



## Concept Paper

---

Project Number: 51309-001  
February 2018

# Proposed Programmatic Approach and Policy- Based Loan for Subprogram 1 Republic of the Philippines: Inclusive Finance Development Program

This document is being disclosed to the public in accordance with ADB's Public Communications Policy 2011.

Asian Development Bank

## CURRENCY EQUIVALENTS

(as of 6 February 2018)

Currency unit	–	peso (₱)
₱1.00	=	\$0.0194
\$1.00	=	₱51.6350

## ABBREVIATIONS

ADB	–	Asian Development Bank
BSP	–	Bangko Sentral ng Pilipinas (central bank of the Philippines)
MSMEs	–	micro, small, and medium-sized enterprises
NGO	–	nongovernment organization
NIS	–	national identification system
NRPS	–	national retail payment system
NSFI	–	National Strategy for Financial Inclusion
TA	–	technical assistance

## NOTE

In this report, "\$" refers to United States dollars.

<b>Vice-President</b>	Stephen Groff, Operations 2
<b>Director General</b>	Ramesh Subramaniam, Southeast Asia Department (SERD)
<b>Director</b>	Kelly Bird, Director, Philippines Country Office, SERD
<b>Team leaders</b>	Kelly Hattel, Financial Sector Specialist, SERD
<b>Team members</b>	Stephen Schuster, Principal Financial Sector Specialist, SERD
	Joven Balbosa, Principal Country Specialist, Philippines Country Office, SERD
	Arup Chatterjee, Principal Financial Sector Specialist, Sustainable Development and Climate Change Department (SDCC)
	Jenamae Dajay-Java, Operations Assistant, SERD
	Poornima Jayawardana, Financial Sector Specialist, SERD
	Laurence Levaque, Social Development Specialist (Gender and Development), SERD
	Hanif Rahemtulla, Senior Public Management Specialist, SDSC
	Sabine Spohn, Senior Investment Specialist, Private Sector Operations Department
	Karen May Sanchez, Senior Project Assistant, SERD
<b>Peer reviewer</b>	Inmaculada Martinez, Senior Private Sector Development Specialist, Central and West Asia Department

In preparing any country program or strategy, financing any project, or by making any designation of or reference to a particular territory or geographic area in this document, the Asian Development Bank does not intend to make any judgments as to the legal or other status of any territory or area.

## CONTENTS

	<b>Page</b>
PROGRAM AT A GLANCE	
I. THE PROPOSAL	1
II. PROGRAM AND RATIONALE	1
A. Background and Development Constraints	1
B. Policy Reform and ADB's Value Addition	2
C. Impacts of the Reform	4
D. Development Financing Needs and Budget Support	4
E. Implementation Arrangements	4
III. DUE DILIGENCE REQUIRED	5
IV. PROCESSING PLAN	5
A. Risk Categorization	5
B. Resource Requirements	5
C. Processing Schedule	5
V. KEY ISSUES	5
APPENDIXES	
1. Design and Monitoring Framework	6
2. Problem Tree	8
3. List of Linked Documents	9

