SECTOR ASSESSMENT (SUMMARY): FINANCE

Sector Road Map

1. Sector Performance, Problems, and Opportunities

1. The Philippines was the first country in the Asia and Pacific region to integrate microfinance into the banking system and is recognized worldwide as a leader in the development of microfinance.[1] Starting with only a few large microfinance nongovernment organizations (MNGOs) in the late 1990s, the industry has grown to 1,400 operating microfinance finance institutions, including MNGOs, rural banks, thrift banks, and cooperatives serving about 7 million active clients. As of the third quarter of 2017, the banking sector alone had 168 operating microfinance banks serving 1.83 million clients with outstanding loans amounting to $279 million.[2] The growth of the Philippine microfinance industry is largely attributed to the government's adoption of a market-based policy environment espoused in the National Strategy for Microfinance[3] and supported by legislative and executive issuances.[4]

2. **Financial inclusion is still low.** Despite the advances and accomplishments in the microfinance sector, financial outreach in the Philippines remains low. As of 2017, (i) the proportion of adults holding an account was 34%;[5] (ii) there was a higher share of female adults (39%) with an account compared to male adults (30%); (iii) disproportionally, the lower income population was financially excluded, as only 18% of adults in the bottom 40% income group had an account at a formal financial institution (unchanged from 2014); and (iv) 31% of women still did not have a bank account in a formal financial institution despite gender gaps favoring women in some indicators on access to finance.[6]

3. **Usage of financial services is limited and sparse, particularly in the agriculture sector.** The 2017 Financial Inclusion Survey released by the Central Bank of the Philippines (BSP) reported that of the 48% of adults who had savings, only 18.8% saved in a financial institution, and of the 22.3% who had outstanding loans, only 14% borrowed from a formal financial institution.[7] While 90% of small enterprises have checking or savings accounts, the 2015 World Bank Enterprise Survey reported only 23% had loans or lines of credit with a bank.[8] Similarly, the 2014 Small Farm Indebtedness Survey conducted by the government's Agricultural Credit Policy Council reported that only 15% of small farmers borrowed from banks.[9]

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[1] The General Banking Law of 2000 recognized microfinance services and directed the Monetary Board to formulate rules and regulations that recognize the peculiar characteristics of microfinance (i.e. cash-flow based lending without collateral). Economic Intelligence Unit. 2016. *Global Microscope 2016: The Enabling Environment for Financial Inclusion.* London.

[2] Bangko Sentral ng Pilipinas (BSP). 2017. *Financial Inclusion in the Philippines: Dashboard as of Third Quarter 2017.* Manila.

[3] Department of Finance-National Credit Council (DOF-NCC). 1997. *National Strategy for Microfinance.* Manila

[4] The Agriculture and Fisheries Modernization Act and the Social Reform and Poverty Alleviation Act, both enacted in 1997, and Executive Order No. 138 issued in 1999.

[5] Defined as the percentage of people who have an account, on their own or with someone else, at a bank or another type of financial institution, or who have personally used a mobile money service in the past 12 months.

[6] World Bank. *The Global Findex Database 2017: Measuring Financial Inclusion and the Fintech Revolution*. Washington, DC.

[7] Bangko Sentral ng Pilipinas (BSP). 2017. 2017 *Financial Inclusion Survey.* Manila.

[8] The World Bank. http://www.enterprisesurveys.org (accessed 28 June 2018).

[9] The Small Farm Indebtedness Survey is conducted every 2 or 3 years by the Agricultural Credit Policy Council to track borrowing of small farmers and fishers and their access to formal credit. Agricultural Credit and Policy Council (ACPC). 2014, *Small Farm Indebtedness Survey.* Manila.

