Creating a Conducive Rural Finance Policy Environment and Regulatory Framework in the Philippines

By Jocelyn Alma R. Badiola

MESSAGE from the APRACA CHAIRMAN

Greetings to all! The *PHILIPPINE country book* is a testimony of APRACA's strong commitment to pursue the promotion of efficient and effective rural financial systems and broadened access to rural financial services in order to help reduce rural poverty among countries in Asia and the Pacific.

In all these aspirations, the International Fund for Agricultural Development or IFAD has played the role of APRACA's strategic partner. APRACA and IFAD share that mutual desire to pursue and create conducive rural finance policy environment and regulatory framework in Asian countries, including the development of sustainable financial services in rural areas, pilot testing of innovative approaches, delivery mechanisms and linkage programs, promoting finance reforms aimed at poverty alleviation, and disseminating best rural finance practices to more countries. IFAD has, therefore, granted APRACA a five-year technical and financial assistance grant officially dubbed as the APRACA Regional Program of Accelerating the Financial Empowerment of Poor Rural Communities in Asia and the Pacific through Rural Finance Innovations or the IFAD-supported APRACA FinPower Program.

This book is one of the outputs resulting from the FinPower Program's first year of implementation. Through the program, a national policy forum was conducted in the Philippines to discuss the country's rural finance and microfinance policy environment as well as the issues that impinge on the delivery of financial services to the rural poor. The forum also showcased Philippines as one of the few countries in Asia with a well-defined rural finance and microfinance policy framework. This book puts together the findings from that forum including those from existing related studies

May I therefore thank Dr. Thomas Elhault, IFAD Asia Division Director, and Dr. Ganesh B. Thapa, 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.

I wish to congratulate Mr. Benedicto s. Bayaua, APRACA Secretary General and FinPower Regional Programme Manager, for initiating the programme and supervising the FinPower activities.

I also want to thank APRACA's research and training arm, the Center for Training and Research on Agricultural Banking (CENTRAB), particularly to Ms. Jovita M. Corpuz, President and Atty. Eduardo Garcia, Managing Director, for their support and commitment in implementing the Finpower Program.

I wish to extend my gratitude to the people of the Philippines who helped in making that forum a success particularly the officers and staff of Bangko Sentral ng Pilipinas represented by the Deputy Governor Nestor Espenilla, officers and staff of the Agricultural Credit Policy Council, Land Bank of the Philippines, Cooperative Development Authority and the National Livelihood and Support Fund.

MR. THIRAPHONG TANGTHIRASUNAN
President, Bank for Agriculture and Agricultural Cooperatives and
Chairman, Asia-Pacific Rural and Agricultural Credit Association

MESSAGE from the APRACA-CENTRAB PRESIDENT

Greetings to all! It is my ardent wish for all the readers of this book to share in our quest to help uplift the lives of the rural poor through a conducive rural finance policy environment that will allow the delivery of adequate, timely and appropriate financial products and services in the rural areas.

We are very fortunate because we have the International Fund for Agricultural Development (IFAD) as one of our partners in helping promote a conducive rural finance policy environment and regulatory framework among the APRACA-member countries. The IFAD has, thus, awarded APRACA a five-year technical and financial assistance grant officially dubbed as the APRACA Regional Program of Accelerating the Financial Empowerment of Poor Rural Communities in Asia and the Pacific through Rural Finance Innovations or the IFAD-supported APRACA FinPower Program primarily for the development of sustainable financial services in rural areas, pilot testing of innovative approaches, delivery mechanisms and linkage programs, promoting finance reforms aimed at poverty alleviation, and disseminating best rural finance practices to more countries.

The Center for Training and Research on Agricultural Banking (CENTRAB), the research and training arm of APRACA, takes pride in providing research expertise under the APRACA FinPower Programme. Together, we promote the interchange of information among member countries through inter-country studies, training, consultancy, research and publication services in order to help these countries address critical issues and formulate strategies towards sustainable and effective rural financial markets.

This book is one of the major outputs of that program. I would like to thank Mr. Thiraphong Tangthirasunan, APRACA Chairman; and Mr. Benedicto Bayaua, Secretary General and FinPower Regional Programme Manager; Dr. Thomas Elhault, IFAD Asia Division Director; Mr. Ganesh Thapa, IFAD Asia Division Regional Economist; and other IFAD officers as well as Atty. Eduardo Garcia, CENTRAB Managing Director for their full support and commitment to implement the Finpower Program, without which the conduct of this study and the publication of this book would not have been possible. I also want to thank my officers and staff at the Agricultural Credit Policy Council for incessantly sharing their talents and expertise to help APRACA achieve its objectives.

May we all continuously be inspired to be generous in sharing our resources to help reduce poverty in this world.

MS JOVITA M. CORPUZ
President, APRACA-CENTRAB and
Executive Director, Agricultural Credit Policy Council

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And finally, to the “*wind beneath her wings*”, **Alec and Pancho**…

LIST OF ACRONYMS

ACCESS	Accelerating Change in the Countryside thru Equity Sharing Strategy
ACPC	Agricultural Credit Policy Council
ADB	Asian Development Bank
AFMA	Agriculture and Fisheries Modernization Act
AFMA	Agriculture and Fisheries Modernization Act
ALF	Agricultural Loan Fund
AMCFP	Agri-Fisheries Modernization Credit and Financing Program
APPEND	Alliance of Philippine Partners for Enterprise Development
ARBs	Agrarian Reform Beneficiaries
ATM	Automated Teller Machine
BACs	Bank-Assisted Cooperatives
BMEs	Barangay Micro Business Enterprises
BSP	Bangko Sentral ng Pilipinas
CAC	Cooperative Accreditation Criteria
CALF	Comprehensive Agricultural Loan Fund
CARL	Comprehensive Agrarian Reform Law
CARP	Comprehensive Agrarian Reform Program
CB	Central Bank
CDA	Cooperative Development Authority
CFI	Countryside Financial Institution
CFIEP	Countryside Financial Institutions Enhancement Program
CPIP	Credit Policy Improvement Program
CUES	Credit Union Empowerment and Strengthening
DA	Department of Agriculture
DAF	Development Advocacy Fund
DBP	Development Bank of the Philippines
DCPs	Directed Credit Programs
DevAd	Development Advocacy
DSWD	Department of Social Welfare and Development
ED	Enterprise Development
EO	Executive Order
FFFCI	Federation of Free Farmers Cooperatives, Inc.
GAWAD PITAK	Gawad sa Pinakatanging Kooperatiba
GBA	Grameen Bank Approach
GDP	Gross Domestic Product
GFIs	Government Financial Institutions
GFSME	Guarantee Fund for Small and Medium Enterprises
GNP	Gross National Product
IB	Institution Building
IBS	Institution-Building Specialists
ICB	Institution Capacity Building
IFAD	International Fund for Agricultural Development
IFS	Innovative Financing Scheme
IRF	Integrated Rural Financing Program
LGU	Local Government Unit
MABS	Microenterprise Banking Services
MASSSPECC	Mindanao Alliance of Self-help Societies and the Southern Philippines Educational Cooperative Center
MCPI	Microfinance Council of the Philippines
MCPI	Microfinance Council of the Philippines, Inc.
MFIs	Microfinance Institutions
MFPC	Microfinance Program Committee
MicSMEs	Micro Small and Medium Enterprises

MIX	Microfinance Information eXchange
MSP	Microfinance Support Program
MTPDP	Medium-Term Philippine Development Plan
NAMVESCO	National Market Vendors Cooperatives Service Federation, Inc.
NAPC	National Anti-Poverty Commission
NATCCO	National Confederation of Cooperatives
NCAC	National Cooperative Advisory Council
NEDA	National Economic and Development Authority
NFBIs	Non-Bank Financial Intermediaries
NGOs	Non-Government Organizations
NLSF	National Livelihood Support Fund
NORLU	Northern Luzon Cooperative Development Center, Inc.
NPN	Negotiable Promissory Notes
NSO	National Statistics Office
PCFC	People's Credit and Finance Corporation
PFCCI	Philippines Federation of Credit Cooperatives Inc.
PFCCO	Philippine Federation of Credit Cooperatives
PHILEXIM	Philippine Export-Import Credit Agency
PKBs	Private Commercial Banks
PSEI	Philippine Stock Exchange Index
QUEDANCOR	Quedan and Rural Credit Guarantee Corporation
RA	Republic Act
RBAP	Rural Bankers Association of the Philippines
RBs	Rural Banks
RFC	Rehabilitation and Finance Corporation
RFIs	Rural Financial Institutions
SB Corp	Small Business Corporation
SBGFC	Small Business and Guarantee and Finance Corporation
SCUs	State Universities and Colleges
SCWE	Savings and Credit with Education
SEC	Securities and Exchange Commission
SHGs	Self Help Groups
SMEs	Small and Medium Enterprises
SONA	State of the Nation Address
SSS	Social Security System
SULONG	SME Unified Lending Opportunities for National Growth
TAGCODEC	Tagalog Cooperative Development and Education Center, Inc.
TODO UNLAD	Total Development Options Unified Lending Approach for Development
TPCs	Technology Promotion Centers
USAID	United States Agency for International Development
VICTO	Visayas Cooperative Development Center, Inc.

TABLE OF CONTENTS

LIST OF TABLES

LIST OF FIGURES

LIST OF ANNEX

FOREWORD

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.

Moreover, the degree and quality of access to financial services available to low-income rural households and their small businesses is influenced by the quality of the legal and regulatory framework of a country. However, some countries have a regulatory framework that restricts rather than expands access to financial services. This is because factors like the operational, market and client characteristics of the rural finance and microfinance sector are not being considered. Rural finance policy authorities should take note of the fact that financial services for the rural poor go beyond the traditional credit products and savings deposit facilities. The design of the regulatory framework for institutions providing financial services to the rural finance and microfinance sector is therefore different from those for formal banking and finance institutions. It is therefore important for countries to design a regulatory framework that should allow financial institutions to develop and implement products and services that cater to the peculiar requirements of low-income households.

Given these premises, the Asia Pacific Rural and Agricultural Credit Association (APRACA), in collaboration with the International Fund for Agricultural Development (IFAD), seeks to evaluate the current state of the rural finance policy environment as well as the regulatory framework of APRACA-represented countries and determine the gaps that tend to restrict access of the rural poor to financial services. The end view is to promote a conducive policy environment as well as an effective regulatory framework among APRACA-member countries in order to improve and sustain the delivery of financial services to the rural poor.

In order to achieve these objectives, the APRACA and IFAD are collaborating on *"Accelerating the Financial Empowerment of Poor Rural Communities in Asia and the Pacific through Rural Finance Innovations" or the Finpower Programme*. The goal of the programme is *"to promote the financial empowerment of the rural poor in Asia-Pacific countries through policy dialogue, innovative pilot programmes and knowledge-sharing among actors in the rural finance sector".*

Thus, on April 6-10, 2007, the first Regional CEO Dialogue Forum on "Creating a Conducive Rural Finance Policy Environment and Regulatory Framework" was conducted in Kunming, China by the Asia-Pacific Rural and Agricultural Credit Association (APRACA) through the support of the International Fund for Agricultural Development (IFAD). This forum served as the initial activity of the APRACA-IFAD *"Finpower" Program*. There were 15 countries in all that participated in this forum including Cambodia, China, India, Indonesia, Iran, Japan, Korea, Lao-PDR, Malaysia, Myanmar, Nepal, Philippines, Sri Lanka, Thailand and Vietnam. The forum provided the venue for discussions on each country's policy environment and regulatory framework as well as the outstanding issues that affect rural finance development particularly the delivery of financial services to the rural poor.

Following the regional policy forum, APRACA also conducted national policy fora, as part of the Finpower Program framework, in Cambodia on July 10, 2007 and Lao-PDR on July 13, 2007. The national policy fora aimed to assess more closely the status of rural finance development in these transition countries, including policies, institutions and outreach as well as to examine the most important issues that affect the efficiency and effectiveness of rural finance as a developmental tool. A third national policy forum was likewise conducted in the Philippines on September 27, 2007 to showcase Philippine experience, being one of the few countries in Asia with a well-defined rural finance/microfinance policy framework.

Based on the results of the Philippine National Policy Forum as well as findings from related studies, this paper examines the development of rural finance and microfinance policies in the Philippines. It puts together current information on the rural finance and microfinance policy environment; analyzes the outstanding rural finance and microfinance issues; and provides specific strategies towards the development of an effective and efficient rural financial system.

Section 1 presents the socio-economic profile of the Philippines; Section 2 provides an overview of the country's financial system; Section 3 describes the development of rural finance as well as microfinance policies in the country including outstanding issues that affect the delivery of financial services in the countryside; and Section 4 provides the author's final remarks which contain some recommendations to improve and sustain the country's rural financial market.

