Innovative Solutions to Increase Access to Finance: The Role of Enabling Policy and Regulation

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The municipality of Agutaya in Palawan Island has ten barangays and over 10,000 residents (NSCB, 2011). Should the residents want to access financial services from a bank, they have to travel for two and a half days and spend a significant amount of money to rent a lantsa (big boat). This situation is not unique. Agutaya is only one of 610 municipalities in the Philippines (out of 1,635) without a banking office.

Access to financial services is important for every household. Recent empirical evidence indicated that access to basic financial services such as savings, payments and credit makes a substantial positive difference in people's lives (Dupas & Robinson, 2009). For the poor, the need for such access is even more important. Financial tools become vital for managing meager incomes that will allow them to meet their family's daily needs. In the book *Portfolios of the Poor* (Collins, Morduch, Rutherford and Ruthven, 2009), it was found that without access to basic forms of financial intermediation, small emergencies often triggered broader economic crises. Families were also unable to accumulate savings, build assets and seize opportunities to increase income thereby depriving them of a chance at a better life.

In addition, a financial system which is able to mobilize broad-based savings and invest in the growth of the productive sector drives economic growth (Levine, Loayza and Beck, 2000). Aside from the strong indications of the relationship of deep financial systems to growth, a deeper and more diversified financial system also contributes to financial stability (Hannig & Jansen, 2010).

Interest in building an inclusive financial system, one where there is access for all, has therefore become an important policy objective. In 2009, the G20 leaders, amid the global financial crisis and economic downturn, recognized the reinforcing policy objectives of financial stability, financial inclusion and consumer protection (G20 Leaders Declaration, 2009). This recognition is also evident in the growing number of countries adopting some aspect of a financial inclusion agenda under the purview of the main financial regulator (Consultative Group to Assist the Poor (CGAP) & World Bank (WB), 2010). [1]

Realizing that both the depth and breadth of access are crucial to stable and broad-based growth in the Philippines, the Bangko Sentral has taken significant and pioneering steps in ensuring a sound, stable and inclusive financial system.

Current Access Scenario and the Bangko Sentral's Response

The Bangko Sentral's banking reforms and efforts at strengthening the banking system to allow strong banks to expand their operating networks have borne fruit. The banking system has expanded its reach with 739 head offices, 8,176 branches/other offices and 9,847 automated teller machines (ATMs). This is an impressive 17 percent increase of banking offices in the last six years despite closure and consolidation of some banks (Bangko Sentral ng Pilipinas (BSP), 2011).

[1] 90 percent of the 142 countries included in the survey have some financial inclusion agenda.

Yet, the challenge of increasing access to financial services remains a daunting one. Aside from the lack of banks in a large percentage of the country's municipalities, concentration of banking services are generally biased toward higher-income areas leaving much of the low-income areas significantly underserved. For example, more than 50 percent of the country's deposit accounts are found in the National Capital Region where each of its 17 municipalities/cities have banking offices as compared to the Autonomous Region of Muslim Mindanao, the poorest region, where only 8 of their 118 municipalities/cities (7 percent) have banking offices (BSP, 2011).

There is also much room for improvement in terms of usage of formal financial services. The latest global Financial Access Report (CGAP & WB, 2010) indicated that only 26 percent[2] of the country's adult population has a basic deposit account. Other studies have estimated this figure at 35 percent (McKinsey, 2010).[3] Further, in a survey of mid-sized, non-metro cities, over 60 percent[4] of households still keep their savings at home (CGAP, 2005). While these indicators are not perfect measurements of inclusion or exclusion, and do not even touch on the many possible reasons for such exclusion, it can be safely surmised that many Filipinos, especially the poor, are therefore left wanting for much needed financial services.

The current access to finance scenario shows that traditional constructs, while successful in delivering financial services, leave much to be desired. There is an urgent need to find new ways to deliver useful and quality financial services to more people in a safe, sound and sustainable manner. Thus, innovation plays a central role in expanding the scale and scope of the banks to effectively reach the unserved or underserved.