Among small farmers, 40% borrowed from informal sources (e.g., family, friends, relatives, and traders) and about 45% borrowed from nonbank financial institutions (e.g., cooperatives, nongovernment organizations, farmers' associations, and lending investors).[10] Despite BSP's issuance of the Agriculture Value Chain Financing Framework in 2016, compliance rate of banks was still low (1% of the required 10% for the agrarian loan requirement, and 13% of the required 15% for the agriculture loan requirement).[11] While gender gaps favor women in some indicators on access to finance, as of 2014, 62% of women still lacked a bank account at a formal institution.[12]

4. **Limited scale and outreach of financial service providers.** MNGOs serve the most excluded population, including poor women, and have significant scope to expand their outreach and the range of services they provide. As of December 2017, 28 MNGOs reached 4 million active borrowers.[13] Meanwhile, 164 banks with microfinance operations had extended loans to 1.8 million borrowers. Both type of entities (banks and MNGOs) have great potential to increase efficiency and outreach, particularly within their target markets, which consist of micro, small, and medium-sized enterprises (MSMEs) in rural areas and agriculture-based enterprises. In the meantime, very few, if any, financial institutions are providing Islamic financial services. This represents a significant barrier to inclusion for a large segment of the population, particularly in the Autonomous Region in Muslim Mindanao.

5. **Lack of alternative credit enhancement measures.** The Credit Information Corporation (CIC), which is mandated to collect credit information, actively collects data but is not yet fully operational. Similarly, the lack of a movable collateral registry restricts credit decision-making of financial institutions and limits access to only those that have land as collateral.[14] This constrains financial institutions to provide credit particularly for micro and small loans—hence excluding this segment from formal credit. Financing those that are currently deemed excluded (e.g. MSMEs, agriculture enterprises, small farmers, and the low-income segment of the population) is considered too costly or impossible without enhancements that compensate for credit risks. The available guarantee mechanisms (e.g. the industry guarantee loan fund and agriculture guarantee program) are perceived by financial service providers as costly and not sufficient to entice them to lend to those currently excluded.

6. **Risk protection for low-income and agriculture sector is still inadequate.** Acknowledging the low-income sector's need for protection from unforeseen and unfortunate events, the Department of Finance's National Credit Council (DOF-NCC), in coordination with the Insurance Commission (IC) and the insurance industry, formulated the National Strategy and the Regulatory Framework for Microinsurance in 2010. In accordance with the strategy and the regulatory framework, the IC issued additional regulations in 2016 that allowed insurance providers to use innovative delivery channels and guidelines for the design of new microinsurance products (such as micro agriculture, micro health and micro pension). In 2008,

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[10] The relatively higher proportion of borrowers from nonbank financial institutions is attributed in part to the successful operations of microfinance institutions that are mostly grassroots based (e.g., MNGOs and cooperatives). These institutions make microcredit and other financial services more accessible to micro and small entrepreneurs in rural areas.

[11] Total loanable funds to be made available by banks for agriculture and agrarian reform credit.

[12] World Bank. *The Global Findex Database 2017: Measuring Financial Inclusion and the Fintech Revolution*. Washington, DC.

[13] Data provided by the Microfinance NGO Regulatory Council (MNRC), Securities and Exchange Commission.

[14] A bill on secured transactions has been filed in Congress and is pending approval.

there were only a few insurance companies and six mutual benefit associations (MBAs)[15] covering about 3.1 million individuals. Since then, the number of microinsurance providers has increased by tenfold. As of September 2017, 171 insurers (comprising 4 composite insurance providers, 27 life insurance providers, 60 non-life insurance providers, 35 MBAs, 16 pre-need companies,[16] 28 health maintenance organizations, and 1 reinsurer) served 32 million Filipinos with a total of 188 IC-approved microinsurance products.[17] Nevertheless, agriculture and disaster risk insurance products are still grossly inadequate in terms of type of coverage and number of people and/or entities covered. The Philippine Crop Insurance Corporation reported that in 2017, only 1.7 million small farmers and fisherfolks were covered by agriculture insurance.[18] Additionally, only one private insurance company has an ongoing pilot activity to provide agriculture insurance.

