International Cooperation provided both technical and funding assistance to the micro-insurance sector. They were also seriously involved in project formulation, preparation and implementation. There was effective donor coordination to avoid overlaps or conflicting activities. This was made possible by having only one steering committee for the two donor-funded projects making coordination simple and easy (ADB, 2013). In effect, project activities were effectively coordinated and the end result was efficient use of those grant funds.

5. Other Recommendations

To guide replication following recommendations from the Philippine experience to sustain the development of the micro-insurance sector may be considered:

- **Enhance the technical and managerial capacity of the Insurance Regulator**

For micro-insurance to be sustainable, regulation should provide adequate protection to consumers while ensuring the growth and stability of the industry. The capacity of the Regulator should therefore be strengthened in the following areas:

(viii) Development of appropriate rules and guidelines to ensure the effectiveness and soundness of innovative delivery channels that will keep the cost of administration and distribution to a minimum without sacrificing the timely settlement of claims and that will minimize the transaction costs on the part of the clients;

(ix) Consumer protection through appropriate market guidelines

(x) Formulation of an appropriate policy framework and rules and regulations for technology-based platforms in micro-insurance that will facilitate expansion and at the same time, protect consumers;

(xi) Adoption of risk-based supervision approach to enable insurance supervisors to review the manner in which insurers identify, manage and control risks;

(xii) Formalization of informal insurance schemes in the light of the proliferation of informal insurance schemes provided by some entities dealing with the low-income market;

(xiii) Approval and evaluation of index-based micro-insurance products given the increased frequency of natural calamities due to climate change through the formulation of guidelines for evaluation and approval; developing standards; and implementing evaluation and approval procedures for parametric and index-based insurance products.

(xiv) Formulation of regulations for mutual benefit associations, which are the institutions that have a greater proximity to the low income market, to ensure standardization of operations and practices for prudential purposes.

- **Develop innovative micro-insurance products addressing multiple risks**

This is in response to the numerous risks faced by the low-income sector, which they want entirely covered in one insurance product under one insurance entity. While Insurance Memorandum Circular 1-2010 in the Philippines recognizes and allows the bundling of life and non-life insurance products, there has yet to be a product of this type that would cover the multiple risks faced by the poor.

- **Harness public-private sector partnerships in micro-insurance**

Given the gaps in the services provided by the government in providing social insurance for low income groups and the increasing interest and willingness of private insurance providers to cater to the low-income market, there is great potential in harnessing partnerships with the private sector to address these gaps.

- **Develop micro-insurance innovative products dealing with effects of climate change**

There is a need to expand the range of options of the poor to reduce vulnerability to current and future risks brought by the climate change phenomenon. The poor are more severely impacted by the negative effects of climate change. Government agencies and organizations implementing climate change adaptation programs may be encouraged to partner with micro-insurance providers in order to give additional risk protection to low income groups. Such innovative micro-insurance products can be initially pilot-tested in selected areas based on a set of criteria given the occurrence of natural disasters and catastrophic risks.

- **Educate clients on micro-insurance**

Teaching the poor about the benefits of insurance remains a tough challenge. It is not easy to explain and make them appreciate the importance of paying premiums with the promise of benefits when a contingent event occurs. A consistent and comprehensive financial education program is critical in building a strong insurance culture among the poor in the future.

F. Timetable

Implementation may be done in two phases:

Phase 1 (Years 1 and 2):

1) Formulation of the National Strategy and Regulatory Framework for Micro-insurance
2) Formulation of Reform Measures, Policy Actions and Regulatory Guidelines

Phase 2 (Years 2 and 3)

1) Conduct of nationwide information campaign
2) Capacity-building activities for different stakeholders
3) Conduct of financial education program among micro-insurance clients

