

2010 YEAR END REPORT ON BANGKO SENTRAL NG PILIPINAS INITIATIVES IN MICROFINANCE AND FINANCIAL INCLUSION

In 2000, 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. Ten years hence, microfinance has become a mainstream activity in the banking sector, and microfinance supervision has been institutionalized within the BSP.

In the past ten years, the BSP has been proactive in implementing various initiatives to enable and support the development of sustainable microfinance. For the year 2010 alone, the BSP issued six Circulars and undertook several activities to further improve microfinance provision in the banking sector. The BSP's experience in microfinance development has inspired its initiative to further expand access to finance and mainstream the unbanked and underserved population into a truly inclusive financial system. This makes sense considering that the Philippines is an archipelagic country where 37% of municipalities are still unbanked and many are left wanting for much needed financial services.

The year 2010 was a good year for Philippine microfinance. The Economist Intelligence Unit (EIU), in its "Global Microscope on the Microfinance Business Environment", ranked the Philippine regulatory environment for microfinance as the best among 54 countries around the world. In terms of overall microfinance business environment, the Philippines moved up the rank, occupying the number two position in 2010, from being number three in 2009.

The EIU cited the BSP's regulations that expand the range of microfinance products that banks can offer to their clients as the main reason for the upward ranking of the Philippines. This citation affirms that the BSP's regulatory approach and initiatives in microfinance and financial inclusion are making an impact, and are truly benefiting the microfinance market.

An inclusive financial system is characterized by strong and ubiquitous financial institutions that utilize multiple channels to deliver a wide range of financial services to all Filipinos. This system provides scope for the adoption of responsive business models and new technologies, competitive pricing and innovative product design, increased efficiencies in serving new markets, and enhanced consumer protection mechanisms. The BSP's perspective is that financial inclusion and financial system stability and integrity are mutually reinforcing and can be pursued alongside each other. Increasing access to finance has attendant risks but these can be adequately managed through

proportionate regulation, or the application of sound regulatory principles and safeguards that are commensurate to risks.

This report presents the BSP's 2010 initiatives, classified within its three-pronged approach: to provide an enabling policy and regulatory environment; to increase the capacity of the BSP and the banking sector in inclusive finance operations (microfinance, SME finance, others); and to promote and advocate for the development of a sound, sustainable and truly inclusive financial system.

QUICK FACTS

202 Banks With Microfinance Operations
932,622 Clients Currently Being Served
Php 6.5 Billion Outstanding Loan Portfolio
Php 3.1 Billion Savings Component

20 Electronic Money Issuer - Banks
3 Electronic Money Issuer - Others
Php 220.5 Billion Cash-In/Cash-Out Transactions

I. ENABLING POLICY AND REGULATORY ENVIRONMENT

The 2010 issuances of the BSP focused on expanding products and services that can be offered by banks to service the varying needs of the market; widening access points where financial services can be delivered; developing market infrastructure to increase transparency and competition in the industry; promoting innovation to scale up growth and increase efficiency; and addressing existing barriers to access.

A. EXPANDING PRODUCTS AND SERVICES : HOUSING MICROFINANCE (CIRCULAR 678 DATED 06 JANUARY 2010)

The BSP issued Circular 678, which provides guidelines in the provision of housing microfinance with the objective of addressing the need of the poor for affordable shelter. With this regulation, banks have the opportunity to diversify their portfolios and complement their microfinance operations by offering housing microfinance. By offering housing microfinance loans, banks reduce the risk of borrowers using microenterprise loan proceeds to finance house improvements.

Housing microfinance involves the application of microfinance principles in financing home improvements, house construction and house/lot acquisition. As defined under Circular 678, the maximum loan amount for home improvement is PhP 150,000 which is similar to microenterprise loan ceilings. The maximum loan amount

for house/lot construction/acquisition may reach up to PhP 300,000 considering that such projects usually entail higher costs. In classifying this housing loan product as microfinance, it enjoys the incentives granted to microenterprise loans, such as the acceptance of collateral substitutes (i.e. secure tenure instruments as proof of legal use, possession or ownership of a property) as well as simpler documentary requirements. This product addresses the usual barriers faced by the poor when accessing housing finance, and supports the government's efforts to reduce the country's housing backlog.