## PROGRAM AT A GLANCE

<b>1. Basic Data</b>		<b>Project Number: 51309-001</b>	
<b>Project Name</b>	Inclusive Finance Development Program (Subprogram 1)	<b>Department/Division</b>	SERD/SEPF
<b>Country Borrower</b>	Philippines Philippines	<b>Executing Agency</b>	Department of Finance
<b>2. Sector</b>	<b>Subsector(s)</b>	<b>ADB Financing (\$ million)</b>	
✓ <b>Finance</b>	Inclusive finance		300.00
		<b>Total</b>	<b>300.00</b>
<b>3. Strategic Agenda</b>	<b>Subcomponents</b>	<b>Climate Change Information</b>	
Inclusive economic growth (IEG)	Pillar 2: Access to economic opportunities, including jobs, made more inclusive	Climate Change impact on the Project	Low
Environmentally sustainable growth (ESG)	Disaster risk management		
Regional integration (RCI)	Pillar 3: Money and finance		
<b>4. Drivers of Change</b>	<b>Components</b>	<b>Gender Equity and Mainstreaming</b>	
Governance and capacity development (GCD)	Civil society participation	Some gender elements (SGE)	✓
Knowledge solutions (KNS)	Organizational development		
Partnerships (PAR)	Pilot-testing innovation and learning		
	Civil society organizations		
	Implementation		
	Private Sector		
Private sector development (PSD)	Conducive policy and institutional environment		
<b>5. Poverty and SDG Targeting</b>		<b>Location Impact</b>	
Geographic Targeting	No	Nation-wide	High
Household Targeting	Yes		
SDG Targeting	Yes		
SDG Goals	SDG10		
<b>6. Risk Categorization:</b>	Complex		
<b>7. Safeguard Categorization</b>	<b>Environment: C Involuntary Resettlement: C Indigenous Peoples: C</b>		
<b>8. Financing</b>			
<b>Modality and Sources</b>		<b>Amount (\$ million)</b>	
<b>ADB</b>		<b>300.00</b>	
Sovereign Programmatic Approach Policy-Based Lending (Regular Loan):		300.00	
Ordinary capital resources			
<b>Cofinancing</b>		<b>0.00</b>	
None		0.00	
<b>Counterpart</b>		<b>0.00</b>	
None		0.00	
<b>Total</b>		<b>300.00</b>	

## I. THE PROPOSAL

1. The Government of the Philippines recognizes that access to financial products and services is a key component of an inclusive economic growth agenda. But it also recognizes that despite having a strong, conducive regulatory environment for financial services, the Philippines still has a low level of financial inclusion.<sup>1</sup> The proposed Inclusive Finance Development Program will support government efforts to increase financial inclusion in the country. The program is consistent with the Philippine Development Plan 2017–2022, the government’s 10-point socioeconomic agenda, and the Asian Development Bank (ADB) country partnership strategy, 2011–2016 for the Philippines; and is included in ADB’s country operations business plan, 2018–2020 for the Philippines.<sup>2</sup>

2. The program will have two subprograms covered by a medium-term results framework. ADB chose the programmatic approach through a policy-based loan and potential technical assistance (TA) loan over other financing modalities because it supports government efforts to increase financial inclusion concurrently at the policy and the implementation levels.

## II. PROGRAM AND RATIONALE

### A. Background and Development Constraints

3. The Philippines is enjoying its longest economic expansion since the 1960s, with economic growth averaging 6.2% annually during 2011–2017. As a result, the poverty incidence dropped from 26.6% in 2006 to 21.6% in 2015 (latest official estimate). Despite strong growth, household income inequality in the Philippines remains among the highest in Southeast Asia and is rising. The latest estimated Gini coefficient for the Philippines was 0.44 in 2015, compared with 0.40 in Indonesia in 2015 and 0.38 in Thailand in 2013.<sup>3</sup> Empirical studies show underinvestment in infrastructure (road and rail access to markets, clean water, and sanitation) in poorer regions, low levels of educational attainment of adults in poorer households, high levels of local labor market informality, and financial exclusion to be the main contributors to the Philippines’ high income inequality.

4. Despite having an internationally recognized regulatory framework for inclusive finance, financial inclusion in the country remains low. Only 31% of adults held an account at a formal financial institution in 2014 (latest data available), compared with 36% in Indonesia, 78% in Thailand, and 81% in Malaysia. Only 12% of the adult population has borrowed from a formal financial institution, ranking the Philippines the lowest in the region. Lower-income households are disproportionately excluded, with only 18% of adults from the bottom 40% income quintiles holding an account at a formal financial institution. Additionally, the regional disparities in financial access are substantial. Bank offices are concentrated in highly populated regions, and nonbank financial institutions such as microfinance nongovernment organizations (NGOs) only partially cover excluded areas. Many individuals as well as micro, small, and medium-sized enterprises (MSMEs) have limited access to or are completely excluded from the full range of financial

---

<sup>1</sup> Financial inclusion is defined as effective access to a wide range of financial products and services by all.