The Bangko Sentral has taken serious and deliberate measures in establishing a supportive regulatory environment that can allow such innovations and market-based solutions to address financial access issues to blossom. The general approach is to promote an enabling environment based on the proportionate application of sound and generally accepted regulatory and supervisory principles toward the establishment of an inclusive financial system.

The envisioned inclusive financial system recognizes the need for a wide range of services such as savings, credit, insurance, payment services and remittance which are appropriately designed and priced; and delivered by institutions that have the authority and capacity to safely and effectively provide or deliver such services. New players also have a crucial role in leveraging on the physical network of banks to further expand the touch points to access financial services. For all these to work, it is important that all providers are properly and proportionately regulated to ensure consumer protection, financial system stability and integrity.

[2] This estimate is based on a regression model created using data from 46 countries with household data on banked individuals wherein the number of banked individuals is predicted using the estimates of the model where the number of deposit account per 1,000 adults and number of branches per sqkm are controlled for.

[3] This is based on a survey with a sample of 900 consumers undertaken jointly by GSM Association (GSMA), CGAP and McKinsey.

[4] Based on a random sample of 1,285 persons in major market places in the cities of Butuan (North Eastern Mindanao), Baguio (Central Cordillera region) and Bacolod (Negros Occidental). Approximately 70 percent of the sample had incomes below the median household income in the Philippines at that time.

Founded on this framework, many innovations have emerged which have demonstrated success. Innovations in products as well as delivery channels boast of positive results in terms of sustained and expanded delivery of financial services.

Microfinance: A Success in Product Innovation

Microfinance is defined as a broad range of financial services such as deposits, loans, payment services, money transfers and insurance products to the poor and low-income households, generally for their microenterprises and small businesses, to enable them to raise their income levels and improve their living standards (BSP, 2010). Apart from this definition, microfinance is also seen as a methodology and technology which has proven that a properly designed product, aligned with the needs and capacities of the low-income sector, can be provided in a sustainable and viable manner.

In 2000, the General Banking Law mandated the Bangko Sentral to recognize microfinance as a legitimate banking activity. This came at a time when microenterprises, and even the small and medium enterprises, faced the usual barriers in accessing credit – lack of collateral, voluminous requirements, lack of credit history, among others. Microenterprises often had to resort to informal lenders who exacted a steep price. Financial institutions were also wary of this market due to high credit risk and transaction costs.

The Bangko Sentral then endeavored to create the environment to address these barriers. The main objective in the approach to bank-based microfinance is to enable the delivery of commercially sustainable microfinance in the banking sector where the government only provides a supportive role through policy, regulation and capacity building. Successful microfinance practices around the world were studied to set in place regulations that recognized and accepted best practices such as using group support or liability arrangements, cash flow-based lending, and high-frequency amortizations that matched a client's cash flow. This allowed traditional rural banks and thrift banks that were willing to adopt the new technology from technical assistance providers to legitimately transform their business model.

Entry into the banking system was also liberalized, which created an environment that allowed new entrants into the market particularly through the establishment of microfinance-oriented banks which are licensed and regulated as regular banks but dedicate at least 50 percent of their loan portfolio in microfinance. This became an ideal vehicle for microfinance NGOs that wanted to transform into formal financial institutions which are able to mobilize savings from the general public. The further liberalization of branching regulations allowed the establishment of microfinance-oriented branches as well as micro-banking offices (MBOs). In terms of requirements, MBOs are "stripped-down" or simple branches that make it easier for a bank to have a presence in areas where it may not be immediately economically feasible to set up a full bank branch such as small markets or hard-to-reach areas.

Box 1[5]

MBOs Bringing Services to Hard-to-Reach Areas

CARD Bank has successfully delivered microfinance products to its nearly 300,000 clients. It has attributed using MBOs as a key factor to the significant increase in its outreach. As an example, just five of its MBOs are servicing 11,000 clients with a loan portfolio of PhP 55 million and a savings portfolio of PhP 32 million. In less than one year of its MBO operations, these five offices have seen an increase in its clients, loans and savings by 34 percent. The bank sees the MBO as an ideal vehicle to service harder-to-reach areas, reach new markets as well as provide greater convenience for its clients. The increase in its deposits has been significant due to the proximity of the MBOs to its clients.

