Financial Inclusion in the Philippines

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Small loans can help the poor and low income people to start or expand their businesses and experience remarkable gains not only in income and consumption but also in health, education, and social empowerment.

What is Microcredit?

Hi folks! I am Juan, a small guy with a big heart for financial inclusion. I will be your guide as you flip through the pages of this publication. By the way, what can you say about the previous issues? I hope you've had an appreciation of microfinance and the role it plays in increasing access to financial services to the poor and low income households.

We will now have a series of product-focused publications following the broad topic of microfinance. This third publication talks about microcredit while succeeding issues will look at other microfinance products such as microdeposit and microinsurance. Sounds exciting, right?

Microcredit (also known as *microfinance loans*) are small loans granted to the poor and low-income households for their microenterprise and small businesses to enable them to raise their income levels and improve their living standards.

Microfinance is the provision of a wide range of financial services to the poor and low income people. Other microfinance products include loans, deposits, transfers or payments or microinsurance.

Traditionally, banks and commercial financial institutions are not inclined to extend loans to the poor and low-income population due to lack of information to their collateral and credit history. Microcredit opens the door to those who do not have access or are inadequately served by the formal financial sector.

Did you know that…

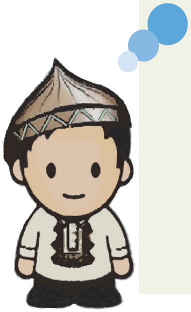
It is believed that microcredit has been around for centuries. However, the birth of 'modern' microcredit is said to have occurred in rural Bangladesh when Dr. Muhammad Yunus began the Grameen Bank in 1976. Since then, microcredit has rapidly gained widespread acceptance in many other countries.

Brief History of Microcredit in the Philippines

The microcredit approach aims to deliver financial services to the low-income, unserved population while addressing the challenges of an earlier generation of directed credit and guarantee programs. Instead, it emphasizes market-based approach on the delivery of microfinance services by the private sector in a viable and sustainable manner. The government's role is to provide an enabling policy and regulatory environment for the markets to function efficiently.

Period	Highlights
1970s to mid-1980s	• The government, through its directed credit programs (DCPs), provided highly subsidized credit to the rural poor. • These programs had limited success and were unsustainable. • Credit players did not reach intended markets, repayment was poor and was very costly for the government.
Late 1980s	• The Philippines was among the first group of countries to replicate Grameen banking on a large scale. • Legitimate non-government organizations (NGOs) implemented microfinance programs through the Grameen Bank Approach Replication Project.
1990s	• Government policies were reformed to encourage greater private sector participation in the delivery of credit. • The National Credit Council (NCC), crafted in 1997, the National Strategy for Microfinance, which reinforces the government's market-oriented credit policy.
2000s	• The BSP was mandated by the General Banking Law to recognize microfinance as a legitimate banking activity and to set the rules and regulations for its practice within the banking sector. • Other forms of microcredit such as housing microfinance loans, micro-agri loans and microfinance plus for growing microentrepreneurs, and other types of microfinance products such as microdeposit and microinsurance were developed.
At present	• Microfinance is fully mainstreamed in the banking sector. • A steady increase of providers, products, delivery channels and outreach is evidence of a growing and dynamic microfinance industry.

Unique Features of Microcredit



Most of us are familiar with "5-6" credit or loan sharks, which is popular among low-income sectors and areas where access to financial products and services is limited or lacking. Unfortunately, this leaves the poor more vulnerable to debt and poverty. Microcredit products offered by duly authorized financial service providers is a viable alternative and can protect the poor from unreasonably high interest rates and financial distress.

Microcredit technology and methodology:

- Cash-flow based
- Frequent amortization (i.e. daily, weekly, bi-monthly)
- Minimal requirements
- Typically unsecured

Individual lending focuses on one client and does not require other people to provide collateral or guarantee a loan.

Group lending, also known as solidarity lending, is a mechanism that allows a number of individuals to provide collateral or guarantee a loan through a group repayment pledge. Some group lending methodology base incentives to repay on peer pressure while others use a joint liability scheme.

Microcredit can now be accessed through the following financial institutions:

MICROFINANCE
NGO

Provides microcredit to microentrepreneurs using either individual or group lending methods; or a combination of both. Lending methodologies are tailor-fit to the characteristics of their clients. A key feature of NGOs is the social development dimension.