<sup>2</sup> Government of the Philippines, National Economic and Development Authority. 2017. *Philippine Development Plan 2017–2022*. Manila; ADB. 2011. *Country Partnership Strategy: Philippines, 2011–2016*. Manila; and ADB. 2017. *Country Operations Business Plan: Philippines, 2018–2020*. Manila. ADB extended the country partnership strategy through the country operations business plan. The design and monitoring framework is in Appendix 1.

<sup>3</sup> One common measure of household income inequality is the Gini coefficient, with 0 denoting perfect equality and 1 denoting perfect inequality. Generally, a Gini coefficient above 0.36 indicates relatively high income inequality. ADB 2017. *Asian Development Outlook 2017. Transcending the Middle-Income Challenge*. Manila.

services, including savings, credit, remittances, payments, cash drawdowns, e-money conversions, and insurance. While women fared better in some indicators on access to finance, 62% of women still lacked a bank account at a formal institution in 2014.

5. **Development constraints.** The constraints to increased financial inclusion are primarily structural rather than regulatory. The first of three constraints relates to institutional and policy impediments to access to finance. These include the absence of an integrated national identification system (NIS) and a lack of diversity in financial products and services tailored to the poor and MSMEs. International experience shows that the establishment of an NIS with a foundational identification card can improve poor households' access to government benefits and services. It can also make it easier for poor households to open a bank account. The country does not have a sufficient variety of financial products and services that would help rural households and MSMEs generate income and mitigate financial risks.<sup>4</sup> Nor does it offer enough tailor-made financial literacy activities for poorer households and MSMEs that can increase the proper use of financial services. The second constraint is incomplete financial infrastructure. The payment system is fragmented and cannot support the efficient provision of electronic payments to reach the underserved. The limited content of the credit information system excludes small businesses such as those in the microfinance industry, and the absence of a movable collateral registry inhibits bank lending, especially to MSMEs. Credit guarantee mechanisms often fill this gap, but in the Philippines these mechanisms are fractured, inefficient, and undercapitalized. The third constraint is the limited scale and outreach of financial service providers. Microfinance NGOs, which serve the most excluded populations, including poor women, need to grow and professionalize. Rural banks, which are best placed to reach MSMEs and agricultural enterprises in rural areas, exhibit limited capacity. The lack of Islamic financial services, particularly in Mindanao, serves as a barrier to inclusion for a large segment of the population in that region.

## B. Policy Reform and ADB's Value Addition

6. On 1 July 2015, the government launched the National Strategy for Financial Inclusion (NSFI) to coordinate broad-based initiatives for greater financial inclusion.<sup>5</sup> Stakeholders include 13 government agencies, private sector institutions, and development partners. The Bangko Sentral ng Pilipinas (BSP) is the NSFI secretariat responsible for monitoring and coordinating NSFI implementation. NSFI initiatives cover digital finance, financial literacy, credit information systems, development of a movable collateral registry, diversification of financial products and services, and capacity strengthening of microfinance NGOs. The government institutionalized the NSFI by establishing a steering committee; requiring line agencies to develop medium-term work plans to achieve NSFI targets; and developing a monitoring and evaluation framework, including bank account data by gender, to track overall progress.

7. **Proposed policy reforms.** The program will support government efforts to increase financial inclusion by supporting high-impact, complex policy actions under the NSFI to: (i) strengthen the institutional and policy environment; (ii) strengthen the financial infrastructure; and (iii) increase the capacity and reach of service providers with a focus on nonbank financial institutions in rural areas. TA support with a budget of \$500,000 from ADB's Technical Assistance Special Fund (TASF-other sources) will be provided through a stand-alone RETA to support policy reforms proposed under subprogram 2 and the medium-term results framework. The TA will also support implementation of the possible TA loan for subprogram 2.

---

<sup>4</sup> The agriculture sector represents 9.7% of gross domestic product and yet has a high, unmet demand for more sophisticated agricultural and agricultural value chain finance and crop insurance.

<sup>5</sup> Government of the Philippines. 2015. *National Strategy for Financial Inclusion*. Manila.