Recently, more innovative products have been developed by the market to respond to the obvious demand for a wider range of products beyond credit or microenterprise loans. These include micro-agri loans, housing microfinance loans, micro-deposits and microinsurance. These products are built on the best practices of microfinance, such as frequent amortizations or payments based on client capacity and cash flow.

The Bangko Sentral remained responsive to these innovations and created the regulations that allow them to be provided in the market in a safe manner. At present, microfinance clients are now able to access loans for their businesses and at the same time access other products for their other needs. No longer do they have to apply for a microfinance loan and use it both for their business and for the expansion of their homes. There are now products directly attuned to their needs. For the banks, they have been able to increase the value of their service to their markets as well as improve the transparency in their portfolios.

Box 2[6]

Benefits of Product Innovation

Ms. Rizza Mascardo has been a client of Cantilan Bank since 2003 under its microfinance program. Her business of selling local snacks and treats such as puto, ice candy, banana cue and bread has been steadily growing with the help of a microfinance loan. Since 2003, she has had 20 loan cycles from the bank starting from PhP 5,000 to her last loan of PhP 100,000. Even before her business flourished, she always dreamed of a bigger and better home for her family. In 2009, she applied for a housing microfinance loan and, in two cycles, she was able to proudly construct her new home.

While these innovations have been allowed in the banking system, prudent standards have been instituted for the conduct of microfinance operations, including the use of portfolio-at-risk[7] to monitor and measure portfolio quality in the context of risk-based supervision. This approach has allowed bank supervisors to fully understand the risk profile of microfinance and not lead the banks to simply avoid exposure to this market.

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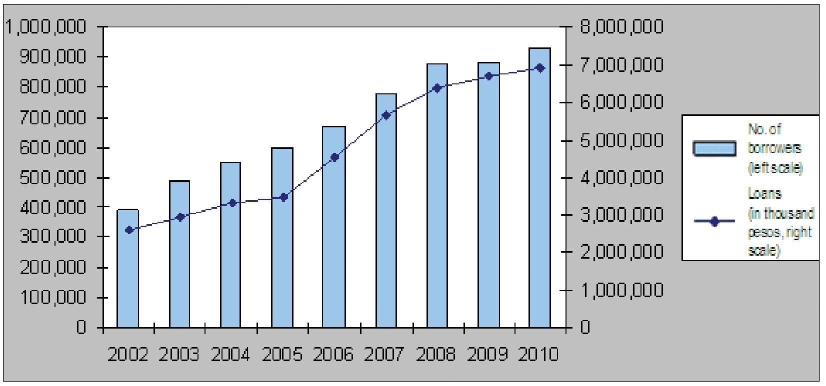
[5] Information from CARD Bank, a microfinance-oriented rural bank

[6] Information from Cantilan Bank, a rural bank with microfinance operations

[7] The outstanding principal amount of all loans that have at least one installment past due for one or more days. The amount includes the unpaid principal balance but excludes accrued interest (BSP, 2003).

The Bangko Sentral's enabling environment for microfinance has borne much fruit. In 2001, shortly after the initial issuance of circulars for microfinance, there were 119 banks with microfinance operations serving 390,000 clients with an outstanding portfolio of PhP 2.6 billion. As of March 2011, there were 202 banks with microfinance operations reaching nearly one million clients/households with loans outstanding amounting to PhP 7.3 billion and savings of PhP 3.6 billion (BSP, 2011). The steady increase of players and outreach is evidence of a growing and dynamic industry.

Box 3



Apart from the numbers, the Bangko Sentral has received international recognition for the significant strides it has made in microfinance. For three years in a row, the Economist Intelligence Unit's global survey on microfinance (Economist Intelligence Unit, 2011) has ranked the Philippines as number one in the world (out of 55 countries) in terms of policy and regulatory framework for microfinance and consistently in the top 10 overall, which includes other criteria such as institutional frameworks and stability.