The information provided in this document is limited to data gathered from the results of the Finpower Regional Policy forum as well as the Philippine National Policy Forum and available information from existing literature.

I. Socio-Economic Profile

Based on the national income accounts prepared by the National Economic and Development Authority (NEDA) for the second quarter of 2007, the country's gross domestic product (GDP) and gross national product (GNP) increased by 7.5 percent and 8.3 percent, respectively, exceeding forecasts by both the NEDA and private firms.

Economic growth drivers for the period were the industry (8.0%) and services (8.4%) sectors, which made up for the lackluster showing of the agriculture sector (3.9%), whose growth was severely hampered by a prolonged dry spell. On the demand-side, growth was stimulated by household and government consumption, which expanded by 6.0 and 13.5 percent, respectively. Capital formation (8.2%) also grew robustly compared to the 1.5 percent growth recorded in the same period last year.

Despite moderate growth in agriculture, palay production (4.4%) remained healthy on account of increases in area harvested due to better irrigation and policy interventions (i.e. DA-GMA Rice Program). High value crops, fishery and forestry also supported the sector's growth.

The mining and quarrying sector sustained its growth in the first quarter, getting a boost from the upturn in construction due to the property market boom and strong growth in public construction (39.6%). Likewise, the services sub-sectors also thrived, led by finance (11.8%), transportation, communication and storage (9.8%), private services (8.6%) and trade (8.4%). The country's sound macroeconomic fundamentals and strong corporate profits drove up the Philippine Stock Exchange Index (PSEI). Higher earnings of banks and other financial services providers; affordable airfares and intensive marketing promotions in the air transport sector also helped fuel economic growth.

Is economic growth felt by the poor? The trickle-down nature of economic growth in developing countries, coupled with the unchecked population management problem in the country, makes it hard for the poor to immediately reap the benefits of whatever economic gains the country is having. Although the annual population growth rate exhibited a generally declining trend since the 1960s (see Table 1), the decline appears to have slowed down during the 90s and reversed the trend by again increasing from 2.32 in 1995 to 2.36 in 2000, a figure which is still very high relative to our Southeast Asian neighbors.

Apart from population growth *per se*, another demographic aspect of population that has a significant bearing on the impact of economic growth is the proportion of the population living in rural and urban areas. In the Philippines, the number of rural dwellers declined significantly from about 63 percent (of the total population) in 1980 to only 39 percent in 2003. The opposite trend was exhibited by urban dwellers, which increased from only about 37 percent in 1980 to 61 percent in 2003 (see Table 2).

Table 1. Population and Average Annual Growth Rate, Philippines: 1903-2000

Year	Population (millions)	Average Annual Rate of Increase Over Previous Year (percent)
1903	7.6	-
1918	10.3	1.9
1939	16.0	2.22
1948	19.2	1.91
1960	27.1	3.06
1970	36.7	3.01
1975	42.1	2.78
1980	48.1	2.71
1990	60.7	2.35
1995	68.6	2.32
2000	76.5	2.36

Source: National Statistics Office (NSO), 1903-2000 censuses

Although not directly attributable, this phenomenon gives a strong indication that rural to urban migration has taken place, and it is no secret why. Lower wages, limited job opportunities, uncertainty in agriculture – the main livelihood in rural areas – are among the things that force rural settlers to migrate to urban areas in search of higher-paying jobs. However, it is a well-known fact that many migrants eventually end up settling for menial jobs in the informal sector (e.g. as household help).

Poverty incidence, rural vs. urban. Racelis [2003] remarked that the Philippines serves as a typical example of a developing country whose economy is growing but which faces serious problems in its efforts to end poverty. One major cause is the skewed distribution of investments and hence, economic benefits existing between rural and urban areas, resulting in huge disparities (in terms of development) which tends to favor the latter. According to a DSWD Survey in 2002, 16 of 80 provinces show poverty incidence levels of over 50 percent, with Sulu in the Muslim south having the highest level at 76.6 %, and Metro Manila and adjacent provinces having the lowest, at 9%.

Racelis [2003] also cited the following results:

- Rural poverty is over twice that of urban poverty (46.9% vs 19.9%), which also means that one out of every two Filipinos in rural areas is poor compared to one of five in urban centers (Reyes 2000).

- Approximately one-third (3 ½ million) of Metro Manila's population live in informal settlements (squatter areas or illegal shantytowns) in varying levels of poverty and poorly served by urban services.
- Urban areas are growing much faster than rural ones. The urban rate of population increase is 3%, while the rural equivalent is less than 1%. Urban areas also account for 80% of all population growth and absorb 1 million people annually (Webster, Corpuz and Pablo 2002).

Table 2. Rural/Urban Population in Southeast Asia (in % share)

		1980	**1990**	**1995**	**2000**	**2002**	**2003**
Southeast Asia							
Brunei Darussalam	Rural	40.1	34.0	31.0	---	---	---
	Urban	59.9	66.0	69.0	---	---	---
Cambodia	Rural	89.7	88.4	85.6	84.0	84.0	---
	Urban	10.3	11.6	14.4	16.0	16.0	---
Indonesia	Rural	77.5	69.1	63.9	59.8	---	54.4
	Urban	22.4	30.9	36.1	40.2	---	45.6
Lao's People Democratic Republic	Rural	86.6	81.4	79.0	76.5	80.0	79.4
	Urban	13.4	18.6	21.0	23.5	20.0	20.6
Malaysia	Rural	62.5	45.3	45.3	41.2	37.6	37.4
	Urban	37.5	54.7	54.7	58.8	62.4	62.6
Myanmar	Rural	76.0	75.2	74.0	72.3	71.0	70.5
	Urban	24.0	24.8	26.0	27.7	29.0	29.5
Philippines	Rural	62.7	51.4	46.0	41.4	40.0	39.0
	Urban	37.3	48.6	54.0	58.6	60.0	61.0
Singapore	Rural	---	---	---	---	---	---
	Urban	100.0	100.0	100.0	100.0	100.0	100.0
Thailand	Rural	82.4	82.3	81.7	81.5	71.4	71.4
	Urban	17.6	17.7	18.3	18.5	28.6	28.6
Timor-Leste	Rural	91.6	92.2	92.5	92.5	92.4	92.3
	Urban	8.4	7.8	7.5	7.5	7.6	7.7
Vietnam	Rural	80.7	80.5	79.3	75.8	74.9	74.2
	Urban	19.3	19.5	20.7	24.2	25.1	25.8

Source: www.unescap.org/stat/data/statind/pdf/t3_dec04.pdf

Major occupation of population, rural vs. urban. Out of a total sample of almost 33 million employed persons nationwide (as of October 2006), about 32% are composed of laborers and unskilled workers while some 19% are either farmers, forestry workers or fishermen (2006 Labor Force Survey, See Table 3). The latter could be classified almost exclusively as a rural occupation while the former may be subdivided into both rural and urban. Although no data exists as to the exact number of rural and urban workers by major occupation, it is certain that more than one-fifth (19.1%-agricultural workers) are rural workers.

Table 3. Employed Persons by Major Occupation Group: October 2005 and October 2006

Major Occupation Group	October 2005		October 2006	
	Number ('000)	%	Number ('000)	%
Philippines	**33,185**	**100.0**	**32,875**	**100.0**
Officials of Government and Special Interest Organizations,Corporate Executives, Managers, Managing Proprietors and Supervisors	3,874	11.7	3,767	11.5
Professionals	1,437	4.3	1,391	4.2
Technicians and Associate Professionals	913	2.8	871	2.6
Clerks	1,564	4.7	1,465	4.5
Service Workers and Shop and Market Sales Workers	3,177	9.6	3,042	9.3
Farmers, Forestry Workers and Fishermen	6,263	18.9	6,268	19.1
Trades and Related Workers	2,688	8.1	2,767	8.4
Plant and Machine Operators and Assemblers	2,533	7.6	2,553	7.8
Laborers and Unskilled Workers	10,591	31.9	10,612	32.3
Special Occupations	145	0.4	139	0.4

Notes : Details may not add up to totals due to rounding. Estimates are preliminary and subject to change.
Source : Income and Employment Statistics Division, Household Statistics Department, National Statistics Office

This data, when combined with the high poverty incidence in rural areas (relative to urban areas) as well as strong evidence of rural to urban migration, could serve as an indicator that rural workers, including those in agriculture, are not sufficiently being compensated in their current work and are looking for better jobs elsewhere, particularly in urban areas.

The Philippine agricultural economy. Agricultural productivity in the country has perpetually been under threat of either inclement weather conditions (e.g. typhoons), prolonged drought, *force majeure* events (e.g. calamities) or pests. Agricultural workers are oftentimes operating under a veil of risk and uncertainty, disrupting the steady flow of income and, hence, the need for more stable, if lower paying jobs in urban areas. Nevertheless, the government is finding ways to work around these inherent problems in agriculture. Some measures include: boosting the productivity of the sector during the "good times" (e.g. suitable weather), providing safety measures such as crop insurance during the "bad times" (e.g. in case of typhoons, calamities), and improving the overall viability and sustainability of the sector by improving support services such as infrastructure, post-harvest facilities, marketing strategies, and credit support.

In 2006, the sector proved to be resilient amidst shocks and severe weather disturbances. It actually performed better in 2006 compared to previous years despite missing the growth targets set under the Medium-Term Philippine Development Plan (MTPDP). The sector's performance hit 4.1% from 1.8% in 2005, barely missing the low-end MTPDP target of 4.2%. A major reason is that job generation proved to be difficult with the decreasing number of jobs created for the sector. On the other hand, agriculture grew because of good performance of the crops, livestock and fisheries (particularly seaweeds) sub-sectors as the volume and value of production increased, compensating for the contraction in the poultry sub-sector. The forestry sub-sector likewise contributed to the growth in the sector, with increased log production from industrial tree plantations (NEDA Socio-Economic Report 2006).

Credit as key in developing new agribusiness lands and creating jobs. The NEDA Report also acknowledged the crucial role that credit plays in the attainment of *Goal 1*[1] of the agriculture sector. The government aims to increase the flow of credit to the agriculture sector by making available farm credit facilities and financing programs for new agribusiness lands thereby creating more work opportunities intended for small farmers and fisherfolk.

II. The Philippine Rural Financial System

2.1 Overview

Agabin and Owens [2006] describe the country's financial system as being composed of formal, semiformal, and informal financial institutions and providers. Formal institutions include banks that are regulated and supervised by the Philippine Central Bank, the Bangko Sentral ng Pilipinas (see Table 4). The formal sector is also complemented by other semiformal institutions that offer financial services such as credit cooperatives, which operate under the cooperative law, and non-government organizations (NGOs), which are registered organizations but not regulated or supervised by any government entity.

The financial sector is dominated by banks comprised of 41 commercial and universal banks, 84 thrift banks, and 754 rural and cooperative banks. The combined number of bank branches and head offices total 7,670 (see Table 5). Rural banks comprise 27% of this total number, with almost two thirds of their branches being located in 3rd, 4th, 5th, and 6th class municipalities that are mostly rural.

While rural banks are the major players in many rural areas, there are also other financial service providers including formal non-bank institutions such as lending investors and pawnshops; semiformal financial institutions comprised mainly of credit cooperatives and NGOs; and informal financial providers such as moneylenders, and traders/millers who also provide credit.

[1] One of two national goals set by the Department of Agriculture which is also cited in the MTPDP. Goal 1 is specifically aimed at developing at least two million hectares of new land for agribusiness by maximizing the transformation and use of the following: 1) underused farmlands, 2) idle and marginal lands, and 3) idle offshore and inland bodies of water into productive agribusiness enterprises.

Which institutions provide agricultural finance and microfinance services? Commercial and rural banks, credit cooperatives, and farmers cooperatives/organizations are known to provide agricultural finance services (e.g. for production and other agricultural loans). Banks, in particular, are mandated by Presidential Decree 711 (Agri-Agra Law) to set aside 25% of their total loanable portfolio for agriculture/fisheries and agrarian lending. On the other hand, NGOs, rural banks and cooperatives are considered the major providers of microfinance services according to the benchmarking report conducted by the Microfinance Council of the Philippines (MCPI) and the Microfinance Information eXchange (MIX).

Bank lending to agriculture. According to reports of the *Bangko Sentral ng Pilipinas* (BSP), the combined loans granted to the agri-fishery and forestry sectors (AFF) in 2006 amounted to P584.6 billion, a mere 3.3% of the total credit disbursements of P17.9 trillion by the banking system. Nonetheless, total agricultural loans granted increased by as much as 12%, which is a half percentage point higher than the growth rate in 2005.