8. **Institutional and policy environment for financial inclusion.** This reform area will support the government in implementing institutional reforms to improve the access of poorer households and MSMEs to finance through the development of an integrated NIS, financial products and services, distribution channels, and financial literacy. Under subprogram 1, the government submits draft legislation to Congress for the development of an NIS and an identification card that will, among others, increase the reach of the government's financial inclusion efforts and improve data availability. The government will commit financing for the NIS through the General Appropriations Act for 2018–2020, issue regulatory guidelines to support agricultural value chain finance, and revise the regulatory framework to enable better distribution of microinsurance. Finally, the government will conduct a financial literacy assessment with a gender perspective. Under subprogram 2, the government will begin NIS implementation and will provide a road map for the design and development of an identification card. The government will develop and implement an agricultural finance road map and will roll out new microinsurance schemes to increase coverage, especially for farmers. It will also implement tailored financial literacy programs.

9. **Infrastructure for financial inclusion.** This reform area will support government efforts to improve the national retail payment system (NRPS), launch a national credit registry, establish a collateral registry, and reform the credit guarantee schemes. Under subprogram 1, the BSP will upgrade the NRPS to provide more varied and safer means of payment. The BSP will establish two clearing houses to facilitate digital payments and will expand non-branch deposit and cash services to reach the rural poor. The Securities and Exchange Commission (SEC) will initiate integration of microfinance credit information with the credit information registry. To expand access to credit, legislation will be submitted to Congress to strengthen the national collateral registry, thereby allowing smaller borrowers to use a wider range of collateral. Further, the government will complete an action plan to rationalize and improve existing credit guarantee schemes by consolidating and strengthening their management and governance. Under subprogram 2, the BSP will continue enhancing the NRPS to support the expansion of digital payments, will issue additional financial technology licenses, and will increase the ability of banks to reach the underserved through agents and off-premise cash and deposit services. Coverage of the credit information registry will continue to increase. The Land Registration Authority will establish a collateral registry. Finally, the government will launch its plan to rationalize and improve existing credit guarantee schemes, including a capital injection if required.

10. **Capacity of financial service providers.** This reform area will implement actions to improve the capacity of microfinance NGOs and rural banks to scale up and expand their reach. Under subprogram 1, the SEC, as Chair, will establish a Microfinance NGO Regulatory Council and will adopt accreditation standards to strengthen the financial performance and governance practices of microfinance NGOs. The program will pilot test new technological innovations (cloud-based core banking solutions) to improve rural banks' operational efficiency and outreach. The government will submit legislation allowing banks to open Islamic financial service windows. Under subprogram 2, the council will accredit and monitor compliance of microfinance NGOs and provide training programs to help build their capacity for compliance. Support for technical innovation will continue with the mainstreaming of cloud-based core banking solutions in the banking industry. The BSP will develop prudential standards for Islamic financial services.

11. **ADB engagement and development partner coordination.** From 1996 to 2012, ADB supported government efforts to develop a vibrant microfinance industry. The Rural Microenterprise Finance Project laid the foundation for successful microfinance wholesale lending

operations and contributed to the growth of microfinance.<sup>6</sup> The Microfinance Development Program improved the microfinance regulatory environment, strengthened regulatory and operational capacity, and implemented the national microfinance literacy program.<sup>7</sup> These program were subsequently complemented by the Developing Financial Cooperatives Project, which improved the regulatory environment for credit and savings cooperatives.<sup>8</sup> The Developing Microinsurance Project helped government set up a suitable regulatory environment and launch the National Strategy for Microinsurance in 2010.<sup>9</sup> These ADB interventions and strong government commitment have created a vibrant microfinance industry and a conducive regulatory framework. Complementing this support, the Encouraging Investment through Capital Market Reforms Program approved by ADB in 2015 has supported reforms to deepen the capital market and expand institutional investors to increase access to long-term finance laying the market prerequisites for expanding financial inclusion to the poor.<sup>10</sup>

### **C. Impacts of the Reform**

12. The program's overall impact will be a resilient and inclusive finance sector. The program will include policy reforms and interventions to expand financial inclusion. The first reform area will lay the foundational reforms through the development of the NIS; diversification of financial products, services, and distribution channels; and complementary financial literacy (para. 8). The second reform area will increase the scale and a depth of financial services (para. 9). With its focus on microfinance NGOs, rural banks, and Islamic financial services, the third reform area will improve the quality, affordability, and reach of financial services (para. 10).