B. EXPANDING PRODUCTS AND SERVICES : MICRO-AGRI LOANS (CIRCULAR 680 DATED 03 FEBRUARY 2010)



(Picture depicts clients of Cantilan Bank)

Circular 680, which sets guidelines in the provision of micro-agricultural loans, was issued to address the financing needs of small farmers, especially the microfinance borrowers engaged in farming that have other sources of non-farm income. Like microenterprise loans, micro-agri loans are in small amounts not exceeding P150,000; with a short term and frequent amortizations; based on borrowers capacity to pay as determined through household cash flow analysis; and typically unsecured

or secured with non-traditional collateral substitutes like group guarantee or household/personal assets. Considering the seasonality and cycles of agricultural production, Circular 680 gives flexibility in the payment of micro-agri loans by allowing the lump sum payment of up to 40% of the total loan amount. By applying microfinance principles to agricultural loans, small farmers in the countryside can potentially have more access to bank credit and increase productivity.

C. EXPANDING PRODUCTS AND SERVICES : MICROINSURANCE (CIRCULAR 683 DATED 23 FEBRUARY 2010)

Circular 683 allows rural, cooperative and thrift banks to market, sale and service microinsurance products, subject to prudential rules and regulations. This is groundbreaking, as these banks can now take part in a business that was once limited only to universal and commercial banks. With this regulation, the branch network of rural, cooperative and thrift banks has potential to become distribution points for authorized microinsurance products of licensed insurance providers. Since many of these banks have existing relationships with microfinance clients, they can add value to

their services by selling and servicing microinsurance. The microfinance clients also benefit as they get protection against death, injury, loss of property and other contingent events through banks which are geographically close and easily accessible. This regulation also intends to minimize and even eliminate informal insurance schemes and unauthorized insurance products which are generally unsafe.

Microinsurance, as defined by the Insurance Commission (IC), is the provision of insurance, insurance-like and other similar products and services that meet the needs of the low-income sector for risk protection and relief against distress, misfortune and other contingent events. Microinsurance products have a maximum guaranteed benefit not exceeding 500 times the daily minimum wage of non-agricultural workers in Metro Manila (about PhP 200,000 at current wage rates). The total amount of premiums, contributions, fees and charges of a microinsurance product do not exceed five percent of the daily minimum wage (about PhP 20 at current wage rates). This ceiling makes microinsurance products affordable to the poor, who are more vulnerable to the effects of contingent events.

D. EXPANDING PRODUCTS AND SERVICES : MICRODEPOSIT ACCOUNTS (CIRCULAR 694 DATED 23 FEBRUARY 2010)

Recognizing the need of microfinance clients for a savings instrument that is not linked to a microfinance loan product, the BSP allowed the opening and servicing of a deposit account that is specially designed to fit the capacity and serve the need of small savers. This account is called “microdeposit”, a basic savings account with a minimum maintaining balance not exceeding PhP 100 and is not subject to dormancy charges. This is articulated in the Notes to Microfinance annexed to Circular 694. With this regulation, even clients that do not have any microfinance loans but have a microdeposit account are considered as microfinance clients. By making this product available, the BSP hopes to promote and encourage a savings culture among the poor and low-income people.

E. IMPROVING MARKET INFRASTRUCTURE : RECOGNITION OF MICROFINANCE RATING AGENCIES (CIRCULAR 685 DATED 7 APRIL 2010)

The BSP issued Circular 685, which defines procedures for the recognition of Microfinance Institution Rating Agencies (MIRAs), in order to create an enabling environment for the appropriate use of objective, credible and competent third-party ratings. MIRA’s holistically assess and rate the governance and management, human resources, operations and financial performance a microfinance institution (MFI). Such ratings can be an effective tool to raise the quality and efficiency of the MFI, increase transparency in the industry and provide confidence for social and commercial investors, thereby improving the investment climate.