G. Budget Estimate[56] if Replicated in Another Country

Cost Item	Government Counterpart	Donor
Phase 1 (Years 1 and 2)		
Consultants/Study Team	PHP 500,000	PHP 1,000,000
Formulation of the National Strategy and Regulatory Framework for Micro-insurance (1 National Meeting; 3 Regional Consultations; 3 Roundtable Discussions)	PHP 200,000	PHP 200,000
Formulation of Reform Measures, Policy Actions and Regulatory Guidelines (1 National Meeting; 3 Regional Consultations; 3 Roundtable Discussions)	PHP 200,000	PHP 200,000
Phase 2 (Years 2 and 3)		
Consultants/Study Team	PHP 500,000	PHP 1,000,000
Conduct of Nationwide Information Campaign	PHP 500,000	PHP 500,000
Capacity Building Activities for Different Stakeholders	PHP 500,000	PHP 500,000
Conduct of financial education program among micro-insurance clients	PHP 250,000	PHP 250,000
TOTAL	PHP 2,650,000 ($57,609)[57]	PHP 3,650,000 ($79,348)

[56] This would depend on specific needs of the country where replication or pilot-testing will be done.
[57] Exchange Rate P46 = $1

3. Proposal to Pilot-test Value Chain Finance Model

1. Background: The Case of Kalasag Cooperative

The pilot collaboration project of the NLDC, CRS, ASKI, LGU, and the JFC was successful in linking the small farmers of Kalasag Cooperative to JFC and other markets. This approach has become a local model in supporting farmers through sustainable agro-enterprise development.

ASKI, a non-stock, non-profit foundation promotes and develops microfinance services. It engaged in a partnership with Jollibee, CRS, NLDC and Jollibee Foundation to bridge the farmers to the Jollibee supply chain since 2004. The project aims to train small farmers for production and marketing for agro-enterprises and link institutional markets like Jollibee Foods Corporation. The project management set up has different stakeholders: the technical working group comprises of Jollibee CRS and NLDC and the Jollibee Foundation CRS and NLDC. The site working group involves the CRS, their field facilitator and the local government unit representatives, the MFI which is represented by ASKI Northern Luzon for the onion producers in Nueva Ecija and the farmer leaders organizing the farmers to be a cooperative.

The implementation strategies entailed a lot of time and costs. There is a need to change the mindset of the individual farmers towards an entrepreneurship. These farmers believed that partnering with a food giant like Jollibee is next to impossible. How can a big corporation partner with traditional farmers who don't even issue receipts for their sales. ASKI worked on the capacity building side of the project for 6 months entailing a lot of costs. ASKI released PHP6.2 million for the project and they gathered 40 individual farmers. All 40 farmers had a 100 percent repayment rate to ASKI and saved around PHP300,000 as capital buildup. The group of onion farmers in the name of Kalasag Cooperative is now supplying 400 metric tons of onions to Jollibee for their Central Luzon food chains.

2. Objectives

The overall goal of the project is to enable small farmers increase their incomes through value chain finance. Specific Objectives are: (1) to organize farmers into agro-enterprise clusters for the purpose of consolidating supply, pooling transport logistics and linking to formal business entities under the traditional set up, the role is being played by the traders or middlemen; (2) to assist farmers to engage in value-adding activities in order to enhance their compliance of quality requirements and increase competitiveness; and (3) to increase the knowledge of farmers about farming practices thereby increasing their productivity and reducing costs, and ultimately, increase the income of farmers.

3. Players/Actors and Roles

This project recommends the following set up to support the implementation:

a. Project Management Team

The head of the MFI or its representative and the NLDC shall jointly oversee this Project. Day-to-day activities shall be carried out by an Agro-Enterprise Facilitator (AEF) who will be specifically given the role of implementing the detailed activities and in coordinating with the concerned offices like NLDC, DA, Local Government Units, academe, seed companies (if applicable), cooperative office and the participating farmer-beneficiaries. In case the MFI already an operational unit, its existing structure shall be followed provided that a full-time staff functioning as AEF will be specifically devoted to it.