Community-based and open-type cooperatives provide credit only to their members. They grant loans as a service to members, who also own the cooperative by virtue of capital contributions, wherein a portion of the loan is retained as savings.

Banks with microfinance operations (mostly rural and thrift banks) offer a wide array of credit products such as agricultural, housing and microenterprise loans; usually with no collateral and simple requirements.

BSP Regulations on Microcredit

An enabling policy and regulatory environment is essential in promoting the development of microfinance in the country. The BSP has issued various circulars that provide incentives for banks to engage in microfinance as well as ensure that its practice is done in a viable, sustainable and prudential manner. The BSP is also continuously reviewing and amending its policies and regulations to ensure that they remain responsive to the growing needs of the microfinance sector.

Microenterprises and Small Businesses 82%

Micro-Agri Loan 6%

Housing Microfinance 3%

Microfinance Plus 1%

Others 9%

The Microfinance Loan Portfolio of the banking sector amounts to Php 8 billion as of 31 March 2013. Majority of the portfolio are loans to microenterprises and small businesses.

Key Provisions

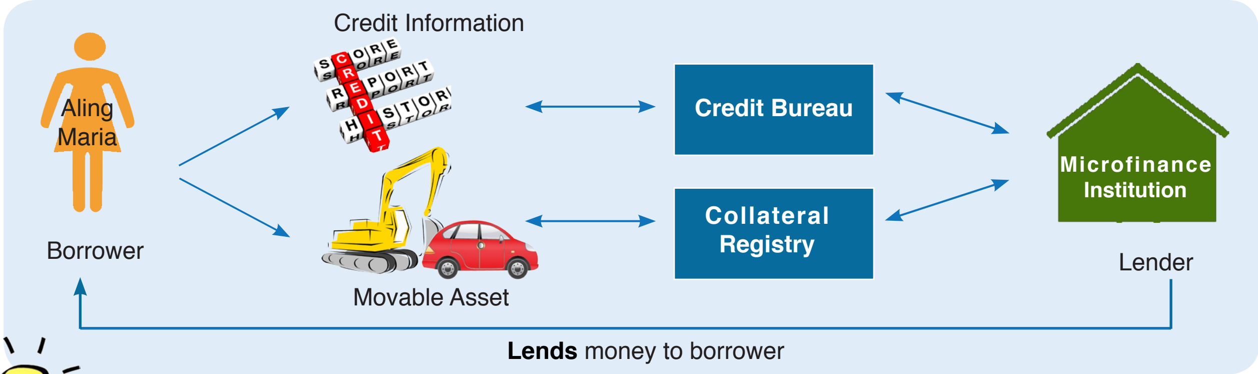
Microfinance Loan Regulations	**Circular 272** defines microfinance loans and recognizes cash-flow based lending as a distinct feature of microfinance. **Circular 364** reduces to 75% the risk weight applicable to loans to small and medium enterprises (SMEs) and microfinance loan portfolios that meet prudential standards. **Circular 409** provides the rules and regulations for determining the “Portfolio-at-Risk “(PAR) of microfinance loans and the required loan loss provision.
Rediscounting for Microfinance Loans	**Circular 282 and 324** opens a rediscounting facility for rural banks, cooperative banks and thrift banks engaged in microfinance.
Reporting Requirements for Microfinance Loans	**Circular 607** contains reportorial requirements of banks’ microfinance loans (Amended by *Memorandum No. M 2012-03* to include new microfinance loan products).
Documentary Requirements for Microfinance Loan Clients	**Circular 746** exempts microfinance from the required submission of additional documents (income tax return, financial statement) for the granting of loans.
Types of microfinance loans	**Circular 678** provides rules and regulations that govern the approval of banks’ housing microfinance products. **Circular 680 and 748** provide rules and regulations on the approval of banks’ micro-agri loans. **Circular 744** defines microenterprise loan plus or “microfinance plus.”

Financial Infrastructure

For microcredit to reach its full potential, in particular, it is essential to develop and strengthen credit bureaus and movable collateral registries.

A **credit bureau** helps financial institutions in their lending decisions. The credit information shared in the credit bureau can be used in assessing a borrower's credit worthiness or ability to pay loans.