For banks with microfinance operations, ratings may provide valuable assessments that can materially improve their access to financing and capital, and generate a useful benchmark vis-à-vis other microfinance institutions both locally and internationally. Circular 685 ensures that a MIRA recognized by the Bangko Sentral demonstrates commitment to comply with the relevant rules and regulations and possesses the technical capability, experience and organizational resources to provide objective and transparent ratings.

F. WIDENING ACCESS POINTS : MICRO-BANKING OFFICES AND OTHER BANKING OFFICES (CIRCULAR 694 DATED 14 OCTOBER 2010)

Circular 694 was issued to redefine the guidelines for establishment of other banking offices (OBOs) and micro-banking offices (MBOs) and provide opportunity for banks to expand their network of brick and mortar offices, particularly in areas where it may not be feasible to establish full-blown branches. OBOs and MBOs, scaled down bank offices other a branch or extension office, are intended to serve the particular needs of the low-income and unbanked population, specifically microfinance clients and overseas Filipinos and their beneficiaries. An OBO/MBO may be authorized to provide non-transactional and transactional banking services, respectively.

OBOs can undertake the following activities: market bank products and services; accept loan applications and conduct preliminary credit investigation; host onsite ATMs; perform customer identification; receive account opening documents; other non-transactional activities authorized by the BSP. On the other hand, MBOs may be authorized to provide any or all the following: accept microdeposits and service withdrawals thereof; disburse microfinance loans and collect payments; sell, market and service microinsurance products; receive and pay out authorized remittance transactions; act as cash-in/cash-out points for electronic money (e-money); receive utility payments; collect premiums and pay out benefits from social security institutions, including government conditional cash transfer programs; and purchase a limited level of foreign currency. To be allowed to do these things, banks must be able to demonstrate that the establishment of its MBOs is an integral business strategy for expansion. A bank must likewise show that the necessary operational and financial plan is in place to ensure sound and safe operations.

Through the OBOs/MBOs, the usual barriers, like of cost and distance, for smaller banks to expand are addressed; and people who have been deprived of a face-to-face banking presence in their areas need not travel far to be able to save, pay their loans or make simple financial transactions.



(Pictures depict clients of Green Bank)

**G. WIDENING ACCESS POINTS AND PROMOTING INNOVATION :
ELECTRONIC MONEY SERVICE PROVIDERS (CIRCULAR 704
DATED 22 DECEMBER 2010)**

In 2009, the BSP issued Circular 649, which provided the regulatory framework for e-money issuance and governed the operations of e-money issuers (EMIs) which can either be banks (EMI-Bank), non-bank financial institutions (EMI-NBFI) or other providers (EMI-Others). This regulation fostered the development of an efficient and convenient retail payment and fund transfer mechanism in the Philippines, while instituting safeguards against risks associated with the business.

To further expand and improve the e-money ecosystem, the BSP issued Circular 704 in 2010, which allows EMIs to outsource certain functions to e-money network service providers (EMNSP), any non-financial institution that provides automated systems, network infrastructure, including a network of accredited agents. This regulation basically addresses the fact that the complex technology and the substantial investment necessary in an e-money business constitute a formidable barrier to entry for smaller institutions. With this regulation, the BSP expects to see more institutions, particularly smaller banks, to become competitive EMIs and therefore service more clients, especially the unbanked in the countryside. This regulation also paves way for more effective convergence of technological innovations with financial service provision through bank and non-bank strategic partnerships and innovative business models. An efficient e-money ecosystem offers a revolutionary solution for banks to service low value payments and transfers, dramatically lower transaction costs, increase the productivity of account officers, decrease cash-on-hand risk and increase accessibility of clients to a wide range of financial services.