The AEF will follow a job function specifically for this purpose. Under this approach, the Local Government Unit shall take an active role in the organization or groupings of the farmers including the support to agri-related technology and infrastructure.

b. Site Working Group (Field)

A Site Working Group (SWG) shall also be created which shall be composed of the AEF of the MFI, microfinance/loan officer of the participating farmers, concerned LGU officials and staff, academe (if necessary), and farmer leaders. The primary function of the group is to decide on major issues affecting the project. The LGUs, however, will not be involved in the selection of farmer-beneficiaries. They may recommend, but the final decision to accept membership rests with the cluster and the MFI. Note that in selecting the SWG members, the persons must show interest in extending assistance to the project.

c. Fund Provider

NLDC or any government institution shall be tapped to provide funding to support the capacity building component of this project. ACPC or any GFI may also be tapped to provide credit/loan funds to be utilized for the value chain financing requirements of the farmers.

4. Mechanics of Pilot Implementation[58]

The first step is to organize small farmers into microfinance centers or agroenterprise clusters with the aim of consolidating product supply, linking to formal business entities, and managing their own agro-enterprise. Groupings shall be made based on the following criteria: a) active in the farm site; b) acknowledged by the community bearing good moral character; c) actual farmer or has knowledge of the farming practices; and, d) willing to work as a team. The intermediate result is to enable farmer clusters work with institutional market and other buyers to establish favorable market arrangements to sustain demand and price for their products.

Following a pattern of the farmers changing mindset as entrepreneurs, this project shall involve a series of activities. These steps may be sequentially followed or altered according to the level of maturity or readiness of the farmers' group. Through this iterative developmental capacity-building process, the farmers acquire knowledge in basic marketing, awareness of alternative market chains for their crops, grasp of buyers' preferences as to quality, volume and price. At the same time, the farmers get a better understanding of their crop supply condition, production costs and practices, and ways to improve product quality, post-harvest handling, and marketing. Farmers appreciate the benefit of forming themselves voluntarily into clusters (of 8-15 farmers), and consequently several clusters pooling their supply capacities to achieve the volume requirements of commercial buyers. Armed with the knowledge about buyer preferences as to quality, volume, delivery and price, the farmers in the clusters make decisions as to what crop and corresponding seed variety to plant, the timing or scheduling of planting and harvesting that will coincide with the purchasing schedules of the buyer, and the committed volume of the product that will be sold through the cluster.

1. Develop partnership with stakeholders – Site selection, partnership building and working group formation is a community process where appropriate site or sites and partners for the agrienterprise project will be identified, and a working group composed of producers, local government units (LGUs), non-government organizations, business sector and other relevant representation shall be constituted.

2. Organize a working group – Once the site working group is formed, potential farmer leaders shall be identified through rapid appraisal in this stage. These leaders will be invited to be part of the working group and to participate in the upcoming initial activities. In this stage, the working group will undergo orientation on the basics of marketing, which includes the following topics: (i) what is marketing? (ii) Farming Profitably by being Market Oriented; (iii) Supply and Demand; (iv) Market Chain, Value Chain, Value Addition; (v) The Marketing Strategy (Target Market and the Marketing Mix); and (vi) Competition and Market Positioning.

[58] *Lifted from the NLDC-MFI Agroenterprise Development Manual of Implementation, the same tool used in the case of Kalasag Cooperative*

3. Gather information on production and marketing practices – The Product Supply Assessment (PSA) will be a participatory research undertaken at the community level with the involvement of farmers and other members of the community. It is designed to identify the community's resources, products, production and marketing practices that have a bearing on agrienterprise planning.

4. Establish market contacts – At the macro level, market contacts are established beforehand to identify market potentials and demand from an institutional market or sector. These are primary data essential to decision making with the cluster. At the institutional markets, the usual sources are purchasing managers or key personnel in the procurement division of the company or organization.

5. Establish market trends – Data on prices per month of commodities like vegetables, rice and corn are available at the Office of the Bureau of Agricultural Statistics, Regional Offices of DA and sometimes at the Consolidation Center or Bagsakan Center. Local prices must also be included in the database. High and low prices are analyzed in order to pinpoint possible planting schedules of farmers. During market studies of the clusters, these data are essential for planning.

