APRACA FinPower Program

COMPLETION REPORT:

FinPower National Forum
Conducive Microfinance Policy Environment and Regulatory Framework

Facilitator:
Benedicto S. Bayaua

Documentor:
Mr. Eduardo C. Jimenez

An APRACA FinPower Publication with the Special Sponsorship of the International Fund for Agricultural Development (IFAD)

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Published by:	Asia-Pacific Rural and Agricultural Credit Association (APRACA)
Printing by:	Erawan Printing Press
Distribution:	For copies write to: The Secretary General Asia-Pacific Rural and Agricultural Credit Association (APRACA) 39 Maliwan Mansion, Phra Atit Road Bangkok 10200, Thailand Tel: (66-2) 280-0195 Fax: (66-2) 280-1524 E-mail: apraca@apraca.org Website: www.apraca.org
Editing:	Benedicto S. Bayaua
Layout credit:	Sofia Champanand
E-copies:	E-copies in PDF file can also be downloaded from APRACA's website.

This book is published by APRACA under the auspices of the IFAD-supported APRACA FinPower Program.

The data gathered were based on primary and secondary data, interviews and information with key informants in selected APRACA represented countries. Opinions expressed by the author do not necessarily represent the official views of APRACA nor of IFAD.

This book is published during the incumbency of Mr. Pham Thanh Tan (APRACA Chairman), Mr. Abdurakhmat Boymuratov (APRACA Vice-Chairman) and Mr. Benedicto S. Bayaua (Secretary General).

MESSAGE from the APRACA Chairman

Greetings! APRACA has successfully established among its members machinery for systematic interchange of information on sustainable rural and agricultural financial services, encouraged inter-country studies and provided training, consultancy, research and publication services on matters of common interest in the field of rural finance and microfinance.

The national forum of creating conducive policy environment and regulatory framework in Bhutan is aimed at sharing the experiences of selected APRACA member countries in the creation of conducive rural and microfinance policy environment and regulatory framework, assessing the current state of rural and microfinance policy in the country; identifying the issues, constraints or obstacles to the efficient and effective provision of rural financial services, and formulating a plan of action towards the development of the rural financial markets including sound policies and regulatory framework.

The International Fund for Agricultural Development or IFAD has played the role of APRACA's strategic partner under the FinPower Program. APRACA and IFAD share that mutual desire to pursue and create conducive rural finance policy environment and regulatory framework. I wish therefore to acknowledge the IFAD support to APRACA.

May we therefore thank Dr. Thomas Elhaut, IFAD Asia Division Director, and Dr. Ganesh B. Thapa, IFAD Regional Economist, for the trust and confidence they have continuously bestowed on APRACA and for their commitment to help alleviate poverty and accelerate rural growth and development among countries in Asia and the Pacific.

We wish to thank Mr. Nawang Gyetse, Bhutan Development Finance Corporation, Limited (BDFCL) Managing Director, for hosting the four-day program.

We sincerely wish that this report will continuously inspire policymakers, practitioners and other stakeholders in the Asia-Pacific region.

Pham Thanh Tan
APRACA Chairman

MESSAGE from the Managing Director, BDFCL

First, let me welcome and thank Mr. Benedicto S. Bayaua and his team for the initiative to organize the sixth in a series of APRACA-IFAD FinPower dissemination activities to be held on a national level in Bhutan. Mr. Bayaua was here in Bhutan last June 2006.

BDFCL has the honor to be the host agency to support this kind of session. I would also like to welcome and thank all the participants from concerned Ministries, Agencies and private entrepreneurs who are gathered here today for this forum.

Poverty in Bhutan is predominantly a rural phenomenon with 98.1 percent of Bhutan's poor living in rural areas. Rural poverty is directly linked to low levels of agricultural productivity and inadequate access to markets, social services and economic services such as credit facilities.

Experiences outside Bhutan have shown microfinance is a cost-effective way of addressing poverty and it has a sustainable economic impact and as a result, rural areas are economically stimulated and poverty at village level is reduced. Microfinance linked to certain income-generating activity can help change the life of individuals and households thereby the nation.

Bhutan's microfinance is very much in its nascent stage and there is a need to develop appropriate strategies and to create a facilitating policy environment. It is timely that such an event has been thought of by APRACA here in Bhutan. I thank the APRACA team once again.

I am confident that, with these kinds of sessions, Bhutanese implementers could certainly learn from the rich experiences from other countries and also put into good practice a strong microfinance system that can assist in reducing poverty. I hope today's forum will be a fruitful and a good learning session for all of us.

Mr. Nawang Gyetse
Managing Director
BDFCL

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Acronyms and Abbreviations

ACPC	Agricultural Credit and Policy Council
APRACA	Asia-Pacific Rural and Agricultural Credit Association
BDS	Business Development Service
BDFCL	Bhutan Development Finance Corporation, Limited
BSP	Bangko Sentral ng Pilipinas (Central Bank)
CAL	Commercial Agricultural Loans
CBOs	Community-Based Organizations
CDA	Cooperative Development Authority
CISA	Credit Information System Act
DBP	Development Bank of the Philippines
DCPs	Directed Credit Programs
EIU	Economist Intelligence Unit
GGLS	Group Guarantee Lending and Savings Scheme
GNH	Gross National Happiness
IGA	Income-Generating Activity
LBP	Land Bank of the Philippines
MCPI	Microfinance Council of the Philippines, Inc.
NCC	National Credit Council
NGO	Non-Governmental Organization
NWAB	National Women's Association of Bhutan
OFWs	Overseas Filipino Workers
PCFC	People's Credit and Finance Corporation
PFIs	Private Financial Institutions
RBAP	Rural Bankers' Association of the Philippines
RMA	Royal Monetary Authority (Bhutan)
SIL	Small Individual Loans
SEC	Securities and Exchange Commission
SMEs	Small and Medium Enterprises

1. INTRODUCTION

a. Background

The rural financial markets of developing countries in Asia and the Pacific are in various stages of development and experience. While some countries already have a policy regime that is fully liberalized and deregulated, there are still a number of countries with a policy environment characterized by credit subsidies, credit allocations and loan targeting and some countries that are partially liberalized and deregulated because interest rate subsidies and loan targeting continue to be imposed for the benefit of certain sectors particularly the poor or the marginalized.

As pointed out in many policy studies, a country should have a conducive rural finance policy environment that would allow financial institutions to operate in areas where there is demand for their services and, in effect, enable them allocate their funds from surplus units (savers) to deficit units (borrowers) at a price that would make them recover their cost and generate sufficient yield to capital. An enabling policy environment, thus, implies deregulated interest rates, compliance to reasonable performance standards and regulations especially with respect to capital requirement, branching policy and risk management, among others. Within such a policy environment, therefore, banks and other financial institutions will be able to operate prudently while providing adequate, sustainable and timely credit and other financial services to the rural sector especially the small farmers and fishermen. Simply put, a conducive policy environment and regulatory framework could mean increased and sustained credit access for the rural households including the poor. Weak rural financial markets discourage rural growth.

However, despite policy reforms instituted, most countries continue to experience inaccessible credit for the rural poor. In fact, microfinance institutions (MFIs) still hesitate to lend to agriculture and fishery projects. Innovative approaches and practices have to be developed so that MFIs can be encouraged to lend to the rural poor in general and to the small farmers and fishermen, in particular. For most microfinance institutions, lending to the agriculture and fishery sector is deemed a risky and therefore, costly lending activity. Making microfinance work in agriculture is the biggest challenge that needs to be addressed.

The Asia-Pacific Rural and Agricultural Credit Association (APRACA), in partnership with the International Fund for Agriculture and Development (IFAD), is currently implementing the IFAD-supported APRACA Regional Program of Accelerating the Financial Empowerment of Poor Rural Communities in Asia and the Pacific through Rural Finance Innovations or dubbed as the **FinPower** Program. The FinPower Program has three central components: a) participatory dialogue, policy forums and technical support, b) pilot programs, exposure visits and documentation and c) training and sharing of innovative practices.

b. Objectives

In consonance with the main goal of the FinPower Program which is *to promote the financial empowerment of the rural poor in Asia-Pacific Countries through policy dialogue, innovative pilot programs and knowledge-sharing among actors in the rural finance sector,* FinPower conducted a national policy forum on rural finance and microfinance policy environment and regulatory framework in Bhutan on November 3, 2009 and provided technical support to key rural finance stakeholders on November 4-6, 2009.

The technical support and national policy forum had the following specific objectives:

- To assess the current status of rural and microfinance policy environment and regulatory framework in Bhutan;

- To identify the issues, constraints or obstacles to the efficient and effective provision of rural financial services in Bhutan;
- To share the experiences of the Bangko Sentral ng Pilipinas (the Philippines' central bank) in the creation of conducive rural and microfinance policy environment and regulatory framework; and
- To formulate a number of recommendations on sound policies and regulatory framework towards further strengthening the rural financial markets in Bhutan.

c. Methodology

Mr. Eduardo C. Jimenez, BSP consultant, was commissioned as APRACA FinPower expert to share in the forum and conduct dialogue with key rural finance stakeholders.

A total of 49 participants from the Royal Monetary Authority of Bhutan, national policymakers, private and government banks, NGOs, cooperatives, and other representatives from government agencies and other relevant institutions participated in the national policy forum.

An open forum immediately followed each presentation. The results of the discussions of the technical support and the national forum discussion were synthesized and presented toward the end of the forum. Recommendations were formulated in order to outline the activities towards strengthening the rural financial policies and regulatory framework of the country venue as well as improving the delivery of microfinance services to the poor especially those in the rural areas.

The consultant likewise conducted dialogue with key rural and microfinance stakeholders including the Royal Monetary Authority of Bhutan, BDFCL, the Ministry of Agriculture and selected cooperatives and traders' association.

d. Forum Opening Ceremony

Mr. Nawang Gyetse, Managing Director of the Bhutan Development Finance Corporation, Limited (BDFCL), welcomed the participants and the APRACA FinPower expert. He thanked IFAD and APRACA for promoting microfinance innovations and initiatives and hoped that participants will draw lessons from the presentation which would be useful to promote microfinance in the country. Mr. Bayaua provided a background of the topic and an introduction to the forum. He thanked the BDFCL for hosting the twin events.

e. Presentation Proper

The Republic of the Philippines and the Royal Kingdom of Bhutan are two distinct countries but at the same time also share some commonalities. The Philippines is an archipelagic country while Bhutan is landlocked one. The Philippines however has a number of landlocked areas that are considered very hard to reach. Some of these areas are also considered "frontier areas" and not easily accessible by government services and by the private sector. Bhutan has a long history of rule by the monarchy and only in recent years have they adopted a parliamentary form of government. The Philippines on the other hand, is considered one of the oldest republics in Asia.