H. COLLABORATION WITH GOVERNMENT AND PRIVATE STAKEHOLDERS TO FURTHER DEVELOP THE MICROFINANCE INDUSTRY

Policy and Regulatory Environment for Microinsurance. The Bangko Sentral collaborated with the Department of Finance-National Credit Council, Insurance Commission, Securities and Exchange Commission, Cooperative Development Authority and private insurance associations to establish an enabling policy and regulatory environment for the safe and efficient provision of microinsurance. This collaboration resulted in the crafting and issuance of the National Strategy and Regulatory Framework for Microinsurance. These documents define the roles of various stakeholders, identify key strategies to be pursued in enhancing access to insurance, provide directions towards mainstreaming informal insurance and insurance-like activities and promote public awareness and financial literacy on insurance.



(Official Microinsurance Logo)

Pricing Transparency and Disclosure. While laws and regulations that promote pricing transparency already exist (e.g. Republic Act 3765 or Truth in Lending Act and its implementing regulations in Section X307 of the Manual of Rules and Regulations for Banks), the BSP recognizes the need to further enhance banks' disclosure of the true cost of credit. This provided impetus to propose the use of a uniform methodology in computing interest rates and a standard disclosure statement, applicable to all types of loans and all providers of credit. The objective of this initiative is not to set limits on rates that banks can charge but to make such rates more understandable to clients. This is in line with a market-based interest rate policy, at the same time promotes consumer welfare and protection. This also facilitates healthy competition among credit providers and clients will be better able to compare products and services.

To ensure a level playing field in the microfinance sector where providers include not only banks but also Non-Government Organizations (NGO), the BSP worked closely with Microfinance Council of the Philippines (MCPI), the microfinance network to which the biggest microfinance NGOs in the country belong, to advocate the adoption of the disclosure statement and method of computation by the NGO sector.

I. WORK RELATED TO IMPLEMENTATION OF NEW LAWS AND PARTICIPATION IN PROPOSED LEGISLATIONS

Draft Implementing Rules and Regulations (IRR) of the Agri-Agra Law. The BSP, in coordination with the Department of Agriculture (DA) and Department of Agrarian Reform (DAR), drafted the IRR of Republic Act 10000, also known as The Agri-Agra Reform Credit Act, signed into law in 23 February 2010. The Agri-Agra Law aims to improve access to finance by farmers, fisherfolks and agrarian reform beneficiaries. The draft IRR was exposed to bank associations and farmers/fisherfolk organizations for their comments. Finalization of the IRR is pending given the new bills amending RA 10000 filed by the present Congress.



(Photo from DAR website)



(Photo from DA website)

Rules Governing Cooperative Banks. The BSP issued Circular 682 dated 15 February 2010 to govern the organization, membership, establishment, administration, activities, supervision and regulation of Cooperative Banks. This regulation implements the provisions of Chapter XII of Republic Act 9520 also known as the Philippine Cooperative Code of 2008. Circular 682 recognizes the unique nature and character of Cooperative Banks, at the same time ascertains that they comply with banking laws, rules and regulations, thereby ensuring that they operating within a level playing field with other types of banks.

Draft IRR for Financial Service Cooperatives. The BSP, in coordination with the Cooperative Development Authority (CDA), drafted the rules and regulations implementing Chapter XVI of the Philippine Cooperative Code of 2008, which pertains to financial service cooperatives. The draft IRR has been exposed to Northern Luzon and NCR cooperatives and federations for their comments. The draft IRR is targeted for exposure to cooperatives and federations in other regions.

Deliberations on the Microenterprise Development Institution (MEDI) Bill. The BSP actively participated in technical working group discussions and legislative deliberations on the MEDI bill. This bill aims to recognize and support the role of non-

stock, non-profit institutions that provide a holistic approach to poverty alleviation with microfinance as the foundation.

II. TRAINING AND CAPACITY BUILDING

To further enhance the skills, capacity, understanding and appreciation of the BSP and the banking sector about microfinance and other financial inclusion issues, the following activities were undertaken:

A. CAPACITY BUILDING WITHIN BSP

Strengthening the Capacity of BSP Examiners in Risk-Based Supervision of Banks' SME Lending. The BSP, with technical assistance from International Finance Corporation (IFC) and German Technical Cooperation (GTZ), implemented a project to strengthen the capacity of BSP examiners to supervise and examine, using a risk-based approach, the SME lending operations of banks. Activities under this project include analysis of gaps in existing training materials; design of supplemental training modules focused on risk-based examination of SME lending operations; conduct of training of trainers and cascade of trainings to selected examiners; and development of a manual of examination procedures to complement existing manuals.