Electronic Money and Mobile Banking: Technological Innovations in Service Delivery

The use of information and communication technology in delivering financial services holds the promise of reaching new markets that conventional infrastructures (i.e., brick and mortar bank offices) are unable to service. One such technological application is the use of mobile phones as channels to access financial services or what some have defined as branchless banking.[8] The potential to reach new markets, together with the promise of increased efficiency and lowered costs, has demonstrated a significant growth and has spurred the interest of many.

The interest is not only from within the financial system but also from other players such as telecommunications companies. A study by McKinsey and Company elaborated that providing financial services for the unbanked are among the most promising opportunities for mobile telecom operators "hoping to counter slowing subscription with auxiliary offerings such as banking, health care and education services (2010)."

These opportunities are clearly present in the Philippines. The country has an estimated 80 percent mobile phone penetration (McKinsey, 2010), significantly larger than banking penetration. An even starker contrast is seen when

[8] The use of information and communication technologies and non-bank retail channels to reduce costs of delivering financial services to clients beyond the reach of traditional banking (CGAP, 2008)

compared to insurance coverage, which is only at around 12 percent[9] (Llanto, Geron and Almario, 2009) of the population. This large mobile penetration represents users across all income groups in both urban and rural areas. Filipinos have also demonstrated comfort with using the short messaging system (SMS) or "texting" (they send over a billion text messages in a day), earning for the Philippines the recognition as the "most SMS-intensive country in the world (Wireless Intelligence, 2007)."

It is crucial to note that results of the survey in the Mckinsey study showed that a large percentage of the country's unbanked has a mobile phone and nearly 60 percent of these unbanked mobile customers keep some form of savings and 13 percent borrow from various informal sources. The overall results of the survey led to the conclusion that the "unbanked have a desire to use a range of financial services, particularly savings, and—especially among the lowest-income groups—are comfortable using mobile devices to get them (2010)."

From a financial inclusion standpoint, these facts present an enormous and possibly even transformational opportunity. The depth and breadth of the reach of mobile phones can be massively leveraged as possible access points for basic fund transfer activities and, with the appropriate linkages, for financial services.

The country's top telecommunications companies recognized this opportunity and launched their respective electronic money (e-money) products. Smart Communications launched Smart Money in partnership with Banco de Oro in 2000 and expanded the product features in 2003 while Globe Telecom, through its 100 percent-owned subsidiary GXchange, launched Gcash in 2004. These e-money products, stored in a mobile phone or a card, are pre-paid, low-value fund transfer mechanisms which allow their holders to make purchases, send and receive e-money, pay bills and make other similar transfers electronically.

The Bangko Sentral recognized the potential of these innovations to increase the efficiency and accessibility to make low-value payments. In addition, these innovations also provided a significant growth potential in terms of efficient and cost-effective delivery of remittances from over 8 million overseas Filipinos amounting to over USD 1.6 billion in monthly remittances (BSP, 2011). Since many of the beneficiaries have mobile phones, they provided an additional safe, convenient and cost-effective channel.

Box 4[10]

Sending PhP 1,500 and Encashment	*E-Money**	*Remittance Agent*	*Pawnshop**	*Bank*
Total for P1500 principal amount	*P11.50*	*P120*	*P80*	*P152.50*
% of PHP 1,500	*0.8%*	*8%*	*5.3%*	*10.2%*

* Average of two e-money providers and pawnshops

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[9] 2006 figures measuring number of life insurance in force to the total population

[10] Prices were gathered through telephone interviews with various stated providers.

The Bangko Sentral therefore endeavored to fully understand the product, the underlying technology and systems to appropriately identify the risks, the possible ways to address them as well as other issues surrounding this novel application. It also remained flexible in light of the different models that were emerging. The Bangko Sentral saw the importance of its involvement in the evaluation and approval of the two products and therefore used existing regulations to appropriately and actively engage both service providers. As a result, adequate space was created for both a bank-led (Smart Money) and a non-bank-led (Gcash) model to be developed.