Agriculture plays a vital role in both countries and a big chunk of farmers in both countries rely on credit as a vital input to agricultural production. The Bhutan Development Finance Corporation, Limited (BDFCL), a government financial institution in Bhutan supports, to a large extent, the requirements of farmers, while the Development Bank of the Philippines (DBP) and Land Bank of the Philippines (LBP), both state banks, have extensive networks of branches supporting farmers in the Philippines. The Philippine State banks and other Government-owned controlled corporations focused on helping the needs of the farmers and other entrepreneurial poor provide wholesale funds to accredit private financial institutions (PFIs). Just like in Bhutan, before credits or loans are given by retailers, whether NGOs, cooperatives or banks, value-laden training sessions are provided to would-be borrowers in the Philippines.

The incidence of rural poverty in the two countries are still large in proportion to their respective total populations, hence, the need for government banks to support the requirements of the poor. Although both countries adhere to the notion of Gross National Product (GNP) as a measurement of economic development, Bhutan has added a new paradigm as one looks at development with the adoption of Gross National Happiness (GNH).

The two papers presented by the two consultants, Dr. Pema Choephyel and Mr. Eduardo C. Jimenez, from Bhutan and from the Philippines, respectively, provided respective insights as to the state of rural and microfinance exposures in the two countries. The papers also laid down the challenges and developments in the field of rural credit and microfinance.

2. BHUTAN

Dr. Pema Choephyel, Agricultural MSME Advisor of the Bhutan Development Finance Corporation, Limited (BDFCL), gave a brief overview of the socio-economic and political profile of Bhutan. The paper commented that although Bhutan is considered one of the most isolated countries in the world, this is changing slowly. Bhutan is slowly opening up its borders with the introduction of a number of international flights coming to the country.

Bhutan, a landlocked country of only 38,394 square kilometers, has a population of 634,982, a recorded rural poverty incidence of 32.7 percent and an unemployment rate of 4 percent. Agriculture is still the predominant source of livelihood and is practiced by about 69 percent of the population. About 79 percent of the population reside in the rural areas. Given these social and economic realities, Bhutan has adhered to a philosophy called Gross National Happiness (GNH), and not just the economic indicator of Gross National Product, to achieve a balanced modernization of the country. The GNH philosophy puts emphasis on harmony between material well-being along with spiritual, emotional and cultural well-being of its citizenry. The preservation of its environment, together with its traditional culture, forms the basis of its economy and Bhutan will be guided by these two as the country moves into the future.

Financial Sector and Rural Financing

Bhutan's financial sector is very small with the Royal Monetary Authority (RMA) functioning as the country's central bank and the financial sector's supervisor. Bhutan has two commercial banks; two non-bank financial institutions, which include the Bhutan Development Finance Corporation, Limited (BDFCL); and, the National Provident and Pension Fund Bureau. The RMA has recently approved the opening of two more private banks, i.e., Druk Punjab Bank and Tashi Bank as well as one insurance company known as the Bhutan Insurance Company.

BDFCL, which was established in 1988, is the sole development finance institution in the country and is 100 percent owned by the government. It promotes and finances agricultural, industrial and commercial ventures, including microfinance activities. Accordingly, BDFCL acts as the only rural credit facility in the country, but its success in such endeavor is hampered by its high operating costs.

Informal lenders exist and provide access to credit and farm inputs, but there are very little or no data at all to analyze and study these particular informal arrangements. It is a common knowledge that some of the well-to-do families in the rural areas provide loans or inputs such as grains or a combination of the two to the poorer villagers. Loans are normally within the three- to six-month period and are charged around 5.0 percent a month, while loans in goods are also expected to be paid with goods also.

Most villages had one or more such informal lenders, who, in some cases, may be the more enterprising individuals in the community. Bhutan's monastic institutions that have substantial revenue collections of its own practiced lending money, grains and dairy products to certain credit-worthy individuals or families. The rate of interest ranges between 15 percent and 25 percent per annum. Lending by the monastic institutions can be treated as a form of informal type of financial and credit arrangement.

During the period 1989-1991, the National Women's Association of Bhutan (NWAB), a non-governmental organization initiated a special credit scheme focused on the credit requirements of women in Trashigang District. Another scheme was started by the National Fodder Seed Production Centre to assist farmers in their requirement for fodder seeds. The scheme was later transferred in 1994 to BDFCL due to logistical challenges. Overall, these initiatives taken by non-governmental organizations to address the financial needs and requirements of the poor had limited success and over time were either stopped or absorbed by another agency.

Rural Financial Policy Environment

BDFCL, acting as the sole provider of microfinance funds to the rural areas at the moment, is beset with a lot of challenges. The Government has given tax holiday to BDFCL but this incentive is being reviewed if it will be renewed or not, noting that the quality of its portfolio as well as its operations is not very satisfactory. The BDFCL accounts only for about 3 percent of the total financial assets of the country and represents only a very small loan portfolio as compared to the total financial system. As stated in the report, the Royal Government of Bhutan has expressed genuine interest to help the rural poor by supporting the work of BDFCL but over the long haul, BDFCL needs to make drastic changes in its operations and structure to make its operations sustainable and viable. The tax holiday and cross subsidies for commercial and rural financing activities can be seen as an expression of policy support of the Royal Government but this may not last long unless the operations of BDFCL produce the needed outcome for operational and financial sustainability.

Regulatory Framework

The presentation aptly pointed out that at the moment, there is no very clear regulatory framework for the practice of microfinance in Bhutan. The BDFCL, acting as retailer and wholesaler of microfinance funds, is being treated like any other bank by the RMA. The existing regulations issued by the RMA for the commercial banks apply also for the BDFCL, although, technically, the BDFCL is not a bank. One particular regulation that the RMA mandates the bank to follow is the use of the "Simple Daily Product" method in calculating the interest to be used by financial institutions. This method is seemingly counterproductive to microfinance operations as it does not take into account the full operational cost of bringing microfinance loans to borrowers, which led to the low market penetration of microfinance clients by the BDFCL.

Even with the absence of a clear regulatory framework for microfinance, the BDFCL started to implemented products that are deemed innovative and are within the purview of existing regulatory and prudential guidelines of RMA. These products are called Small Individual Loans (SIL) and Commercial Agricultural Loans (CAL). Another innovative product that BDFCL is implementing is the Group Guarantee Lending and Savings Scheme (GGLS) which is an adaptation of Bangladesh's Grameen Banking Methodology.

The SIL is available to individuals as a start-up fund for their microenterprises and initial loan is within the Nu30,000.00 to Nu50,000.00 range with an interest of 13 percent per annum. Once the borrower has proven his track record, he can then "graduate" to the Commercial Agricultural Loan window and get higher than Nu50,000.00 loan with the same feature as that of the SIL.

The GGLS window makes initial loans starting from Nu7,500.00 to individual members of a group, and over time loans can be increased to a maximum of Nu50,000.00. Group pressure and support, just like in Grameen Banking, is part of the model, but the enforcement is very weak owing to the weak monitoring and selection of members of a group. The acceptability of this credit model is not strong in Bhutan because of the lax adherence to the sound principles and good practices embedded in the model by the implementer.

A new program concept called "Nucleus Farming", that is being studied by the BDFCL for implementation, focuses on a farmer organizing a group of farmers who are interested to do a similar type of farming activity. The organizing farmer, acting as a promoter, encourages individual farmers to look within their locality for other farmers who might be interested to do a group farming activity. After agreeing as a group, to implement a new income generating activity, the group works with the nucleus farmer to look at the market, credit needs, distribution and marketing channels, and the running of the economic activity on a day-to-day basis. The nucleus farmer assists the individual members of the group to obtain loans from BDFCL. As loans, with 10 percent interest charges per annum are released, the nucleus farmer monitors the use of the funds. As the output of the farm is harvested over time, the nucleus farmer integrates and/or bulks the products/outputs of the other similar groups and the nucleus farmer deals as a wholesaler of products, in behalf of the farmers, to the bigger market. The objective is to have economies of scale and protect the small farmers from usurious lenders and uneven market practices. The model also strongly advocates for partnership between the nucleus groups and the insurance companies.

Major Issues and Constraints in Microfinance

The major issues and constraints in the development of microfinance in Bhutan are as follows:

1. Absence of microfinance strategy document that will guide all the major stakeholders in Bhutan;
2. High cost of doing microfinance loans;
3. The low quality of the credit portfolio and/or recovery rate of the loans provided to the borrowers;
4. Lack of adequate infrastructure/logistics appropriate for the rugged terrains of Bhutan;
5. Poor market linkage and entrepreneurship; and
6. Low literacy rate.

3. THE PHILIPPINES

Socio-Economic Profile of the Philippines

The Philippines, an archipelagic nation composed of about 7,100 islands, with three island concentration in Luzon, Visayas and Mindanao, has a total population of 88.7 million in 2007. The national capital region, MetroManila, reports a current population of about 11 million.

The Philippine economy has been resilient in the last 8 years even with the rest of the world and the advanced countries facing economic woes and financial meltdowns. The upward growth was threatened the last two quarters of 2009, when a modest growth of 1.5 percent GDP was posted. Inflows from overseas, primarily brought by Overseas Filipino Workers (OFWs) helped stabilized the economy. The remittances helped stem the negative impact as total exports dived by 16.7 percent, the lowest since the 4^{th} quarter of 1998. It is estimated that about USD16 billion will further enter the system by year-end.

About 50 percent of the population of the Philippines live in the rural areas where poverty is most severe and widespread. Subsistence farming and fishing are generally the source of income for the rural poor. Ironically, the fisher folks and farmers who produce the basic food commodities belong to the poorest sector.

The average annual growth in 2007 was 2.04 percent, much lower than the average population growth in the last four decades of 2.52 percent, but, still the population growth will pose a big challenge as we look at scarce resources.

Rural Finance and Microfinance Policy Development

The rural finance and microfinance environment is part of the bigger Philippine financial system, which is made up of formal, semi-formal and informal financial institutions and providers. The formal financial system, which is monitored, regulated and supervised by the Bangko Sentral ng Pilipinas, is dominated by banks and non-bank institutions with quasi-banking functions.

As of 30 June 2009, the Philippine banking system consisted of 804 institutions, composed of universal/ commercial banks, thrift banks as well as rural and cooperative banks. The universal/commercial banks are the single largest block in terms of assets and resources. The thrift banking sector, with 74 savings and mortgage banks, development banks and stock and savings and loan associations, is focused on providing varied developmental type of lending to small and medium enterprises and agriculture based industries.