Microfinance Committee Exposure Visit to Banks and Clients in Agusan del Norte (23-25 July 2010). The BSP Microfinance Committee visited three banks in Agusan del Norte to look at their specific microfinance programs. The Committee went to Cantilan Bank (Butuan city branch) to know more about its micro-agri loan product; Enterprise Bank (Butuan city branch) to learn about housing microfinance; and Green Bank (head office in Butuan City) to experience its mobile banking service for microfinance clients. The Committee also made onsite visits to selected clients.

The visit was successful in exposing the Committee to the actual implementation of the above-mentioned microfinance products/services. During the discussions with bank officials and staff, the challenges faced by the bank in increasing their efficiency and expanding their operations were brought to fore. The interaction with clients provided the Committee with insights about clients' perspective on the benefits of microfinance. The visit also provided opportunity for the Committee to dialogue with the Federation of CARAGA Rural Banks which provided insights into the prevailing issues in the region's banking sector. In this dialogue, members of the Committee were able to share the BSP's current policy and regulatory initiatives.



The BSP Microfinance Committee headed by Monetary Board Member Juanita D. Amatong (4th from left) and Deputy Governor Nestor A. Espenilla, Jr. (5th from left) interact with Ms. Maria Lovella Lim (6th from left), a hog-raiser and a micro-agriculture loan client of Cantilan Bank, in Brgy. Calamba, Cabadbaran, Agusan del Norte last 23-25 July 2010.

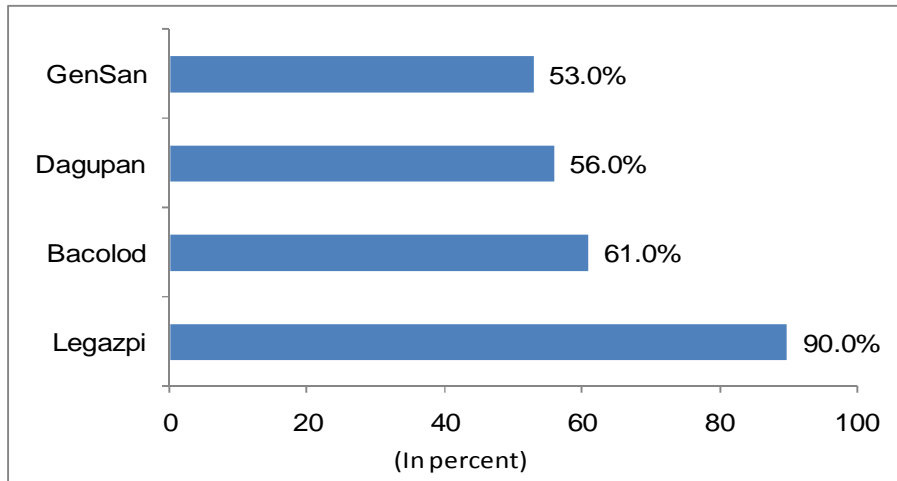
B. CAPACITY BUILDING WITHIN BANKING SECTOR

Financial Learning Seminars (FLS) for Microfinance Clients and the Unbanked. In 2010, four FLS for Microfinance Clients and the Unbanked were conducted in the cities of Legazpi (12 August), Bacolod (21 October), Dagupan (29 October) and General Santos (11 November). Participants included existing and prospective microfinance clients of banks that have microfinance operations and bank officers involved in implementing microfinance programs. The main objective of the FLS is to provide participants with information and tools to help them understand and later on apply financial literacy skills in their personal lives. In the case of clients, it is expected that the FLS lessons would help them in managing their businesses while in the case of bankers, it is hoped that they would be able to cascade the lessons to their workmates and other clients.