Among financial institutions, private commercial banks (PKBs) remained the major source of loans for the AFF sector because of their sheer size and huge capitalization. For 2006, PKBs accounted for nearly 84% of all loans granted to the sector, or 2.7% of the loans channeled by these institutions to all the sectors of the economy. Meanwhile, loans granted by the Land Bank of the Philippines (P18.5 billion) increased by 18%. Loans granted by rural banks have also consistently increased every year since 2000, with the highest increase registered in 2006 at P44.25 billion (See Table 6 and Figure 1).

Among commercial banks, the Land Bank of the Philippines is particularly mandated by law to provide financial services to small farmers and fisherfolk. It is by far the largest formal credit institution in the countryside and services more than 5,000 cooperatives and farmers groups benefiting about 500,000 small farmers and fish folk. The bank provides credit to small farmers and fisher folk through cooperatives and rural financial institutions (e.g. rural banks and cooperative rural banks) to finance various livelihood projects, which include the production of agricultural crops, livestock/cattle raising and the acquisition of pre- and post-harvest facilities, among others.

On the other hand, the Quedan and Rural Credit Guarantee Corporation (Quedancor), a non-bank government financial institution also caters to the credit needs of small farmers and fisherfolk. In 2006, Quedancor facilitated the release of P3.6 billion in loans and guarantee assistance nationwide.

Table 4: The Philippine Formal Financial System

Type	Institution
Banking institutions	Universal banks Commercial banks Thrift banks Rural banks Specialized government banks
Non-bank Financial Intermediaries (NBFIs)	Investment houses Financing companies Securities dealers Investment companies Fund managers Lending investors Pawnshops Government NBFIs* Venture capital corporations
Non-bank Thrift Institutions	Mutual building and loan Associations Nonstock savings and loans Associations

* Government NBFIs include the Social Security System, the Government Service Insurance System, and the Home Development Mutual fund.
Source: Gochoco-Bautista, Ma. Socorro. 2000. The Past Performance of the Philippine Banking Sector and Challenges in the Post crisis Period. In *A Study of Financial Markets, Volume 10*, Manila: Asian Development Bank., p. 35.

Table 5: The Philippine Banking System, 2005

Type	Head Offices	Branches	Total	% Share
Commercial and Universal Banks	41	4,227	4,318	56%
Thrift Banks	84	1,209	1,293	17%
Rural and Cooperative Banks	754	1,305	2,059	27%
TOTAL	**879**	**6,791**	**7,670**	**100%**

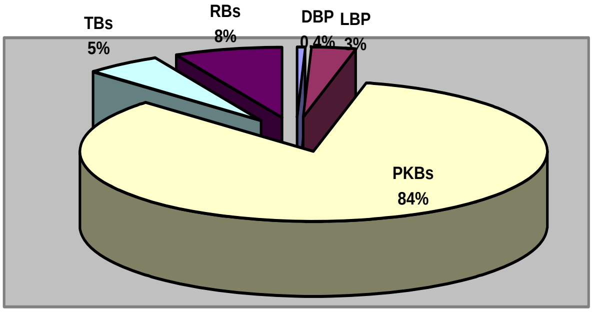
Source: Bangko Sentral ng Pilipinas

Table 6. Agricultural Loans Granted, By Type of Bank (Amounts in PM)

Financial Institution	2005		2006		% Increase (Decrease)
	Amount	% Share	Amount	% Share	
Government Banks	**29,124.6**	**5.6**	**20,969.2**	**3.6**	**(28.0)**
DBP	13,437.3	2.6	2,436.6	0.4	(81.9)
LBP	15,687.3	3.0	18,532.5	3.2	18.1
Private Banks	**492,573.7**	**94.4**	**563,661.6**	**96.4**	**14.4**
PKBs	428,968.1	82.2	488,266.9	83.5	13.8
TBs	25,197.8	4.8	31,143.7	5.3	23.6
PDBs	2,994.6	0.6	3,080.5	0.5	(2.9)
SMBs	17,879.7	3.4	22,859.0	3.9	27.8
SSLAs	4,323.6	0.8	5,204.2	0.9	20.4
RBs	38,407.7	7.4	44,251.0	7.6	15.2
TOTAL	**521,698.3**	**100.0**	**584,630.7**	**100.0**	

Source: Agricultural Credit Policy Council 2006 Annual Report

Figure 1. Banks' Loans Granted to Agriculture, Fisheries and Forestry, 2006 By Type of Bank, %



Source: Agricultural Credit Policy Council 2006 Annual Report

The Onset of Microfinance. Microfinance is currently one of the ten-point agenda identified in the MTPDP for 2004-2010 as one of the more significant tools favored by the current administration for poverty reduction. As mentioned, the MIX/MCPI benchmarking reports NGOs, rural banks, and cooperatives as the three major providers of microfinance services in the Philippines. The report estimated that 500 NGOs, 195 banks and 4,579 savings and credit cooperatives are currently engaged in microfinance. Many other types of registered cooperatives also provide some form of financial services. As of September 30, 2007, BSP reports 224 banks engaged in microfinance, 8 of which are microfinance-oriented rural banks with an outreach of about 819,000 clients and loan portfolio of Ph7.8B.

The National Credit Council also reports that as of June 30, 2007, 2.7 of 3.9 million poor households have been reached by microfinance and a total of P70 billion had been released within 3 years since 2004.

Table 7 shows the main microfinance providers with their amount of gross loan portfolio and number of active borrowers (as of December 2005):

Table 7. Major Microfinance Providers and Selected Indicators

Microfinance Institution	Charter Type	Gross Loan Portfolio (PhP)	Gross Loan Portfolio (US$)	Number of active borrowers
TSPI Development Corporation	NGO	613,728,146	11,565,156	151,714
Taytay sa Kauswagan, Inc. (TSKI).	NGO	603,269,563	11,368,074	162,867
Center for Agricultural and Rural Development (CARD), Inc.	NGO	473,828,363	8,928,870	109,477
Negros Women for Tomorrow Foundation (NWTF), Inc.	NGO	356,368,241	6,715,440	67,982
CARD Bank, Inc.	Rural Bank	281,213,999	5,299,225	31,479
CCT Credit Cooperative	Cooperative	247,342,519	4,660,948	63,084
Kabalikat para sa Maunlad na Buhay, Inc.	NGO	231,989,325	4,371,631	80,078
New Rural Bank of San Leonardo, Inc. (June 2005) *	Rural Bank	160,071,772	3,016,409	15,699
Opportunity Microfinance Bank, Inc.	Thrift Bank	137,984,972	2,600,203	23,044
ABS-CBN Bayan Foundation, Inc. (December 2004)	NGO	137,382,059	2,588,842	38,422
Producers Rural Banking Corporation (December 2004)*	Rural Bank	122,529,316	2,308,955	24,336
Alalay sa Kaunlaran sa Gitnang Luzon, Incorporated	NGO	103,059,979	1,942,073	31,099

* Data for Producers and NRB San Leonardo cover their microfinance operations only.
ER December 2005: US$1 = PhP 53.067
Source: MIX/MCPI Benchmarking 2004 Report

The informal lending market. Llanto [2004] cites the continued existence of informal credit markets as evidence of excess demand for credit from a significant segment of the borrowing population that the formal institutions can not satisfy. Factors such as information asymmetry, transaction costs and risk costs make it difficult for formal institutions to serve the rural areas without incurring losses. Informal lenders, on the other hand, are able to hurdle the information barrier in rural credit markets and maintain low transaction costs, making their lending operations cost-effective. Various credit arrangements allow the informal lender to eliminate or minimize the costs of information, monitoring and enforcement. For instance, they have the liberty of setting the loan interest rates, which many consider as already usurious. Interlinking credit with other markets is another commonplace arrangement, particularly in the Philippines. The threat of withdrawing future credit to prevent default also works well particularly in credit markets practicing segmentation. However, the rural borrower and the lender know each other well enough for the latter to form a more accurate probability distribution of the former's default risk and factor it into the loan contract. The information wedge can thus be easily eliminated because both transactors operate within the same or familiar socio-cultural and economic milieu. The informal lender has the distinct comparative advantage of knowing his borrower and the specific rural community where the borrower lives. He also has at his disposal a reliable (although informal) communication network and a set of informants that help him assess the likelihood of repayment and default.

Tolentino [1987] also notes that, compared to banks, informal lenders are very accessible to borrowers, often providing the loan at the farmer's house, and collecting the repayment at the farmgate. In addition, payments in kind are accepted in many cases. Informal lenders also demand minimum processing and paperwork and lend not only for production but for consumption purposes as well.

Informal Lending Still Persists… Despite the outreach of Landbank, Quedancor, and other formal and semi-formal rural financial intermediaries, a sizeable number of small farmers and fisherfolk still flock to the informal sector for their loans albeit at a decreasing rate as shown by the 2005 Small Farmer Credit Access Survey conducted by the ACPC. Of the 813 borrowers surveyed, 44 percent have accessed their loans purely from formal institutions while 48 percent reported that they have availed only from informal institutions. Around 8 percent claimed that they sourced their loans from both institutions.

…But increasing trend in formal borrowing continues. Over the past 4 surveys covering the period 1996-2005, data show that formal sources have slowly penetrated the rural market which used to be the turf of informal lenders. There is an up trend of borrowing from formal sources with an average increase of about 25 percent. The largest increase occurred from 1996 to 2000 at 60 percent. Borrowing from informal institutions, in contrast, is on the down trend which has an average decline of 14 percent over the 4 survey periods (see Table 8). If the trend continues (treating other factors equal), informal lenders may be overtaken by formal sources in the coming survey periods.

Table 8. Borrowing by Major Source of Loans: 1996-2005

Loan Source	1996-1997	1999-2000	2001-2002	2004-2005
	%	%	%	%
Formal	24.0	38.6	40.0	44.0
Informal	76.0	61.3	60.0	48.0
Both formal and informal				8.0
Total	100.0	100.0	100.0	100.0

2.2 <u>Institutional Structure</u>

The Philippines has two levels of rural finance delivery: wholesale and retail. The main players at the wholesale level include Land Bank of the Philippines, People's Credit and Finance Corporation (PCFC), Development Bank of the Philippines and Small Business Corporation. Those that provide rural finance/microfinance services directly to clients include: rural banks, NGOs and credit cooperatives. In addition, there are two thrift banks with main focus on the provision of microfinance services[2]. Some cooperative rural banks, that is, rural banks owned by primary cooperatives are also engaged in microfinance. The Bangko Sentral ng Pilipinas (BSP) classifies banks engaged in microfinance into two broad categories: (a) microfinance banks and (b) microfinance-oriented banks. Microfinance banks are those whose loan portfolios are 100% microfinance loans. On the other hand, microfinance-oriented banks are those banks whose microfinance loans comprise at least 50% of their gross loan portfolio.

2.2.1 Main Players: Wholesale Level

2.2.1.1 Land Bank of the Philippines

By far, the largest single source of credit to small farmers and fisherfolk is the *Land Bank*, which was established in 1963 to purchase landholdings and finance their distribution to tenants under the Agricultural Land Reform Code of that year. It is fully owned by the government with a capitalization of P1.8 billion. In 1973, it was given a license to operate as a universal bank and it has steadily stepped up

[2] The two thrift banks have been established by private investors to focus on microfinance activities. They are thus, called 'microfinance-oriented' thrift banks. In general, thrift and commercial banks are not engaged in microfinance because they are not structured to handle very small loans without collateral. The commercial banks and thrift banks cater to bigger clientele who provide the traditional collateral such as real estate, commercial papers, etc. The structure of the Philippine banking system is shown in Annex 1-4.

its support of agrarian reform operations as their scope has widened through the series of land reform acts over the years.

The Land Bank is organized into three sectors: (a) the Agrarian Sector which provides lending and extension services to agrarian reform beneficiaries, in particular and small farmer in general; (b) the Banking Sector which handles its commercial banking functions; and (c) the Executive Operations Support Sector which provides administrative support.

The semi-formal financial sector (composed of cooperatives and NGOs) is handled by the Field Operations Group in the agrarian sector staff, through a network of field offices at the regional and provincial level. Also part of the agrarian sector staff is the Countryside Financial Institutions Group, which is responsible for accrediting Rural Banks and processing rediscounting lines to them and equity infusion as part of the scheme to strengthen them. Regular commercial lending, including that to private and corporate agriculture, is handled by banking sector staff through a separate branch network.

Under the Comprehensive Agrarian Reform Law (CARL) of 1987, Land Bank has primary responsibility for land valuation and payment of compensation to land owners under the Comprehensive Agrarian Reform Program (CARP), and for collection of land amortization payments from Agrarian Reform Beneficaries (ARBs). To further expand its outreach of ARBs/small farmers, it adopted the strategy of wholesaling funds through cooperatives or through private rural financial institutions such as rural banks through the Land Bank's rediscounting program.