7. **The use of digital financial services to enhance financial inclusion should be maximized.** The use of digital technologies minimizes the cost of servicing low-value accounts and extends banking infrastructure to the unserved and underserved market. Recognizing this, the BSP issued regulations on the following starting 2009: (i) use of electronic money; (ii) operations of e-money issuers; and (iii) guidelines on risk management for information technology.[19] Also, to extend the reach of traditional branches, the BSP allowed banks to use third-party cash agents as a cost-efficient service delivery channel (e.g. to collect deposits, disperse cash, and provide other financial services). Despite these initiatives, there were only 11.4 million registered e-money accounts and about 26.1 million prepaid cards linked to e-money issued as of the fourth quarter of 2017—about 7 million of which are considered active. The benefits of digital financial services to enhance financial inclusion have been hampered by the lack of a single national identification system and an integrated national database.

8. **Interoperability issues restrain the development of e-commerce*.*** Payment networks are still fragmented across different types of entities (e.g. commercial banks, rural banks, MNGOs, and mobile network operators). It is only recently that e-money agents and ATMs were permitted to be shared between banks, nonbank financial institutions, and electronic money issuers.[20] The result is that customers are confronted with higher costs and fewer options for payments and transfers compelling them to rely on cash-based transactions. This has constrained financial inclusion, particularly for those in remote areas.

9. **Financial literacy programs need enhancements*.*** Literacy and education are key parts of effective financial inclusion. Considering the socioeconomic diversity in the Philippines, financial education and consumer protection programs should target and cater to the diverse constituents (including women, farmers, fishers, youths, and MSMEs) and be responsive to their

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[15] A Mututal Benefit Association (MBA) is any society, association or corporation formed or organized mainly for paying sick benefits, providing financial support to members while out of employment, or paying relatives of deceased members a fixed or any sum of money.

[16] A pre-need company offers financial program with easy payment terms that offers planholders affordable means to prepare for certain future needs such as education of children, retirement or burial and funeral expenses.

[17] Asian Development Bank (ADB). 2017. *Assessment of Microinsurance as Emerging Microfinance for the Poor: The Case of the Philippines*. Manila.

[18] Cajucom, Norman. *PCIC: Current Status, Issues and Challenges in Agriculture Insurance. Presentation during the Roundtable Discussion on Agriculture Insurance held at the Insurance Commission on April 30, 2107.*

[19] These include the following BSP circulars: Circular No. 808 (Guidelines on Information Technology Risk Management for All Banks and other BSP Supervised Institutions); Circular No. 944 (Guidelines for Virtual Currency Exchanges); and Circular No. 949 (Guidelines on Social Media Risk Management).

[20] Oliver Wyman and MicroSave. 2017. *Accelerating Financial Inclusion in South-East Asia with Digital Finance*. Manila: ADB.

differentiated needs for financial services, including digital financial services. To date, several institutions have engaged in delivering various types of financial literacy programs. To ensure that relevant financial literacy needs are addressed and to avoid duplication and overlaps, a stocktaking of financial literacy programs is necessary to inform and be used as basis for forging strategic partnerships among providers.

2. Government's Sector Strategy

10. On 1 July 2015, the Government launched the National Strategy for Financial Inclusion (NSFI) which provides the framework for government and the private sector to work together toward a financial system that is accessible and responsive to the needs of the entire population, particularly those that are traditionally unserved or underserved. [21] Within the NSFI, the national retail payment system will be modernized to scale-up access to finance by linking effective e-payment systems to bank accounts. A national strategic plan for financial education will be developed. To reach the underserved, the MNRC was established to formulate performance standards (financial, social, and governance) as part of an accreditation system for MNGOs. The proposed law to create a nationwide movable collateral registry, and the planned consolidation of existing guarantee funds under the Philippine Export-Import Agency will provide MSMEs with a means to access financing with alternative forms of collateral. BSP is also developing an enabling regulatory framework for Islamic financial services.