The rural and cooperative banks, totaling 692, are the smallest type of banks in terms of assets/ capitalization and operations, although they are the most popular and closest to the rural communities. These banks are primarily established to promote and expand the rural economy, which are normally run by the local entrepreneurs.

Aside from the rural and thrift banks that have a strong physical presence in the rural areas, non-governmental organizations (NGOs), cooperatives, lending investors, private money lenders, traders/ millers and other Government line agencies are also providing various form of financial services and products to the rural population.

It is estimated that about 30,000 NGOs are registered with the Securities and Exchange Commission (SEC); unfortunately, there is very poor monitoring of the activities of these NGOs done by the regulator. About 500 NGOs are doing some form of microfinance operations. On the other hand, it was reported that there are about 66,000 cooperatives registered with the Cooperative Development Authority (CDA) and about 100 are doing some form of serious microfinance operations which have acceptable operational self-sufficiency ratios.

The Philippine National Strategy for Microfinance

One of the strategies that the Philippine Government employed to alleviate poverty is microfinance. The Philippines defines microfinance as the provision of a broad range of services which include savings, credit, remittance, transfers and insurance to poor and low-income households who are involved in some form of economic or income-generating activities. The country's National Strategy is envisioned (1) to have viable and sustainable private microfinance market and (2) to provide poor households and microentrepreneurs greater access to microfinancial services. The Strategy has four core principles, namely:

1. Greater role of private microfinance institutions (MFIs) in the provision of financial services;
2. Provision of an enabling policy environment that will facilitate the increased participation of the private sector in microfinance;
3. Adoption of market-oriented financial and credit policies, e.g., market oriented interest rates on loans and deposits; and
4. Non-participation of Government line agencies in the direct implementation of credit and guarantee program.

As the National Strategy was approved and adopted, several laws and issuances were subsequently approved in support of its implementation:

1. Social Reform and Poverty Alleviation Act;
2. Agriculture and Fisheries Modernization Act;
3. General Banking Act of 2000;
4. Executive Order 138; and
5. Barangay Micro Business Enterprise Act

The Regulatory Framework for Microfinance Institutions

The need for a very clear regulatory framework governing the practice of microfinance by the various types of players became necessary both to protect the providers as well as the users of funds. The framework helped clarify the various roles, accountabilities and responsibilities of the key players in the microfinance sector. In response to the growing commercialization of microfinance, the need for a clear regulatory framework also emerged. The regulatory framework put into motion the adoption of a set of standards for those providing microfinance services, most especially savings and credit. This standard is known as PESO: **P**ortfolio Quality, **E**fficiency, **S**ustainability and **O**utreach.

The regulatory framework was established with the following premises and assumptions:

- Deposit-taking institutions are subject to prudential regulation and supervision;
- Microfinance NGOs that collect "savings" beyond the compensating balance will be subject to prudential regulation and supervision;
- Banks engaged in microfinance operations will continue to be regulated and supervised by the Bangko Sentral ng Pilipinas;
- The Cooperative Development Authority (CDA) is the designated regulatory authority for credit cooperatives; and
- The Microfinance Council of the Philippines, Inc. (MCPI) is designated as the repository of information for all MFIs that are not regulated.

The Key Rural Finance and Microfinance Players

The growth of rural and microfinance financing in the Philippines can be traced to a large extent, with the approval, acceptance and adoption of a very clear National Strategy as well as the adoption of a very clear Regulatory Framework. The key players can be categorized into three (3) major players, i.e., policymakers and regulators, wholesale financing institutions and retail financing institutions.

Policymakers and regulators: National Credit Council, Agricultural Credit and Policy Council (ACPC), Bangko Sentral ng Pilipinas (BSP), Cooperative Development Authority (CDA), Securities and Exchange Commission (SEC), Insurance Commission (IC) and the Microfinance Council of the Philippines, Inc. (MCPI)

Wholesale Financing Institutions: Government financial institutions like the Land Bank of the Philippines (LBP), Development Bank of the Philippines (DBP), Small Business Guarantee and Finance Corporation (SBGFC) and People's Credit and Finance Corporation (PCFC), which is the microfinance wholesale apex institution in the Philippines. Generally, private commercial and universal banks are encouraged to do wholesale lending and keep away from direct retail.

Retail Financing Institutions: Cooperatives, rural and cooperative banks, microfinance NGOs, lending investors, thrift banks, and other community-based organizations (CBOs) with proper legal registration.

Current Rural and Microfinance Update

The Department of Agriculture reported that in 2008, the ACPC partnered with financial institutions such as LBP and cooperative banks to facilitate the release of PhP3.2 billion of loans to 111,175 farmers and fisher folks through two major credit programs under the Agro-Industry Modernization Credit and Financing Program (AMCFP).

As of 30 June 2009, the banking sector has reported a total outreach of 902,104 clients with an outstanding portfolio of P6.3 billion as provided for by 213 banks. On the other hand, the MCPI reported that its members have given a total of P8.7 billion to 1,554,336 clients as of 30 December 2008. The MCPI report included about 5 banks that are also reporting to the BSP. The growth of microfinance in the banking sector would have not been possible were it not for the very pro-active stance of the BSP, as it looked into the microfinance operations in the banking sector. So far, the BSP has issued 19 circulars to strengthen the practice and promotion of microfinance in the regulated sector. The various issued circulars tackled the definition of microfinance, partial lifting of moratorium to establish new banks as long as the banks are microfinance-oriented, opening of rediscounting facility for microfinance clients of banks, liberalization in branching for microfinance-oriented branches, reduction of risks weight applicable to micro and SME loans and adoption of the portfolio-at-risk (PAR) concept in the operations of banks

The practice of microfinance in the Philippines has been cited as one of the most advanced in the world, from a list of 55 countries in a pilot index and study done by the Economist Intelligence Unit (EIU). The study was commissioned by the International Finance Corporation (IFC), the Inter-American Development Bank (IADB) and by the Corporacion Andina de Fomento (CAF). The study revealed that the Philippines ranked number 3, largely due to a very clear and supportive regulatory framework. The study focused on three broad categories: regulatory framework, investment climate and institutional development. The Philippines got an index score of 68.4, after Peru and Bolivia, which got index ratings of 73.8 and 71.7, respectively.

The selection of the Philippines as number 3 (and number 1 in Asia) after Peru and Bolivia, the leaders in sound microfinance regulatory environments, is a testament to the commitment of the key stakeholders to see a vibrant, dynamic and sustainable microfinance environment at work in the Philippines.

Lessons Learned/Future Directions and Issues

The world of rural finance and microfinance is a very dynamic and a challenging one. Commitment to pursue sustainable rural and microfinance programs can be translated in how policies are crafted and adopted. In the Philippines, the growth of the rural and microfinance sector can be attributed to the presence and adoption of a very clear national strategy and a comprehensive regulatory framework that covers all microfinance institutions. The Philippine Government, especially through the Bangko Sentral ng Pilipinas, fostered market development through policies that address microfinance activities directly.

The Government of the Philippines rationalized the use of directed credit programs (DCPs) and in fact stopped implementing large-scale subsidy programs that distort the market. The DCPs were transferred to Government financial institutions for implementation from Government line agencies, which in essence helped put discipline and clear accountabilities as to how Government funds should be used.

The policymakers and regulators are of one mind and have a common objective, that is, protect the soundness of the financial system and to craft policies and regulations that will not exclude people, especially the poor, but would rather move towards financial inclusion for all.

The lessons learned can be summarized in the following acronym:

C – Committed to Financial Inclusion
B – Bold to implement and to think outside of the box
A – Adaptive
N – Nationalistic without being xenophobic
K – Knowledge-focused
E – "Earthy" mind
R – Responsive

Challenges and Issues

Looking into the Philippine setting, a number of evolving issues and challenges ahead are listed below:

Credit Pollution – As microfinance institutions expand their programs and services, the tendency to be lax in client selection and in preparing their clients whether individuals or groups is growing. Based on anecdotal reports as well as some official reports of MFIs, the quality of portfolio was reported to be going down. As MFIs tend to "poach and capture" good clients of their competitor MFIs, preparing the clients in the old-fashioned way of credit discipline and savings habit have been forgotten.

The Philippine Congress recently passed the Credit Information Systems Act (CISA) which is viewed to establish a comprehensive data system and structure that would help systematize relevant data of borrowers. It is envisioned that all borrowers of banks and cooperatives, and later even that of the NGOs would be subjected to the credit information processes that will be handled by Credit Information Corporation (CIC), a Government-owned corporation established by the Act. With the approval of the CISA, access to credit by micro, small and medium as well as agri-based workers would be enhanced as well as the risks issue involved in multiple borrowings of clients would be addressed. The CIC will complement the on-going work of the three existing private credit bureaus.

Financial Literacy and Consumer Protection of Clients – Clients need to be aware of their rights and responsibilities in the use of credit as well as savings; budgeting, planning and investing skills are needed by the clients and there is a need to capacitate the clients on these skills. Finally, consumer protection of clients must be an on-going concern by all.

Need for Business Development Services (BDS) – Clients need help in product design, marketing, branding, and compliance with standards. The response of the MFIs is either to link these clients to existing organizations who are focused on these needs. The MFIs need not directly address these particular needs of their clients but by linking them up to appropriate organizations, the services needed by the clients can be met.

Branchless banking/phone banking – More than 55 percent of the population own a cell phone, thus making the country the texting capital of the world, with over 650 million texts that go around everyday. The BSP, in partnership with the Rural Bankers' Association of the Philippines, has allowed the use of cell phone for loan payments, deposits and withdrawals of savings by microfinance clients. Allowing the use of this technology has brought down the cost of such transaction and increased convenience for both the institution and the client. This facility has enabled the clients who are unable to travel to the physical branch office of the bank to transact with the said office.