6. Conduct market visits – Using the rapid market appraisal method, the Working Group shall undertake the following sub steps: (i) identify several market chains for each of the products (that were identified in the previous step (ii) and analyze the farmers' position in them; (iii) select the best market chain(s) to work on and the buyer(s) that offer the most benefits; (iv) come up with strategies to assist the farmers participate in specific market chain(s) with the attendant costs and margins in their participation, as well as the development support the farmers will need; and (v) report the findings back to the farmers for goal setting in agrienterprise development.

7. Orient farmers on marketing basics and clustering – In this step, the Working Group (i) will present to the farmers the findings of the previous steps on PSA (step 2) as well as the Market Chain Study (step 3); (ii) shall provide orientation to the farmers on marketing basics and the clustering approach to business organizing; (iii) will provide farmers with informed choices by discussing the benefits of clustering as a business group.

8. Initiate formation of clusters and identification of leaders – After the analysis, the Coordinator will facilitate the formation of agrienterprise clusters and leader identification, as well as the cluster basic agreements. *Agrienterprise clustering* is a type of cooperation wherein farmers are organized into small groups or clusters and consolidate their products, coordinated with a common plan, and directed at the agreed market(s). An *agrienterprise cluster* is a small group of 5-15 individual farmers who, under a shared agrienterprise plan, commit to work together for collective undertaking. On the minimum cluster members are expected to agree to help one another in order to: (a) consolidate a particular product volume; (b) attain agreed quality; (c) deliver as promise or scheduled; (d) follow the agreed product operational flow (from farm to consolidation point and labeling for traceability of supply source); and (e) plan and implement group agreements such as regular meetings, the payment of marketing facilitation fees (management fee and marketing fee), and the mobilization of savings.

9. Facilitate enterprise and operational planning – This step is aimed at enabling the newly formed farmers' clusters to: (i) appreciate the value of understanding markets in making an agrienterprise plan; (ii) utilize the findings of the PSA (step 2), MCS (step 3); (iii) translate the strategy into an agrienterprise plan that will guide the clusters when they set up the selected agrienterprise; and (iv) formulate an operational plan for the product deliveries in the ensuing test marketing. An *agrienterprise plan* will serve as a "road map" that will guide the farmers market their produce, increase income, and attain sustainable livelihood. It shall help prepare the clusters before they make that 'leap', their first product supply delivery to the buyer. An agrienterprise plan has four basic components, namely: (1) the market plan, (2) the supply plan, (3) the management plan, and (4) the financial plan.

10. Facilitate test marketing activities – This step will enable the newly formed clusters to: (i) undertake the trial product delivery; (ii) assess the performance of the trial product deliveries and come up with contingency plans to address the immediate needs for adjustments using the tools prepared in step 5; and (iii) review the clusters' agrienterprise plan and revise as needed for the next step in marketing – the commercialization step. At least four trial deliveries are usually conducted to enable the cluster to have a good assessment of its capacity and the market. Documentation of the activities, outputs and outcomes related to the delivery should be done as an aid to monitoring and assessment. Immediately after each trial delivery, an assessment is done by the cluster to make some adjustments or changes. A basic requirement in monitoring is information on product delivered by the clusters and received by the buyers. Forms are prepared to gather this information; the forms may be simple or very detailed depending on the type of product and the requirements of the buyer.

11. Clusters and other partners initiate recruitment of new cluster members – Step 7 is aimed at enabling the clusters to: (i) assess the performance of the test marketing activities in preparation for scaling up; (ii) document the scaling up of marketing activities and periodically assess the marketing operations; (iii) review the Cluster Agri-enterprise Plan, and make the needed adjustments; and (iv) determine the support systems needed to increase the chance of success of the scaled up marketing operations.

12. Identification of new farmer partners – Cluster members usually endorse incoming members of the cluster. Associate membership is the usual offer for the incoming member while undergoing production and marketing activities with the group.