In granting loans, financial institutions often prefer *real property* (land and real estate) over *movable property* (inventory, vehicle, machinery and equipment) as collateral. Most microentrepreneurs, however, do not have real property to offer as collateral. A **movable collateral registry** will facilitate acceptance of movable assets as collateral for loans of microentrepreneurs.



Did you know that…

In 2008, the **Credit Information System Act** (R.A. 9510) mandated the creation of the Credit Information Corporation (CIC), which receives and consolidates basic data on the credit history and financial condition of borrowers. This establishes an efficient credit information system that enables financial institutions to reduce their credit risks. The CIC is preparing to commence operations.

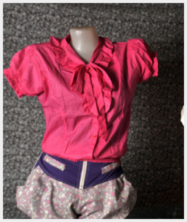
In 2012, a private credit bureau dedicated for microfinance borrowers was formed. The **Microfinance Data Sharing System (**MiDAS) is a pilot credit bureau that allows participating MFIs to submit reports, send inquiries and retrieve information on borrower information. This credit bureau operates on the reciprocity of information wherein only those contributing MFIs can use the platform.

The **Chattel Mortgage Law** covers security interest over tangible personal property called chattels, wherein legal title to the chattel is transferred to the lender on the condition that it will be transferred back to the borrower on repayment of the debt.

Success Story: The Power of Microcredit

From a two-piglet piggery to a million peso livestock enterprise… From less than a hundred to thousands of boxes of buko pie a day… From small seller of homemade peanut butter to supplier of large supermarket chains… From peddlers of *banig* mats to exporters of quality bags and handicrafts…

These are among the numerous life stories in which microentrepreneurs prove that success may come even from modest beginnings and humble undertakings.



With an initial loan of Php 5,000 from a microfinance institution, Corazon was able to purchase fabric that can be sewn into 100 short pants. Through determination and hard work, she was able to expand her business to include corporate wear. Today, her RTW fashion line and garments can be bought in 15 shopping malls in Metro Manila.

Stories and photos are lifted from the Citi Microentrepreneur of the Year Awards (CMA) coffee table book "Small Steps to Success."

Microcredit has empowered the country's entrepreneurial poor in converting their small businesses into successful ventures. Nowadays, microentrepreneurs have access to credit products that they use to finance their growing businesses.

Over the years, the continuous developments in the microfinance industry have given rise to success stories of Filipinos. With microcredit, coupled with hard work and determination, microentrepreneurs were able to expand their businesses and improve the quality of their lives.

Individuals who started with little capital for their businesses are now able to provide steady income for their families and generate employment within their communities .

Indeed, credit access to microentrepreneurs has become a way of empowering the poor and promoting inclusive growth.

Microentrepreneurs or the entrepreneurial poor are considered worthy partners toward economic development of the country.

New Trends in Microcredit

Microcredit has entered into a period of advancement and innovation. Moving forward, there is a need to support the development and testing of new models and innovative approaches that promise to help broaden the outreach of microcredit. Among these are credit scoring models and online micro-lending

Credit scoring is probably the next important technological innovation in microcredit. This approach uses quantitative measures to discriminate between good and bad microfinance loans. Scoring can improve estimates of risk and serve as a refinement tool in the lending process. Credit scoring is typically used for big loan accounts, but time is ripe for similar tools to be employed in microcredit.

Digital micro-lending is another recent trend in microcredit. Some financial service providers are now using online tools including mobile platforms, in broadening their reach and extending the advantages provided by the internet and telecom networks. By combining microfinance techniques with social networking and SMS messaging, there are now paperless online lending platforms that provide micro-loans to consumers without compromising the basic principles of sound credit underwriting.

Speaking of microcredit in today's digital age…

In the **2013 Microcredit Summit** in Manila, one of the key topics is about partnerships that use digital technology to expand options and improve products available to those people who are currently excluded from the formal financial system.

With the theme *Partnerships against Poverty: Government, Business, Finance and Civil Society,* the event is organized by the Microcredit Summit Campaign and the Microfinance Council of the Philippines (MCPI), with support from the BSP.

About IFAS

In 2007, the BSP was the first central bank in the world to establish an office dedicated to financial inclusion when it created the Inclusive Finance Advocacy Staff.

IFAS implements, coordinates, and advocates the microfinance and financial inclusion initiatives of the BSP.

Bangko Sentral ng Pilipinas

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