4. SUMMARY OF FINDINGS AND RECOMMENDATIONS

In light of the papers presented and the ensuing discussions during the forum, several key findings were surfaced and observed. Pursuant to these, the BSP presentor proposed the following recommendations to address the concerns in Bhutan, namely:

1. Absence of microfinance strategy document that will guide all the major stakeholders in Bhutan. **The strategy may include defining the respective roles of RMA, commercial banks, BDFCL, insurance companies, NGOs, and the cooperative sector.**
2. High cost of doing microfinance loans. **There should be a clear, contextualized credit delivery model, taking into consideration the geographic nature of the country and the existing low population density.**
3. The low quality of the credit portfolio and/or recovery rate of the loans provided to the borrowers. **This can be linked to the appropriate model that should be used by the implementers but whatever model is to be used, the commitment of credit providers to subscribe to zero or near-zero tolerance for delinquency should be emphasized. Upgrading the skills as well as the knowledge on best practices of credit officers, account officers and portfolio managers should be done.**
4. Lack of adequate infrastructure/logistics. Bhutan has rugged terrains and scattered settlements thus increasing the cost of providing credit facilities to its people. **Given this reality, providers may want to consider the use of technologies like mobile phone to deliver financial services.**
5. Poor market linkage and entrepreneurship. **Studies and researches should be made ascertaining the link between the products of the clients and the intended market so as to lower the incidence of non-payment of loans as well as debt trap for borrowers.**
6. Low literacy rate. **The government through the BDFCL may want to consider, in partnership with other government agencies and other private stakeholders, to take the lead in crafting a program focus on increasing the financial literacy and financial awareness of its people, given the reality of low literacy rate in Bhutan.**

Annex 1

Full Text of Paper on BHUTAN MICROFINANCE By

A. Socio-Economic Profile

Bhutan is a small landlocked country with a population of around 634,982 persons and area of 38,394 sq kilometers. Bhutan has been one of the most isolated nations in the world, but with developments it now has direct international flights, internet, mobile phone networks, and cable television that have given leverage even to the banking facilities in the country.

Farmers and people living in rural areas are now blessed as they are able to get immediate access to small loans through mobile banking and group lending schemes. This has enabled a large number of the rural population to start micro and small businesses, finance farm activities, and other income generating projects. The country has balanced modernization with Gross National Happiness as its philosophy. The GNH construct emphasizes on harmony between material well-being and spiritual, emotional and cultural well-being. Preservation of the traditional culture and environment forms the basis of its economy and how Bhutan develops will be guided by them in the future.

Agriculture is the primary occupation and is still carried out by over 69 percent of the population mainly as a subsistence activity. About 79 percent of the population reside in rural areas. At US$1,770, the per capita GNI in Bhutan is among the highest in South Asia. However, rural poverty at 32.7 percent in Bhutan remains a serious social and economic issue and the government has poverty alleviation as one of the thrust in its 10th FYP mainly driven by the MDG. With the switch from Monarchy to Democratic Monarchy, Bhutan is at an interesting stage in its history. The economy is opening up and new institutional frameworks are taking shape to enable the creation of NGOs, cooperatives, new banks and insurance companies.

B. The Financial System/Rural Financial System

The financial sector in Bhutan is at a very embryonic stage especially in terms of the micro and small financing and targeting of the rural populace. There are two commercial banks, one insurance company and one development financial institution. Most of these have near monopoly status in their fields. Bhutan Development Finance Corporation, Limited (BDFCL), which is owned primary by the Government, is the only institution in Bhutan providing financial services to the rural communities and the poor.

Bhutan's financial sector consists of the Royal Monetary Authority (RMA) functioning as the central bank; two commercial banks, the Bank of Bhutan and the Bhutan National Bank; two non-bank financial institutions, the Royal Insurance Corporation of Bhutan and BDFCL and the National Provident and Pension Fund Bureau. In addition, the Royal Securities Exchange of Bhutan established in 1993 deals with a limited number of traded stocks, government bonds, and RMA bills. Limited clearing and payment mechanisms have also been established. Recently the RMA has allowed the opening of two private banks- Druk Punjab Bank and Tashi Bank and one insurance company known as the Bhutan Insurance Company. Due to the small size of the economy, the supervision of the whole financial sector is entrusted to RMA.

BDFCL is the sole development finance institution in Bhutan, established in 1988 under the Royal Government charter to promote and finance industrial, agricultural and commercial enterprise. At present it operates under the Companies Act and Financial Institutions Act. It is mandated to operate under the overall economic policy of the Government and in the process has been lending for industrial and agricultural activities, as well as microfinance. It is seen as an instrument to pursue Government policies for the industry and agriculture sectors. Moreover, a large percentage of people living and working in the poorer, non-monetized rural areas have little or no financial services. Accordingly, BDFCL provides the only rural credit facility, but this scheme has had limited success because of its high operating costs.

Moreover, there exists informal arrangements at the local level for financial and credit services in some parts of the country, there are very little or no data of such facilities and related arrangements documented anywhere. Prior to the monetization of the Bhutanese economy, the well to do families or person(s) would loan out cash or grain or both to the poorer villagers to resolve their seasonal or emergent difficulties. The terms of such lending/borrowing were believed to be usually between 15 percent and 25 percent and repayable within the fixed period of 3 to 6 months. Loans taken in kind had to be repaid with interest in kind also.

It is believed that most villages had one or more such informal lenders, who in some cases may be the more enterprising individual(s) of the community. The most common one in the urban centers with development being the personal loans from people who can afford to roll the money for a fixed monthly interest ranging from 5 percent to 10 percent per month. The monastic institutions that had substantial revenue collections of its own had the practice of lending money, grains, and diary produces to certain creditworthy individuals or families. The rate of interest ranges between 15 percent and 25 percent per annum. Lending by the monastic institutions or centers could be treated as the informal type of financial and credit arrangements. In the business arena, some money lenders charge interest as high as 5 percent – 10 percent a month.

In the past, the National Women's Association of Bhutan (NWAB), a non-governmental organization in collaboration with BNB has initiated a special credit scheme to cater to the women's requirement in Trashigang District between 1989 to 1991. The mechanism used to guarantee the repayment of these loans is through peer pressure where people within each credit group ensured no defaults on the repayment. The scheme was mainly targeted to the women clients and on a very small scale. Another scheme by National Fodder Seed Production Centre was initiated by Helvetas, Bumthang to cater for fodder seed requirements of the farmers in the beginning of 1990. The operation was later handed over to the BDFCL in 1994 in view of the logistics problem. In general, with the increasing popularity and access to credit services provided through the formal financial services, reliance on the informal financial services is on the decline both in urban and rural areas.

C. Rural Financial Policy Environment

Total assets of BDFCL as of 31 December 2008 was recorded at Nu2,546.16 million. Loan receivables was at Nu2,499.00 million. Industrial lending was at 17.03 percent, agriculture lending at 22.87 percent and service and tourism at 25.26 percent. BDFCL's commercial lending to an extent subsidizes its microfinance operations. The rural credit profitability being low, the Government has granted a tax holiday to BDFCL. The Government has entrusted BDFCL to play a key role in poverty reduction through the provision of financial services. However, BDFCL has less than 3 percent of the total financial assets in the country, which makes BDFCL a relatively small part of Bhutan's financial system and has not been able to grow as fast as other financial institutions, partly because it has been encumbered with low quality assets and low profitability. BDFCL's lending operations rely mostly on lines of credit through assistance from foreign concessional lending such as ADB, United Nations Capital Development Fund, UNDP and equity infusion by the Government for capital reserves, and bonds issued by the Government. The tax exemption that is renewable indicates that the Royal Government is genuinely concerned to provide financial services to the remote communities. However, the dual role of the BDFCL has impacted the operation of the organization as it has to operate under the prudential regulation of the RMA like any other commercial banks even for its microfinance operations. Therefore, it will be pertinent to mention here that a separate microfinance strategy for the BDFCL to meet its operational cost and avoid cross subsidizing its rural credit through its commercial or industrial operations needs to be put in place.

D. Description of Regulatory Framework

Microfinance is very much in its nascent stage at the moment and there is no microfinance regulatory framework as such at the present. The BDFCL like any other bank is governed by the RMA prudential regulation. The prudential regulation that was revised on 2002 clearly spells out the banks requirements but has no mention of how the microfinance needs to be regulated. BDFCL on its own initiatives and within the scope of the RMA prudential regulation operates rural credit by cross subsidizing through the commercial operation. In fact the RMA regulation on the interest calculation for all the financial institution by the "Simple Daily Product method" seems to be counterproductive for the microfinance operation as it does not account for the operational cost of microfinance. This has led to the low penetration and coverage of the credit disbursements. Hence, a strategy paper or modus operandi that will direct the microfinance operation with BDFCL as the wholesaler or apex microfinance organization may be looked into.

The Government has however, tried to support its only development bank by providing Government bonds, equity infusion and exemption from taxes. It has also facilitated the rural credit operations by sourcing funds from organizations such as the Asian Development Fund and the United Nations Capital Development Funds for rural credit operations. There seems to be a great scope for microfinance operation given that the country has 32.7 percent rural poverty and especially for the micro and small enterprise development in the rural settings. In this, BDFCL could play a vital role in not only poverty alleviation but reducing the rural urban migration by providing access to credit linked with income-generating activities (IGA). However, pertinent strategies and regulations that facilitate microfinance will need to be developed and followed earnestly.

E. Innovative Approaches to Encourage Credit

In order to make credit accessible to the needy and poor, BDFCL has launched several credit products such as the Small Individual Loans (SIL) and the Commercial Agricultural Loans (CAL) schemes. The SIL was made available to individuals as a start up fund for small individual enterprises. The loan amount ranged from Nu30,001.00 to upper limit of Nu50,000.00 and was given at the interest rate of 13 percent. Once individuals are found performing well, they would graduate to take higher amount of Nu50,001.00 or more loans that are classified into CAL at the same interest rate as SIL. This system of graduation allowed loan access at all times and the bank had the tap on the success of enterprises.

Another approach that BDFCL had undertaken was the Group Guarantee Lending and Savings Scheme (GGLS). This was a carbon copy of the Grameen Bank with core group leader and center group leader and the individual members in the group stood guarantee for the other members. The loan amount was small and it started with Nu7,500.00 and slowly graduated to the loan amount of Nu50,000.00 per member of the group. The interest rate is given at the rate of 10 percent per annum. In Bhutan, this approach has not gained popularity due to several reasons. One of the main reasons was that the bank had failed to identify the like-minded people in the group and members met only on the day of the repayment. Secondly, it was difficult to get the group in full strength due to the scattered nature of the settlement and remoteness of the target clients. Moreover, the income-generating activities were never monitored from the bank's side which in fact led to the poor repayment of the loans. The success of this scheme in Bhutan has to be further tested and modality revisited especially from the point of target client and IGA monitoring. The above credits are facilitated through the mobile banking system that is implemented on the fixed time and date of the month as agreed by the clients. The mobile banking system has greatly enhanced the loan repayment by the clients and also the accumulation of the deposits. BDFCL is planning to undertake this on a real-time basis by providing palmtops in the near future.

BDFCL has also launched the nucleus farmer concept and the farming concept especially targeting farmers of the village. In the case of the nucleus farmer, the individual farmer is made to lead the other groups of the village or gewog by initiating an income generation activity. Once the nucleus farm is established, the groups are formed and linked to the IGA. BDFCL supports the groups by providing loans at 10 percent interest rate for investment in the IGA by the individuals in the group. The nucleus farmer helps in the management, input delivery and marketing of the product.