### **D. Development Financing Needs and Budget Support**

13. In 2017, the government's total gross borrowing requirement was about \$12.6 billion, a fifth of which was from foreign borrowing. Official development assistance in the form of program loans accounted for \$1.4 billion. Similar financing needs are expected in 2018. Subprograms 1 and 2 are envisaged as single-tranche policy-based loans. The government has requested a loan of \$300 million from ADB's ordinary capital resources to help finance subprogram 1, with an indicative \$300 million for subprogram 2. Subprogram 2 may include a \$10 million TA loan to help develop financial inclusion capacity.

### **E. Implementation Arrangements**

14. The Department of Finance will be the executing agency. The BSP, the Securities and Exchange Commission, and the Insurance Commission will be the primary implementing agencies. Implementation will be overseen by a steering committee chaired by the Department of

---

<sup>6</sup> ADB. 1996. *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 Rural Microenterprise Finance Project*. Manila.

<sup>7</sup> ADB. 2005. *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 Microfinance Development Program*. Manila.

<sup>8</sup> ADB. 2006. *Grant Assistance Report: Grant Assistance to the Philippines for the Developing Financial Cooperatives Project*. Manila.

<sup>9</sup> ADB. 2008. *Grant Assistance Report: Grant Assistance to the Republic of the Philippines for the Developing Microinsurance Project*. Manila.

<sup>10</sup> ADB. 2015. *Report and Recommendation of the President to the Board of Directors: Proposed Programmatic Approach and Policy-Based Loan for Subprogram 1 to the Republic of the Philippines for the Encouraging Investment through Capital Market Reforms Program*. Manila; and ADB. 2017. *Report and Recommendation of the President to the Board of Directors: Proposed Policy-Based Loan for Subprogram 2 and Technical Assistance Grant to the Republic of the Philippines for the Encouraging Investment through Capital Market Reforms Program*. Manila.



Finance, with the implementing agencies as members. The implementation periods are June 2016–June 2018 for subprogram 1 and July 2018–July 2020 for subprogram 2.

### III. DUE DILIGENCE REQUIRED

15. Public financial management and program impact assessments will support the sector assessment. A gender expert will conduct gender gap assessment during due diligence to support gender mainstreaming, especially for subprogram 2 and the medium-term results framework. Subprogram 1 is expected to be classified *category C* for all safeguard aspects.<sup>11</sup> The program design benefited from the explicit commitment of the government and incorporates knowledge gained from sustained ADB policy dialogue and ongoing TA implementation.

### IV. PROCESSING PLAN

#### A. Risk Categorization

16. The program is considered *complex* because of its loan size.

#### B. Resource Requirements

17. The estimated internal resource requirements are for a mission leader (18 months), a commission leader and principal finance sector specialist (9 months), a microinsurance expert (3 months), a MSME enterprise finance expert (2 months), a private sector expert (2 months), a principal country economist (3 months), a gender expert (3 months), a civil society expert (3 months), a legal counsel (3 months), national officers and analysts (6 months), and an operations assistant (6 months).

#### C. Processing Schedule

18. The proposed processing schedule is in the table.

<b>Milestones</b>	<b>Expected Completion Date</b>
Concept paper approval	February 2018
Loan fact-finding mission	March 2018
Management review meeting	April 2018
Loan negotiations	August 2018
Board consideration	October 2018
Loan signing	November 2018

Source: Asian Development Bank.

### V. KEY ISSUES

19. No key issues.

<sup>11</sup> Initial Poverty and Social Analysis (accessible from the list of linked documents in Appendix 3).