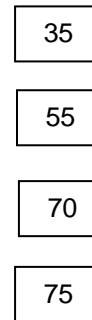
The FLS covers topics in basic personal finance (budgeting and planning, savings and investments), rights and responsibilities in the use of credit and consumer protection principles. The learning sessions were delivered using a combination of

powerpoint presentations, videos of success stories and practical exercises. The average bank participation rate (ratio of the number of invited banks to those that actually sent participants) in all seminars was 65%.

Bank Participation

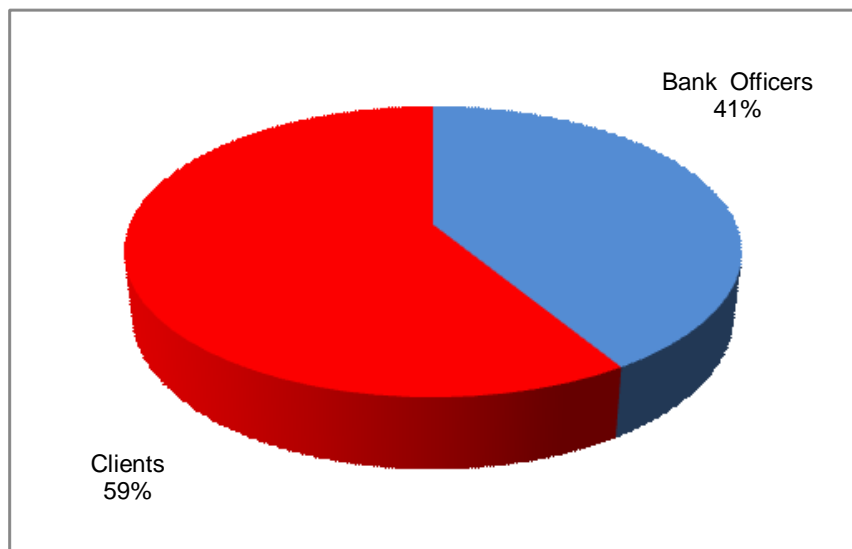


Actual No. of Participants



More than half of the participants comprised of existing and prospective clients, while the rest comprised of bank officers. The total number of participants in all seminars is 235.

Participant Profile



The overall conduct of the seminars was rated with an average score of 4.5, reflecting participants' appreciation of the BSP's efforts to promote financial literacy for microfinance clients and bankers.

Result of Program Evaluation

Areas	Average Rating
1. Financial Learning and Microfinance	4.5
2. Budgeting and Planning	4.6
3. Savings and Investments	4.6
4. Client Roles and Responsibilities in the Use of Credit	4.5
5. Consumer Protection	4.6
6. Expertise of Resource Speakers	4.6
7. Meals and Venue	4.3
8. Overall Seminar Facilitation	4.6
Average Score	4.5
<i>5 - highest score; 1 - lowest score</i>	

The four FLS for Microfinance Clients and the Unbanked were conducted in synchrony with other learning activities under the BSP's Economic and Financial Learning Program (EFLP). These activities included Financial Learning Campaign for Overseas Filipinos which is targeted for overseas workers and their beneficiaries, Public Information Campaign and Financial Education Expo, both targeted for students, the employed and the general public.

III. PROMOTING AND ADVOCATING FOR SUSTAINABLE MICROFINANCE AND FINANCIAL INCLUSION

The BSP provided support, input and relevant assistance to various groups that were interested in microfinance, mobile banking and other financial inclusion initiatives. Advocacy work in 2010 revolved in the following areas:

Alliance for Financial Inclusion (AFI) and G20 Global Partnership for Financial Inclusion (GPFI). The BSP remains committed to advocate financial inclusion in the international arena through its membership in AFI, a knowledge network of central banks and other financial regulatory bodies in developing countries (65 countries as of end 2010). The BSP was one of AFI's pioneering members since its establishment in 2008. In 2010, the BSP (represented by Deputy Governor Nestor A. Espenilla, Jr.) was unanimously chosen as co-chair of the Steering Committee, AFI's governing body. The work of AFI is focused on the following areas: consumer

protection; mobile financial services; agent banking; financial identity; financial inclusion data and measurement; formalizing micro-savings; role of state financial institutions.