With the wholesale lending thrust, Land Bank employed a Cooperative Accreditation Criteria in 1994. The objective is to rationalize and systematize the delivery of financial and technical assistance to bank-assisted cooperatives (BACs). A criteria set is applied to cooperatives to enable the Field Offices to assess, rationalize and calibrate credit assistance to BACs based on their loan absorptive capacity; and to plan and implement timely, adequate and necessary measures to graduate BACs to a higher level of growth. To access appropriate financial and technical assistance a cooperative must first meet a set of performance standards and credit requirement. The accreditation criteria depend on whether the cooperative is a newly accessing cooperative or an existing bank-assisted cooperative. Eligible projects range from crop and livestock production, post-harvest and processing activities, cottage industries, irrigation facilities to other income-generating projects.

Land Bank's lending facilities in support of countryside development can be classified into three broad programs: (a) Cooperative Credit Delivery Program for financing cooperatives' projects; (b) RFI Rediscounting Program for the liquidity requirements of accredited rural financial institutions (RFIs) including rural banks, cooperative rural banks, private development banks, stock savings and loan associations; and (c) Special Financing Programs which are being implemented by or in coordination with other government agencies.

Land Bank is also tasked to implement the AFMA-mandated Agri-Fisheries Modernization Credit and Financing Program or the AMCFP as one of the program's wholesalers. As provided for in the Agriculture and Fisheries Modernization Act (AFMA) or RA 8435 of 1997, the AMCFP is meant to replace the different credit programs under the Department of Agriculture in order to make credit delivery to small farmers and fisherfolk efficient, responsive and sustainable.

In 1995, the Land Bank fully capitalized the *People's Credit and Finance Corporation (PCFC)* as its principal arm in lending to the poor. PCFC became fully operational in June 1996. The objective is to use PCFC for poverty alleviation lending programs.

More recently, the Land Bank has also decided to play an active role in microfinance. It has recently launched a nationwide microfinance program.. It expects to have a complementary role with PCFC in providing wholesale loans to various MFIs. Before this happened, Land Bank's involvement in microfinance has been mainly to guarantee the loans obtained from ADB-IFAD and the World Bank for the funding needs of PCFC. The loans of Land Bank to PCFC is in the amount of 1.62 billion pesos as of December 31, 2003. Before the pilot test of 12 microfinance accounts, Land Bank has not lent directly to microfinance institutions (MFIs) at the retail level although some bank officers believe they have actually been doing microfinance through rural banks and cooperatives under their other programs.

Land Bank has an extensive network presence in 79 provinces of the country with 356 field units (285 branches, 38 extension offices and 33 lending centers). The Bank has a total of 731 ATM units located in strategic areas throughout the country. It has manpower complement of 7,106 personnel as of December 31, 2006.

In 2006, Land Bank attained a net income of P3.5 billion which is 17 percent higher than its 2005 net income of P3.01 billion. LANDBANK was able to surpass its year-end net income target of P3.3 billion by 7 percent.

LANDBANK performed very well in terms of major performance indicators. Resources increased by P50.3 million or 16 percent from P310.4 billion to P360.7 billion. Deposits grew by P24.9 million or 10 percent from P242.8 billion to P267.7 billion. Capital improved by P8.9 billion or 36 percent from P24.7 billion to P33.6 billion. Its loan portfolio grew by 15.6 percent from P120.6 billion to P139.5 billion.

Because of this, LANDBANK was able to maintain its ranking among the top five banks in the industry.

Landbank's Rural Finance/Microfinance Programs. To date, 68% (P82 B) of LANDBANK's loan portfolio are in direct support of agricultural related projects including agribusiness, trading, processing and infrastructure. On top of the regular agri-production and infrastructure lending programs, the LANDBANK also implements various program approaches to provide a more holistic assistance to the clients. These programs include:

TODO UNLAD Program. TODO UNLAD stands for Total Development Options Unified Lending Approach for Development. It is our flagship program for countryside development and implemented in Phases (Enterprise Development Phase and Integrated Area Development Phase).Through its various lending programs and support services, TODO UNLAD links cooperatives, local government units, private corporations, small and medium enterprises and non-government organizations in specific areas. TODO UNLAD promotes synergy of effort and resources among the key players in the area. It hopes to increase productivity, improve basic infrastructure and pave the way towards industrialization by linking producers, processors and markets.

TODO UNLAD projects are composed of a combination of two or more of any of the following loans or services:1. local government lending, 2. commercial lending, 3. cooperative lending, 4. production or post harvest-facilities financing, 4. market matching and production, marketing and management agreements, 5. cooperative strengthening, 6. LGU advisory services, 7. import/export financing and 8. integrated loan packages for agrarian reform communities.

Among the Program's features and characteristics include the following: 1.integrated packaging of lending services for local government units, 2. private sector, 3. cooperatives and 4. rural financial institutions.

ACCESS Program.. ACCESS stands for Accelerating Change in the Countryside thru Equity Sharing Strategy. ACCESS is an initiative of LANDBANK aimed at inviting key players in rural development (farmers and fisherfolk cooperatives and their federations, private entities, non-government organizations, LGUs and other interested investors) to become partners of the Bank in undertaking equity investments in agri-related or off- farm economic projects. It aims to catalyze countryside development by promoting livelihood and rural employment, and by priming up local agri-related and off-farm economic projects to raise productivity and income in priority areas of the Philippines. Program features include equity investment, provision of professional management team, technology transfer and marketing assistance and equity divestment.

LANDBANK provides equity investment to augment the financial strength of farmers, fisherfolk, cooperatives, NGOs, LGUs, private entities, and other interested investors, to engage in new economic ventures or expand existing economic projects through pooling of resources. The extent of partners' participation shall be determined based on capital requirement, viability, social and economic impact of the identified economic projects.

To ensure operational cost-effectiveness and efficiency of the new economic activity, the Program also promotes and facilitates the transfer of appropriate technology and marketing assistance to partner organizations.

The Program also makes provision for the tapping of professional management team to assist in project planning, implementation, and monitoring to ensure profitability and sustainability.

Another program component is equity divestment which refers to the gradual recovery of the Bank's equity investment for over a period of time depending on the projected cash flow of the economic projects but not to exceed 15 years.

Innovative Financing Scheme (IFS). The IFS is a joint program between the ACPC and LANDBANK. It is an alternative (non-traditional) way of financing the credit needs of small farmers and fisherfolk who are not eligible to access credit from formal lending institutions.

IFS is a non-traditional way of providing financing assistance to small farmers and fisherfolk who are not a member of LANDBANK's traditional conduits such as cooperatives and not eligible to borrow from other formal lending institutions.

This program calls for the participation of non-traditional lending agents such as Agri-based enterprises (i.e., input suppliers, processors, rice millers, etc.), people's organizations and non-government organizations to provide financial assistance to small farmers and fisherfolk.

SME Unified Lending Opportunities for National Growth (SULONG). SULONG is a program jointly implemented by different government financial institutions (GFIs), composed of LANDBANK, Development Bank of the Philippines (DBP), National Livelihood Support Fund (NLSF), Philippine Export-ImportCredit Agency (PHILEXIM), Quedan and Rural Credit Guarantee Corporation (Quedancor), Social Security System (SSS) and Small Business and Guarantee and Finance Corporation (SBGFC) in support of the government's National Small and Medium Enterprise Development Plan. The Program adopts a simplified and unified lending procedure and guidelines, thereby enhancing the SME's access to credit fund from various GFIs with LANDBANK as the biggest contributor of credit funds.

Under the program, the SMEs may avail of credit funds to finance an export business, temporary/permanent working capital for any eligible business, purchase of equipment, or for the construction of building/warehouse to support their businesses for a maximum loan amount of P5.0 M loan per borrower. To date, part of the P19.0 billion outstanding loans for MSMEs were lent in support to SULONG, the national government's credit flagship program.

LBP Microfinance Program for Microfinance Institution (MFI.) The Microfinance Program of LANDBANK aims to support the government's thrusts of poverty alleviation and jobs generation. Under the Program, the Bank provides credit assistance to small farmers and fisherfolk and micro entrepreneurs to finance their livelihood projects through various Microfinance Institutions (MFI) retailers and wholesalers.

The LANDBANK Microfinance Program is also in support to the government's call to address the credit requirements of the Barangay Micro Business Enterprises (BMEs) and the poor sector by opening a special wholesale financing window for various MFIs. The program aims to support government efforts to alleviate poverty by empowering the marginalized sector through the provision of micro-credit. LANDBANK's microfinance loans are extended to retailers such as cooperatives, non-government organizations, and rural banks.

LANDBANK's MFI-retailers are the cooperatives, non-government organizations and countryside financial institutions (i.e., rural and cooperative banks) that passed the bank's accreditation criteria under the program. On the other hand, LANDBANK's existing MFI-wholesalers are the PCFC, and Philippine Business for Social Progress.

Similar to SULONG, a Microfinance Program Committee (MFPC) has been formed consisting of LANDBANK, PCFC, SBGFC, NLSF, DBP, National Anti-Poverty Commission (NAPC) and the Department of Social Work and Development (DSWD) for possible areas for convergence and coordination. Standardization of the lending criteria, to the extent possible, of all agency partners with microfinance lending operations is being worked out by the Committee.

***LANDBANK Development* Advocacy *(DevAd) Program*.** The DevAd Program aims to generate a different perspective in lending to the mandated and priority sectors of the Bank. In lending to small farmers and fisherfolk and MSMEs, the DevAd Program will consider the core fundamentals of credit, but appreciate the same in the light of the peculiarities of the mandated/priority sectors.

In essence, the DevAd Program is an institutional approach to increase confidence in using new approaches/methodologies in extending loans to the small farmers and fisherfolk and MSMEs and other emerging markets.

Through the DevAd Program, the Bank hopes to further expand its reach and increase financial assistance to the small farmers and fisherfolk and MSMEs. The Bank will likewise hope to develop lending modalities/approaches that appreciate the use and strength of other credit instruments.

The Development Advocacy Fund (DAF) will be set up from the LANDBANK's internal funds, and will have an initial allocation of One Billion Pesos (P1.0 B). This will be used specifically to support new lending approaches, technologies and conduits, including emerging markets/products.

The loan portfolio supported by the DAF will be reviewed periodically, performance of which (loan portfolio) will determine whether or not the DAF will be increased.

Countryside Financial Institutions Enhancement Program (CFIEP). This is a joint program of the Bangko Sentral ng Pilipinas (Central Bank), LANDBANK and Philippine Deposit Insurance Corporation meant to strengthen the capital base of the RFIs. The program consists of three (3) modules, namely:

Module 1 – Purchase of Countryside Financial Institution (CFI) Arrearages with the CB. Under this module, the RFI is required to put in fresh capital equivalent to 50% of the total amount of arrearages where such amount shall be used to purchase Negotiable Promissory Notes (NPN) with face amount equivalent to twice the amount actually infused by the investor. The NPN will be used to redeem arrearages with the CB.

Module 2- LANDBANK's equity investment program is extended to Rural Banks and Thrift Banks to strengthen their capital base where LANDBANK puts in capital in preferred shares not exceeding forty-nine percent of the bank's issued capital stocks. LANDBANK sits in the RFI board to ensure close monitoring of the bank's operations. The program has three (3) sub-modules such as developmental, business and risk recovery type. Developmental module is meant for newly-established bank and those undergoing merger, consolidation and acquisition. Business module is made available for relatively strong banks. Risk recovery is meant for banks that act as collecting agent for written-accounts in the LANDBANK's previous lending programs where 85% of the amount collected is converted into equity investment.

Module 3 – Merger, Consolidation and Acquisition Incentives. The amount of financial assistance shall be the amount that would generate income spread to the surviving or consolidated RFIs equivalent to 50% of the undercapitalized CFI's eligible non-performing loans and value of acquired assets.

Capacity Building and Enterprise Development Programs. As major development partner in the countryside, development assistance has been extended to support cooperatives. This is essentially aimed at improving the absorptive capacity of these cooperatives. Development assistance consists of two key interrelated components, namely, capacity and institution building (IB) and business or enterprise development (ED). IB interventions are meant to enhance the operations and economic viability, while ED support aims at increasing productivity and improving market efficiency of cooperatives. The most significant technical or development assistance being provided by the Bank to these cooperatives includes: (i) cooperative accreditation which involves evaluating the qualifications of potential/newly accessing cooperatives using the Cooperative Accreditation Criteria (CAC); and (ii) key cooperative strategy which aims to identify, strengthen, and accredit at least one key cooperative per municipality nationwide, which can act as LBP's valued development partner and credit conduit.