**DESIGN AND MONITORING FRAMEWORK**  
(Initial Draft)

<b>Country's Overarching Development Objectives</b>			
Resilient and inclusive finance sector achieved (Philippine Development Plan, 2017–2022) <sup>a</sup>			
<b>Results Chain</b>	<b>Performance Indicators with Targets and Baselines</b>	<b>Data Sources and Reporting Mechanisms</b>	<b>Risks</b>
<b>Effect of the Reform</b> Financial inclusion increased	By 2022 a. Individuals holding an account at a bank or another type of financial institution increased to 46% overall: men's share increased to 36%, women's to 57%, and youth's to 30% (2014 baseline: overall-31%, men-24%, women-38%, and youth-19%) <sup>b, c</sup>  b. Individuals at the bottom 40% of the population (age 15+) with an account at a formal financial institution increased to 27% (2014 baseline: 18%)	a-b Global Findex Survey	Macroeconomic instability and volatility affects the capacity of individuals to open bank accounts.  Confidence in the formal finance sector weakens.
<b>Reform Areas Under Subprogram 1</b> 1. Institutional and policy environment for financial inclusion  2. Infrastructure for financial inclusion	<b>Indicative Policy Actions</b> By 2018 (program loan) 1.1 Legislation establishing a single national identification system submitted to Congress (2016 baseline: not submitted)  1.2 Agricultural value chain lending framework issued (2016 baseline: not issued)  1.3 Financial literacy assessment with gender perspective conducted (2016 baseline: no comprehensive assessment)  By 2018 (program loan) 2.1 Upgrade to NRPS launched (2016 baseline: no strategy for NRPS upgrade)  2.2 National credit information registry officially launched with data collected disaggregated by sex (2016 baseline: no live national credit registry) <sup>d</sup>  2.3 Legislation establishing a national secured transactions registry submitted to Congress (2016 baseline: not submitted)	1.1 Legislative reports  1.2 BSP, Department of Agriculture, and Agricultural Credit Policy Council reports  1.3 BSP reports  2.1 BSP circular issued for NRPS upgrade  2.2 CIC press release  2.3 Draft legislation	Changes in political priorities prevent implementation of identified reform areas.

Results Chain	Performance Indicators with Targets and Baselines	Data Sources and Reporting Mechanisms	Risks
3. Capacity of financial service providers	<p>2.4 Action plan to consolidate government guarantee schemes under one governing body submitted to Congress (2016 baseline: not submitted)</p> <p>By 2018 (program loan)</p> <p>3.1 Microfinance NGO Regulatory Council established (2016 baseline: not applicable)</p> <p>3.2 Cloud-based banking system approved as part of a sandbox pilot<sup>e</sup> (2016 baseline: not applicable)</p> <p>3.3 Legislation expanding the availability of Islamic finance submitted to Congress (2016 baseline: not applicable)</p>	<p>2.4 Bureau of the Treasury reports</p> <p>3.1. SEC reports</p> <p>3.2-3.3 BSP reports</p>	
<p><b>Budget Support</b>            ADB            Subprogram 1: \$300 million (policy-based loan)            Subprogram 2: \$300 million (indicative)            \$10 million (possible TA loan)</p>			

BSP = Bangko Sentral ng Pilipinas, CIC = Credit Information Corporation, NGO = nongovernment organization, NRPS = national retail payment system, SEC = Securities and Exchange Commission, TA = technical assistance.

<sup>a</sup> Government of the Philippines, National Economic and Development Authority. 2017. *Philippine Development Plan, 2017–2022*. Manila.

<sup>b</sup> Number of people who have an account, on their own or with someone else, at a bank or another type of financial institution or personally using a mobile money service in the past 12 months.