The nucleus farming concept looks at capacity development of the farming community for commercial agriculture commodity production through the help of BDFCL. Here too the group formation is encouraged for the creation of commodity bulk by allowing the individual borrowers to invest on their land for agricultural production. The product bulking and market is carried out as a group. The inputs are bought through the loan and repayment made from the marketing of the commodities. Aligning to the producer groups, BDFCL has also launched the vendors' group loan through the group guarantee concept. The vendors are grouped together in a group of three to five members, loan are provided to them on a weekly repayment and a saving deposit system is created. It is envisaged that vendors and producers groups would link themselves to undertake agricultural commercialization.

Some of the IGAs are high risk and linking with the insurance companies will be critical. At the moment entrepreneurs are not insured as they find the premium either very high or the procedure cumbersome. Therefore, it will be very important to establish a common understanding between the bank and the insurance companies on the insurance of high risk IGA both in procedures and premium. It is suggested here that a dialogue with various stakeholders be initiated for the purpose.

F. Major Issues, Constraints or Obstacles to the Development of the Rural Finance Market

Microfinance Strategy document

There is no strategy to guide and regulate the microfinance operation in the country. The strategy document needs to be developed that allows BDFCL to operate as the apex organization for microfinance governed by the RMA as it is the only central bank in the country. However, the strategies for microfinance need to facilitate greater credit penetration and ease the accessibility to credit by the majority of rural populace.

High Cost of Administration

The cost of administration is high as Bhutan has geographically difficult terrain and the settlements are scattered has resulted in low penetration in rural areas. However, BDFCL has started mobile banking which covers all the gewogs once every month. This provides the opportunity for people in the remotest part to access the financial services. However, this entails high administration cost in terms of the travel and per diems for the staff and transactional costs.

Low recovery rate

The low rate of recovery has been one of the major problems encountered and as of December 2008 the non-performing loans stood at 33.23 percent for agriculture sector which is the highest among the sectors. The recovery rate has been improving and as of 1st December 2008 had reached 95.15 percent as compared to the figure of 77.33 percent in early 2000.

Low population density

The density of population is quite low at about 16 persons per square kilometer on an average in Bhutan. The scattered settlement especially in the rural setting makes the operation of microfinance not only difficult but expensive to administer resulting in low penetration and coverage. Moreover, the low population density means lower clientele base for a given jurisdiction leading to higher operational costs in terms of the travel and per diem for the staff of the BDFCL. The given constraint also hampers in the product marketing of the income-generating activities and therefore microfinance in this sense will require substantial external support.

Lack of adequate infrastructure/logistics

Bhutan has a rugged terrain and scattered settlements that entail high operational cost. Most of the rural areas lack motorable roads and regular transport facilities. Some of the villages are 3-4 days of walking distance from the district offices and only few farmers are willing to avail of credit facilities as they do not see investment opportunity except for meeting their daily requirements. The lack of infrastructure and logistics has constrained farmers in taking active part in the microfinance programs in Bhutan.

Poor market linkage and entrepreneurship

Lack of market for the local products not only reduces the demand for credit, but also contributes to the producers' failure in meeting loan repayments. Therefore, it is very important that IGAs are properly linked to the market so that the IGA products are targeted to the consumers needs. There is no attempt in linking the enterprises with the needs of the consumers. Therefore, BDFCL should invest in enterprises after proper consumer demand studies on new enterprises.

Low literacy rate

Bhutan has low literacy rate of 47 percent ranked at 167th out of 177 countries. The low literacy rate of the population plays a vital role in the credit administration as the farmers are not able to comprehend the mode of financial transactions. This paves way to low repayment and high default in the microfinance operation. Therefore, it will be critical and important for the microfinance programs to dwell on improving the literacy of the microfinance clients.

Low Recycling of Fund

Most microfinance loan repayments are made on longer-term basis as they do not have the ability and capacity to pay back faster. This impedes quick recycling of available funds and higher earning opportunity. Hence, it will be very important for the BDFCL to look for shorter-term loans with daily or weekly repayment of the loans as is presently being done for the vegetable vendors.

Conclusion

BDFCL has been fortunate until now as the RGoB and donors and have been able to provide financial support. Bhutan should realize that the situation will change and there will be need for microfinance to operate as a separate entity with its own regulatory framework and modus operandi. Definitely, there is scope for independent microfinance organization with BDFCL as the apex organization functioning under the overall supervision of the Royal Monetary Authority. The scope for microfinance is great as

Bhutan with its' GNI growth of 7 percent still has 32.7 percent rural poor. There is also great scope for investment in the micro- and small enterprises which cannot provide collateral but contribute substantially to the national economy by way of self-employment and providing employment for the unemployed youths in micro- and small enterprises and industries.

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Annex 2

Full Text of Paper on
CONDUCIVE RURAL AND MICROFINANCE POLICY ENVIRONMENT AND REGULATORY FRAMEWORK IN THE PHILIPPINES
BY
EDUARDO C. JIMENEZ

1. Socio-Economic Profile

The Philippines, is an archipelagic nation of about 7,100 islands, with 3 major island concentration, i.e, Luzon, Visayas and Mindanao. In its 2007 census, the Philippines reported a total population of 88.7 million. The Philippines is politically and administratively divided into 16 regions with MetroManila as the center of business and commerce as well as political activities. MetroManila reports a current population of about 11 million.

Even with the adverse economic, environmental and political events that affected most of the countries of the world in the last eight years or so, the Philippines continued to exhibit resiliency and sustained growth. As of the second quarter of 2009, the Philippines, posted a very modest growth as GDP grew by 1.5 percent compared to the 4.2 percent posted as of the same period of the previous year. The simple growth was brought about by the push from Government spending as well as from construction, mining and quarrying sectors, as the manufacturing sector posted negative growth in the last two quarters of 2009. The Government's economic resiliency plan boosted Government consumption to grow by 9.1 percent from its zero growth in 2008. Meanwhile, the agriculture, fisheries and forestry sectors also recorded minimal growth of 1.0 percent, mainly brought about by fisheries, banana, poultry, livestock and palay[1] . The reported growth in the 2nd quarter, effectively avoided the recession that had threatened the Philippines when GDP declined the previous reporting quarters.

The continuous US dollars inflows sent by the Overseas Filipino Workers (OFWs), estimated to reach over USD16.0 billion by yearend, also helped stabilize the Philippine economy. The inflows stemmed the negative impact as total exports dived to negative 16.7 percent, the lowest since the 4th quarter of 1998.

Secretary General Romulo A. Virola of the National Statistical and Coordination Board (NSCB) in the same report, pointed out that as population reached an estimated 92.0 million as of June 2009, per capita GDP declined by 0.5 percent from 2.1 percent in the previous year while per capita GNP decelerated to 2.4 percent from 3.2 percent. He also reported that at current prices, the per capita GNP now stands at P44,828.00 or USD937.00 for the first semester.

On the immediate short-term, the big challenge for the Philippine economic managers for the remaining months of the year is to see to it that growth would continue, however modest, and not fall into recession. The Philippines in the last few years has made in-roads in battling poverty through pro-poor and middle class programs, including access to financial resources, generally hard to access by the poor from the regulated financial sector.

About 50 percent of the population of the Philippines live in the rural areas where poverty is most severe and widespread. Dependence on agriculture, mostly subsistence farming and fishing are generally the only source of income for the rural poor. The roots of poverty in the rural areas differ from island to island

[1] Government stimulus resuscitates economy to 1.5 percent GDP growth: Second Quarter 2009 Report by NSCB.

but generally, the causes of rural poverty can be traced to the decline in the productivity of farm activities, unsustainable practices that led to deforestation as well as absence of economies of scale due to smaller farm sizes.

As we look at poverty in the Philippines, the NSCB official poverty statistics for 2000, 2003 and 2006 show that ironically, farmers and fishermen, the producers of our basic food commodities, rice and fish, are two of the poorest sectors because of insufficient income. Indeed, responding to the needs of our fishermen and farmers should be a major issue that must be addressed by any poverty reduction program. We need to increase the production/supply of rice and fish to ensure affordable prices but at the same time, we need to increase the income of our farmers and fishermen.[2]

The unabated population growth continues to exert pressures not only for the policymakers and government in general, but practically to the whole country as resources are not increasing but rather dwindling. As can be gleaned in Table 1, the average annual population increase stood at 2.04 percent, which is much lower compared to the last 6 census made, lower growth rate is very much desired. On the average, the population growth in the last 4 decades is 2.52 percent.

Table 1: Population of the Philippines
Census Years 1903 to 2007

Year	Population	Ave. Annual rate of increase (%)	Source of data
1918	10,314,310	2.03	Census
1939	16,000,303	2.11	Census
1948	19,234,182	2.07	Census
1960	27,087,685	2.89	Census
1970	36,684,486	3.08	Census
1975	42,070,660	2.78	Census
1980	48,098,460	2.71	Census
1990	60,703,206	2.35	Census
1995	68,616,536	2.32	Census
2000	76,504,077	2.36	Census
2007	88,574,614	2.04	Census

2. Rural Finance and Microfinance Policy Development

The Philippine Financial System

The Philippine financial system is made up of formal, semi-formal and informal financial institutions and providers. The formal financial system, which is dominated by banks and non-banks institutions with quasi-banking activities, is supervised, monitored and regulated by the Bangko Sentral ng Pilipinas (BSP) otherwise known as the Central Bank of the Philippines. Insurance companies, on the other hand, which are part of the formal regulated financial system, are under the ambit of the Insurance Commission.

Table 2 shows that as of June 30, 2009, the Philippine banking system consisted of 804 institutions, composed of universal and commercial banks, thrift banks, rural and cooperative banks. The 38 universal

[2] Statistically Speaking: www.nscb.gov.ph/headlines/StatsSpeak/2009/091409_rav_bbb_food.asp

and commercial banks are the largest single group in terms of assets and other resources. These banks offer the widest choices of banking services in the banking sector. Aside from the regular commercial services that they can offer, these banks are also allowed to engage in underwriting and related investment functions. They can also invest in equities of non-allied undertakings.

The thrift banking sector is made up of 74 savings and mortgage banks, private development banks, and stock savings and loan associations. This sector is focused in providing varied developmental type of lending, especially to small and medium enterprises (SMEs). These banks generally provide short-term working capital and medium- and long-term financing to economic activities engaged in agriculture, services, industry and housing, and other allied and financial interests.

The rural and cooperative banks, on the other hand, totaling 692, are the more popular and closest to the rural communities. These banks are primarily established to promote and expand the rural economy, which are normally run by the local entrepreneurs. Rural banks as well as cooperative banks help farmers by providing the needed financial services so that production, marketing, distribution of agricultural produce can be done efficiently. Generally, rural banks are organized by private individuals and families while cooperative banks are set up and managed primarily by cooperatives or federations of cooperatives.