3. ADB Sector Experience and Assistance Program

11. Over the last two decades, the Asian Development Bank (ADB) has continuously supported the government's efforts to develop a vibrant microfinance sector. The Rural Microenterprise Finance Project in the Philippines (Loan 1435-PHI) which was implemented from 1996 to 2002 provided on-lending support to the wholesale lending operations of the People's Credit and Finance Corporation.[22] The Microfinance Development Program (Loan 2199-PHI) which was implemented from 2005 to 2007 improved the regulatory environment, strengthened regulatory and operational capacity, and implemented the national microfinance literacy program. The Developing Financial Cooperatives Project helped improve the regulatory environment for cooperatives engaged in credit and savings operations.[23] The Developing Microinsurance Project.[24] and the Capacity Building for Microinsurance Project catalyzed the growth of the microinsurance industry through the establishment of an appropriate policy and regulatory environment.[25] The Encouraging Investment through Capital Market Reforms Program was approved by the ADB Board in 2015 and subprogram 2 which was approved in 2017 helped pave the way for the shift in ADB's focus to financial inclusion.[26]

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[21] Bangko Sentral ng Pilipinas (BSP). 2015. *National Strategy for Financial Inclusion (NSFI).* Manila.

[22] The People's Credit and Finance Corporation (PCFC) was a government finance company affiliated to the Land Bank of the Philippines (LBP). More recently, PCFC was closed and its operations folded into operations of the LBP in 2016. The LBP now provides wholesale microfinance funds to microfinance providers.

[23] ADB. 2006. *Grant Assistance Report: Proposed Grant Assistance to the Philippines for the Developing Financial Cooperatives Project*. Manila.

[24] ADB.2008. *Grant Assistance Report: Proposed Grant Assistance to the Philippines for the Developing Microinsurance Project*. Manila

[25] ADB.2012. *Grant Assistance Report: Proposed Grant Assistance to the Republic of the Philippines for Capacity Building for the Microinsurance Project*. Manila.

[26] ADB. 2015. *Report and Recommendation of the President to the Board of Directors: Proposed Loan and Technical Assistance Grant to the Republic of the Philippines for the Encouraging Investment through Capital Market Reforms Program*. Manila

Problem Tree for Finance

Elevated poverty, high level of income inequality, and uneven economic development

Low level of financial inclusion

Structural impediments limit access to finance, especially for the rural poor.

Adequate identification to open an account is lacking for the most vulnerable segment of the population.

- No enabling law exists to implement a national identification system.
- Insufficient resources are allocated for development and implementation.

The regulatory environment provides limited support for financial services in low-income areas, especially in agriculture.

- Enabling environment provides limited support to agriculture value chain finance.
- Insurance providers have not been encouraged to offer crop insurance.

A unified financial consumer protection framework is lacking.

- Financial literacy programs are not tailored to and do not meet the specific needs of different groups (e.g., women, farmers, fishers, MSMEs).

The financial infrastructure is fragmented and does not provide an enabling environment.

The payment system is costly and discourages participation.

- The retail payment system is fragmented and discourages electronic banking.
- Cost discourages MSMEs from using e-commerce.

Credit enhancement mechanisms are underdeveloped and inefficient.

- A functioning credit registry is missing.
- It is not possible to pledge movable collateral to secure loans.
- Credit guarantee mechanisms are fragmented and underused.

Financial institutions and service providers exhibit limited capacity to expand outreach and increase access to finance.

Technical capacity is low and financial service providers are unable to tap emerging technologies.

- Financial service providers in low-income areas have not adopted minimum standards for performance and governance.
- Financial service providers are slow to embrace emerging technologies that can improve service quality and reduce costs.

The regulatory framework does not provide an enabling environment for all types of financial services.

- A lack of enabling legislation has stunted the growth of Islamic finance, thereby excluding large numbers of the population in the Autonomous Region of Muslim Mindanao.

MSMEs = micro, small, and medium-sized enterprises.
Source: Asian Development Bank.