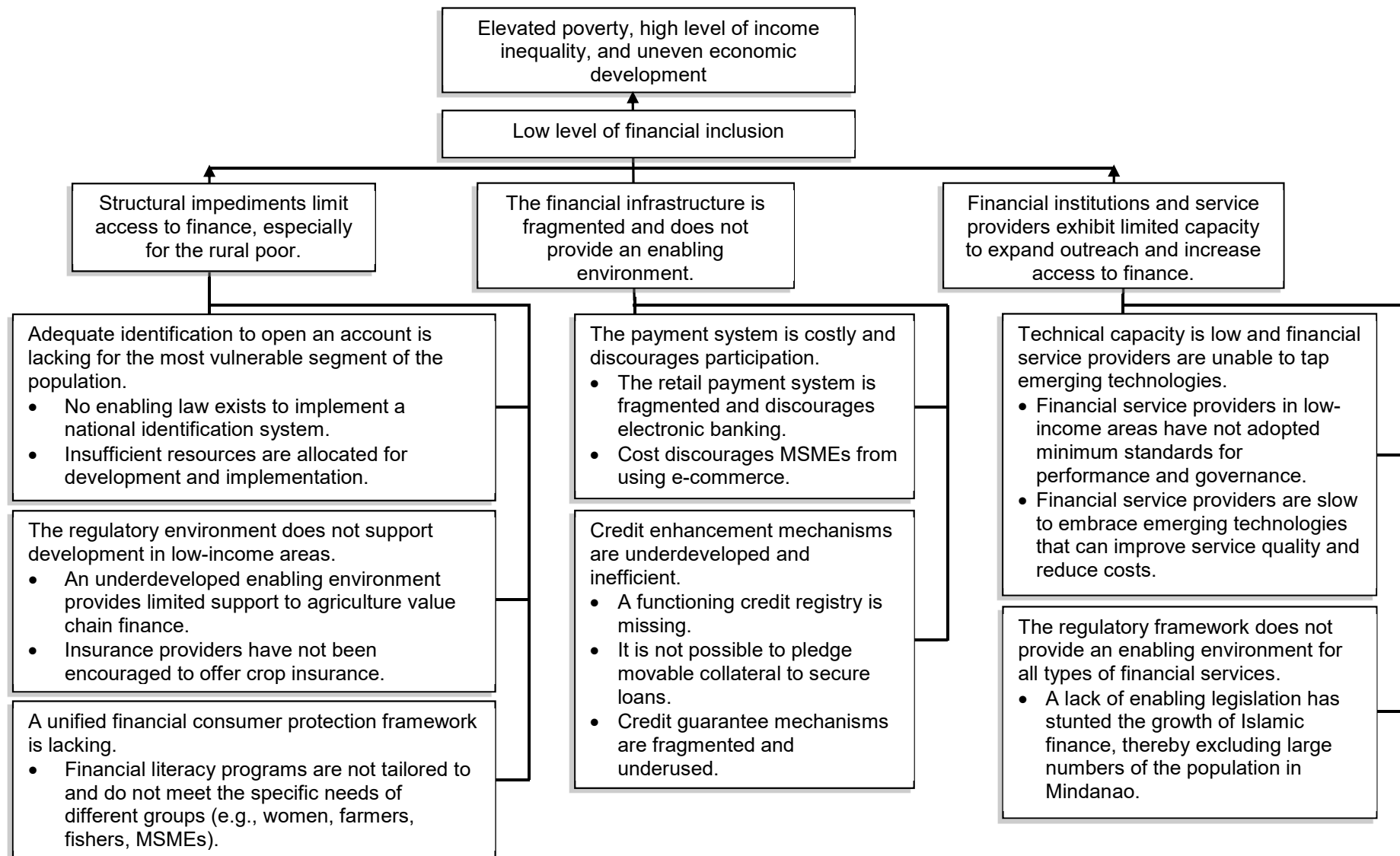
<sup>c</sup> Youth is defined as teenagers and young adults aged 15–24 years.

<sup>d</sup> In its beta test phase, the CIC previously provided CIC-compliant financial institutions access to its credit information registry.

<sup>e</sup> Cloud-based banking involves full migration from a hardware-based core banking system to cloud infrastructure. This frees the financial institution from the technological infrastructure limitations, reduces costs, and puts the financial institution in control of their portfolio and processes.

Source: Asian Development Bank.

### PROBLEM TREE



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

**LIST OF LINKED DOCUMENTS**

<http://www.adb.org/Documents/LinkedDocs/?id=51309-001-ConceptPaper>

1. Initial Poverty and Social Analysis

**Supplementary Document**

2. Sector Assessment (Summary): Inclusive Finance