Table 2. Financial Institutions (FIs) under BSP Supervision/Regulation (As of 28 August 2009)

	End-March 2009			End-June 2009		
	TOTAL	HEAD OFFICE	OTHER OFFICES	TOTAL	HEAD OFFICE	OTHER OFFICES
BSP SUPERVISED/REGULATED FIs	**22,654**	**7,259**	**15,395**	**22,796**	**7,261**	**15,535**
I. BANKS	**7,876**	**811**	**7,065**	**7,898**	**804**	**7,094**
A. Universal and Commercial Banks	*4,422*	*38*	*4,384*	*4,435*	*38*	*4,397*
Universal Banks	3,928	18	3,910	3,938	18	3,920
Private Domestic Banks	3,497	11	3,486	3,507	11	3,496
Government Banks	415	3	412	415	3	412
Branches of Foreign Banks	16	4	12	16	4	12
Commercial Banks	*494*	*20*	*474*	*497*	*20*	*477*
Private Domestic Banks	410	7	403	413	7	406
Subsidiaries of Foreign Banks	69	3	66	69	3	66
Branches of Foreign Banks	15	10	5	15	10	5
B. Thrift Banks[1]	*1,297*	*76*	*1,221*	*1,291*	*74*	*1,217*
C. Rural and Cooperative Banks	*2,157*	697	*1,460*	*2,172*	692	*1,480*
Rural Banks[1]	2,025	653	1,372	2,032	648	1,384
Cooperative Banks	132	44	88	140	44	96
II. NON-BANK FINANCIAL INSTITUTIONS	**14,771**	**6,441**	**8,330**	**14,892**	**6,451**	**8,441**
A. With Quasi-Banking Functions	36	13	23	37	14	23
B. Without Quasi-Banking Functions	**14,735**	**6,428**	**8,307**	**14,855**	**6,437**	**8,418**
NSSLAs[2]	151	76	75	150	75	75
Pawnshops	14,500	6,285	8,215	14,622	6,296	8,326
Others	84	67	17	83	66	17
III. OFFSHORE BANKING UNITS	7	7		6	6	0

[1] Including Microfinance-Oriented Banks

[2] Refers to non-stock savings and loan associations

Source: Supervisory Data Center, Supervision and Examination Sector

A total of 7,898 units consisting of head offices, branches and other banking offices support the banking requirements of the Filipinos. Most of these units however are located in highly urbanized and developed centers, thus the big need to address the requirements of those in the rural and other areas outside of the urban centers.

The Bangko Sentral ng Pilipinas also regulates and monitors 6,451 non-bank financial institutions. The group of non-bank financial institutions with quasi-banking functions is very small, totaling only 14 institutions plus 6 offshore banking units. The big bulk of the non-bank financial institutions (without quasi-banking authority) sector, is mostly composed of pawnshops numbering about 6,296. Pawnshops typically provide credit accommodations to the general public on a collateralized basis and with a higher interest rates compared to the regulated banks.

Aside from the rural and thrift banks that have strong physical presence in the rural areas, non-governmental organizations (NGOs), cooperatives, lending investors, private moneylenders, traders/millers and other government line agencies also provide financial services to the general public which include farmers, fishermen and other agrarian workers.

In an interview with Mr. Edgardo Garcia, Executive Director of the Microfinance Council of the Philippines, Inc. (MCPI) as to the current update of microfinance providers in the informal sector, he stated that around 500 non-governmental organizations (NGOs), out of the more than 30,000 registered with the Securities and Exchange Commission (SEC) are involved in some form of providing microfinance services. He also volunteered that around 300 cooperatives, from the over 66,000 registered with the Cooperative Development Authority (CDA) are doing some form of microfinance operations but about 100 are doing serious microfinance operations resulting in acceptable operational self-sufficiency ratios.

The Philippine National Strategy for Microfinance

One of the Government's strategies in poverty alleviation is to provide households engaged in microenterprise and income generating activities access to production and consumption – smoothing credit. A number of directed credit and guarantee programs, especially focused on agriculture were started in the 1970s up to the middle of 1980s. These credit and guarantee programs were either funded by the national government through budgetary allocation, foreign borrowings and implemented by national line agencies and through the rediscounting windows of the then Central Bank of the Philippines. Most of these credit and guarantee programs were provided at highly concessional rates to the end users. These programs, with all good intentions to help the poor, through the provision of credit and related services, did not fare well insofar as outreach were low, financial sustainability was poor and the fiscal cost to the Government was enormous. Replicability can not be sustained and the desired positive impact to the intended users of funds was low. Several studies and evaluations pointed out these negative findings.

The approved National Strategy is envisioned to have a (1) viable and sustainable private microfinancial market and to (2) provide poor households and microentrepreneurs greater access to microfinancial services.

The National Strategy has the following four core principles:

1. Greater role of private microfinance institutions (MFIs) in the provision of financial services;
2. Provision of an enabling policy environment that will facilitate the increased participation of the private sector in microfinance;
3. Adoption of market-oriented financial and credit policies, e.g., market-oriented interest rates on loans and deposits; and
4. Non-participation of Government line agencies in the direct implementation of credit and guarantee programs.

As the National Strategy was approved, several laws and issuances were subsequently approved that supported the operationalization of the National Strategy. These laws and issuances, with their features are:

1. Social Reform and Poverty Alleviation Act or RA 8425
   - Rationalization of Government-directed credit and guarantee programs
   - Emphasis on savings mobilization
   - Capacity-building assistance to MFIs to but exclude any and all forms of capital seed funding, equity infusion and partnership funds from Government to MFIs

2. Agriculture and Fisheries Modernization Act or RA 8435
   - Consolidation of Government-directed programs in the agriculture sector in the AMCFP
   - Adoption of market-based credit and financial policies
   - Government financial institutions as wholesalers
   - Private sector MFIs as conduits and retailers

3. General Banking Act 8791
   - Recognition of the peculiar characteristics of microfinance (e.g., non-collateralized loans, short-term, frequency of payments, etc.)
   - Use of household's cash flow as a basis in the design of microfinance product

4. Executive Order No. 138
   - Transfer of directed-credit programs of Government line agencies to Government financial institutions
   - Discontinuance of interest rate subsidies
   - Government financial institutions to act as wholesaler of funds to avoid competition with MFIs
   - Use of sustainable community-based private MFIs in the actual delivery of microfinance services

5. Barangay Micro Business Enterprises (BMBE) Act or RA 9178
   - Government financial institutions to set up wholesale credit windows for accredited MFIs
   - Private sector MFIs will be tapped to provide credit support to microenterprises
   - Small Business Guarantee and Finance Corporation (SBGFC) and Quedan Corporation to provide the necessary credit guarantee cover to *barangay* (village) microbusinesses
   - Loans under the BMBE window shall be computed at twice the amount of its face value in compliance with the Agri-Agra Law and the Magna Carta for Small and Medium Enterprises

The Philippine Regulatory Framework for Microfinance Instittutions

The need for a very clear regulatory framework for the practice of microfinance in the Philippines came out as a response to clarify the roles, responsibilities and accountabilities for the institutions providing various microfinance services. The regulatory framework is also a response to the increasing competition among the microfinance players as well as to uphold certain performance standards in governance and operations. The regulatory framework is also a response to the increasing commercialization of microfinance in the Philippines. As in other countries, microfinance services are given by the following three major providers of retail microfinance services: cooperatives, banks and NGOs.

The regulatory framework encompasses all types of microfinance institutions, whether bank or non-bank. The emphasis of the framework is on: (1) portfolio quality, (2) outreach, (3) efficient and sustainable operations and (4) transparent information.

Insofar as the regulatory structure is concerned, the framework affirms that the CDA is the regulatory authority of the credit cooperatives while the BSP will continue to regulate and supervise banks doing microfinance operations. The NGOs on the other hand, which are not regulated, will have the MCPI as its repository of information.

A uniform set of standards that cuts across all types of MFIs, applicable to the peculiarities of each institution were crafted and approved. The performance standard is known by its acronym PESO: Portfolio Quality, Efficiency, Sustainability and Outreach. The regulatory framework has also incorporated the principle of "compensating balance" for those NGOs that are not allowed to mobilize savings but would take capital build-up from their clients. The compensating balance basically means that at any point of time during the partnership between the NGO and its clients, the NGO would always be a net lender to the clients; hence, the risk is much bigger as compared to the clients of the NGO.

The Key Rural and Microfinance Players

The growth of rural and microfinance financing in the Philippines can be traced, to a large extent, with the approval, acceptance and functioning of a very clear National Strategy as well as the setting up of enabling laws and regulations, before and after the National Strategy was approved. The National Strategy as well as the regulatory framework, especially for microfinance will be discussed later in this paper. The three major players are the policymakers and regulators, wholesalers and retailers:

- **Policymakers and Regulators**

National Credit Council (NCC)/Department of Finance (DOF) – The National Credit Council was created by an Administrative Order No. 86 signed by the then President Fidel V. Ramos on October 8, 1993. It is tasked mainly to rationalize and optimize the Government credit and guarantee programs. It aims to institutionalize consultations and policy dialogues so that a higher level of private sector participation in the delivery of credit in the countryside. The Secretary of the Department of Finance concurrently chairs the Council with the Land Bank of the Philippines as Co-Chairman. It is composed of Government regulators, Government financial institutions and other Government line agencies as well as representatives from the private sector. Under the leadership of the NCC, several policy dialogues and consultations were made that resulted in the crafting of the National Strategy for Microfinance. The NCC was also instrumental, together with Agricultural Credit and Policy Council (ACPC), in crafting and supporting changes in laws, regulations and policy framework that supported growth of credit in the rural areas.

Agricultural Credit and Policy Council (ACPC) – The ACPC is an attached agency with the Department of Agriculture (DA). It is the agency tasked to oversee the country's rural financial system, by adopting a holistic approach towards an efficient, effective and sustainable delivery of rural financial services in the countryside[3] Executive Order No. 113 signed by President Aquino in 1986 mandated ACPC to provide policy directions on agricultural credit towards a healthy and sustainable rural financial system. The ACPC, in support of its mandate, assists in credit facilitation so that credit can flow to the countryside. The ACPC is also the lead agency that developed a system whereby Government credit resources were used when all directed credit programs were terminated and subsequently replaced by the virtue of Agro-Industry Modernization Credit and Financing Program under the AFMA Law of 1997.

[3] Creating a Conducive Rural Finance Policy Environment and Regulatory Framework in the Philippines: A Paper by Jocelyn Alma R. Badiola.