Integrated Rural Financing Program (IRF). The IRF is a comprehensive financing program for small farmers and fisherfolk cooperatives. In partnership with the ACPC and the DA, cooperative development technicians (referred to as "Institution-building Specialists or IBS) provide on-site, hands-on technical support – business/enterprise project identification, planning, and packaging, marketing assistance, technology transfer, project monitoring and documentation, operations management training and the like to some 574 cooperatives in 12 regions and 29 provinces nationwide. Credit assistance is provided by LANDBANK, with P230 million seed fund from DA-ACPC.

The program is in consonance with the DA's present thrust of pursuing increased agricultural production and LANDBANK's expansion of agri-credit in the countryside. However, these can only be achieved through continued extension of development assistance to farmers and fisherfolk. The program directly supports the Agro-Industry Modernization Credit and Financing Program through provision of institution and capability building activities to farmers cooperatives.

The IRF program management structure consists of Executive Committee as the highest policy making body. It consists of LANDBANK, ACPC and DA. Supporting the Executive Committee is the Program Management Committee consisting of DA, QUEDANCOR, Cooperative Development Authority (CDA), ACPC and LANDBANK. The Program Management Office was established to undertake the day-to-day implementation of the program.

LANDBANK-Local Government Unit (LGU) Cooperative Strengthening Partnership Program. This Program is envisioned to enhance the partnership with the LGUs in cooperative strengthening thru identification, planning, and implementation of needed interventions and projects to hasten cooperative development under the 'resource-sharing arrangement.' The provincial or municipal government provides the necessary funds, on an annual basis, as its equity contribution to the Program to defray costs of cooperative strengthening activities, such as training, workshops, business development forums, etc. LGUs also provide seed or guarantee funds for those cooperatives that fall short of certain eligibility requirements for LANDBANK financing.

Gawad sa Pinakatanging Kooperatiba (Gawad Pitak). Over the years, LANDBANK has given recognition to model cooperatives that have exhibited exemplary performance as countryside developers. This is meant to showcase outstanding cooperative and cooperative banks in various categories such as agri-based, non-agri based cooperatives, cooperative rural banks, ginintuang Gawad Pitak, Hall of Fame, and Special Awards, to inspire other cooperatives to perform and strive harder in their business operations.

The Gawad Pitak Program targets the thousands of active cooperatives operating in all parts of the country that have pooled their resources and expertise to uplift the lives of their member and their communities.

Technology Promotion Centers (TPCs). The TPC Program is a partnership among LANDBANK and state universities and colleges (SUCs) for field testing and commercialization of matured and viable agri-based technologies for adoption by farmers and fisherfolk. The basic strategy is for SUCs to undertake inventory of agri-based technologies that had been developed through research. Such technology shall be validated through field testing to determine suitability and viability. Only those technologies proven viable will be commercialized and financed by LANDBANK. On the other hand, private entities, called Private Technology Providers, are also allowed to validate and promote their developed technologies thru the TPC.

2.2.2 The People's Credit and Finance Corporation

The leading Philippine government agency on microfinance is the People's Credit and Finance Corporation (PCFC). It was established in June 1996 as a subsidiary of Land Bank of the Philippines. The objective is for PCFC to focus on poverty alleviation lending programs while Land Bank concentrates on its mandate to be the financing arm of agrarian reform and to service the agriculture sector's growing demand for financial services.

The PCFC provides credit to accredited NGOs, financial institutions and people's organizations, collectively called "program partners", that implement credit assistance programs for the poor. It also provides credit for institution and capability building activities related to the lending program. Its institutional policy for reaching the poor is to deliver credit to the twenty priority provinces considered the poorest in the country based on poverty incidence statistics. The

PCFC also aims to cover 57 provinces in 12 regions. Targeting the poorest provinces forms part of the government's development agenda to fight poverty in rural as well as in the urban sectors.

To implement PCFC's programs are its account officers in all the regions of the country. These officers usually have accounting, economics or development studies degrees. They do partial credit investigation, processing of application documents, conduct financial analysis, prepares program proposals, conducts field validation and monitoring. The account officer is the frontliner of the organization in the field and deals directly with clients.

PCFC encourages the formation of self-help groups basically because it lends to NGOs who utilize the Grameen Bank technology and its variants. The Corporation views the SHGs as essential in instilling credit discipline and in enforcing repayment. The NGOs are basically the ones in charge of the group formation. Formation is done within the targeted population. There are five self-chosen members but not more than one member coming from the same household. Officers are rotated. Contiguous group training is conducted where there are discussions on benefits, responsibilities, rules and regulations, compulsory savings and verbal contracts. After the training, there is a group recognition test where there is a verification of the eligibility criteria and verbal testing of prospective members.

2.2.3 Small Business Corporation (SB Corp.)

The SB Corporation is the result of a merger between the Small Business Guarantee and Finance Corporation (SBGFC) and the Guarantee Fund for Small and Medium Enterprises (GFSME). SBGFC was created under a law passed by Congress in 1991 and amended in 1998. The law is known as the Magna Carta for Small and Medium Enterprises. SB Corporation is under the direct supervision of the Department of Trade and Industry. The accounts of SB Corporation are examined by the Bangko Sentral ng Pilipinas (BSP) and the Commission on Audit. The mandate of SB Corporation to undertake microfinance operations is included in the BMBE Act of 2002. Its existing loan portfolio consists largely of loans to small and medium enterprises (SMEs) and only a small fraction for microfinance.

2.2.4 Development Bank of the Philippines (DBP)

DBP was established by an act of Congress in 1949. It had its origins in the defunct Rehabilitation and Finance Corporation (RFC) which was established after the Second World War to help finance the reconstruction and rehabilitation efforts designed to revive the war-ravaged economy. RFC was renamed DBP in the late 50s'. DBP is a development bank catering mainly to small and medium enterprises (SMEs). The bank is under the administrative supervision of the Department of Finance and also under the regulatory supervision of the BSP. It is likewise audited by the Commission on Audit. Its mandate to undertake microfinance operations is spelled out under the BMBE Act of 2002. Under the bank's Window III operations[3], the bank has allocated the amount of 500 million pesos for wholesale lending to retail MFIs. DBP is relatively new to microfinance.

[3] Window III is a special loan facility established by the bank to serve the microcredit needs of the urban and rural poor sectors.

Its main clientele are SMEs, mostly those in the manufacturing and agri-based processing sectors.

2.2.5 Quedan Guarantee Corporation (Quedancor)

The Quedan Guarantee Corporation (Quedancor) was created by an act of Congress, namely, RA 7393. Its primary purpose is to accelerate the flow of investments into the countryside in order to increase productivity, livelihood and income opportunities. Under RA 8435 known as the Agriculture and Fisheries Modernization Act (AFMA), Quedancor is mandated to manage the agriculture and fisheries credit guarantee fund to enable it to focus on providing guarantees to the loans of small farmers and fisherfolk. The intention of the AFMA law is for Quedancor to provide guarantees to loans and not necessarily extend direct credit to farmers and fisherfolk.

Discussions with the National Credit Council (NCC) identified the LBP and PCFC as the major wholesale loan providers for microfinance. Quedancor's focus should be on providing loan guarantees to small farmer loans.

2.2.6 Bangko Sentral ng Pilipinas (BSP)

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

The BSP rediscounting facility for MFIs targets those that are able to meet the following eligibility requirements: (1) a one-year track record in microfinance; (2) those with at least 200 borrowers; and (3) a repayment rate of not less than 95 percent during the preceding twelve month period. The BSP also requires the submission of a policy manual on the MFI operations of applicant-banks.

Data from BSP indicate a total number of 220 banks engaged in microfinance, 8 of which are microfinance-oriented banks with an outreach of about 700,000 clients as of September 30, 2007.

2.3 Institutional Players at the Retail Level

Recent data on the state of rural finance/microfinance in the Philippines indicate that the potential suppliers of loans at the retail level include 1,809 rural banks (including branches); about 300 NGOs; 462 credit cooperatives; 7,513 pawnshops; and 2,594 lending investors (Llanto, 2000).

2.3.1 Rural Banks

Rural Banks are private banks that were established in the 1950s with government assistance and subsidies, to service the agricultural sector. They constitute a system of unit banks that is unique in the developing world, and many of them grew out of the operations of moneylenders. They participated heavily during 1973-81 in the Masagana-99 credit program that aimed to bring about self-sufficiency in rice production. Through special deposits and rediscount facilities, the government provided about P6 billion of subsidized and uncollateralized production loans, through them, 80% of which were never recovered. This, and the discontinuation of rediscount lines in 1985 led to widespread closures. About 850 of these banks were rehabilitated by Bangko Sentral ng Pilipinas.

To date, there are 754 rural banks, 54 if which are cooperative rural banks. In addition to the 754 head offices, the rural banking system has 1,305 banches and offices for a total network of 2,059 bank units.

Rural banks are present in 106 out of 114 cities and in 753 out of 1,493 municipalities. About 71% of the municipalities covered by the rural banking system are classified as 3rd, 4th, 5th, and 6th class municipalities. As such, the rural banking system is a potential dominant player in the microfinance sector. The system is a significant partner of the Land Bank in countryside development.

Rural banks in general are familiar with individual lending as this is the methodology employed in their regular banking operations. The individual lending approach targeted to poor clients was formally promoted among the rural banks by a USAID-funded project, called the Microenterprise Banking Services (MABS). The MABS Program provides technical assistance and training to rural banks in microfinance best practices. The program is designed to develop the capability of rural banks to profitable provide financial services to microenterprises. The MABS approach involves training and technical assistance geared toward understanding microfinance best practices. On the other hand, about 15 rural banks also learned the group lending methodology generally patterned after the Grameen Bank approach (GBA) to microlending. Rural banks that had an early start on GBA are reporting higher than average outreach compared to other RBs that are into individual lending. RBs using the GBA are among the top-ranked conduits of PCFC.

Under regular banking operations, the clients of rural banks generally belong to the non-poor. In this case, rural banks require collateral which, in effect, prevents access by the poor to banking services. Thus, for their microfinance operations, rural banks target microenterprises based on cash-flow lending, requiring no collateral from the borrowers. Rural banks target the entrepreneurial poor located in and around centers and small cities. Lending rates to microenterpreneurs are in the range of 24% to 30% per annum, computed on a flat rate basis. The rates include payment of upfront service fees, commonly in the range of 2% to 5%. Frequency of loan collection for microfinance loans is either daily or weekly. Majority of loans are collected on a weekly basis.

Moreover, rural banks are authorized by law to collect savings from the public. Under the MABS approach, rural banks are trained to mobilize savings from micro depositors. One significant achievement of the MABS program is that the number of micro deposit accounts has increased to four times the number of micro loans. The amount of the aggregate micro deposits is approaching the aggregate value of micro loans outstanding. This fact suggests that rural banks are able to finance their micro loans with micro deposits mobilized from the public.

Rural banks are supervised and regulated by the BSP. Most rural banks are members of the Rural Bankers Association of the Philippines (RBAP), a national tertiary organization for rural banks. These banks are also members of their own provincial networks and regional federations. RBAP and the regional federations are effective lobby groups that advocate for policy change. One constraint identified by rural banks in expanding their microfinance operations is the very slow process exhibited by the BSP in approving applications for the opening of new branches. Rural banks view the BSP process for approving new branches as very conservative.

Managers of rural banks engaged in microfinance claim that microfinance best practices like zero tolerance for delinquency and enforcement of strict credit discipline have positively affected their normal rural bank lending operations. Staff in-charge of regular banking operations are learning good practices from the microfinance unit of the bank. As such, significant improvements in financial performance are being felt by rural banks that established microfinance operations. Some rural banks also continue to innovate and come up with new financial products that address the needs of their respective clients.

2.3.2 The Cooperative Sector

The Cooperative Development Authority (CDA) supervises the registration of cooperatives in the country. CDA reports that cooperatives have grown rapidly in recent years from a total of 2,888 cooperatives and pre-cooperatives (or Samahang Nayons) in 1987 (according to a census conducted by NATCCO, in that year) to over 60,000 registered with the CDA as of end June 2004. One reason for this rapid growth could be the encouragement given to cooperative formation during the "people power" administration of President Aquino in 1986 and the liberalized rules for registration. In the Marcos era, no cooperative could be formed without going through the government sponsored pre-cooperative or Samahang Nayon, or village association stage. At their peak were about 20,000 Samahang Nayons which collapsed following the termination of the Masagana 99 Program of cheap credit in the 1970s. Another reason could be the massive expansion on the use of cooperatives as conduits for small farmer credit by the Land Bank, which has formed and assisted over 10,000 cooperatives since 1987.