13. Conduct regular meeting and cluster assessments – Conduct regular meetings among cluster members. Cluster leaders will facilitate monthly meetings among their members to resolve issues on production, organization, marketing and other areas of concern. Plans for the next period are the usual output from this meeting. This is also the appropriate occasion when Project Facilitators, LGU staff and other visitors will share relevant information issues that could directly and indirectly affect them as individual farmers or as cluster.

14. Conduct of training on financial and organizational management – In step 8, learning opportunities such as training, reflection sessions, hands-on-learning activities, observations visits and others shall be provided to the cluster.

5. Development Cost Estimate

Provision of loan/financing support to farmers must be preceded by an investment or development cost which, under this case, is shared between the government (local and national) and the MFI partner. The financing assistance may be used for: (1) farmers' organizing activities; (2) continuous capacity building of the MFI facilitator and the farmer leaders; and (3) startup equipment or gadgets to be used for the trial planting. With these preparatory mechanisms, farmers are equipped to compute the cost of produce based on value addition including the MFI interest charges on loan. They are also capacitated to negotiate with market based on the said cost, thus aware of the break-even price of produce. The table below summarizes the development cost[59] prior to availing of loan from the MFI partner.

[59] Cost estimate per NLDC's expansion project using the same model/approach

Cost Items	Particulars (Estimated for 6 months)	LGU/Academe	MFI	Government
1) Capacity-building Interventions Session1: Leadership Training and completion of Management Plan Session 2: Values Formation	Travel of farmer leaders and facilitators to the site (Meals, Transportation, Lodging, materials, etc.)	PHP 87,500 500/pax/day 35 pax 5 days	PHP 17,500 500*35 pax	PHP 218,750 1,250/pax 35 pax 5 days 2 training sessions
2) On-site Coaching and Review of Agri-enterprise and Supply Plan	Conduct of coaching, review and finalization of supply and agroenterprise plan		PHP 40,000 4visits@10K	PHP 31,250 5visits@6,250
3) Office Supplies and Materials	Supplies, trial planting materials and IT services	PHP 6,000	PHP 15,000	
4) Communications/ Indirect Cost	Covering facilities, vehicles and communication for personnel	PHP 6,000	PHP 15,000	
5) Salaries and Benefits	Salaries/Professional Fees of permanent staff of MFI assigned in the project		PHP 144,000 8,000/pax/mo 6 months	
Total Budget		**PHP 99,500**	**PHP 231,500**	**PHP 250,000**
Cost-sharing Arrangement		**17%**	**40%**	**43%**
Total Fund Requirement				**PHP 581,000**

6. Critical Success Factor

a. Sustainability Strategies

The project's inputs to the farmers are in the form of information, knowledge, skills and capacities sharing with support on minor equipment or farm inputs. These benefits that will be acquired by the participating farmers will make the project sustainable as these will continuously be practiced and enhanced during the course of the project implementation.

b. Sustainability Measures

The involvement of the MFI and the local governments shall ensure that the project will continue even after the supports are given by APRACA/IFAD. The management set up at the institution and grassroots levels will be maintained as they agree to meet regularly.

c. Financial Sustainability of Recurrent Costs

At the farmers' level, the group shall implement a savings scheme wherein the crops that will be consolidated and marketed through the clusters will be charged a marketing facilitation fee at a flat rate of 5 percent of the gross sales. This reverts to the common general fund of the farmer group.

d. Pre-Conditions

To facilitate the implementation of the pilot project, the following conditions shall be satisfied:

1) Target farmers are clustered and given capacity building interventions.
   a) Collective planning with desired modules as basis of cost and return
   b) Common planting calendar
   c) Series of marketing initiatives
   d) Readiness to graduate from subsistence to commercial producers.

2) Markets are identified and accept the farmers' produce on a regular basis.
   a) Existence of formal or informal marketing agreement
   b) Open communication between the farmer-organization and the market
   c) Possibility for expansion of supply requirement

3) MFI operates actively as main facilitator.
   a) Site development cost is recognized as part of investment.

Financing is treated as a tool for sustainability rather than provision of short-lived dole-outs.

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