Bangko Sentral ng Pilipinas (BSP) – The Bangko Sentral ng Pilipinas or Central Bank of the Philippines is the regulator, supervisor and examiner of all banks in the Philippines. The BSP also regulates a number of non-bank institutions, either with quasi-banking functions or not. The BSP employs a three-pronged approach to microfinance in the banking sector, i.e., (a) development of a microfinance "friendly" policy and regulatory environment, (b) capacity building through microfinance training within the BSP and the banking sector and (c) promotion and advocacy.

Cooperative Development Authority (CDA) – The CDA is the Government agency tasked to register, monitor, develop and supervise all cooperatives in the Philippines. The Congress of the Philippines recently amended the Cooperative Code of the Philippines, thus, empowering the CDA to do more supervision and regulatory functions over the cooperatives.

Securities and Exchange Commission (SEC) – The SEC is the government registering agency for all non-governmental organizations (NGOs). The SEC only registers and gives legal personality to an NGO but monitoring and supervision activities over NGOs are not done. However, the SEC has required all NGOs providing microfinance loans to categorically state in their respective charters and by-laws that microfinance is part of the services that the NGOs are providing.

Insurance Commission (IC) – The Insurance Commission, which is administratively under the Department of Finance (DOF), supervises all insurance activities in the Philippines, including the provision of microinsurance products. The IC is currently reviewing its policies and regulations insofar as the practice of microinsurance is concerned, especially by the Mutual Benefit Associations or MBAs. Hopefully, a very clear framework would have evolved.

Microfinance Council of the Philippines, Inc. (MCPI) – The MCPI is not a Government agency but a duly registered NGO with the Securities and Exchange Commission. In the approved microfinance regulatory framework in the Philippines, the MCPI is viewed as the repository of data of microfinance practitioners. It is envisioned, that over time, the MCPI will act as a self-regulatory organization (SRO), especially for the NGOs doing microfinance programs in the Philippines.

- **Wholesalers of Funds to Retailers**

In the Philippine setting, as enunciated in the National Strategy and the regulatory framework, the wholesalers of microfinance funds are the Government financial institutions. Private commercial banks are strongly encouraged to act as wholesalers but there is no prohibition for them not to do direct retail. So far, commercial banks establish their own subsidiaries like rural and/or thrift banks that provide retail microfinance services. A couple of commercial banks have asked the BSP for licenses to set up microfinance-oriented branches to service the requirements of their clients.

The People's Credit and Finance Corporation (PCFC) is the microfinance apex institution in the Philippines. It is a Government- owned and -controlled corporation and is an attached agency of the Land Bank of the Philippines (LBP). The LBP, Development Bank of the Philippines and the Small Business Corporation are the three major Government financial institutions doing wholesale lending to conduits and retailers.

- **Direct Retailers to End Users**

Cooperatives, rural and cooperative banks as well as microfinance NGOs are actively servicing the requirements of both urban and rural clients. Some of the best performing microfinance banks and NGOs are members of the MCPI and the Alliance for Philippine Partners in Enterprise Development (APPEND), Inc., the oldest network of microfinance NGOs in the Philippines.

The MCPI as the network organization has some of the largest and oldest microfinance institutions in the Philippines reported that as of 31 December 2008, the total number of active borrowers of the MCPI reporting organizations (Table 3) registered 1,554,336 with a total outstanding volume of PhP8.707 billion.

Table 3. MFI Ranking Based on the Number of Active Borrowers and Gross Loan Portfolio (as of December 31, 2008)

	MFI	2008 Clients	2008 Portfolio	Ranking
1	CARD NGO	364,483	1,738,951,972	1
2	CARD Bank	205,097	956,177,546	4
3	TSPI	199,087	1,096,667,445	3
4	TSKI	172,857	1,234,006,153	2
5	KMBI	123,913	386,395,980	8
6	NWTF	84,958	444,874,313	6
7	CCT	70,023	478,858,003	5
8	ASKI	41,303	414,995,711	7
9	PB CARAGA	36,349	298,199,604	9
10	ABS-CBN	29,895	246,722,259	10
11	KCCDFI	23,493	114,598,572	15
12	KAZAMA	21,757	119,856,867	13
13	PALFSI	20,887	165,038,573	11
14	MILAMDEC	20,080	85,671,709	17
15	FCBFI	19,919	83,970,376	18
16	KASAGANA-KA	15,083	60,957,114	21
17	ASHI	14,932	155,060,761	12
18	ARDCI	13,317	116,820,296	14
19	MALLIG	12,854	76,411,130	19
20	OMB	12,628	69,530,658	20
21	SERVIAMUS	9,439	39,241,853	26
22	BK	8,135	86,574,161	16
23	PMDF	7,539	39,452,908	25
24	CANTILAN	7,463	49,771,197	24
25	CMEDFI	7,219	54,079,816	23
26	TALISAYAN	5,457	24,752,348	27
27	ECLOF	4,392	59,392,766	22
28	MEDF	1,777	10,150,351	28
	TOTAL	1,554,336	8,707,180,443	

In the formal financial sector, microfinance services are given directly by rural and cooperative banks and by the thrift banks. Wholesale lending by commercial banks, universal banks as well as by government specialized banks are given to microfinance institutions (cooperatives, non-governmental organizations and to other rural finance institutions, including rural banks) who in turn do the retailing of microfinance loans. As can be seen in Table 4, total microfinance loans by 213 rural and thrift banks registered at PhP6.346 billion and assisted a total of 902,104 households. Similarly, a total of PhP1.550 billion as savings was generated from same number of microentrepreneurs and small farmers.

Table 4. Microfinance Exposures of Rural/Cooperative/Thrift/Microfinance-oriented Banks (as of 30 June 2009, Preliminary, in Million Pesos)

	Number of Banks	Number of Borrowers	Loan Amount (In Million)	Savings Component
Microfinance-Oriented Rural Banks	5	161,886	903.48	58.70
Microfinance-Oriented Thrift Banks	3	56,285	221.96	119.80
Sub-total	8	218,171	1,125.44	178.58
Microfinance-Engaged Rural Banks	161	581,511	3,857.52	1,083.10
Microfinance-Engaged Cooperative Banks	25	85,528	907.49	151.00
Microfinance-Engaged Thrift Banks	19	16,894	456.29	137.30
Sub-total	205	683,933	5,221.30	1,371.53
Grand Total	213	902,104	6,346.74	1,550.10

The performance of these banks would have not been possible had the Bangko Sentral ng Pilipinas not taken seriously the practice of sustainable but with prudential standards microfinance operations in mind. The BSP was mandated by the General Banking Act of 2000 through Sections 40, 43 and 44 to recognize microfinance as a legitimate banking activity. Since then, 19 circulars have been issued by the BSP to support the practice of microfinance in the banking sector. The BSP has also taken pro-active and significant initiatives and activities to promote the development of sustainable microfinance programs in the Philippines. Prior to 2001 when the first BSP circular on microfinance was issued, only a handful of banks are reporting microfinance loans.

The growth of microfinance in the formal regulated sector was made possible with the issuance of 19 circulars to date. These circulars cover a wide range of prudential as well as regulatory practices that made possible such growth of microfinance in the banking sector.

These circulars with their respective subjects are:

- Circular 272 (January 2001) provides the operating guidelines of the General Banking Law Provisions specifically it recognizes cash-flow based lending as a peculiar feature of microfinance, defines microfinance loans and provides for the exemption of microfinance loans from rules and regulations issued with regard to unsecured loans;
- Circular 273 (27 February 2001) provides partial lifting on moratorium on establishment of new banks as long as the new banks are microfinance-oriented;
- Circular 282 (19 April 2001) opens a rediscounting facility for rural banks/cooperative rural banks engaged in microfinance;
- Circular 324 (2 March 2002) opens a rediscounting facility for thrift banks engaged in microfinance;
- Circular Letter 2002 requires reporting of banks with microfinance operations;
- Circular 340 (30 July 2002) provides the rules and regulations concerning the establishment of branches or loan collection and disbursement points (LCDPs);
- Circular 365 (16 January 2003) liberalizes select provisions of Circular 340;
- Circular 364 (19 January 2003) reduces to 75 percent the risk weight applicable to small and medium enterprises (SMEs) and microfinance loan portfolios that meet prudential standards;
- Circular 369 (17 February 2003) liberalizes select provisions of Circular 340;
- Circular 374 (11 March 2003) sets the guidelines for the implementation of the Barangay Micro-Business Enterprise Law;

- Circular 409 (14 October 2003) provides the rules and regulations for the portfolio-at-risk (PAR) and the corresponding allowance for probable losses which depend on the number of days of missed payment;
- Circular 505 (22 December 2005) revises branching guidelines by allowing qualified microfinance-oriented banks and microfinance-oriented branches of regular banks to establish branches anywhere in the Philippines;
- Circular 549 (9 October 2006) exempts microfinance from the required submission of additional documents for the granting of loans;
- Circular 570 (24 May 2007) allows wholesale loans of universal, commercial and branches of foreign banks to non-bank microfinance institutions as compliance to the 6 percent mandatory credit allocation to small enterprises;
- Circular 607 (30 April 2008) includes reportorial requirements for microfinance loans;
- Circular 624 (13 October 2008) includes amendments to branching regulations with incentives for microfinance oriented banks or microfinance-oriented branches;
- Circular 625 (14 October 2008) implements mandatory allocation to MSMEs per Republic Act 9501;
- Circular 649 (March 2009) regulates on the issuance of electronic money; and
- Circular 669 (22 October 2009) amends the existing rules on loan collection and disbursement points of microfinance-oriented banks and microfinance-oriented branches by allowing the servicing of deposits and withdrawals only of microfinance clients.

Status of the Philippine Microfinance "Sector"

For a clearer appreciation of microfinance, the Philippines looked into how the multilateral and other bilateral organizations have defined it. The Philippines defined it as the provision of a broad range of services which include savings, credit, remittance, transfers and insurance to poor and low-income households.

Related to the provision of microfinance loans and savings, some of the Philippine microfinance institutions are also providing microinsurance products, to their clients. MFIs either partnered with insurance companies to provide insurance products or by directly providing limited type of microinsurance products to these clients. A handful of MFIs, on the other hand, facilitated the establishment of mutual benefit associations or MBAs that are owned by the clients of MFIs. Some of the microinsurance products being offered to the clients are either life or non-life in nature, agricultural insurance linked with weather based data/index, or plain insurance of loans. The government is currently reviewing the legal, regulatory framework of these activities, and hopefully, in the next year or so, a very clear, sound and prudentially focused framework would evolve to help the poor, whether in the rural or urban setting.