There are several types of cooperatives: multi-purpose cooperatives, consumer cooperatives, marketing cooperatives, savings and credit cooperatives, housing cooperatives and electricity distribution cooperatives. CDA estimates that 50% of registered cooperatives or 33,000 are functioning. While Credit cooperatives used to account for about half of the total number of cooperatives, multi-purpose coops now dominate the rest, with a share of about 85%. However, many of them are multi-purpose only in name, at least so far, since the Land Bank encourages its cooperatives to register as multi-purpose so as to avoid having to re-register should they engage in other activities later. By coverage of membership, cooperatives are also classified into "institutional" (i.e., those restricted to the employees of an institution, such as the office employees of a company), and "community", where membership is open to all residents, say, of a municipality. However, there are many overlapping categories such as “market” based, whose members are the vendors in a public market, and who are organized in their own national federation like the National Market Vendors Cooperatives Service Federation, Inc. (NAMVESCO). During the period 1973-1986, while the government development policy focused on assisting agricultural, electric and transport cooperatives, the other sectors in the cooperative movement were left on their own with little support from the government. This was a blessing in disguise because these non-agricultural cooperatives pursued a self-reliant and progressive development that contributed to their business viability and success.

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

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

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

Cooperatives have recently become active in providing microfinance services through their affiliation as program partners of PCFC. Cooperatives engaged in microfinance are community-based open-type savings and credit cooperatives.

Data from CDA indicate that there are around 100 savings and credit cooperatives that have assets exceeding 100 million pesos. Around 50 coops are deemed to be engaged in microfinance operations. This figure is partly confirmed by the number of cooperatives (50) reported as conduits of PCFC, having an aggregate loan portfolio of 485 million pesos.

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

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

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

Like the rural banking system, the cooperative sector has a big potential to be a significant player in microfinance because of its extensive network. However, there are too few financially strong cooperatives; great efforts need to be exerted to build up the capacity of cooperatives to undertake microfinance in a sustainable manner.

2.3.3 Non-Government Organizations

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

Most NGOs are small and highly localized organizations with a small full-time staff. Because of their strong social orientation including value formation and community organizing, their operational cost tends to be high. Many of them see their role as organizing cooperatives or associations that will eventually be in a position to access credit directly. There are a growing number of them, however, that see a continuing role for themselves in delivering credit especially to the poorest of the poor and there are some NGOs in fact that undertake only microfinance projects.

It was originally estimated that around 300 NGOs were involved in some form of delivery of microcredit to the poor, but slightly over a hundred NGOs responded to a survey conducted in 1998 by the Microfinance Council of the Philippines. NGOs with a respectable size of operation in microfinance number around 30. The responses of microfinance NGOs to questions in this survey reflect their continuing commitment to service the needs of poor people. Survey results show that most NGO respondents provide small-sized loans and are reaching more clients, indicating to a large extent that poor clients are being reached with microfinance services albeit on a limited scale. Further, a growing awareness on the characteristics of the poor prompted most of them to focus on specific poverty sectors: small farmers and fishing communities, women, market vendors, and marginal entrepreneurs.

Survey results indicate further that the inability of a number of microfinance NGOs to provide information for this survey, particularly financial data, is one of the glaring evidences of their poor record-keeping practices. This further translates to capacity and institutional problems that could be a result of failure to effectively monitor basic performance indictors, identify problems and areas for strengthening, and come up with appropriate measures and interventions. Furthermore, varying accounting practices did not allow accurate presentation of some statistics on financial performance. These findings put emphasis on the need to standardize reporting among microfinance NGOs and upgrade record-keeping capacities.

However, there are microfinance NGOs, albeit small in number, which are performing well. Presumably, these are institutions which, through the years, have steadily expanded in terms of microfinance operations, outreach and assets and have reached desirable levels of sufficiency and efficiency. In fact, the sector can be seen as having two extremes: the bigger, more established NGOs, and the smaller ones. There is hardly a sector in between.

The presence of two extremes in the sector should not be seen as a setback against the microfinance NGOs' continuing role in poverty alleviation. Instead, the extremes may be seen as an indication that there are institutions which have succeeded and are successfully operating microfinance operations. In a sector still within its youth, much interaction can transpire between the two to somehow bridge the gap, and with the appropriate interventions, there is potential toward greater outreach and sustainability.

With respect to methodology, the NGO sector engaged in microfinance is the chief proponent of the group lending methodology, essentially patterned after the Grameen Bank approach (GBA) to microlending. The experience of NGOs in GBA spans a period of more than 15 years. GBA is the preferred methodology by

NGOs due to its feature of group accountability for loans. The introduction of the ASA methodology by a UNDP-funded project called Microfinance Support Program (MSP) is overhauling the group lending methodology by doing away with the group accountability feature. Groups are still formed in the ASA method but group members are solely accountable for the payment of their respective loans.

Both the GBA and ASA methodologies specifically target the poor, especially women with existing microenterprises. GBA and ASA utilize the Housing Index and the means test to screen out the non-poor from entering the microfinance program.

NGOs generally charge interest on loans at rates ranging from 24% to 40% per annum flat rate, inclusive of upfront service fees of 2% to 5%. Collection of loan payments is done weekly. NGOs are not expressly authorized by law to collect deposits from the public but nevertheless collect compulsory savings from member-borrowers as a form of compensating balance for members' outstanding loans. NGOs are not supervised nor regulated by any government agency. They are, however, required by law to submit audited financial statements to the SEC.

NGOs with a sizeable scale of operations are affiliated with the Microfinance Council of the Philippines. Another network, the Alliance of Philippine Partners for Enterprise Development (APPEND) groups together Christian development organizations engaged in microfinance. NGOs have no visible constraint to branch expansion. They can establish branches in any place they want to. Inadequate funding is generally the reason why NGOs cannot expand their number of branches as fast as their plans warrant.

The ASA methodology is offering a way to low-cost fast growth and rapid expansion of the branching network.

As NGOs dealing in credit are not allowed to accept deposits, they depend mostly on grant financing from national or international NGOs or bilateral donors. But due to dwindling donor funds, coupled with increasing competition from rural banks and cooperatives, the role of the NGO sector in microfinance may diminish in the long run. However, there will remain some 10 to 20 NGO MFIs that will continue to operate with a mission to serve the poorest while maintaining their drive towards financial sustainability. These NGOs will operate on a scale that can match the competition posed by rural banks and cooperatives engaged in microfinance.

III. Rural Finance Policy Development

3.1 Before the Reforms

Prior to reforms, the Philippine rural financial market followed the supply-led approach through a massive infusion of institutional credit using cheap credit funds from the government (Corpuz and Kraft, 2005). Various commodity-specific agricultural credit programs such as the *Masagana 99* for rice, *Masaganang Maisan* for corn, *Gulayang Pangkalusugan* for vegetables, and *Bakahang*

Barangay for livestock, among others were implemented through rural banks as conduits. Rural banks were, thus, 'gifted' with 'cheap' funds (i.e., at very low interest rates) via the Central Bank's rediscounting window as an incentive for them to lend to small farmers. Without the 'incentive', these banks would normally not lend to these farmers because lending to the latter is generally perceived as risky and quite costly to administer. Moreover, some government non-financial agencies did the lending themselves, providing loans directly to program beneficiaries but without putting in place an appropriate loan collection mechanism. It was during this period that the borrowing incidence among small farmers greatly increased and the country achieved self-sufficiency in rice production. However, these positive effects were short-lived since farmers started to default on their loan repayment, government funds dwindled and a great number of rural banks closed shop and went bankrupt. While some farmers blamed the weather, others simply refused to pay because of the notion that government funds are a dole-out and need not be returned. In addition, the government agencies that implemented credit programs did not exercise due diligence in loan collection. And because of too much dependence on cheap funds from the government, most rural banks neglected deposit mobilization and demonstrated leniency in loan screening and collection which led to poor repayment rates.

Numerous research studies have documented this experience and it is now well-recognized and accepted that a supply-led strategy or the massive infusion of institutional credit at subsidized interest rates is not effective and can be very costly. Some of the lessons learned from this experience can be summarized as follows:

- Lending by government non-financial agencies is costly and not sustainable; lending should, thus, be a function of banks or financial institutions;
- Government should focus on creating a conducive policy environment, providing the needed infrastructure and support services including opportunities for institution building in order to increase participation of the private sector in the delivery of credit to agriculture;
- Banks should be capable of generating its own funds and be less dependent on the government and other external sources;
- In order to encourage banks to lend to agriculture, banks should be allowed to cover its lending costs through market-determined interest rates and lend only to qualified borrowers and/or viable projects; other means to reduce the risk of lending to agriculture should be pursued by both the government and private sectors such as making the crop insurance and guarantee programs work;
- Credit access is not just a supply issue but a demand issue as well; it is critical to work towards making clients or borrowers creditworthy through capability building programs including the provision of technical assistance in order to promote viability of their projects.

3.2 Liberalization and Deregulation of the Rural Financial Market

In response to the mounting arrearages problem as well as the failure of the low-interest rate policy which gave rise to the bankruptcy and closure of many rural banks, the government started to liberalize and deregulate the financial markets in the early eighties. Greater reliance on market principles especially in pricing as well as allocating credit funds was the basic framework for reforms. Interest rates were therefore deregulated and subsidies gradually removed. For one, the Central Bank of the Philippines was asked to stop its involvement in government credit programs and to transfer the Agricultural Loan Fund (ALF) to the Land Bank of the Philippines. The government also dismantled subsidized agricultural credit programs which had been funded at great cost to taxpayers but failed to succeed in making credit more accessible and sustainable to the small farmers. Also part of the reform package was the promotion of universal banking or expanded commercial banking along with an increase in the required minimum bank capitalization. While restrictions were imposed on bank branching and entry especially after the financial crisis of 1983, this was liberalized in September 1989 which led to the increase in the number of banks and branches particularly of commercial banks and Land Bank of the Philippines (Lim and Esguerra, 1996). Essentially, the objective of financial liberalization was to encourage private banks to lend more to agriculture by allowing these financial institutions to cover their lending costs through market-determined interest rates and to lend only to viable projects.

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

3.3 The Agricultural Credit Situation After the Financial Liberalization

Unfortunately, however, the expected increase in credit flows to small farmers and other smallholder-borrowers following the paradigm shift to a market-oriented credit policy did not happen. In fact, the proportion of loans granted to agriculture by various types of banks declined steadily during the early 1990s including commercial banks and rural banks. It was only Land Bank, which is the government bank mandated to serve agrarian reform beneficiaries, that increased its share of agricultural loans relative to its total loan portfolio from 7% in 1987 to about 30% in the late nineties. In general, however, the share of agricultural loans dipped from 21-23% before the 1980s to proportions of less than 1% in the late nineties (Castillo and Casuga, 1999).

At the borrower level, the incidence of borrowing among small farmers also declined from 60% in the seventies to 35% in the nineties when policy reforms should have already started bearing “fruits” through increased access to formal credit (Table 9).

Table 9. Borrowing Incidence Among Farm Households in the Philippines

Sub-Period Averages, Various Years

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

Why the decline in agricultural credit despite the policy reforms? One, banks continued to find lending to agriculture risky, costly and therefore totally unattractive despite the existence of a local guarantee scheme for farmers called the Comprehensive Agricultural Loan Fund or CALF. Without the 'carrots' in the form of cheap government funds, banks would not venture into agricultural lending using their own funds. Two, there was a slow growth in agricultural output and per capita output during the nineties which, on the average, was a low 1.9% per annum below the population growth rate of nearly 3% per annum. Three, a significant number of farmers were disqualified from borrowing due to arrearages incurred under government credit programs especially in the late seventies and early eighties. And four, given the reduced access to formal credit, more farmers preferred to finance farm operations from savings, liquidation of fixed assets and income from off-farm and non-farm activities.

3.4 Forward-Backward Policy in the Mid-Nineties: The Resurgence of Subsidized Credit Programs

As the nineties wore on, it became evident that credit access to farmers and other smallholders was not gaining ground. While other government agencies (outside the Department of Agriculture) continued to implement subsidized credit programs, the agriculture sector through the Agricultural Credit Policy Council was the only sector that tried to terminate such programs and consolidated the remaining fund balances for the CALF. However, it did not take long before politicians and government bureaucrats 'restored to life' the subsidized credit programs due to the clamor of various interest groups. In effect, by the end of the Aquino administration, subsidized credit programs had once again mushroomed, undermining the government's own market-oriented credit and financial policy reform efforts. In fact, there were as many as 86 government credit programs implemented in 1999 by 21 government agencies (Llanto, Geron and Tang, 1999), more than three times the number of directed programs before the policy reforms in 1986. Llanto and others (1999) further showed that more than P40 billion or 1.8 percent of GNP in 1996 was invested in these programs of different agencies (DA and non-DA), the bulk of said funds having been borrowed from foreign sources. In terms of beneficiaries, limited data from 24 reporting directed credit programs indicate that for two years in 1995-1996, about 686,000 farmer-borrowers obtained loans from these programs – quite a miniscule number considering that billions of pesos were made available to said agencies. Again, the directed credit and subsidized programs proved to be a costly load on the government's shoulders.