Through AFI, the BSP also participates in the G20 process as a non-G20 partner in the GPMI. The role of a partner involves participation in key decisions on GPMI initiatives, provision of information and feedback on reports/studies and application of financial inclusion principles. This collaboration among the G20 and non-G20 countries has brought financial inclusion into global attention, and financial inclusion objectives now forms part of the G20 agenda.

Windsor Global Leadership Seminar of the Consultative Group to Assist the Poor (CGAP)/ Department for International Development (DFID). In March 2010, the BSP participated in the Annual Windsor Global Seminar on Regulating Transformational Branchless Banking. This seminar, designed with an “executive education” format, brings together selected policymakers and regulators from a diverse group of countries engaged or interested to engage in branchless banking. Together with top experts, participants discuss issues, solutions and innovations for possible application in their own jurisdictions.

Microentrepreneur of the Year (MOTY) Awards 2010. The BSP continued to co-organize, together with Citibank and MCPI, the MOTY Awards which is running on its eighth year in 2010. MOTY gives due recognition to outstanding microentrepreneurs, provide incentives for them to improve their businesses, highlight them as role models for other aspiring entrepreneurs, and generate greater appreciation for microfinance. MOTY winners are tangible proof of how microfinance can empower the poor to create economic opportunities that benefit their households.



The MOTY National Selection Committee chaired by BSP Governor Amando M. Tetangco, Jr. (2nd row left) and co-chaired by Citibank Country Manager Mr. Sanjiv Vohra (2nd row right) pose with National Winner for Masikap Category Ms. Ester Lumbo (first row left) and for Maunlad Category Ms. Nora Bagaforo (first row right).

Presentation to International Groups, Policy Makers and Regulators. The BSP continued to share its experiences in microfinance, mobile banking and financial inclusion with central bankers, policymakers, regulators, and market players from other countries. In 2010, the BSP provided briefings to visiting delegates from Tanzania, Burundi, Pacific Islands, Yemen, Bangladesh, Ecuador, Guatemala, Malaysia, Sri Lanka, Namibia, Lao Democratic Peoples Republic, Cambodia, Malaysia, Pakistan, Bhutan, India, Nepal and Russia. The BSP also provided presentations to delegates of study visits organized by the Asia Pacific Rural and Agricultural Credit Association (APRACA), Association of Development Financing Institutions (ADFIAP) and Rural Bankers Association (RBAP) Foundation.



Governor Amando M. Tetangco, Jr. and Deputy Governor Nestor A. Espenilla, Jr. present the book "Central Banking in Challenging Times: The Philippine Experience" to Russian Federation officials Ms. Anna Popova, Deputy Minister for Economic Development and Mr. Alexey Savatyugin, Deputy Minister of Finance during their Study Visit to the BSP on 7 April 2010.

Deputy Governor Nestor A. Espenilla, Jr. greets fellow regulators from the Central Bank of Burundi during their Knowledge Exchange Visit to the BSP on 12-13 April 2010.



IV. SNAPSHOT OF MICROFINANCE EXPOSURES OF THE BANKING SECTOR

Data as of 31 September 2010	No. of Banks	Amount (P Millions)	No. of Borrowers	Savings Component (P Millions)
Microfinance Oriented Banks:				
Rural Banks	5	1,282.98	249,730	1,030.39
Thrift Banks	3	203.39	9,092	106.98
Sub-total	8	1,486.37	278,822	1,137.37
Microfinance Engaged Banks:				
Rural Banks	149	3,846.88	556,427	1,516.69
Cooperative Banks	23	708.90	80,609	253.43
Thrift Banks	22	489.92	16,764	201.74
Sub-total	194	5,045.70	653,800	1,971.86
Grand Total	202	6,532.07	932,622	3,109.23