The practice of microfinance in the Philippines has been cited as one of the most advanced in the world, from a list of 55 countries. In a pilot index and study done by the Economist Intelligence Unit (EIU)[4] as commissioned by the International Finance Corporation (IFC), Inter-American Development Bank (IADB) and by the Corporacion Andina de Fomento (CAF), the Philippines ranked number 3, largely due to a very clear and supportive regulatory framework. The study focused on three broad categories: regulatory framework, investment climate and institutional development. The Philippines landed number 1 in regulatory framework. The Philippines got an index score of 68.4, after South American countries Peru and Bolivia, with index ratings of 73.8 and 71.7, respectively.

[4] Global Microscope on the Microfinance Business Environment: A Pilot Index and Study by the Economist Intelligence Unit of the Economist

The selection of the Philippines as number 3 (and number 1 in Asia), after Peru and Bolivia, the leaders in sound microfinance regulatory environments is a testament to the commitment of the key Philippine stakeholders to see a vibrant, dynamic and sustainable microfinance environment at work in the Philippines.

According to the report, the countries at the top of the index share several characteristics:

- Their Governments seek to foster market development through policies that directly address microfinance activities;
- In cases, where the "sector" is not specifically addressed by laws and regulations, the more general framework that govern microfinance still allows it to grow;
- Governments in these countries also refrain from implementing large scale and distorting subsidy programs;
- In cases where subsidies exist, they have not crowded out microfinance provision by specialized microfinance institutions like NGOs and cooperatives; and
- In some cases, central banks in these countries have created specialized microfinance units in their organizations.

One may surmise that, with this recognition, the Philippine microfinance outreach would be in the millions, approximating the reported outreach of Bangladesh, India and other Latin American countries. The Philippine outreach and volume, however, are not in the same league due to contextual reasons. The microfinance practice in the Philippines is making in-roads and is now substantially reaching a greater number of poor clients as against the total population.

2. Lessons Learned/Future Directions and Issues

The world of rural and microfinance is a very dynamic and a very challenging one. The commitment to serve the poor, whether in the urban or rural setting in a viable, replicable and sustainable manner brings tensions, pressures and challenges to the players involved. The tensions and pressures to produce profit at the end of the day coupled with the social dimension of bringing down poverty and creating more incomes and resources for the poor will always be in the mind of the providers of credit and other financial resources. Regulators and policymakers have a common objective, i.e., protect the soundness of the system and to craft policies and regulations that will not exclude people, especially the poor, but would rather move towards financial inclusion for all.

Let me share on this paper some of my own personal lessons and experiences as I work with regulators and policymakers as well as with the owners of financial resources. My several years of experience as a direct implementer of microfinance program has enriched my life as I facilitate and link up the flow of resources from the funders to the direct users of funds, the entrepreneurial poor that I am involved with.

As we, whether bankers, policymakers, regulators, development workers and users of funds, commit ourselves on technical as well as financial principles to see to it that rural and microfinance program effectively work to reach the intended clients, the following points should be made integral to one's self. There is a need for

- C – COMMITTED TO FINANCIAL INCLUSION
- B – BOLD AND TO THINK OUTSIDE OF THE BOX
- A – ADAPTIVE

- N – NATIONALISTIC
- K – KNOWLEDGE-FOCUSED
- E – “EARTHY” MIND
- R – RESPONSIVE

With these points in mind, we can then look at the challenges ahead with greater resolve and certainty that we would be able to hurdle them. Some of these challenges that we are facing in the Philippines may or may not be present in the context of Bhutan, but it worth looking at them, so that in the event that they manifest in your setting, then you would be in a better situation to address them.

1. Credit pollution – As microfinance institutions expand their respective microfinance programs and services, the tendency to be lax in client selection and in preparing their clients, whether individuals or groups have become an issue. In a number of anecdotal reports as well as some official reports of MFIs, the quality of portfolio was reported to be going down. As MFIs tend to “poach and capture” good clients of their competitor MFIs, preparing the clients in the old fashioned way of credit discipline and savings habit have been forgotten. Community organizing and community development preparation have been shortened too, thus increasing the risk of bad portfolio over time.

A solution to this problem is to employ the use of credit bureau. Although there are at least three functioning private credit bureaus in the Philippines, their operations are not covering microfinance loans. On top of these, these three credit bureaus do not share information among themselves and they only focus on the negative list, i.e., clients who have bad credit history.

The Philippine Congress recently passed the Credit Information Systems Act (CISA) which is viewed to establish a comprehensive data system and structure that would help systematize relevant data of borrowers. It is envisioned that all borrowers of banks and cooperatives, and later even that of the NGOs would be subjected to the credit information processes that will be handled by Credit Information Corporation, a Government-owned corporation established by the Act. With the approval of the CISA, access to credit by micro, small and medium as well as agri-based workers would be enhanced as well as the risks issue involved in multiple borrowings of clients would be addressed.

2. Financial Literacy and Consumer Protection of Clients – As clients get exposed to financial transactions offered by various providers of funds, regulators and providers of funds need to think of ways so that clients can be empowered to become financially literate. Clients need to be aware of their rights and responsibilities in the use of credit as well as savings, budgeting, planning and investing skills are needed by the clients and there is a need to capacitate the clients on these skills. Finally, consumer protection of clients must be an on-going concern by all.

3. Need for Business Development Services (BDS) – As clients’ businesses expand, the most common need that is expressed by them is how to help them improve their products and services. Clients need help in product design, marketing, branding, and compliance with standards. The response of the MFIs is either to link these clients to existing organizations who are focused on these needs. The MFIs need not directly address these particular needs of their clients but by linking them up to appropriate organizations, the services needed by the clients can be met.

4. Branchless banking/phone banking – The Philippines is known as the “texting capital of the world”, with over 650 million texts that go around everyday. More than 55 percent of the

population own a cell phone. Along this line, the BSP and in partnership with the Rural Bankers' Association of the Philippines has allowed the use of cell phones for loan payments, deposits and withdrawals of savings by microfinance clients. Allowing the use of this technology has brought down the cost of such transactions and increased convenience for both the institution and the clients. This facility has enabled the clients who are unable to travel to the physical branch office of the bank to transact business.

Annex 3

LIST OF PARTICIPANTS

1.	Mr. Sonam Dorji	GM, Finance RICBL
2.	Mr. Kinzang Dorji	Office of GM, Credit , RICBL
3.	Mr. Phajo Dorji	Deputy Chief, FISD, RMA
4.	Mr. Dorji Phuntsho	Examining Officer, FISD, RMA
5.	Mr. Chimi Dorji	Head, HRD and Finance, BCCI
6.	Mr. Karma Tenzin	Assistant Finance Officer, BCCI
7.	Mrs. Shanti	PPD, MOA
8.	Mr. Sonam Norbu	Marketing, MOA
9.	Mr. Suda	Program Manager, UNDP
10.	Ms. Yeshey Selden	Head, PPD, MOEA
11.	Mr. Tshitrum Dorji	Department of Industries, MOEA
12.	Ms. Sonam Pem	Program Director, Tarayana
13.	Ms. Benita Lhaden	Assistant Trader Officer, MOEA
14.	Ms. Sonam Yangden	Accountant, Tarayana
15.	Mrs. Khandu Om	Prime Minister's Office
16.	Ms. Sangay	Private
17.	Ms. Dago Pem	Private
18.	Ms. Kesang Phuntsho	MD, Bhama Farms
19.	Mr. Sonan Dorji	
20.	Kawang Gup	GHNC
21.	Mr. Gyaltshen	Kuensel
22.	Mr. Phuntsho Wangdi	Business Bhutan
23.	Mr. Yeshey	Bhutan Insurance
24.	Mr. Tshewang Norbu	RM, West
25.	Mr. Pema Tashi	RM, East
26.	Mr. Tenzin Tashi	BM, Paro
27.	Mr. Janga Bahadur	ABM, Paro
28.	Mr. Dorji Wangdi	BM, Wangdi
29.	Mr. Yeshey	BM, Punkha
30.	Mr. Jamba	BM, Chukha
31.	Mr. Phub Dorji	BM, HAA
32.	Mr. Ugyen Dhendup	Deputy Managing Director
33.	Mr. Nawang Gyetse	Managing Director
34.	Ms. Karma Choden	OGM
35.	Mr. Pema Wangdi	Head, Treasury
36.	Mr. Sonam Letho	Head, Credit
37.	Mr. Sangay Dorji	AGM
38.	Mr. Tshering Dukpa	DGM, HRD

39.	Mr. Jigme Dorji	Project Officer
40.	Mr. Jigme Dorji	ABM
41.	Ms. Sonam Pakden	Project Officer
42.	Mr. Nidup	DGM, Internal Audit
43.	Ms. Thuji Pem	Project Officer
44.	Ms. Jamyang Zangmo	Project Assistant
45.	Dr. Pema Choephyel	Agricultural Advisor
46.	Mr. Karma T. Dorji	Project Manager
47.	Mr. Benedicto S. Bayaua	Secretary General, APRACA
48.	Mr. Eduardo C. Jimenez	Microfinance Specialist, Bangko Sentral ng Pilipinas
49.	Ms. Thanawan Ampaipanvijit	Administrative Officer, APRACA

Annex 4

IFAD-APRACA FINPOWER NATIONAL FORUM
Creative Conducive Microfinance Policy Environment and Regulatory Framework and Technical Support

Thimpu, Bhutan, November 3-6, 2009

(Hosted by the Bhutan Development Finance Corporation, Ltd.)

November 3, 2009

0920-0930	Welcome Remarks by MR. KARMA T. DORJI, Project Manager, BDFCL
0930-0945	Opening Remarks by MR. NAWANG GYETSE, Managing Director, Bhutan Development Finance Corporation, Ltd.
0945-1000	Opening Remarks by MR. BENEDICTO S. BAYAUA, APRACA Secretary General
1000-1015	Photo session and Break
1015-1115	Presentation by DR. PEMA CHOEPHYEL on Rural and Microfinance Policy Environment and Regulatory Framework in Bhutan
1115-1300	Presentation by MR. EDUARDO C. JIMENEZ, Consultant and Expert from the Bangko Sentral ng Pilipinas
1300-1400	L U N C H
1400-1500	Forum Discussion
1500-1515	Tea Break
1515-1600	Conclusions and Recommendations

November 4-6, 2009

	Technical Support to Key Rural Finance Stakeholders

Printed by

ASIA-PACIFIC RURAL AND AGRICULTURAL CREDIT ASSOCIATION (APRACA)
39 Maliwan Mansion, Phra Atit Road
Bangkok 10200, Thailand
Tel: (66-2) 280 0195
Fax: (66-2) 280 1524
E-mail: apraca@apraca.org
Web site: www.apraca.org