3.5 Policy Reforms on the Rebound: The Agriculture and Fisheries Modernization Act (AFMA) of 1997 and Executive Order 138

The government once again decided to do away with these money-losing directed credit programs and embrace market-oriented credit and financial policies as provided for in the AFMA of 1997 and Executive Order 138 issued in 1999. In particular, the AFMA calls for the phase-out of directed credit programs (DCPs) in the agriculture sector and the consolidation of funds from these programs into a comprehensive agricultural credit program called the Agro-Industry Modernization Credit and Financing Program or the AMCFP; the rationalization of loan guarantee programs; adoption of market-based interest rates; and non-provision of credit subsidies. So far, all directed credit programs (DCPs) have already been consolidated by the Agricultural Credit Policy Council (ACPC), an attached agency of the Department of Agriculture, into the AMCFP and loan releases under these programs have been stopped. However, loans previously disbursed under these DCPs continue to be collected through the ACPC. In order to continue the flow of credit to the countryside, the AMCFP is already being implemented using funds previously collected from the DCPs.

Similarly, EO 138 directs government agencies implementing credit programs to adopt the Credit Policy Guidelines of the National Credit Council which includes: (i) non-participation of government non-financial agencies in the implementation of credit programs; (ii) government financial institutions to be the main vehicle in the implementation of credit programs; (iii) adoption of market-based financial and credit policies; and (iv) increased participation of the private sector in the delivery of financial services.

Other reforms include the enactment of the General Banking Act on May 2000 which consists of provisions mandating the Bangko Sentral ng Pilipinas to recognize the unique nature of microfinance as it formulates banking policies and procedures. As such, the moratorium on branching was lifted specifically for microfinance banks; BSP Circular 272 was issued on January 2001 implementing the microfinance guidelines of the General Banking Act (see Annex A); and the supervision and examination process was reviewed to reflect the special nature of microfinance, i.e. non-collateralized loans. Another policy reform was the enactment of the Barangay Microenterprise Business Act which directs the adoption of market-based credit policies in the provision of financial services to barangay or village-based microenterprises. Under this Act, government wholesale financial institutions are directed to create special credit windows adopting market based interest rates for private financial institutions intending to provide credit to barangay microenterprise business.

3.6 Current Imperatives for Increased Access to Rural Finance

Considering lessons learned from the past twenty years, current imperatives aimed at increasing and sustaining access to rural finance, follow the market-based policy principles of the AFMA, as follows:

1. Provision of a conducive policy environment, critical support and capability-building services that would facilitate increased participation of the private sector in the delivery of credit;
2. Greater role of the private sector including rural banks, cooperative rural banks, cooperatives and NGOs in the provision of financial services;
3. Adoption of market-oriented interest rates;
4. Active participation of government financial institutions in the delivery of credit services and non-involvement of government non-financial institutions in credit decision making.

3.6.1 The Agro-Industry Modernization Credit and Financing Program (AMCFP)

As provided for in the law (AFMA of 1997), all directed credit programs are to be terminated and replaced by the AMCFP as the umbrella credit program of the Department of Agriculture. The Agricultural Credit Policy Council (ACPC) took the lead in developing a system whereby government credit resources are administered more efficiently through the AMCFP. The following features make the AMCFP different from the past credit programs of the government: (i) it is demand-driven and not supply-led; (ii) it is not commodity-specific but covers a whole gamut of income-generating projects which farm households may choose to undertake (see Annex B for list of projects); (iii) the government is not involved in any credit decision-making as the program is implemented as a two step loan program with government financial institutions as wholesalers and qualified private banks as retailers (see Figure 1 for illustration of AMCFP structure); and (iv) it adopts market-determined rates as opposed to the subsidized rates of the past.

3.6.2 Role of the Agricultural Credit Policy Council (ACPC)

As the agency tasked to oversee the country's rural financial system, the ACPC adopts a holistic approach towards an efficient, effective and sustainable delivery of rural financial services in the countryside. Towards this goal, the ACPC performs the following:

A. Policy Formulation, Planning and Advocacy

As mandated by Executive Order 113 of 1986, ACPC provides policy directions on agricultural credit towards a healthy and sustainable rural financial system. It reviews and makes recommendations on the socio-economic soundness of on-going and proposed agricultural credit programs, legislations, and other policies that aim to increase the flow of credit to agriculture. The ACPC makes sure that the alternative strategies and policies being proposed are able to address the needs of its stakeholders particularly financial institutions, the policymakers and the small farmers and other smallholders and that these proposed policies are accepted by them. So far, many of the credit policies advocated by the ACPC eventually reached legislation especially with the passing into law of the AFMA in 1997.

B. Credit Facilitation

Credit facilitation means allowing credit to flow to the countryside by bridging the gap between the lenders (supply side) and the borrowers (demand side). The problem of poor access to credit is, therefore, addressed as the credit requirements of small farmers and fisherfolk are determined and private financial institutions are encouraged to finance these requirements. Small farmers and fisherfolk, even those without collateral to offer, are given the opportunity to have access to formal financing while banks are able to reduce the risk of lending to these borrowers. Through the implementation of the Agro-Industry Modernization Credit and Financing Program (AMCFP) and innovative schemes developed by ACPC, credit facilitation can help the government spur growth in the agriculture and fisheries sector by responding to the financial requirements of small farmers and fisherfolk needed for agricultural production.

Agro-Industry Modernization Credit and Financing Program (AMCFP). Through Resolution No. 1 series of 1999 issued by the Council of the ACPC, the ACPC was given the oversight function over the AMCFP. As program oversight, ACPC is tasked to steer program implementation, address policy issues, and monitor and evaluate fund utilization.

The ACPC is also mandated to handle/administer the funds to be transferred from directed credit programs previously implemented by the government to the AMCFP. Part of the function is to conduct a full inventory and accounting of all directed credit programs (DCPs) in agriculture and review their enabling laws/instruments; and to exercise due diligence in ensuring that loans released under these DCPs are collected and that these funds are transferred to the AMCFP. The primary objective is to ensure that the program is able to increase credit access of its intended beneficiaries, i.e., the small farmers and fisherfolk and that the loans released under AMCFP are returned to the program for sustainability.

Innovative Financing Schemes. The ACPC continuously designs and pilot-tests innovative financing schemes particularly those who for some reason do not have access to bank loans or lending facilities of formal institutions. With these schemes, the ACPC is able to identify credit delivery mechanisms that can work for small farmers and be adopted by financial institutions, particularly government as well as private financial institutions for implementation on a wider scale.

C. Institutional Capacity-Building/Training

The ACPC believes that credit alone cannot achieve countryside development. Thus, it extends grant funds for the conduct of institutional capacity-building activities aimed at strengthening the financial/lending capacities of farmers' cooperatives/associations and improving access to financial services of small farmers and fisherfolk. The ACPC believes that grassroot-based institutions like farmers and fisherfolk organizations can be developed and strengthened into effective and efficient lending and collection entities through institutional capacity-building (ICB) mechanisms. It is through these institutions that marginal farmers and fisherfolk can have better access to credit. When more of these organizations are strengthened, access to financial services by small farmers and fisherfolk is likely to increase as well.

D. Information Support

Since information is vital in planning, policy formulation and project development, a monitoring system has been developed and installed by ACPC to monitor implementation of the AFMA-mandated AMCFP, other on-going credit, guarantee and insurance programs, lending to agriculture by the entire banking system as well as the progress of projects and programs in consonance with President Arroyo's State of the Nation Address (SONA) commitments. The extent to which farmers organizations, NGOs, cooperative banks and other institutions provide credit in the rural areas are also being monitored.

3.7 Microfinance Revolution

To complement the provision of agricultural credit in the countryside, microfinance services have become more accessible to farm households as a result of policy reforms that encouraged financial institutions to engage in microfinance. The availability of microfinance services has allowed farm households to diversify and increase their income as well as improve their quality of life. In fact, in the recent Small Farmer Credit Survey done by the ACPC, the incidence of borrowing from formal sources among small farmers has increased significantly mainly because of the increased accessibility of microfinance services in the rural areas. Bangko Sentral ng Pilipinas defines microfinance loans as *small loans granted to the basic sectors, as defined in the Social Reform and Poverty Alleviation Act of 1997 (Republic Act 8425), and other loans granted to the poor and low-income households for their microenterprises and small businesses so as to enable them to raise their income levels and improve their living standards. These loans are granted on the basis of the borrowers' cash flow and are typically unsecured.*

Policy Framework

The Philippines is actually one of a few countries with a well-defined policy and regulatory architecture for microfinance. The government through the National Credit Council (with ACPC as head of the sub-group on agricultural credit) and the Credit Policy Improvement Program (CPIP) has worked for the creation of a favorable environment. The National Strategy for Microfinance provides the policy framework for microfinance and is anchored on the following principles:

1. greater role of the private sector/MFIs in the provision of financial services;
2. an enabling policy environment that will facilitate the increased participation of the private sector in microfinance;
3. market-oriented financial and credit policies, e.g. market-oriented interest rates on loan and deposits;
4. non-participation of government line agencies in the implementation of credit/guarantee programs.

The national microfinance policy framework, therefore, includes the following specific strategies:

1. In providing for a conducive policy environment: a) implementing a market-oriented interest rate policy; b) pursuing financial policy reforms with the end in view of removing existing distortions in the financial market; c) rationalizing all existing government credit and guarantee programs

2. In establishing a market-oriented financial and credit policy environment which is conducive for the broadening and deepening of microfinancial services: a) provision of appropriate supervisory and regulatory framework for MFIs which will enable them to engage in the development of new and innovative product lines and services appropriate to the demand for financial services/products by poor households and microenterprises; b) establishment of standards of performance and business practices to guide the operations of MFIs; c) promotion of broad-based savings mobilization, linkage banking technology and other microfinance technologies; d) provision of information and training on best practices in microfinance to MFIs.

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

The favorable environment has contributed to the rapid growth of outreach of MFIs (which include rural banks, NGOs and credit cooperatives as well as some thrift banks) as well as the strengthening of the microfinance programs of rural banks/cooperative rural banks/ microfinance-oriented banks. The Bangko Sentral ng Pilipinas (BSP) classifies banks engaged in microfinance into two broad categories: (a) microfinance banks and (b) microfinance-oriented banks. Microfinance banks are those whose loan portfolios are 100 percent microfinance loans. On the other hand, microfinance-oriented banks are those banks whose microfinance loans comprise at least 50 percent of their gross loan portfolio.

As of September 30, 2007, BSP reports 224 banks engaged in microfinance, 8 of which are microfinance-oriented rural banks with an outreach of about 819,000 clients and loan portfolio of Ph7.8B.

Regulation of Banks Engaged in Microfinance

The basic law that paved the way for the creation of the favorable environment for banks engaged in microfinance is the General Banking Law of 2000. It recognized the special features and peculiarities of microfinance and asked the BSP to issue appropriate implementing guidelines. Sections 40, 41 and 44 mandated the formulation of appropriate rules and regulations for microfinance operations. Section 40 recognizes the "peculiar characteristics of microfinancing, such as cash-flow based lending to the basic sectors that are not covered by traditional collateral." Section 41 provides for the issuance of regulations covering unsecured loans and Section 44 recognizes that "the schedule of loan amortization shall take into consideration the projected cash flow of the borrower and adopt this into the terms and conditions formulated by banks."

Regulation of Cooperatives[4]

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

Registration of NGOs[5]

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

NGOs collect "forced" savings or the so-called "capital build-up" as compensating balance or the proportion of the loans of their microfinance clients (NCC, 2003). The consensus among the NGOs is that they should be allowed to collect savings from their clients without being subject to any prudential regulation provided that these collected savings do not exceed their total loan portfolios. Those that collect savings beyond the compensating balance shall be required by the government to transform themselves into either a bank or credit cooperative, both of which are regulated entities.

The present view of the NCC is that only regulated financial institutions shall be allowed to take deposits from the public. Banks which are regulated by BSP are considered 'deposit-taking institutions'. Cooperatives which are regulated by CDA mobilize deposits among their members. On the other hand, NGOs are not regulated entities and thus, no external body monitors their performance and

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

[5] This is from Llanto (2003).

imposes sanctions for poor performance, implying that depositors would not be adequately protected from misbehavior by NGOs. Thus, NCC has ruled that NGOs shall not be allowed to mobilize deposits from the public. The NCC also ruled that the total 'forced' savings collected from clients shall not exceed the value of their total loan portfolio at any point in time.