The banks also saw the opportunities in the e-money space and actively made use of these available platforms as channels to provide financial services.In a matter of five years, there were over 50 rural banks that used e-money as a channel to receive deposits and microfinance loan payments, and pay out microfinance loans to their clients (BSP, 2011). This new delivery channel has dramatically lowered transaction costs for both the bank and the client, increased the productivity of account officers, decreased cash-on-hand risk and increased access to financial services.

As the technology, products and applications developed, the Bangko Sentral continued to be responsive by crafting appropriate regulations and undertaking necessary initiatives. By issuing regulations on e-money, it created a clear framework for e-money business in the country. The regulations provided qualifications of e-money issuers (i.e., capital requirements, fit and proper standards, etc.), rules in the issuance of e-money (i.e., transaction limits, anti-money laundering compliance, security features, and consumer protection) and parameters in the development of e-money agent networks. The regulations also addressed the potential entry of new players, provided for a clear and level regulatory framework, and allowed for the orderly development of e-money. The Bangko Sentral further issued regulations that allowed banks to outsource e-money activities to an e-money service provider to leverage on existing investments in infrastructure. This awards banks the option to create linkages with e-money service providers like telecommunications companies or become e-money issuers either directly or through outsourcing arrangements. This presents an enormous opportunity for banks to create their own local agent network in partnership with merchant customers as extended financial access touch points, thereby expanding their virtual reach to unbanked communities.

Recently, the Bangko Sentral issued another circular on updated anti-money laundering rules and regulations which provides a crucial complement to the developing e-money ecosystem. With the new rules, barriers to customer acquisition especially for the unbanked are addressed particularly the requirement of face-to-face contact with a bank personnel to open an account. The recent issuance allows banks to outsource or rely on customer identification by duly authorized agents that are located in unbanked communities. It therefore addresses the limitations of the existing physical reach of banks and lowers the cost of acquiring new customers. The decision to open accounts and provide credit still rests on the bank.

Recognizing the potentially revolutionary solution for low-value payments, what the Bangko Sentral endeavored to create, is a policy and regulatory environment that enables the creation of a broad, sound and proportionately regulated e-money ecosystem comprised of ubiquitous agent networks that can have a massive reach as potential outlets. Financial service providers can therefore build and leverage on this infrastructure to deliver their financial services. At present, there is evidence that this enabling environment is delivering positive results. There are now 21 e-money issuers that are banks and two that are non-banks. These issuers have an expanding agent network currently with 25,000 cash in/out agents. As of end-2010, there were nearly 150 million e-money transactions amounting to PhP 440 billion (BSP, 2011). E-money applications have also enabled meaningful retail payments. E-money is currently being used to pay out government's conditional cash transfer (CCT)[11] to over 400 municipalities in the country.

Complementing these numbers is the recognition that the Bangko Sentral is a global leader in establishing the appropriate enabling environment for mobile banking, in particular, and branchless banking, in general, to flourish in the country (CGAP 2008). *The Economist* published an article with the sub-title "Follow the Filipinos" (2007) referring to the well-balanced regulatory approach by the Bangko Sentral in promoting mobile banking.

Conclusion

Based on the initial positive results, these innovations prove that they can possibly unlock the potential of reaching large populations of unbanked in our country. Innovative solutions, whether in product design or service delivery, can go beyond the confines of conventional thinking, break down barriers to access, bridge gaps and ultimately create new pathways that benefit and transform the lives of millions. In all of these undertakings, proportionate regulation is the necessary approach. Useful innovations need not be stifled but instead be allowed to operate in an environment where the risks associated with such innovations are adequately understood and addressed and where there is a judicious and proportionate application of sound principles.

The municipality of Agutaya now has an e-money cash in/out agent through which many of its residents are receiving their conditional cash transfers from government (GXI, 2011). With enabling policies and regulations that allow for innovative products, delivery channels and strategic linkages, this can be seen as the important first step in finally including the residents of this municipality into the formal financial system.

[11] The Philippines is implementing a CCT program called the Pantawid Pamilyang Pilipino Program (PPPP). The CCT program provides cash to the poorest households as long as they comply with the conditions of the program (Fernandez & Olfindo, 2011).

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