The Microfinance Council of the Philippines, Inc. (MCPI) has adopted a set of performance standards for NGOs. This set of performance standards has not yet been widely adopted and the NCC attributes this to the "absence of incentives for adoption." On the other hand, the NCC and the CPIP have recently collaborated in formulating a set of performance standards that are applicable for all types of MFIs.

Proposed Institutional Framework for Regulation of Microfinance Institutions

The proposed institutional set-up for the regulation of microfinance as developed by the National Credit Council is shown in Figure 2. The proposed institutional set-up shows a comprehensive framework where regulators have their respective regulatory focus and there is coordination between BSP and CDA. Private institutions such as the Microfinance Council of the Philippines, Inc. (MCPI) and a credit bureau also play an important role.

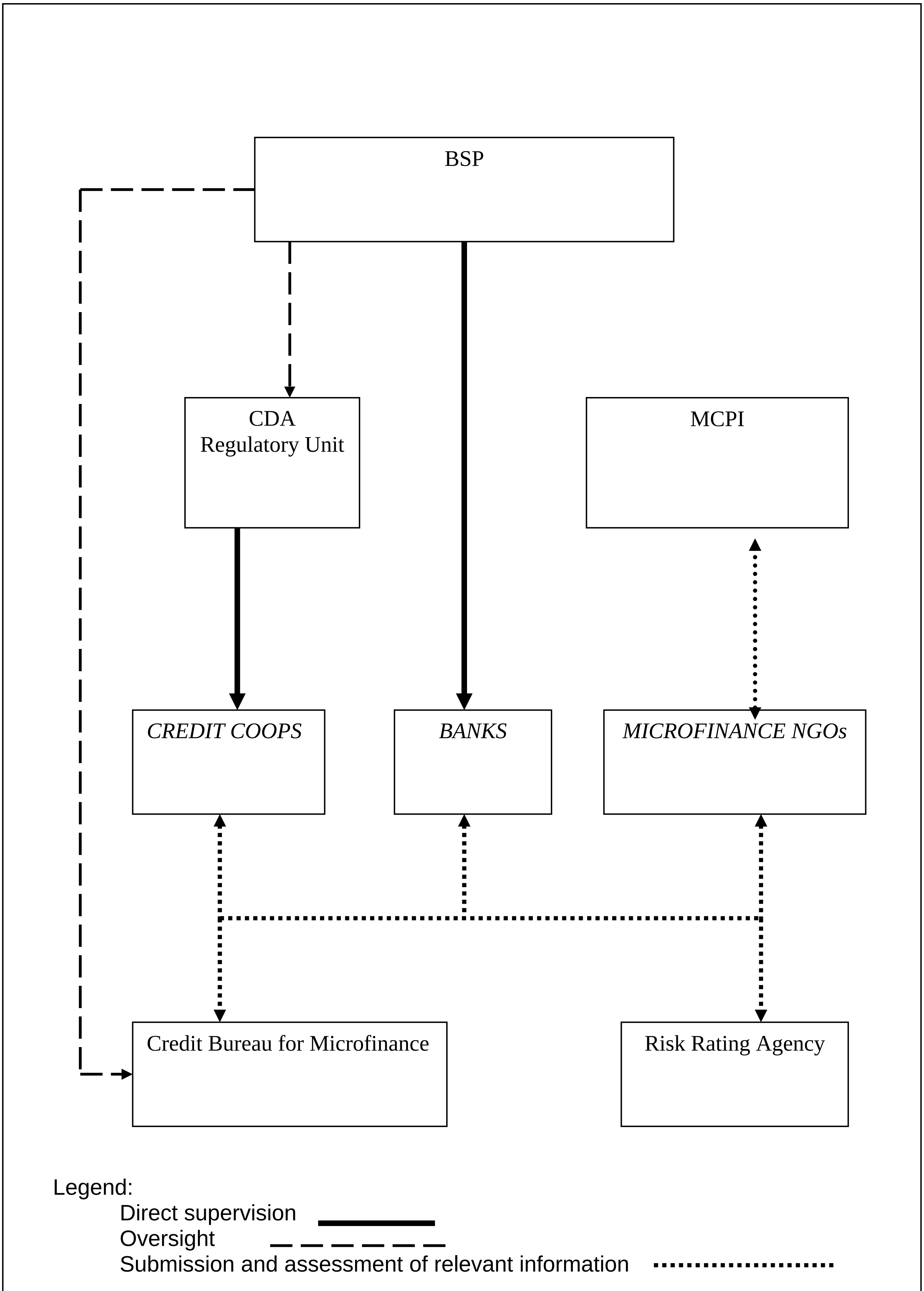
The Bangko Sentral ng Pilipinas as well as the National Credit Council have worked assiduously to advocate for the creation of a comprehensive credit information system in the country. For microfinance, this initiative hopes to increase the access to credit by micro, small and medium enterprises as well as answer problems of credit pollution and multiple borrowings. On a larger scale, the sharing and dissemination of information through such a credit information system will result in the following: 1) ability of lenders to more accurately identify good borrowers, 2) creation of better risk management, 3) increase in volume of lending, 4) extension of credit to underserved sectors such as micro, small and medium enterprises (MicSMEs), and 5) strengthening of credit discipline leading to the over all lowering of default rates. Over all, the information exchange will lead to a sound, healthy and vibrant credit market. The legislative bodies, however, have yet to approve and enact the law for the establishment of the credit bureau.

IV. Final Remarks

The experience of the country in rural finance for the past two decades has shown that market-oriented credit and financial policies form the basic infrastructure for efficient financial markets. It would definitely be a mistake to go back to the directed credit program approach that has proven to be totally ineffective and very costly. Well-functioning rural financial markets enhance the production and consumption possibilities of farm and non-farm households. As pointed out in many research studies, efficient financial intermediation means transferring deposits from surplus units (i.e. savers) with inferior investment opportunities to deficit units (borrowers) with high-yielding instruments. The net result is efficient resource allocation, an increase in the yield to capital and higher output growth (Llanto, 2004). On the other hand, weak rural financial markets discourage rural growth and distort income distribution.

However, the challenge to policymakers lies in utilizing efficient rural financial policies as a potent development tool and in having a strong political will to implement these policies. It will also be useful for policymakers to learn from the best practices of successful rural lenders who have found a way to deal with the factors that constraint the provision of financial services in the rural areas. Some of the best practices utilize informal lending techniques, group guarantees, collateral substitutes and microinsurance to address the problems of imperfect information, high transaction cost and the risks inherent to an agriculture setting. While promoting a market-approach to rural lending via the AMCFP, the ACPC, for instance, continuously experiments on innovative schemes that can encourage banks to lend to agriculture and to improve the creditworthiness of small farmers. The ACPC also believes in building the capacity of grassroot-based institutions as a way of reaching out to more small farmers and other smallholder-borrowers.

Figure 2. Proposed Institutional Set-up for the Regulation of Microfinance



Source: NCC

Annex 1

Subsec. X151.2 of BSP Circular 505, Series of 2005: Prerequisites for the grant of authority to establish a branch/banking office. With prior approval of the monetary board, banks may establish branches subject to the following pre-qualification requirements:

1. Compliance with the minimum capital required or as may be required under existing regulations, which at present are as follows:

Bank Category	**Minimum Capital (In Millions)**
Expanded Commercial Banks	₱ 4,950
Non-expanded Commercial Banks	₱ 2,400
Thrift Banks: With Head Office within Metro Manila With Head Office outside Metro Manila	 ₱ 325 ₱ 52
Rural Banks: Within Metro Manila Cities of Cebu and Davao 1st/2nd/3rd class cities and 1st class municipalities 4th/5th/6th class cities and 2nd/3rd/4th classmunicipalities 5th and 6th class municipalities	 ₱ 26 ₱ 13 ₱ 6.5 ₱ 3.9 ₱ 2.6

2. The bank's risk-based capital adequacy ratio at the time of filing the application is not lower than twelve percent (12%);

3. The bank's camels composite rating in the latest examination is at least "3", with Management component score not lower than "3";

4. The bank has established a risk management system appropriate to its operations, characterized by clear delineation of responsibility for risk management, adequate risk measurement system, appropriately structured risk limits, effective internal control system and complete, timely and efficient risk reporting system;

5. No major supervisory concerns outstanding on safety and soundness, i.e., the bank has complied, during the period immediately preceding the date of application with the following regulatory checkpoints:

a) No unbooked valuation reserves	as of date of application
b) Regular and liquidity reserve requirements on depositsand deposit substitutes	12 weeks
c) Asset and liquidity cover for EFCDU/FCDU liabilities	3 months
d) Ceilings on loans to DOSRI	3 months
e) Liquidity floor on government deposits	3 months
f) Loans-to-deposits ratio	2 quarters
g) Past due loans ratio does not exceed twenty percent (20%) of total loan portfolio	as of date of application
h) No outstanding violation on single borrower's loan limit and limit on total investment in real estate and improvements including bank equipment	as of date of application
i) No past due obligation with the BSP or with any financial institution	as of date of application
j) No float items outstanding in the"Due From/To Head Office/Branches/ Offices" and "Due from BSP" accounts exceeding 1% of the total resources as of end of preceding month	3 months
k) Mandatory allocation of credit resources to small and medium enterprises	2 quarters
l) Mandatory allocation ofloanable funds for agrarian reform and agricultural credit in general	2 quarters
m)Real estate loans ratio does not exceed twenty percent (20%) of total loanportfolio (for EKBs/KBs only)	as of date of application
n) No findings of unsafe and unsound banking practices	6 months
o) Accounting records, systems, procedures and internal control are adequate	as of date of application
p)The applicant bank has generally complied with banking laws, rules and regulations, orders or instructions of the Monetary Board and/or BSP Management	as of date of application
q)Member in good standing of the Philippine Deposit Insurance Corporation	as of date of application

6. For purposes of evaluating branch applications, theoretical capital shall be assigned to each branch to be established, including approved but unopened branches/offices, as follows (in millions):

LOCATION/TYPE OF Bank	UB/KB	TB/ NATIONAL COOP	RB/LOCAL COOP
1) National Capital Region and the Cities of Cebu and Davao	₱ 50	₱ 15	₱ 5
2) 1st to 3rd class cities	₱ 25	₱ 5	₱ 2.5
3) 4th to 6th class cities	₱ 25	₱ 5	₱ 1.5
4) 1st to 3rd class municipalities	₱ 20	₱ 5	₱ 1.0
5) 4th to 6th class municipalities	₱ 15	₱ 2.5	₱ 0.5

The assigned theoretical capital shall be deducted from existing qualifying capital as defined under Subsec. X116.1 for purposes of determining compliance with the ten percent (10%) risk-based capital adequacy ratio.

If the applicant bank's risk-based capital adequacy ratio after deducting the assigned capital for the proposed branch from the existing qualifying capital would be less than ten percent (10%), its application shall not be processed unless it infused such amount as may be necessary to maintain its risk-based capital adequacy ratio to at least ten percent (10%).

7. The bank has been operating profitably for the year immediately preceding the date of application, or in the case of newly-established banks, the submitted projection showed that profitability will be attained on the third year of operations, at the latest;

8. Additional requirements for the establishment of branches of microfinance-oriented banks and/or microfinance-oriented branches of regular banks:

   a) Manual of operations on microfinancing duly approved by the board of directors (for microfinance-oriented branches of regular banks only);

   b) The branch shall have an adequate loan tracking system that allows daily monitoring of loan releases, collections and arrearages, and any restructuring and refinancing arrangements;

   c) The proposed branch shall be managed by a person with adequate experience or training in microfinancing activities; and

   d) At least seventy percent (70%) of the deposits generated by the branch to be established shall be actually lent out to qualified microfinance borrowers and the microfinance loans of said branch shall at all times be at least fifty percent (50%) of its gross loan portfolio (for microfinance-oriented branches of regular banks only).

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Jocelyn Alma R. Badiola has more than 20 years of experience in rural development work with special focus on microfinance/agricultural credit, rural savings mobilization and institution-building. She has done policy research and advocacy work on microfinance and rural finance including monitoring and evaluation of specific programs and projects, conceptualization and administration of farm/household surveys, analysis of policy issues and credit program packaging. She has also done consultancy work for international institutions like the International Fund for Agricultural Development (IFAD), United Nations Development Program (UNDP), the World Bank, the United States Agency for International Development (USAID), the European Union, Japan Bank for International Cooperation (JBIC), Asian Productivity Organization (APO), the Asia Pacific Rural and Agricultural Credit Association (APRACA), CODESPA of Spain and non-government organizations in the Philippines. She has likewise been invited as resource speaker on various rural development issues in the Philippines and in other countries as well. She is blissfully married and mother to a happy 14-year old son.